THE UK'S NO. 1 FREE INVESTMENT PUBLICATION

MAGAZINE masterinvestor

RESEARCH • ANALYSE • INVEST

A CONFLICT OF INTEREST

WHEN WILL INTEREST RATES RISE – AND WHAT ARE THE IMPLICATIONS FOR YOUR PORTFOLIO?

PLUS...

HOW TO VALUE JUNIOR MINERS

CORPORATION TAX AS A TECHNICAL INDICATOR

IS IT TIME TO BUY BP AND SHELL?

SUNNIER TIMES AHEAD FOR SPANISH PROPERTY?

BONUS FEATURES!
OUR GUIDE TO IMPACT INVESTING

ISSUE 06 - SEPTEMBER 2015
WWW.MASTERINVESTORMAGAZINE.CO.UK

WELCOME

After more than half a decade of 'emergency' interest rates, the prospect of an imminent (?) base rate hike from the Federal Reserve has put some market participants on edge. This is understandable, especially when considering that there is a whole generation of financial practitioners out there that have never worked under 'normal' interest rate conditions.

But after six years of being on life support, the US and UK economies now seem to be ticking along at a healthy, albeit modest, growth rate, and such low interest rates now appear to be unjustified...

But wait! "Where's the inflation?" I hear you ask. And well you might! There is a deflationary tidal wave sweeping through the global economy, driven by a rapidly slowing Chinese economy and the concomitant rampant bear market in commodities. Add to this the growing tendency towards currency devaluation, and you have a very potent argument that raising rates now might tip the global economy into a deflationary death spiral, as the pressure exerted on prices through higher interest rates adds fuel to an already raging fire.

Hawks would respond with the observation that core inflation (which strips out volatile elements like fuel and food costs) is in fact running at a relatively healthy c. 1.7% in the US, and that the Fed risks getting behind the curve if it insists on further delays. Indeed, there is even an academic strain of thought that contends that this recovery has been the most protracted in living memory *because*, rather than in spite, of unprecedented monetary easing and intervention. If higher interest rates prove to be the supply-side stimulator of the Austrian school, rather than the demand-side destroyer of the Neo-Keynesians, then all this fuss could prove to be a storm in a teacup...

Nevertheless, "Black Monday" was a painful reminder that markets don't go up in a straight line forever, leading some to proclaim the onset of a new bear market. At Master Investor, none of us claims to be in possession of a crystal ball, but what I would say is that the recent setback feels more like 1987 than 2007. I may be wrong. China clearly has some very serious teething problems as its fledgling capital markets acclimatise to a much slower growth rate and the inevitable de-leveraging that follows such a colossal debt-binge. Its policymakers have a lot with which to contend...

But China's pain is, to some extent at least, the West's balm. Lower demand for raw materials has dealt consumer-based economies a welcome respite from rises in energy and food costs; and Western nations are not yet reliant on China for exports to an extent at which its deceleration would pose a major threat to their recovery. Recent data showed that growth remains well underpinned in the US, still the driving force of the global economy. Europe is beginning to show signs of life.

At times like these, it pays to hold one's nerve. As investors, we require low prices; but as humans, we crave high prices. I leave you with these eternal words of wisdom from Warren Buffett:

"If you plan to eat hamburgers throughout your life and are not a cattle producer, should you wish for higher or lower prices for beef? Likewise, if you are going to buy a car from time to time but are not an auto manufacturer, should you prefer higher or lower car prices? These questions, of course, answer themselves.

But now for the final exam: If you expect to be a net saver during the next five years, should you hope for a higher or lower stock market during that period? Many investors get this one wrong. Even though they are going to be net buyers of stocks for many years to come, they are elated when stock prices rise and depressed when they fall. In effect, they rejoice because prices have risen for the "hamburgers" they will soon be buying. This reaction makes no sense. Only those who will be sellers of equities in the near future should be happy at seeing stocks rise. Prospective purchasers should much prefer sinking prices. "

Best regards

James Faulkner, Editorial Director

CONTACTS

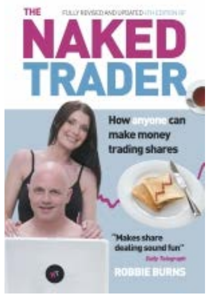
Advertising
swen@masterinvestor.co.uk

Editorial Enquiries
james.faulkner@masterinvestor.co.uk

Subscriptions
admin@masterinvestor.co.uk

FOLLOW US

EXCLUSIVE BOOK OFFER FOR MI READERS!!



To get The Naked Trader 4 for just £10 plus P+P in paperback **CLICK HERE** & use the promo code: NTMI0615

CLICK HERE TO SUBSCRIBE

WANT TO CONTRIBUTE?

If you think you have what takes to be a Master Investor contributor then email us at admin@masterinvestor.co.uk

Vicarage House, Suite 36/37
58/60 Kensington Church Street
London
W8 4DB

Editorial

Editor Swen Lorenz
Editorial Director James Faulkner
Creative Director Lee Akers
Sub Editor Simon Carter

Editorial Contributors

Filipe R Costa
Simon Carter
James Faulkner
Samuel Rae
Robert Sutherland - Smith
Jim Mellon
Maria Psarra
Swen Lorenz
Simon Cawkwell
Adrian Kempton-Cumber
Nick Sudbury
Victor Hill
Bill Blain
John Cornford

CONTENTS

ISSUE 06 - SEPTEMBER 2015

ON THE COVER

INTEREST RATE ARTICLES

06 Mellon on the Markets

Inside the mind of a Master Investor: Jim Mellon updates on his latest investment and trading activity. This month, Jim tells readers to get ready to buy China.

016 The Hot Seat – Michelmersh Brick Holdings

James Faulkner caught up with Martin Warner, Managing Director of Michelmersh Brick Holdings, the UK's largest quoted brick manufacturer, to find out how the company is building on recent success.

068 Fund Manager in Focus – Chris Hohn

Filipe R. Costa reviews the career of Chris Hohn, the man whose "obsession" to donate money led him to make money – lots of it.

088 School Corner – Which markets are right for you?

It's a wild world out there, and these days numerous options are available to you when it comes to how and what to trade and invest in the global financial markets. So how do you make your own personal choice? How do you find what is right for you?

092 Best of the Evil Diaries

Highlights of Simon Cawkwell's (aka Evil Knievil) trading and gambling exploits in recent weeks.

IMPACT INVESTING GUIDE ARTICLES

072 Demystifying "Impact Investing"

In the first article in our guide to Impact Investing, our editor, Swen Lorenz, tries to bring some clarity into a subject that is still little understood, but growing rapidly. As he discovers, it may well offer some exciting investment opportunities to those who know where to look.

082 An Interview with Suzanne Biegel of Clearly Social Angels

Suzanne Biegel of Clearly Social Angels lets us pick her brain on angel investing, impact investing, and networking with other entrepreneurially minded investors.

086 Blackbullion: Online education specialist seeks to end financial illiteracy

Master Investor reports on the case of an ambitious start-up aiming to tackle the issue of students leaving university without the financial literacy skills they need to get through life.

096 Best of the Blog

We look back at some of the most popular pieces from the Master Investor Magazine website during the month of August.

100 Read to Succeed – Elon Musk: How the Billionaire CEO of SpaceX and Tesla is shaping our Future

Often compared to Thomas A. Edison and Howard Hughes, Musk has risen from locally known Internet entrepreneur to being one of America's most influential industrialists. In this unrivalled biography, Ashlee Vance is given rare access to the legend's inner circle. Swen Lorenz reviews.

102 The Final Word – Why a minimum wage is a bad idea

Adrian Kempton-Cumber calls it as it is. This time, Adrian explains why a minimum wage has a cost attached to it – and it's not worth paying.

MELLON ON THE MARKETS

BY JIM MELLON

As I write this, I am in Edinburgh, at the International Arts Festival. While there are many dramatic performances taking place in this beautiful city during the four week show, there is considerably more (expensive) drama going on in world markets.

The utter collapse of Chinese markets has taken many by surprise, particularly those who don't read much history. But what is genuinely surprising is the way that the Great Fall has had a contagious effect on other markets, with the US, Japan, Germany and to a lesser extent, the UK, falling sharply also. In addition, almost everything to do with emerging markets has been massacred, which is definitely not a surprise, given the parlous state of some of them.

China earlier this year displayed many of the signs of a stock market mania in full force; one million brokerage accounts being opened every week, record margin lending, shares that no one had ever heard of going up like rockets. Those of us acquainted with Dutch tulip bulbs and South Sea Bubbles could see it coming.

At the same time, the remarkable strength of the US dollar was overdue for a reversal. China's cack handed managed devaluation (and by the way there is plenty more to come there) was a trigger for rising concern about other Asian economies, particularly those, such as Malaysia and Korea, which have strained finances. Indeed, until last week , the Malaysian ringgit had fallen by a quarter against the US dollar this year, and suspicions of a huge "mislaying" of funds by the Prime Minister added to the fiery pot of decline.

"THOSE OF US ACQUAINTED WITH DUTCH TULIP BULBS AND SOUTH SEA BUBBLES COULD SEE IT COMING."

But it wasn't just Asia; in other countries directly affected by China, the chickens have come home to roost. Australia's mining based rentier economy is teetering on a nasty brink, and I remain convinced we will see further declines in the AUD. After all, there was nothing miraculous about Australia's twenty-odd year boom – it just digs up stuff and sells it to China. Not very much more apart from suntan cream and board shorts. And now China isn't buying so much, and the price of the iron ore etc. that Australia sells has fallen by more than half.

And of course, oil and gas exporter, and serial territorial expansionist, Russia, is fried toast in current markets.

So what now? Well, I confess to being a little early about getting back into some markets, but I don't think this is a time for universal panic and despair, although I note that Evil is less sanguine than me.

"AUSTRALIA'S MINING BASED RENTIER ECONOMY IS TEETERING ON A NASTY BRINK."

I wrote last time that I thought the US market was priced to perfection, and so it was. It has fallen sharply but it is still priced in angelic territory, and I would caution about being too quick to get back in there. I have covered our short in **Apple**, which was a conviction trade at the Master Investor Show, but I wouldn't be in any rush to buy it. The CEO, Tim Cook has come out and said that China remains a robust area for Apple, but I wonder if he is spouting a bit of propaganda. After all, China's economic master has being fudging the national accounts for years. As I have said before, China's growth is 2-3% in real terms and not the posited 7% so beloved of the Politburo. So it might prove with Apple.

Germany, which has done so well from exporting to China, has been affected by this turmoil, as well as the rebound in the Euro (which was something that was going to happen when all of those who forecast a stronger Euro at 1.40 to the dollar forecast parity only a year or so later!). The **DAX** fell by 20% from its peak, and I think that is too much, so I am now a buyer.

"I WOULD BE A STRONG BUYER OF THE NIKKEI AT THESE LEVELS."

I was a buyer of the **Japanese yen** at the 124 to dollar range, but now would be neutral. Although Japan has investments in China, I don't think the two are comparable. Japan's market is not overpriced, and there is little margin debt. I would be a strong buyer of the Nikkei at these levels. Japan's corporate earnings are poised to rise sharply, and there is little outlet for the massive savings of the population in an environment of zero or negative interest rates.

The usual chatter of whether and when **interest rates** will rise in the US goes on; I am not sure this is particularly important. Clearly, the Chinese problems and the fall in US markets will affect Fed thinking, but even so I would be surprised if they don't raise interest rates slightly, to normalise matters, and possibly, restore **QE** at the same time, which might seem paradoxical but would be warranted to mitigate the shock of rising rates at the short end.

In fact, given the China story, which in some ways is exaggerated and in other ways not, I wouldn't be surprised to see a more direct form of QE – for instance printing money to fund infrastructure etc. – in some key markets. Which ones? Possibly Europe, and possibly Japan, though it is not clear that Japan needs more roads to nowhere.

In terms of currencies, I would be a seller of **Euros** at the 1.17 level, and indeed I wouldn't be surprised to see the ECB do something to push the currency back at that level. Europe's economic recovery is just too fragile to support a strong currency.

I think some emerging markets are just too cheap, and I am looking at Brazil right now as an example. I would continue to be a seller of the **Australian dollar**. I remain a holder of **Greek shares** (rock solid in the turmoil!), and I am optimistic that Japan will do well.

Avoid the US for now, the UK is blah, and get ready to buy **China**. A few months ago, many commentators were pushing China. It will be years before those who followed their advice will get their money back. But at 8x PE (admittedly with economic problems ahead and a big debt problem), China isn't expensive anymore and one day soon it will be the world's largest economy. I would dip a toe in to a reputable ETF and avert your gaze as the roller coaster goes up and down in the next few months.

Among stocks, I still like **Fanuc** in Japan, **Kuka** in Germany, and **Synergy Pharma** in the US.

Plenty to be getting on with... Oh, and the good news about this "performance" that has been going on while I am at the Edinburgh Festival is that a lot of hedge funds will have been crushed. Yeaaah!!!

Happy Hunting!

Jim Mellon

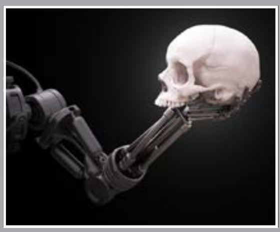
Click HERE to follow Jim's trades on twitter

What Jim read this month...

Amazon wants drone lanes in the sky

At the time mostly dismissed as a gimmicky PR stunt, it seems Amazon was serious after all. With the increasing number of unmanned aircraft, both professional and amateur, Amazon has called for the creation of high-speed sky lines to allow for the safe flying of automatic drones.

http://www.thetimes.co.uk/tto/technology/article4511405.ece



Robots could destroy us all, says Hawking

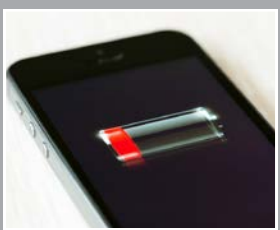
This reassuring article is another gem from the Times, as super-genius scaremonger Stephen Hawking voices his concern over the use of Artificial Intelligence for warfare. He and a thousand other high profile signatories call for a ban on autonomous weapons that could kill without human involvement.

http://www.thetimes.co.uk/tto/technology/article4510998.ece

$100m project uses world's best radio telescopes to find aliens

Yuri Milner, a Russian Venture capitalist, has launched a $100 million project to bolster the search for extra-terrestrial life. The first stage of the project will focus on the closest million star systems and look to pick-up 'leaked' alien signals, the equivalent of stray alien TV broadcasts, and then hone in on the source and find intelligent life. Although, chances are we'll just be getting the re-runs.

https://www.newscientist.com/article/dn27923-100m-project-uses-worlds-best-radio-telescopes-to-find-aliens/



The battery revolution that will let us all be power brokers

The bane of the modern man, low battery. The race is on to provide more efficient and longer lasting batteries to power our increasingly tech dependent world. But with advances in the way batteries are made, they are becoming cheaper, more accessible and rechargeable, meaning that we could soon be able to generate, store, and distribute our own electricity from home. Power to the people and all that.

https://www.newscientist.com/article/mg22730312-100-the-battery-revolution-that-will-let-us-all-be-power-brokers/

Apple car clues emerge from letter to test facility

Despite managing to overlook anything untoward penned by Corbyn, the Guardian (of all newspapers) has managed to get its hands on correspondence between Apple engineer Frank Fearon and officials from Go-Mentum Station, a car testing facility. The letters apparently fuel the rumour that Apple is building a car, dubbed 'Project Titan'.

http://www.bbc.co.uk/news/technology-33945098

AROUND THE WORLD IN A DOZEN PROPERTIES (PART 6)

SUNNIER TIMES AHEAD FOR SPAIN?

BY SWEN LORENZ

A 12-part series of articles by Swen Lorenz, reporting on easy-to-access investment opportunities in high quality real estate around the world.

This series looks at investments on a country-by-country basis. The truth is, however, that it should really be done on the basis of regions or even cities. Most countries we have looked at so far are fairly big, and even the property market of a medium-sized country is usually split into different regions, some of which couldn't possibly be any more different from each other in terms of price, quality and prospects.

Take Germany as a prime example. In the West, booming prices across the board; in the East, one bright spot (aka Berlin) combined with depopulated regions where tens of thousands of apartments are being torn down because they are deserted and essentially worthless. Investors who got into Germany in 2005/06, when the country's real estate was priced even below its replacement value, made a fortune if they invested in the right region, but only very modest returns (if any) if they put their money into the wrong part of the country.

There are currently a lot of similarities between Germany back in 2005 and present day Spain. Germany's real estate boom started with the introduction of REITs, or Real Estate Investment Trusts, i.e. publicly listed investment trusts that offers investors different tax advantages and the ability to buy and sell their investment on a daily basis through an exchange. With the introduction of REITs came large private equity groups that bought up portfolios of tens of thousands - sometimes even more than a hundred thousand - apartments. Foreign capital sparked the turnaround of the German market and Germany turned into a property market juggernaut from there onwards.

Spain also recently introduced REITs, as one of the measures aimed at injecting life back into the Spanish property market. Between 2007 and 2013, prices in Spain fell 35% across the board, according to the official statistics of the real estate registrar. Take into consideration that in some regions transactions essentially stopped happening, and it is likely that the aforementioned figure is an understatement. Some statistics speak of a "real" loss in value of Spanish property of 58%, which is nothing short of extraordinary. The most famous example for the kind of bloodbath that happened in Spain is the sale of Ciudad Real passenger airport, which was built for €1.1 billion and subsequently sold for a ridiculously paltry €10,000 (with the new investors agreeing to invest €100 million into getting the dormant airport relaunched as a cargo hub). Major cities weren't protected either, and prices for

prime real estate in Madrid also fell by 30% to 40%. Imagine that kind of fall in a place like London!

A slow recovery

The good news is that since 2014, prices have been rising again. So far, they have recouped one fifth of the losses incurred during the bust. In other words, whereas London, Berlin and a few other markets have long reached entirely new highs, Spanish prices still have a lot of catching up to do before they even reach their pre-crisis levels.

Some regions though may never again see those pre-crisis prices, at least not in our lifetime. Spain has regions where supply and demand is so out of whack, and the quality of real estate so questionable, that prices are unlikely to go anywhere. Also, the economy has a long way to go before it truly shakes off some of its structural issues, such as the high levels of youth unemployment; in 2013, a staggering 56% of Spain's young were unemployed. That figure is now down to 49.2%, but it'll be years before the country has a chance to get back to anywhere near normal. Even the high percentage of young people working in the informal economy doesn't change that.

There'll be a number of other regions though where the recovery is likely to continue, and might even gather pace. The two economic centres of the country, Madrid and Barcelona, are where things are likely to stabilise and move forward the fastest. Cities adapt faster to changing economic environments, and they are also the first place where foreign investment gets washed ashore once the initial panic is over. It's actually already evident in the case of Spain: private equity firms like Cerberus and Blackstone started moving into the country in 2013, and sovereign wealth funds from the Middle East have also been buying up Spanish assets, including retail and hotels.

Barcelona is increasingly turning into Europe's no. 1 "urban resort" and will continue to be seen as an attractive place to make a long-term investment. Madrid, as the country's capital and with more than 5 million inhabitants, will also naturally remain one of Spain's powerhouses. There are also certain coastal regions where demand has picked up again. However, these areas tend to be more attractive to investors looking to buy their holiday home rather than for investors who are purely looking for a financial return and a low-risk, liquid asset.

The recovery is also being driven by a number of macro factors. Following years of contraction, Spain's economy is currently up 2.7% over the past 12 months. Banks have begun lending again, and the return of local buyers has led to new mortgage approvals growing by 27% compared to a year ago. Whereas before the crisis close to 40% of all the mortgages in Spain were taken by foreigners speculating with properties that generally they hardly ever lived in (if at all), now overseas buyers account for just 3% of outstanding mortgages. The increase in demand is currently mostly due to people buying property for actual use or for renting instead of merely looking for capital gains, which gives the market a much stronger foundation to stand on.

There has also been a trend of new groups of buyers moving into some markets. British and German buyers used to dominate foreign purchases in the residential market before the crisis, but now there is also a much larger contingent of Asian, Middle Eastern, American and Swiss buyers - buyers that generally pay in cash and don't require a mortgage. A newly introduced visa scheme helped, too. Launched in September 2013, a "Golden Visa" scheme that offers residency to foreigners who invest more than €500,000 led to nearly 500 transactions during the first year. Not enough to make a difference to the overall market, but following the kind of bust the Spanish market experienced, every incremental improvement helps to build new momentum.

REITs already playing a major role

During 2014, more than €10 billion of investment found its way into commercial real estate in Spain. Of that, a quarter came from the "Socimis", as the REITs are called in Spain. Their funding in turn is heavily based on foreign investors looking for an easy, liquid way to grab a piece of the action. As ever, buying a listed security is much easier than purchasing and managing an actual piece of real estate.

For those who are looking to invest with a view to an attractive financial long-term return, rather than wanting a place in the sun or the trouble of managing individual tenants themselves, the obvious answer is to look at REITs with heavy exposure to Barcelona and Madrid. Incidentally, this leads us to one very obvious candidate: **Merlin Properties**, the new giant in the Spanish real estate industry.

Having listed on the Spanish market just last year, Merlin quickly rose to become the country's largest property holding company. It made headlines by buying a minority stake in Testa, the property holding of a financially stricken Spanish construction firm, Sacyr. Two months ago, in a transaction valued at €1.8 billion, Merlin purchased all remaining shares of Testa. What's noteworthy about the transaction is not just the size, but also the fact that Testa was widely known as the highest quality portfolio of real estate in the country.

With a portfolio worth €5.5 billion, the company is now the single largest investment entity in the Spanish real estate market. It's portfolio is focussed on Madrid (71%) and Barcelona (11%), the two powerhouses of Spain. The majority of its investments are in office buildings (53%), with hotels (12%), retail (11%) and residential (8%) adding to the mix. Currently, 98% of the available space is rented (or 92% if space that is currently out of commission because of refurbishments is counted as empty). The Madrid and Barcelona office portfolio is recognised as virtually irreplicable, with many international firms and corporate headquarters as anchor tenants.

The next largest Spanish property company has €1.3 billion in Spanish real estate, leaving Merlin towering over the rest of the industry. Foreign investors – i.e. investment funds, hedge funds and private investors – are likely to favour investments into Merlin because of the liquidity its shares offer and the high quality of the portfolio. Once the transaction to purchase Testa has been executed, the company will be financed with 50% equity and 50% debt, i.e. the company is not highly geared and therefore particularly suited for long-term investors who want to put the investment aside and sit tight for three, five or ten years. The dividend yield is currently around 2.5%.

"THE NEXT LARGEST SPANISH PROPERTY COMPANY HAS €1.3 BILLION IN SPANISH REAL ESTATE, LEAVING MERLIN TOWERING OVER THE REST OF THE INDUSTRY."

Having a player like Merlin emerge is also a clear sign that Spain's property market is going through a process of globalisation and is becoming more integrated with the financial sector - just as Germany did 10 years ago! The data clearly indicate that the worst of the real estate crisis is behind the country, and Spain is now entering a two speed recovery where Barcelona and Madrid will lead the way.

The shares of Merlin listed in June 2014 at €10, and are now trading virtually unchanged at €10.25. Those seeking to squirrel away some money into relatively cheap real estate and not have to worry about its management could do worse than take a closer look at Merlin Properties. Once the market has digested the Testa transaction, and the significant issue of new shares that was necessary to fund it, the price for Merlin shares should improve. Longer-term, getting in on the Spanish opportunity could turn out to be as good a decsion as investing into Berlin a decade ago.

AN INTERVIEW WITH MARTIN WARNER

MANAGING DIRECTOR OF MICHELMERSH BRICK HOLDINGS

James Faulkner: Thanks for taking the time to speak to Master Investor. Could you begin by giving our readers a brief overview of Michelmersh Brick Holdings (MBH) and its history, for the benefit of the uninitiated?

Martin Warner: *We started in 1997 with the acquisition of two brickworks in the Home Counties manufacturing about 10 million bricks serving local markets where the product had been manufactured for generations and supplied product to match the local vernacular.*

We made further acquisitions buying three more works over the years so that we now produce 70 million products, having floated on AIM in 2004. We also have significant land assets that come along with the brick making, some of which can be used for landfill and some for residential development.

JF: Most people are aware that the housebuilding and construction sectors are acutely cyclical. Where do you think we are in the cycle right now and what implications does that have for equity investors?

MW: *We are at the beginning of a new cycle for brickmaking. These tend to be much longer than in the construction sector because the industry is so capital intensive. Since the 1980s, when the last major investments were made in the industry, the UK market has been oversupplied as construction, especially housebuilding, declined. The last recession saw a brutal reduction in capacity, so imported bricks are now needed to fill the gap.*

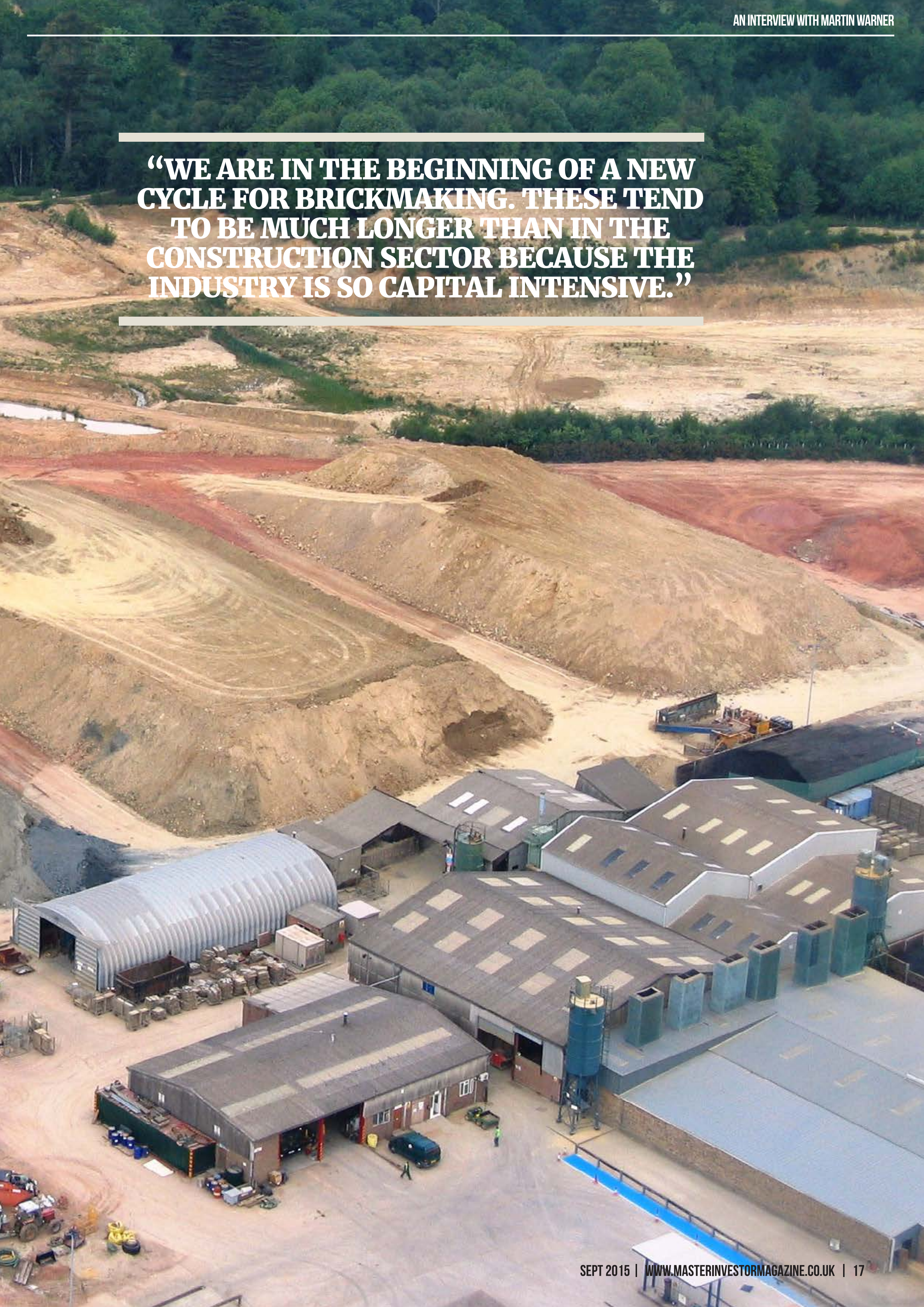
JF: With interest rate rises apparently on the horizon, does that necessarily entail a cooling off of construction activity? Much attention is paid to the break higher interest rates exert on demand, but very little is mentioned about the positive impact on the supply of credit as banks find it more profitable to lend. What is your take on this?

MW: *As noted above we are at the start of a new cycle with brick demand exceeding supply recovering from a very low base. Coupled with an undersupply of new housing the overall dynamics for the industry are pretty resilient even when interest rates do rise. These have long been expected and all the pundits seem to think they will be slow and gradual.*

JF: From the point of view of a UK equity investor looking to gain exposure to the sector, why not go straight for the jugular and simply invest in one of the housebuilders? What distinguishes building materials suppliers such as Michelmersh as an investment?

MW: *We are now at the beginning of this new cycle which is highly capacity-constrained so I think the dynamic is different. We will now see a normalising of the market over the medium term after many difficult years.*

JF: Michelmersh puts a strong emphasis on its stable of brands whilst operating in an industry that produces what most people would consider to be a fungible product. What's the logic behind this?



"WE ARE IN THE BEGINNING OF A NEW CYCLE FOR BRICKMAKING. THESE TEND TO BE MUCH LONGER THAN IN THE CONSTRUCTION SECTOR BECAUSE THE INDUSTRY IS SO CAPITAL INTENSIVE."

MW: *We started with bricks which fit the local landscape and our products enhance the street scene. The price of a brick is less than the price of a Mars Bar and yet they last at least 150 years longer! Half the market is repair and maintenance. The first thing a potential buyer sees when he drives up is the front of the property and for a small amount of money something that looks absolutely right can be built so our products are also very often favoured by architects and indeed local planners as well as developers.*

Probably the best example I can give is that when St Pancras Station was redeveloped there was no other manufacturer who could match the appearance and size of the 100 year old brickwork.

JF: Michelmersh recently returned to the dividend list for the first time since 2007. Given that the recovery in the housing market has been in place for several years, why did it take so long for Michelmersh to resume paying a dividend?

MICHELMERSH
Brick Holdings PLC

MW: *The industry has lagged because when the market crashed in 2008 there was a massive stockpile of bricks on the ground – about 10 months' supply. It took until 2013 for these to be sold down. This illustrates the point about long cycles.*

JF: Whilst turnover climbed by 13% during the first half of this year, the majority of profit growth was accounted for by an increase in margins. Given that the number of brickworks has actually declined since 2007, is there scope for further margin progression on the back of supply constraints?

"THE CHALLENGE FOR A LARGE PART OF THE INDUSTRY NOW IS TO INVEST IN EXISTING PLANT AFTER A LONG PERIOD OF UNDERINVESTMENT AND THIS IS LIKELY TO BE WHERE MOST RESOURCES ARE DIRECTED IN THE FORTHCOMING PERIOD."

MW: *We are now expecting that this new cycle will start to bring normalised returns. Our focus now is to improve efficiencies in our business by incremental investment – for example we have just finished our new expansion project at our Freshfield Lane works which is bringing extra capacity on stream and we have installed more robots at our Blockleys site. We will continue to invest to improve efficiencies which will bring margin improvement.*

JF: The General Election cast a cloud of uncertainty over the housebuilding sector. Now that that cloud has been lifted, has the market responded in kind? Is the current government doing enough to stimulate the sector?

MW: *There is stimulus in the sector from the 'Help to Buy' scheme, but there are capacity-constraints in every part of the market. One of the biggest is the planning system which is certainly not getting any easier and although this is recognised by Government it is difficult to see much change coming.*

JF: Hanson and Ibstock, two of the UK's largest brick manufacturers, were recently acquired by private equity. What implications does this have for the industry?

MW: *It is hard to comment on this apart from the fact it should bring a more financially disciplined market place at this point in the cycle.*

JF: The UK currently imports around 20% of its bricks. What would it take for domestic manufacturers to plug the supply gap? Is there still a lack of confidence to invest in new capacity in spite of the recovery?

MW: *To build a new plant requires a good supply of mineral, planning consent with all the problems this entails, a cheque in the order of £60–70 million for a 100 million unit plant, and several years to bring on stream.*

The challenge for a large part of the industry now is to invest in existing plant after a long period of underinvestment and this is likely to be where most resources are directed in the forthcoming period.


FINANCIAL-SPREAD-BETTING.COM
SPREAD BETTING ACADEMY
As much as we would like it to, money doesn't grow on trees...

...but we can give you the opportunity to plant the seeds of your own success!

In our own experience with hundreds of traders from around the world, the 'secret' - if there is one, as to why some of these guys always seem to make money right from the start, is that they keep things simple.

First you must grasp a good understanding of basic market mechanics. Trading with trend lines for example is not rocket science, and is more akin to simple geometry - it does not take a genius to draw a line on a chart. Momentum ndicators require a few more brain cells, but any 10 year old can be taught to recognise a divergence of momentum indicator and price.

It is a known fact that the traders who lose money seem to let emotion affect their judgement and this makes trading very risky. But get past that hurdle, and trading can be incredibly profitable.

You need to work with facts only. That's what our spread betting and technical analysis courses teach you. How to work with hard facts not soft emotions.

Start planting the seeds of your trading future with our completely FREE Stock Market Training!

Access all our free financial tools, including:

Q&A - All your spread betting questions answered.

Training - In-depth technical analysis and money management courses teaching you how to trade.

Videos - Check out our finance and audio interviews.

Reviews - Unbiased reviews and perspectives on spread betting companies.

Deals - The best spread betting offers and freebies around right now.

Tips - Pearls of financial wisdom and tactics to help improve your trading.

Discuss - Blog your trading journey in our Trading Community section.

Simply visit: www.financial-spread-betting.com

US INTEREST HIKE IN SEPTEMBER? REALLY?

BY BILL BLAIN

A few lifetimes ago, in early August, the editor asked me to write about optimal portfolio composition ahead of the then expected US rate hike in September. I scribbled up a note on how global growth remains sub-par, under threat, and how a rate hike might just result in the surprising outcome of lower bond yields as more and more global money would flock towards the mighty dollar. I then took a week off to enjoy what we laughingly call an English Summer...

While I was out, the China Syndrome finally exploded.

Global markets were a sea of red. Expectations of a Fed hike in the face of such global dislocation evaporated. But, the following day, as Asia continued to nosedive, the Occidental markets stabilised. There are definitely bargains out there in equities!

But where does the bursting China Bubble leave us? To answer the question what happens tomorrow, it's important to understand what happened yesterday, so here goes...

Seven years after the Global Financial Crisis exploded with the collapse of Lehman Brothers in 2008, global markets remain perverse and difficult to call. The current threat list includes obvious ones like the ongoing China crisis, the oil and commodities collapse, Greece Elections, and emerging markets struggling to cope with the strong dollar.

Policy responses have been disappointing. For all the talk of co-ordinated G7 action to stimulate global growth, what we've seen is competitive devaluations and protectionism. Central banks have pumped money into the system through QE, but zero interest rates, cheap energy, minimal inflation and low wage pressure have done nothing to stimulate real global growth.

"SEVEN YEARS AFTER THE GLOBAL FINANCIAL CRISIS EXPLODED WITH THE COLLAPSE OF LEHMAN BROTHERS IN 2008, GLOBAL MARKETS REMAIN PERVERSE AND DIFFICULT TO CALL."

For the last seven years we've seen global growth fail to meet expectations, fizzle out and disappoint. Market sages have been talking about the "new normal" - low growth and low interest rates going on forever. I call it Null Entropy. The end of the commodities "super-cycle" and low oil prices are proving long-term fixtures rather than short-term featurettes.

Any portfolio strategy has to address the realities of low growth, low inflation and potential long term stagnation. Some economies – notably the US, the UK and even some European states – are seeing some signs of real growth, but it's still sub-par. Other economies remain in crisis. And should that surprise us? The countries in the recovery room are those with the most market based economies.

Prior to the China bubble exploding, the consensus was that the US Fed would announce its first rate hike since 2007 as early as September. When it comes it will be a modest 0.25% rise. What will it entail for growth, stocks, commodities, foreign exchange and bond prices, and how should these assets figure in a portfolio mix?

As I write this note, the market is discounting a Fed hike. Many banks say it won't now come till 2016. However, I suspect it may still come this year. In normal markets, rate hikes produce fairly predictable and uniform outcomes – fear and panic in bond markets (as higher rates imply lower bond prices), countered by optimism in stocks (on the back of rising growth prospects), and strengthening currencies (as money follows higher rates). In such perfect markets, choosing an optimised portfolio is fairly simple – buy stocks for growth, rising rate currencies, and sell bonds. And since dollar rates are rising, be long the dollar.

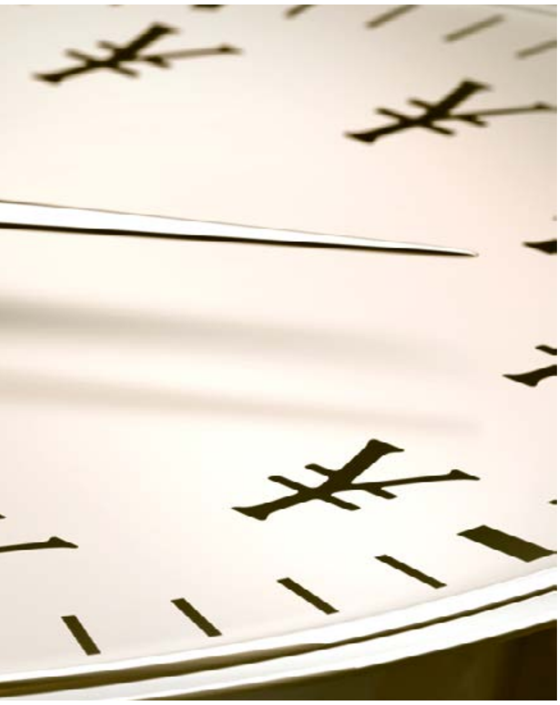
However, this time it's different.

First, there are the markets: Seven years of central bank financial repression and the unintended consequences of quantitative easing have distorted asset prices across the financial markets, creating a host of knock-on effects in the relative values between asset classes. Ultra-low yields forced "yield-tourists" to go hunting for returns in less familiar markets. As a result we've seen stronger bond sectors and stock markets than the metrics justify – fuelling the suspicion current asset prices are bubbles in the wake of QE distortions.

The fact that bond yields remain so low is causing less concern than it should. The foundations of the global collapse of 2007 were firmly rooted in overly easy monetary policy – it was too easy for banks to lend money, building up the debt crisis and US housing ructions that toppled money markets leading to the drying up of bank funding. The end of easy money precipitated a funding crisis for Northern Rock and sank half-a-dozen structured bond investment funds, before escalating out of control and into the near total rolling collapse of the banking sector in 2008. Only the swift action of central banks, led by the Fed, kept the financial system open and afloat.

These were brutal days as the surviving US banks underwent forced recapitalisation. It worked – the US banks have repaid their bailout cash and are functional again. The situation in Europe is far less clear – banks and sovereign debt remain intimately linked in mutual co-dependency under the ECB. European banks show disturbingly few signs of ever being fixed.

Second, there is the global economy. It remains critically vulnerable to recession. The fact that banks haven't been lending hasn't helped. They have been constrained by draconian new capital regulations and requirements, and by



over $200 billion of fines stemming from their crisis inducing behaviours. As the investment banks have been forced to give up market making across security markets, many investors fear being trapped by illiquidity if markets turn – hence market reactions are likely to be exacerbated.

Fears that flooding markets with QE cash would create inflation have proved utterly wrong. There is almost zero inflationary pressure in the global economy. Commodity prices have crashed. Oil prices have tumbled. Low rates, low commodities and low energy prices have not created perfect lift-off conditions for economies - instead we've seen stagnation. Deflation rather than inflation has become the market's fear.

Attempts to drive global growth through trade agreements and growth initiatives have become mired in political treacle with a strong protectionist theme emerging. Abenomics – credited with perhaps rescuing Japan after 25 years of decline – is basically devaluation by any other name.

"FEARS THAT FLOODING MARKETS WITH QE CASH WOULD CREATE INFLATION HAVE PROVED UTTERLY WRONG. THERE IS ALMOST ZERO INFLATIONARY PRESSURE IN THE GLOBAL ECONOMY."

Global investors haven't felt pushed to invest in risk/reward assets. While interest rates have languished at millennial lows, the expectation had been a glut of entrepreneurial growth. Instead, investors have preferred to park cash in safe places rather than risk investing in high risk/low reward projects. What we've proved is that ultra-low rates act as a disincentive to risk-taking and funding risk ventures. When container rates from Asia are at record lows because of limited demand, when global steel capacity usage is only 68%, and global commodities grind lower every day, why take the risk of building new factories?

As global business risks rise in the wake of the commodities crisis and crashing Asian demand, that raises increased risks for corporate debt and stocks.

Low rates have distorted and damaged economies.

Ultra-low bond rates have caused corporates to borrow billions from the bond market. But rather than invest that cash in new factories or other forms of job creation, the cash has been used to shore up pension schemes or to buy back stocks, pushing up (and further distorting) stock prices. The only beneficiaries have been CEOs seeing their bonuses rise on higher stock prices. Increased income inequality is just one effect! Weaker corporate credits and leveraged balance sheets are another.

Let's look at the underlying asset markets themselves:

• Stocks

In recent months we've seen a distinct softening in global stock markets, reflecting a lack of confidence in future growth and doubts about current valuations, culminating in August's Black Monday. The biggest loser has been China, but that was patently a bubble that has now conclusively burst. More worrying are the travails of strong firms like Apple, highlighting how tired markets are. Apple produces and sells lots of high value goods, yet when it only beat estimates by a small amount, the stock crashed by 16% as negative concerns such as declining China sales and the lack of new product pipeline came to the fore. Some folk think Apple's time as a top stock is past, but I rather see it as a canary-in-the-coalmine for stock markets. If it's in trouble, then so is everything else.

• Currencies

Most major nations have been playing a game of competitive devaluations to make exports more attractive. China tried to address its deepening dismal economic woes through devaluation. The effect has been to favour the dollar – which will clearly continue if the US is the only economy to hike rates – which begs the question: does the US actually need to hike? And a strong dollar simply creates greater stress in emerging markets!

• Bonds

When bond yields spiked higher in the US, Asia and Europe in March, many called the end of the bond bull market. The corrections told us a new bear market had arrived with bond prices likely to see further significant losses as the global economy recovered and bond buyers priced in central bank rate hikes. However, the bond sell-off has stalled.

> **"SOME FOLK THINK APPLE'S TIME AS A TOP STOCK IS PAST, BUT I RATHER SEE IT AS A CANARY-IN-THE-COAL-MINE FOR STOCK MARKETS. IF IT'S IN TROUBLE, THEN SO IS EVERYTHING ELSE."**

If I were pushed to recommend portfolio approaches for September and the "we-might-get-a-US-rate-hike" scenario I'd go with the following:

Short Term

Bonds are likely to rally on ongoing weakness and demand as global investors pile into the US Dollar and treasuries in particular. This is counter-intuitive as bonds should slide on a hike, but this time is different.

Stocks are likely to weaken on the threat of higher rates, but clearly some are good defensive long term plays.

Bonds – defensive corporate bonds and secured debt.

Currency – dollars, dollars and more dollars.

Long term

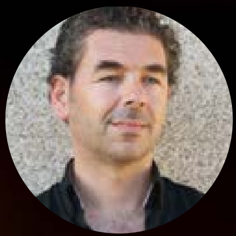
I go for the old adage that "Americans usually do the right thing after first exhausting every other possibility." On that basis, buy US stocks on weakness and sell bonds into strength!

Bill Blain is Head of Capital Markets and Senior Strategist at Mint Partners.

ECONOMICS CORNER

HIKING RATES BEFORE THE BUST

BY FILIPE R. COSTA



"Everything that goes up must come down. But there comes a time when not everything that's down can come up."
– George Burns

One of the biggest issues with interest rates relates to the fact they are not freely established in the market but instead dependent on a key benchmark rate set by the central bank, which it sets according to its own goals and views on the economy. As a result, only by pure coincidence would interest rates reflect the natural levels that result from the interaction between market forces. Under such conditions, a distortion is created, and interest rates no longer reflect fundamentals and so lead to erroneous economic decisions. To be fair, that is the main goal of a central bank: it wants to create the illusion you should consume or invest more than you ought to, or the opposite, at times. The central idea – to help smooth the business cycle and eliminate part of the systemic risk – is praiseworthy. But if such intervention is prolonged and significant, with the central bank convincing you to invest and consume more than the market warrants for a prolonged time; then bigger distortions may be created and one should ask whether the central bank isn't creating the business cycle itself rather than smoothing it. Since the 1980s, central banks have been increasing the degree of intervention, being ever more successful in keeping consumer inflation low but creating ever more distortions. At a junction when central banks seem to have spent all their ammunition to reflate the economy and are preparing to reverse policy, it is time to take a look back and try to understand what is coming. The near future may be tough for investors.

“THE NEAR FUTURE MAY BE TOUGH FOR INVESTORS.”

Central banks have sight but no vision

To keep a long story short, there are many theories about the effects monetary policy may have in the real economy, but almost all agree that in the long term the real economy cannot be boosted through it. In the long term, any increase in the supply of money will lead to increases in prices. But, as Keynes said, "in the long run we are all dead", and then monetary policy may be helpful in stabilising the short-term volatility of the business cycle. That is at least what Paul Krugman and the Post-Keynesian school of thought believe. When the economy is derailing and prices are sufficiently low, lowering interest rates may then help boost the economy towards full employment and smooth the business cycle, they argue. But, without disagreeing, one could ask whether seven years of uninterrupted intervention is in fact smoothing the business cycle; or whether such a prolonged period of intervention isn't proof of the ineffectiveness of monetary policy in the real economy.

While some central banks keep a dual mandate, monetary policy today is almost solely charged with targeting an inflation level. Central banks then find justification for their action from the deviation of inflation from their target and measure that inflation with a very simple measure that tracks the rise in consumer prices. But these CPI measures just account for a few products that were produced within a certain period. *What about products that were consumed in the period but that were produced in an earlier period? What about financial assets and real estate?* These are ignored at large. No need to care about that… markets are rational, remember!? This way, central banks ignore any effects that derive from their action other than the effects on CPI. Because CPI readings have been low, central banks were able to keep interest rates near zero for seven years. But the risks have expanded, as other prices are booming without accompanying fundamentals, sowing the seeds of another crisis. With the central banks now preparing for a policy inversion, massive corrections are also expected – and have in fact already begun.

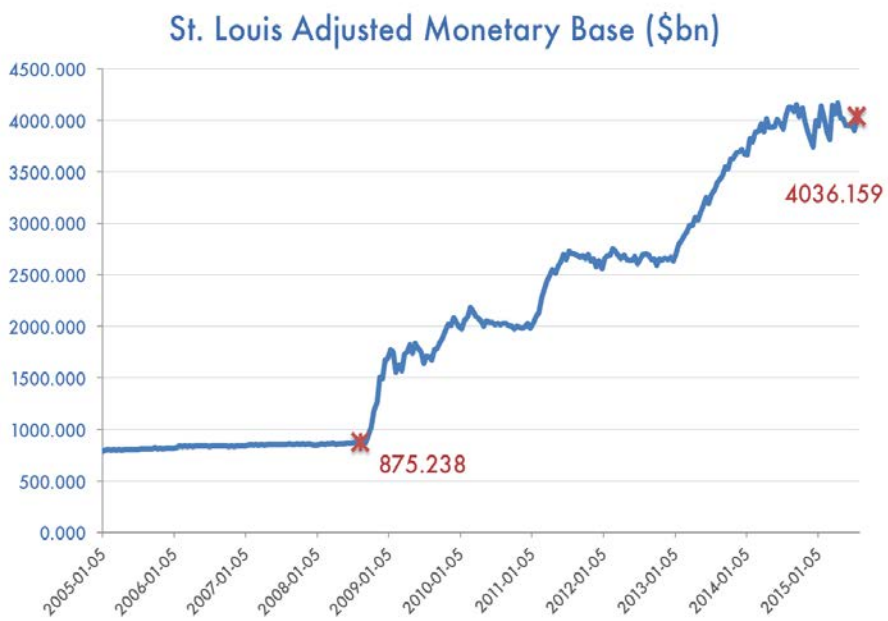
Ignoring fundamentals

Sharing the Austrian School of Economics' view, the Bank of International Settlements (BIS) has been expressing its concern about the effects of excessive global easing, claiming that central banks will end up slowing the recovery by entrenching excessive reliance on debt and leading to misallocations of capital (malinvestment, as the Austrian School dubs it).

The central bank's asset purchases lead to higher prices, which creates a feedback effect, attracting new buyers into the market. These buyers will bid up the prices of pre-existing assets, pushing prices even higher and leading to increases in investor sentiment, which further contributes to more buying and additional price increases. The feedback loop goes a long way towards explaining why funds are directed away from the real economy, in the direction of financial markets, to create an asset bubble. It also goes a long way towards solving the puzzle of why increases in the money supply do not lead to proportional increases in consumer prices, but rather in prices in a broader sense.

> **"THE EXTREME CENTRAL BANK INTERVENTION OF THE LAST FEW YEARS HAS PLANTED THE SEEDS OF THE NEXT RECESSION."**

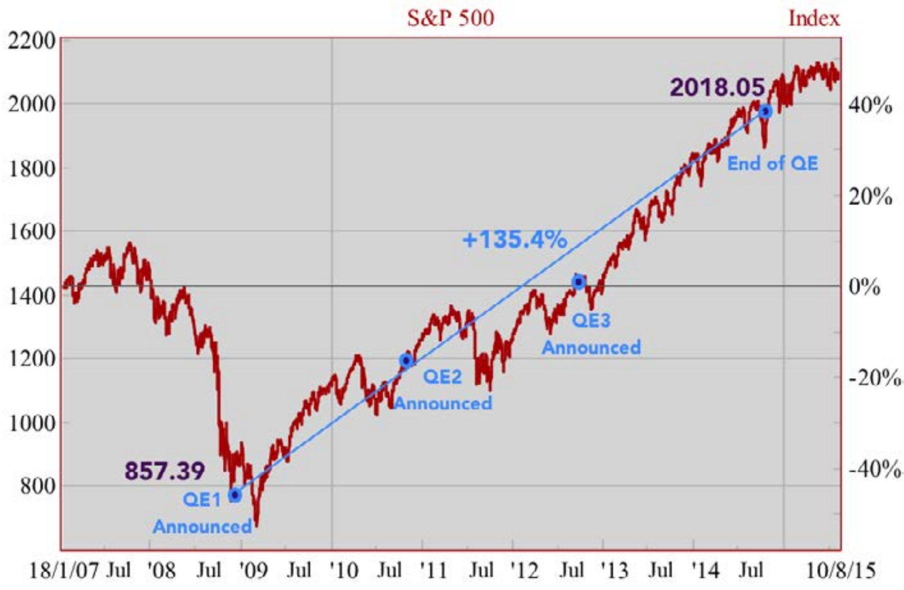
By the same token, as the current interest rate is no longer set in the free market, it will be lower than the natural rate (the level resulting from the interaction of market forces), giving faulty signals about the economy and leading to ineffective allocations of capital between industries, favouring long-term projects with distant and more uncertain cash flows. As soon as the rates are normalised many of these projects will show negative NPVs and will end up being shut down. The longer interest rates stay at these artificially low levels, the greater the number of unreliable projects that will be abandoned in the future. The extreme central bank intervention of the last few years has planted the seeds of the next recession. The US Federal Reserve, under Ben Bernanke and now Janet Yellen, adopted an extremely expansionary policy which saw the monetary base rise by a factor of 4.6x from $875 billion in August 2008 to $4,036 billion at the end of July 2015.



Because central banks concentrate on the effects their policies impart on a narrow measure of consumer prices, they fail to foresee the largest part of the impact of those policies. Consumer prices remain low because the target of the policy has been financial assets, which are owned only by a few in the economy. The increase in the wealth of that minority has not really flowed through the economy to increase disposable income and lead to a sustained increase in consumption that would press prices of real assets up. The inflation created by a massive asset purchase programme occurs in financial assets, not in real assets. During the period between the announcement of QE1 at the end of November 2008 and the end of QE3 in October 2014, the S&P 500 rose 135.4% while the real economy grew by 10.8%. The massive asset purchase has limited real effects (if any), as the US economy grew at an annualised pace of 1.3% during the QE period. When this happens, a massive disconnect between prices and fundamental value occurs.

A good way of getting an overview of how the market is being valued from a historical perspective, is by taking a look at the Cyclically-Adjusted Price-Earnings Ratio (CAPE), developed by the Nobel-Prize winner Robert Shiller. The current reading (at time of writing) points to 26.07, which is 58% above its historical mean level of 16.5x. For more than a century, every time the market deviated too much from its historical mean, it ended up reverting. That happened across the years with no exception, so there's no reason to believe this time will be different, and thus one should expect the market to mean-revert once again.

The human being is affected by cognitive bias. When interest rates decrease very quickly and are kept at low levels for prolonged periods of time, sentiment rises. Theory shows that when distortions end, sentiment deteriorates, the contemporaneous returns for equities also rise but the future returns are poor. That happens because, when distortions end, sentiment decreases and prices revert to fundamentals. It is difficult to estimate how long markets can



stay above fundamentals, but the *irrational exuberance* usually lasts until some event occurs, which triggers a reversal of sentiment. A normalisation in monetary policy is that kind of event. At a time when the equity market seems overvalued by 58% in the US, there are three options: (1) corporate profits rise at a never-before-seen extremely high rate, such that sentiment stays high for longer, which is very unlikely; (2) prices crash for the price-earnings ratio to revert to historical levels, which is very likely; or (3) as soon as prices start declining, the Federal Reserve stops policy normalisation and pushes for another round of QE, which I wouldn't say is unlikely at all.

"THE NORMALISATION OF INTEREST RATES IS THE KIND OF EVENT THAT BRINGS SENTIMENT DOWN TO EARTH AND HELPS DEFLATE BUBBLES."

Not all equities are created equal

The normalisation of interest rates is the kind of event that brings sentiment down to earth and helps deflate bubbles. Recent literature on the effect of sentiment on equity prices states that not all shares suffer the same boost during high sentiment periods. Stocks whose valuations are highly subjective and that are difficult to value are usually more exposed to overvaluation. Small stocks, young stocks, high volatility stocks, stocks with a lack of track record, non-dividend-paying stocks, extreme growth stocks, unprofitable stocks: all are more exposed to such overvaluation. When the rate normalisation starts, those are the stocks that will suffer the most.

"WHILE THE DEVELOPED WORLD HAS BEEN UNDERGOING MASSIVE DELEVERAGING, THE DEVELOPING WORLD HAS BEEN INCREASING DEBT LEVELS AT AN ASTONISHING RATE."

Investors should benefit from selling these stocks while purchasing those more established big capitalisation stocks with a long track record of positive profits. Facebook, Linkedin and Twitter are just a few examples of companies that have been helped by years of positive sentiment to trade at unrealistic price-earnings levels. Investors will certainly realise how unrealistic the assumptions on which they based estimates were when sentiment deteriorates. These stocks are much more exposed to a potential crash than those trading on low price-earnings and low price-book ratios. By this token, the whole mining and oil industry seem extremely undervalued, in particular for those who are looking for long term opportunities.

At the market level, The CAPE ratio is a very good way of having an idea of how overvalued it is. At this point, valuations are much more favourable for European equities where price ratios are still conservative and normalisation is distant. Spain, Italy, Portugal and Greece show CAPE ratios between 10x and 13x and offer the best opportunities inside the Eurozone. The UK market is still a go, where the same ratio is around 13x. European emerging economies like Hungary, Russia and the Czech Republic also offer good long-term opportunities.

There is no Emerging Markets asset class

Emerging markets are among the countries that benefited the most from quantitative easing in the developed world. In 2008, when a liquidity squeeze led to the Lehman collapse and the subsequent credit crunch, investors pulled money out of emerging markets, leading to a collapse in equity prices in these markets. The subsequent interest rate cut and quantitative easing decreased the yields offered in the developed world and seduced investors into returning to emerging markets. The capital inflow allowed many developing countries to keep interest rates low and led companies to increase debt to levels that are concerning. While the developed world has been undergoing massive deleveraging, the developing world has been increasing debt levels at an astonishing rate. Debt creation jumped from $8 trillion to $23 trillion between 2007 and 2014 in those countries. A large part of the debt was issued in Eurobonds, as local companies saw the low-yielding US market as a huge opportunity to finance their projects at a very low cost. But with the US dollar increasing in value at a rapid rate, the countries where debt has grown fastest may end up in trouble.

EM Currencies - Performance Against US Dollar

Currency	YTD (%)	1-Year (%)	3-Year (%)	Nearness to 1-Year High	Nearness to 1-Year Low
USD/BRL	31.9	53.9	73.9	99%	64%
USD/MYR	14.2	25.0	28.2	100%	79%
USD/CLP	12.1	18.4	42.0	100%	85%
USD/ZAR	10.8	20.5	58.4	100%	82%
USD/MXN	10.7	23.9	24.8	100%	80%
USD/IDR	10.2	16.9	43.9	100%	86%
USD/KRW	7.9	14.2	4.2	100%	86%
USD/RUB	6.1	78.7	102.5	93%	56%
USD/CNY	2.0	2.8	-0.6	100%	97%
USD/INR	1.9	5.1	16.4	100%	94%

Source: Sharescope, Own Calculations

Emerging Markets - Stock Market Performance

Asset	YTD (%)	1-Year (%)	3-Year (%)	Nearness to 1-Year High	Nearness to 1-Year Low
iShares MSCI Russia ADR/GDR UCITS ETF	9.3	-23.6	-35.6	70%	82%
iShares MSCI India Index Fund	4.1	4.1	36.7	93%	92%
iShares MSCI UK Index Fund	3.6	-7.0	8.6	91%	92%
iShares MSCI USA Index Fund	2.1	8.6	49.7	99%	87%
iShares MSCI World	1.6	10.1	37.7	92%	88%
iShares MSCI China Index Fund	1.4	0.3	21.6	79%	91%
iShares MSCI Mexico Index Fund	-4.3	-18.9	-9.9	78%	96%
iShares MSCI South Africa	-5.2	-5.2	-2.1	83%	95%
iShares MSCI Emerging Markets	-8.6	-12.4	-12.0	79%	100%
iShares MSCI Chile Investable Mkt Idx Fund	-9.3	-17.9	-40.0	81%	97%
iShares MSCI Thailand Index Fund	-11.5	-15.8	-3.5	80%	98%
iShares MSCI Korea	-12.5	-19.2	-14.3	75%	100%
iSHARES MSCI Indonesia Investable Market Index Fund	-18.1	-22.7	-24.9	77%	98%
iShares MSCI Turkey	-20.9	-15.0	-21.2	70%	97%
iShares MSCI Brazil	-27.3	-41.5	-51.0	52%	100%

Source: Sharescope, Own Calculations

At a time when rates haven't even begun to rise, the dollar is already very near one-year highs against all currencies of the 10 largest emerging markets. If rate hikes occur at a faster pace than anticipated the dollar will continue to rise, as capital outflows from emerging markets will accumulate quickly. This problem will be worse in countries where inflation is high and that carry large current account deficits that are financed with capital inflows. On this front Brazil and South Africa are particularly vulnerable. Additionally, their high dependence on China's demand for commodities makes them extra vulnerable, as China is trying to transform itself into a consumer-based economy. Accordingly, commodity prices are near year-lows and markets have not seen the bottom yet. Brazil, Venezuela, and South Africa will be vulnerable to the evolution of commodity prices and Chinese demand.

India is in a different situation as the country depends on crude imports, and mostly exports to the US. It is also not dependent on capital inflows to finance current account deficits.

A currency crisis similar to what happened in 1997 shouldn't be discounted but investors need to analyse emerging markets country by country. There's no such thing as an emerging markets asset class in the sense that such a group is no longer a homogeneous one. Vulnerabilities vary widely from country to country. However, a rate hike will negatively impact all these economies as we already had a small preview of it in 2013 when Ben Bernanke first mentioned the tapering. At that time, emerging markets crashed. Now they may face a "super taper tantrum". Nevertheless, and as mentioned above, many emerging markets look undervalued, particularly in Europe. Those represent good opportunities and their proximity to the Eurozone insures them from at least part of the risks that affect other regions of the globe.

What about fixed income?

In terms of fixed income, in general one should expect that, all else constant, debt with longer maturities might experience larger price volatility than debt with shorter maturities. But while Europe keeps the status quo in terms of monetary policy, yields on longer maturities in the US and UK, where rates are expected to rise faster, may be limited. That is because European investors will seek out better yields in these countries, which will increase demand and help cap the yield increase. I would say that rate hikes in the US and UK will make it harder for the ECB to keep a flat yield curve and I would expect the long term debt yields in Europe to start rising, in particular because the rate hikes will expose the massive bubble that exists is in European bond markets.

A few final words

Rather than helping to smooth-out the business cycle, the departure of central banks from fine-tuning policies in favour of active interventionism has only resulted in exacerbating the cycle, creating ever-bigger distortions with ever-larger consequences. Far from being a success case, the zero interest rate policy is a trade-off between short-term benefits and long term costs that spread over generations and countries. After seven years, the most obvious effect of monetary easing is the huge asset price increases, which is without a comparable improvement in economic growth and is the result of central banks' having sight but no vision. Now, that interest rates are heading towards normalisation, most of the damage will be exposed.

It is not possible to create growth based on credit without any accompanying savings. For an economy to experience sustainable growth, one needs to save some part of what has been produced. When that doesn't happen, what we create is debt that sooner or later will grow to insurmountable levels and lead to another crisis. Then comes the central bank with a few more years of low interest rates and by then some new tools with which to create new distortions and keep asset prices high. This will repeat until the day when *not everything that's down can come up.*

OPPORTUNITIES IN FOCUS

WAITING FOR GODOT

BY VICTOR HILL

In the dark days of the 1930s Depression, policy-makers were divided into those who believed that the best response to the crisis was to stimulate demand and those who believed (for good classical economic reasons) that demand should be choked.

In the current policy crisis – for that is what it is – the only real intellectual controversy is between those who believe that *inflation* is the peerless enemy, and those who believe that *deflation* is the real ogre.

If you don't happen to have much of a leaning either way, you are not alone. The debate is currently being argued out, far from democratic intervention, within an elite patriarchy (and matriarchy) of elders. They are called Central Bankers. And your view does not count; because in Post-Crash Capitalism, they are the people who get to decide what happens, not people like you or me.

Economic priorities change with economic conditions. *Demand management*, to obtain full employment was the universal economic mantra from the 1940s to the late 1970s. This gave way to the *fight against inflation* in the 1980s; and then to *sustainable non-inflationary economic growth* from the 1990s to the late noughties of the new century.

In the weird world that emerged after the dust clouds of the Credit Crunch dispersed, *monetary policy*, previously the domain of academic economists, took centre stage.

I could not have imagined ten or more years ago that, by the 20-teens, monetary policy would have become sexier than fiscal policy. Central bank chiefs, these days, are more prominent and more influential than finance ministers. Globally, everybody who follows the markets knows that Janet Yellen is the Chairman of the Federal Reserve (the central bank of the USA) because the markets hang on her every word. But who is Barack Obama's finance minister?

(Well done, if you know it is Treasury Secretary Jacob "Jack" Lew! But you get my point).

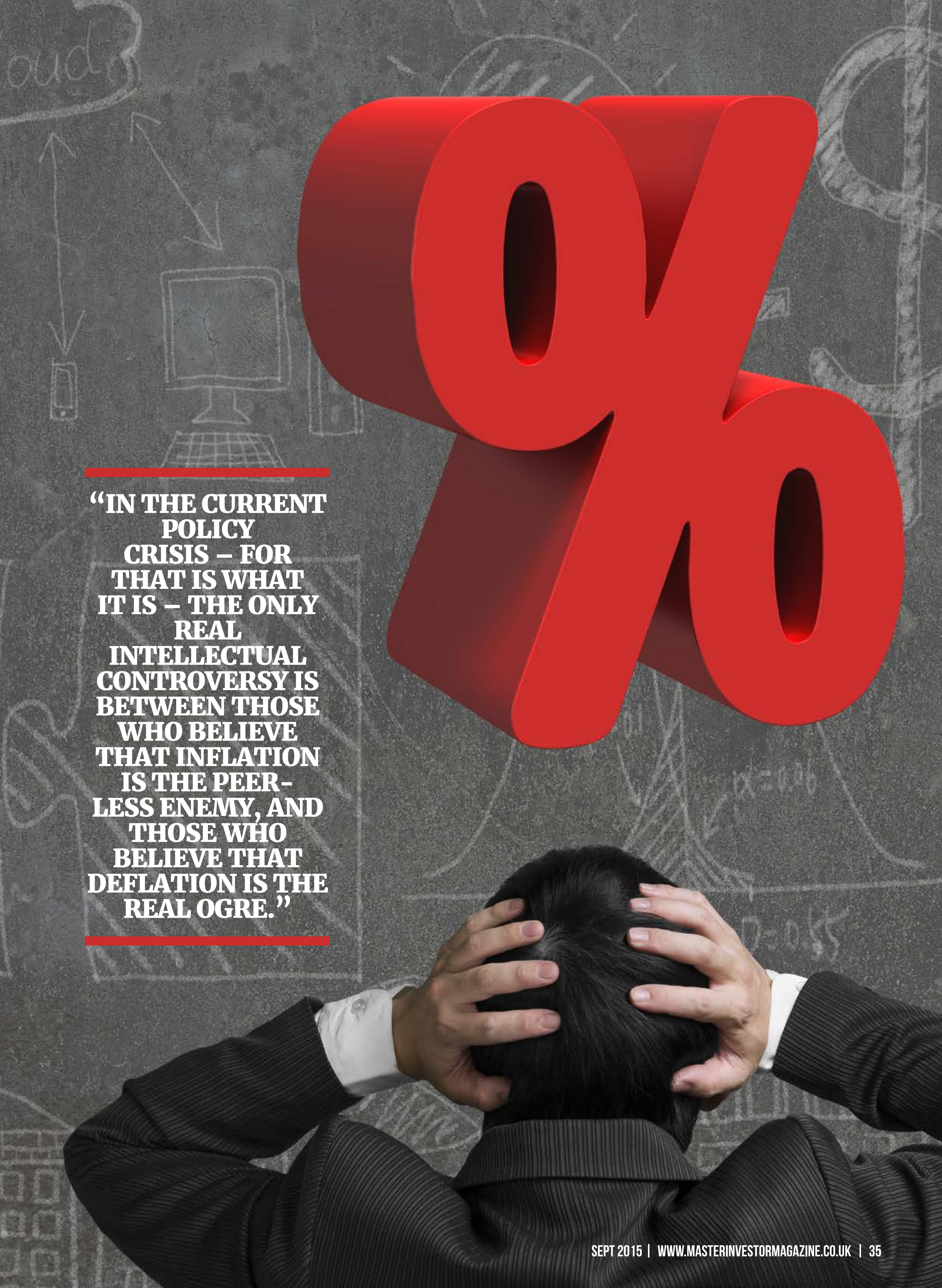
The world is now run by this priesthood of unelected sages whose awesome responsibility it is to do three things, ex-elected legislatures.

First they set interest rates (the price of money); secondly, they regulate the banking system; and thirdly (and most obscurely) they maintain price stability. But in practice, these three things are all one and the same.

And that thing is: *managing the money supply*. Crudely, too much money in the system (and most money is in the form of credit) and prices go up (inflation). Too little money in the system and prices go down (deflation).

The first function – setting interest rates – is easy to understand. This has been undertaken in the UK since 1997 by the nine-member Monetary Policy Committee of the Bank of England. What is harder to understand is why interest rates in the USA have been held at near zero since December 2008 and the Bank of England's base rate has been held at just 0.5% since March 2009.

If you look at the graphic of the Bank of England's key lending rate over the last 321 years you will see that such a low



"IN THE CURRENT POLICY CRISIS – FOR THAT IS WHAT IT IS – THE ONLY REAL INTELLECTUAL CONTROVERSY IS BETWEEN THOSE WHO BELIEVE THAT INFLATION IS THE PEER-LESS ENEMY, AND THOSE WHO BELIEVE THAT DEFLATION IS THE REAL OGRE."

rate is historically unprecedented. Back in 1694 when the Bank of England was established, the rate was set at 6%. And for long stretches of the 18th and 19th centuries the rate fluctuated languorously between 3% and 6%. In the 20th century, rates were more volatile, peaking at a record 17% in November 1979. But before 2008, the Bank of England base rate had never been below 2% in over three centuries[i].

So why have rates been so low for so long?

When Gordon Brown handed over control of interest rates to the Bank of England in 1997 – following the trend of other major economies – we thought that the Old Lady of Threadneedle Street, liberated from political chicanery, would be compelled to set a *natural rate of interest*. That is, in Keynesian terms, one which keeps savings and investments in equilibrium. That is not how things have turned out.

Instead, the Old Lady, just like the Bank of Japan, the Fed and most recently the European Central Bank (ECB) has set a rate which she believes will maintain liquidity in the banking system. In decades to come, this could be seen as a huge gamble. And the politicians will be able to turn around and say: *It was nothing to do with us, Gov., it was all them Central Bankers what done it.*

Why are artificially low interest rates bad? Because they dis-incentivise savings (and therefore investment); they distort investment decisions; they encourage excessive borrowing and sustain zombie companies which, in an ordinary world, would go to the wall. In normal times the zombies' assets would be re-allocated to more productive activities in the glorious process of creative destruction that is capitalism.

Ultimately, I believe that zero interest rates imply zero growth. Stagnation: that is where the world is headed, in my view.

And yet, you say, here in the UK we finally recovered from the 2008-12 recession and we are now growing in the UK at a clip of 3% - well above our long-term trend growth rate. Wages are finally picking up after flat-lining for years. Household debt is on the rise. The banks have raised their capital cushions. Surely, rates should now be back at *normal* levels of 3-6%?

The reason that rates are still on the floor is that our central bankers are haunted by the spectre of *deflation*. Just consider how, as well as holding rates at rock bottom, they have printed money like crazy through *Quantitative Easing* (QE) in a desperate attempt to slay this ghost. In fact, without QE, deflation would already be endemic.

QE is accomplished by arcane means; but the basics are not rocket science. Central banks can lend money to banks *(inject liquidity)*; they can buy banks' bonds; or they can tell their counterparts in the Treasury to issue bonds, which they then buy with freshly minted electronic money.

Central banks make the illusionist David Blaine look like an amateur: they can conjure cash out of thin air. And they have been doing so, on a historically unprecedented scale, from 2008 until today, pushing asset prices (including stocks) to now unsustainable levels.

If the spineless politicians have outsourced to their central banks the task of fighting deflation, it is because the central bankers know from history how deflation can erupt.

Firstly, deflation often follows financial crises. This is because, after severe banking crises (and the 2008 Credit Crunch was in historical terms gigantic) banks de-leverage. That is, they contract their balance sheets by calling in uncommitted lines and withdrawing deposits made with other banks. As committed loans mature, they refuse to renew them, except to borrowers of the highest credit quality.

Moreover, as now, there are always calls after bank failures for bank capital adequacy requirements to be tightened. You may very well think that is sensible – HBOS and others were woefully under-capitalised before the Crunch. Hence *Basel III* and all that jazz. But the point is that this accelerates bank deleveraging.

By way of illustration, consider that much loved financial institution, **Royal Bank of Scotland (RBS).**

In 2008, RBS was sitting on total assets of £2.2 trillion. By the end of 2013 they had total assets of just over £1 trillion. So the balance sheet more than halved. The reduction in RBS's assets should be multiplied by roughly 10 to determine the amount of cash that has been sucked out of the economy because of the *multiplier effect*. That's because when you spend £1, that coin is then used by someone else to buy something. And so on, ad infinitum. In fact, the *multiplier effect* would be infinite if banks did not have to hold reserves.

Now UK GDP last year was about £1.75 trillion. So the contraction of RBS's balance sheet alone has reduced the money supply in the UK by an amount equal to – get this – seven-and-a-half times our total national output. Now add the balance sheet contraction of *all the other banks*, and you begin to see that the deflationary impact of bank de-leveraging is dramatic.

Secondly, deflation can occur, as in the USA in the 1870s, in times of rapid mechanisation, when relative labour costs are falling as a result of technological innovation. The 19th century American experience was related to the opening up of the grain belts of the mid-West by the railroad. Our experience is one of robots taking over production lines. It's not yet consensus thinking, but it soon will be: *Google is deflationary.*

Thirdly, there has been deflation in a swathe of consumer products in the first years of this century as a result of cheap imported goods from China, India, Vietnam and the rest. Go to *Primark*, **about which I posted recently on the MI website.**

Fourthly, commodity price falls can trigger deflation. The oil price collapse, which in the last month seems to have accelerated, is certainly deflationary. On 21st August oil fell below US$40 for the first time in the current slump. Commodities generally are in free-fall. Quite why this is happening is a complex inter-play of technology and geopolitics which I would like to discuss in detail soon.

Fifthly, demographics. The retirement of the post-WWII baby-boomers is conducive to deflation. The world's population is still getting bigger, but the rate of growth is slowing. That means the human race is getting older - fast[ii]. People about to retire tend to stash cash and, once in retirement, they curtail consumption. An ageing global population is deflationary.

Policy makers fear deflation even more than inflation because they know that it would render the management of government finances a nightmare.

JM Keynes, in the *General Theory* of 1936, points out that there is an asymmetry between inflation and deflation. Inflation just affects prices. But deflation diminishes both *prices and employment*[iii]. This is because, in the Keynesian model, deflation stifles investment and therefore reduces demand.

In a deflationary world, output contracts in both nominal and real terms, but debtors still have to repay debts that were taken out when price levels were higher. For a person or company with no debt, net-net, life continues as before. But for companies that have financed investment by debt, their capacity to repay that debt is enfeebled.

"ULTIMATELY, I BELIEVE THAT ZERO INTEREST RATES IMPLY ZERO GROWTH. STAGNATION: THAT IS WHERE THE WORLD IS HEADED, IN MY VIEW."

This is especially problematic for debt-laden governments, which would struggle to service their debt repayments as the economy contracts and tax revenues dwindle.

Both inflation and deflation have been regarded by policy makers as negative, yet perfect price stability is historically exceptional. Overall, our rulers have opted for modest inflation – the current official target in the UK is still 2%. This is at a level that most people will hardly notice if wages are rising modestly. And it also acts as a surreptitious wealth tax on the cash-rich.

In the USA, over the 214 years between 1800 and 2014 for which we have data, *in no fewer than 54 of those years the price level fell*[iv]. Though, for people like me who gained economic consciousness in the late 1970s, it will always seem that inflation is the real ogre.

QE may now be *officially* over in America and in the UK but in Japan and Europe the money presses are working round the clock. Last January, ECB Chief Mario Draghi inaugurated a massive 20-month programme of QE in the Eurozone. Since then the ECB has been hoovering up Eurozone government bonds like crazy - much against the Germans' better instincts.

Here in the UK, Bank of England Governor Mark Carney is now agnostic on QE and has blown hot and cold on the prospect from rate rises since his appointment in July 2013. Most recently, on 16th July he expressed the rather vague view that *interest rates could start to rise by the end of this year.* This of course was seized on by commentators as the *strongest signal yet that policymakers are preparing to act*[v].

There is only one model of an economy that has been sustained on QE and zero interest rates for a protracted period, and that is Japan over the last 25 years. And yet Japan's growth problem has not been solved. Japanese productivity is exemplary, but their demographics are against them. If QE were a long-term wonder-cure, you would expect Japan (ferociously conscientious workforce, state-of-the-art technology) to be doing better.

On 18th August, the Bank of England announced that Consumer Price Inflation (CPI) rose to 0.1% in July on a year-on-year basis. BBC hacks broadcast that inflation was on the rise. Yet this titbit, even one so long awaited and chewed over by the journalistic pack, is anodyne.

"IF I WERE TO HOLD ONE BANK STOCK RIGHT NOW I WOULD GO FOR A SLIM, WELL MANAGED NICHE PLAYER WITH AN EXCELLENT BUSINESS MODEL LIKE CLOSE BROTHERS PLC (LON:CBG)."

It would not be quite correct to say that it is within the margin of error. It's just totally, statistically speaking, insignificant.

But OK, if it does happen, who would be the winners from rising interest rates?

First of all, insurers. Their pension liabilities (such as the value in today's money of all future pay-outs on annuities) are calculated using discount rates that are derived from gilt market yields. That means that, if UK gilt yields were to rise, the value of the insurers' pension liabilities would fall. Thus, their balance sheets would strengthen.

I talked about **Aviva PLC (LON:AV)** on the MI website a little while ago, and I am still medium-term bullish on this stock, although the share price has been skiing a little hors-piste of late.

Secondly, banks. Of course, if all of a bank's loan assets were extended on a floating rate basis then, margin-wise, changes in interest rates should be revenue-neutral. But, of course, it doesn't necessarily work like that. Banks fund their loan books from a number of different sources –customer deposits, inter-bank deposits, discount papers, the bond markets, and so on. So they are really focussed on the composite cost of funds or, if you prefer, the weighted average cost of funds.

When interest rates rise, it doesn't necessarily follow that banks' cost of funds will rise. For a start, they will probably not pass on the full rate rises to savers (depositors). And they will doubtless find ways to raise their lending rates more than the increase in the base rate. Thus lending margins, overall, are likely to increase – a trend already in play - and, all things being equal, so will their return on equity.

I am still negative about the two banks bailed out in 2008 (Lloyds and RBS) because, as already mentioned, they have restored their solvency by massively shrinking their balance sheets. Barclays looks accident prone. **HSBC (LON:HSBA)** has taken risks by leaving the question of its eventual domicile unanswered and conducting a savage down-sizing at the same time. (County towns of England now have boarded-up HSBC branches alongside boarded-up fishmongers, butchers and bakers. It's not pretty).

If I were to hold one bank stock right now I would go for a slim, well managed niche player with an excellent business model like **Close Brothers PLC (LON:CBG).** (By the way, it *is* a bank even though it is sometimes described as a *finance company*). When analysing bank stocks, forget about the Operating Costs Ratio and all that brokers' nonsense and just focus on trends in ROE (adjusted for regulatory and reputational risk). It's that simple.

Thirdly, real estate investment trusts (REITs) in North America. As an asset class, they have taken a battering this

year. Essentially, the markets have taken the view that with bond yields rising, shares in REITs looked less favourable. (In technical terms the present value of their future cash flows has been computed using a higher discount rate). This has been massively overdone.

North American REIT's are weathering the storm. Citigroup's Michael Bilerman believes the worst is over and is optimistic. He expects that REITs can deliver attractive returns in the next year and has lifted his 12-month return forecast to plus 10-15%, with some stocks capable of 20%.

Always favour high quality, diversified real estate portfolios – diversified geographically and by property segment. Check out Artis Real Estate Investment Trust, the units of which trade on the **Toronto Stock Exchange (TSE:AX.UN).** This is a classy Canadian real estate outfit with about 25% of its assets in the USA.

Fourthly, companies financed by equity

with little or no debt. This means that mature, cash flow-stable companies, which tend to have high debt burdens will be disfavoured, while young growth companies, which are overwhelmingly financed by equity, will get a boost.

Look out for opportunities on the AIM – but tread carefully, as there is more chaff than wheat in this barn. If you can get your head around specialty chemicals and materials, take a look at **Alent PLC (LON:ALNT)**, which has been going places of late.

And the losers? There are zombie companies out there which have been sustained on life support since the crash by artificially low rates. It would be unkind to mention names, but beware the debt-financed pub sector on the London market.

Last year I doubled my money on Spirit Pub Co. between May and November when they were taken over by **Greene King (LON:GNK).** But since then, the-sector's debt-financed, fixed asset-heavy, low margin business model has given me pause.

You will have gathered that I am not at all convinced that interest rates will rise this year, next year, or even beyond. The model has changed. Yet central bankers have to intimate that there will be some kind of *return to normality* in order to legitimise their new-found priestly status.

When Janet Yellen and Mark Carney tell us that we should prepare ourselves for rate rises, they are doing what good vicars do. They are telling us to prepare for the hereafter, while they are really focussing on the success of the upcoming church tombola.

Of course I may be wrong and it's important to have an insurance policy, dear reader – even if, at the end of the play, we shall both feel like those two hapless tramps in Samuel Becket's *Waiting for Godot.* Still waiting.

"LOOK OUT FOR OPPORTUNITIES ON THE AIM – BUT TREAD CAREFULLY, AS THERE IS MORE CHAFF THAN WHEAT IN THIS BARN."

Victor is a financial economist, consultant, trainer and writer, with extensive experience in commercial and investment banking and fund management. His career includes stints at JP Morgan, Argyll Investment Management and World Bank IFC.

i. A spreadsheet is available from the Bank of England at: https://docs.google.com/spreadsheets/d/1OKo38R1blO71SGNIVuhaRZ4P2GYPpJQklmOymQiXixQ/edit?hl=en&pli=1
ii. Falling populations in richer countries fuel fears for future, Leo Lewis, The Times, Saturday, 22/11/2014.
iii. The General Theory of Employment, Interest and Money. JM Keynes, Macmillan, 1936. See the final paragraph of Chapter 20, The Employment Function (on page 291 of the 170 Macmillan edition).
iv. My calculation sheet is available. The price level data comes from the Federal Reserve Bank of Minneapolis website at: https://www.minneapolisfed.org/community_education/teacher/calc/hist1800.cfm
v. Szu Ping Chan, Daily Telegraph, 16 July 2015.

CURRENCY CORNER

THE STRAW THAT BREAKS THE CAMEL'S BACK

BY SAMUEL J. RAE

We are about six years into a recovery from the last recession. What does this mean? It means that we are likely closer to the next downturn than we are from the last. In a normal economic environment, this is about the time central banks across the world start to consider interest rate hikes in order to stop their respective economies from overheating.

A traditional approach to an interest rate hike in the currency trading world is to look long. Interest rates are the primary driver behind ups and downs in a currency's valuation – the implications of economic data for a central bank's interest rate decisions are at the root of news trading, and accounts for the vast majority of fundamental analysis.

However, at the moment, things are a little different from normal. Yes, equities markets are up. Yes, unemployment is (relatively) low across developed economies. These are both things that signal strength. However, there is one key ingredient missing – inflation. Inflation is at pretty much zero in the US, the UK and Europe, and has been for the last half decade. Why is this a problem? Well, it suggests that the strength we are seeing across global economies is not really rooted in anything.

Take the US, for example. When the US government initiated its quantitative easing programme, it did so through buying bonds. The vast majority of these bonds were sold by so-called "asset agents", which were primarily large investment houses such as Goldman Sachs and Merrill Lynch. The result of this was funds being injected into equities markets, but not filtering through to individuals. So, essentially, the strength we have seen in equity markets has come about partially as a result of quantitative easing.

Of course, the wealth effect that arises through an increased market capitalisation will stimulate spending to some degree. Further, increased company value should translate to expansion – and this has likely been the driver behind the fall in unemployment we have seen over the last few years. However, the inorganic nature of this growth means that we could be in for some real trouble once interest rates increase.

At our best guess, September looks like the month in which the US Federal reserve will boost rates (although recent events seem to have cooled expectations somewhat). We may well see the same in the UK, but perhaps a little later on down the line. As I mentioned already, in normal economic conditions, this would be fine. However, non-existent inflation illustrates the fragility of this so-called economic recovery.

Higher rates – while likely short to medium-term bullish for the respective currencies – could be the catalyst behind a quick economic turnaround and a reversal of current (mediocre) conditions. Why? Well, both companies and individuals are reluctant to borrow at current rates. When central banks increase the core interest rate, retail banks pass this added rate on to borrowers. If very few people want to borrow at current rates, even fewer will want to do so when it becomes more expensive.

"A TRADITIONAL APPROACH TO AN INTEREST RATE HIKE IN THE CURRENCY TRADING WORLD IS TO LOOK LONG."

No borrowing equals reduced spending, and reduced spending translates to reduced consumption and employment. We saw this happen back in the 30s. What looked to be an economic recovery quickly reversed when the Fed raised rates, and translated to a now infamous Great Depression. Major equity indices lost 50% of their capitalisation as a result of the turnaround.

So how does this translate to forming a bias in the currency markets? Well, as mentioned, regardless of its implications, an interest rate hike will almost certainly initiate some strength. The EUR/USD has gained strength lately, having traded pretty much sideways between parity and 1.15 since May. However, if the Fed does raise rates in September, we could quickly breach parity for the first time since 2002. Beyond that, 0.9 will be the level to keep an eye on.

Notwithstanding the above, looking longer-term, things may not be so rosy for the dollar. An equities market correction that results from higher rates

rooted in zero inflation could – say three to six months down the line – weaken the dollar considerably. The same applies to sterling when the Bank of England raises the UK base rate. The situation in the UK from an economic perspective is very similar to what we are currently seeing in the US, and as a result, the implications of a rate hike are exactly the same.

So, to sum up, a US rate hike in September will almost certainly breach parity in the EUR/USD. However, how long this breach holds remains to be seen. Cracks are already starting to appear in developing nations, and interest rate hikes could easily turn out to be the straw that breaks the camel's back.

FUND CORNER

JUDGEMENT DAY

BY NICK SUDBURY

UK interest rates have been at an all-time historic low of 0.5% since March 2009, but Mark Carney has recently said that the decision to raise them is likely to come into sharper relief by the turn of this year. It was entirely appropriate that the Governor of the Bank of England was speaking in Lincoln Cathedral, as investors who ignore his warning could end up praying for mercy.

The biggest casualty is likely to be your fixed income funds. When interest rates go up it makes the bond yields less attractive and forces the prices lower until investors are drawn back in.

Of course everyone knows that a rate increase is on the cards and bond managers can adjust their portfolios accordingly. The obvious thing for them to do is to hold shorter duration securities as these are less sensitive to changes in interest rates.

Damage limitation

Fraser Lundie, the manager of the **Hermes Multi Strategy Credit fund,** has recently reduced the duration of his portfolio to two years, which should help to protect the value of his fund when interest rates finally go up. He operates in the Sterling Strategic Bond sector where the average duration of the funds is 4.5 years.

The same strategy is also in evidence at Old Mutual, where John Ventre, who heads up their Spectrum, Voyager and Foundation multi-manager funds, has reduced the duration of the fixed income component to the lowest level ever.

With many bond funds it's a case of damage limitation, but there are some mandates that concentrate specifically on the short end of the yield curve with one example being **AXA Sterling Credit Short Duration Bond**. The £258m fund holds investment grade sterling corporate bonds with a bias towards shorter maturities. It has a portfolio of just over 200 securities and an underlying yield of 1.3%.

It is possible that the only fixed interest manager who wants rates to go up is David Basile, who runs the **RWC Global Convertible Bond fund**. He has recently gone on record as saying that he can't wait for interest rates to rise, which is a strange thing to say until you take into account the fact the he invests in convertibles.

Convertible bonds are fixed interest securitie that give the holders the option to exchange them for shares in the same company. Basile thinks that higher interest rates would encourage more firms to issue these sorts of securities, thereby creating additional investment opportunities for his fund. It would also suggest that the economy is getting stronger, which might be beneficial for share prices and the equity option embedded in the convertibles.

Absolute-return bond funds

Another option is to invest in an absolute-return bond fund. These aim to produce positive performance irrespective of the general market conditions and can use derivatives to go long and short. This makes them more complex than a normal bond fund, but gives the manager greater scope to add value.

> **"IT IS POSSIBLE THAT THE ONLY FIXED INTEREST MANAGER WHO WANTS RATES TO GO UP IS DAVID BASILE, WHO RUNS THE RWC GLOBAL CONVERTIBLE BOND FUND."**

One example is the **Kames Absolute Return Bond fund** which is run by Colin Finlayson who tries to generate a positive return over rolling three year periods. He can invest anywhere he wants in the global bond market and attempts to minimise volatility and to protect against losses. The fund has generated a positive return in 32 out of 43 months.


Interest Rate Rise

Absolute Insight Credit is much smaller at £579m and it also has a different objective. The fund aims to generate a return of at least the three-month London Interbank bid rate (Libid) plus 5% on a rolling annualised five-year basis before fees and expenses. It can go long and short and invest in areas such as asset backed securities and credit default swaps. Over the last five years it has made an annualised return of 7.4%.

Dividend paying shares

Some equity funds are likely to be more vulnerable to higher interest rates than others, although the managers are doing what they can to protect their portfolios. A case in point is Hugh Yarrow, who runs Evenlode Income.

Yarrow invests in companies with decent dividend yields and concentrates on those with enough free cash flow to increase the distributions once interest rates go up. He says that businesses that are not able to do this have to rely on higher borrowings to maintain their dividends and this is not sustainable in the long-term.

It is similar to the approach being taken by Jeremy Lang, the manager of the **Ardevora UK Income Fund**. He thinks that the key to navigating an interest rate rise is to invest in reliable dividend payers that can increase their distributions. His largest holdings include the likes of Next, Sky and National Grid.

Lang says that the companies that are most sensitive to increases in interest rates are the high yielding stocks that are not able to growth their dividends. He also steers clear of businesses with substantial levels of debt, as these will have to pay more for their borrowings.

Bond proxies

Another vulnerable area are the so-called bond proxies. These are dividend paying blue chip shares that are considered safe because of their global presence. The problem is that many have seen big rises in their share prices and the yields could quickly become unattractive if rates go up faster than anticipated.

Toby Ricketts, the manager of the **Sentinel Enterprise** fund-of-funds, has been reducing his investment in Terry Smith's **Fundsmith Equity fund** because of its large exposure to these sorts of defensive, large cap dividend paying companies. He also thinks that two other successful funds - **CF Woodford Equity Income** and **CF Lindsell Train UK Equity** – could also be vulnerable on account of their holdings in this area.

Ricketts has re-invested the proceeds in the mid and small cap sectors via **R&M UK Equity Long Term Recovery** and the **Fidelity UK Opportunities fund**. These parts of the market tend to be more exposed to the British economy than the global mega-caps.

Old Mutual's Ventre has opted for a similar strategy, although he has remained faithful to the **Investec UK Special Situations fund**. Its manager, Alastair Mundy, favours lowly valued companies that tend to be more economically sensitive with his largest holdings including the likes of HSBC, Royal Dutch Shell, Lloyds and RBS. These could do well when interest rates start to rise.

Many fund managers are wary of large parts of the FTSE 100 because of the numerous bond proxies and areas like the miners and oil companies that are struggling as a result of the fall in commodity prices.

One such is Nick Roberts, the co-manager of the **JPMorgan Fusion** fund-of-funds range, who prefers products like **Blackrock UK Focus** because of its mid-cap bias. He also likes **Aberforth UK Small Companies,** which has a strict value methodology.

Financials

One sector that would be expected to benefit from an interest rate rise are the banks as higher rates would enable them to increase their profit margins. The **Jupiter Merlin Growth Portfolio** that is headed up by John Chatfeild-Roberts has been building up its exposure to this area by investing in **Aptus Global Financials.**

Aptus Global Financials is run by Johnny de la Hey from the hedge fund manager Toscafund Asset Management. His biggest exposure is to Continental Europe and the UK with banks and insurance companies making up about half of the assets. Other specialist funds in this area include the **Polar Capital Global Financials Trust (PCFT)** and **Henderson Global Financials.**

PCFT was launched in July 2013 and aims to generate capital growth with a rising stream of income from a global portfolio of financial companies. At the end of July the £201m portfolio consisted of 70 positions with 56% invested in the banks. The shares are trading on a small discount to NAV and yielding 2.8%.

Henderson Global Financials is smaller at £63.3m, but has a longer track record with a cumulative return since launch in December 2001 of around 258%. Just over half of the fund is invested in banking stocks with the largest geographic exposure being the US at 41.2%.

The slowdown in China and the volatility that it has created in world markets may delay the first increase in interest rates, but it is unlikely to do any more than that. Investors need to prepare for more normal monetary conditions as we could see a significant rotation with the areas that have done well in the last six years starting to struggle.

SMALL CAP CORNER

SHOW ME THE MONEY! THE SMALL CAP CASH KINGS

BY RICHARD GILL, CFA

As discussed elsewhere in this issue, the inevitable and imminent rise in central bank base rates of interest, both in the UK and US, will not be a positive factor for companies laden with debt. It will also make life more difficult for those firms which need capital for expansion purposes, as debt (and indirectly, equity) becomes more expensive.

So for this month's small cap review I have decided to take a look at companies which should be able to weather any associated interest rate problems by virtue of their high cash balances.

It is rather obvious that having plenty of cash is a good thing for a business. But there are many reasons why.

Perhaps most importantly, a strong cash position will enable a company to pay the bills if trading takes a downturn. Plenty of cash also means that investors can still receive consistent dividends in times of economic trouble. Using the ex-cash multiple (or enterprise value) valuation method benefits businesses with big cash balances. And as every A-level business student is taught, internally sourced capital (i.e. a firm's own profits) is considered to be the cheapest form of funding for a company given the high costs frequently associated with external financing.

Here follows a brief review of three small cap companies which have strong cash positions propping up their balance sheets and which I believe also have solid business models, attractive investment characteristics and good growth opportunities.

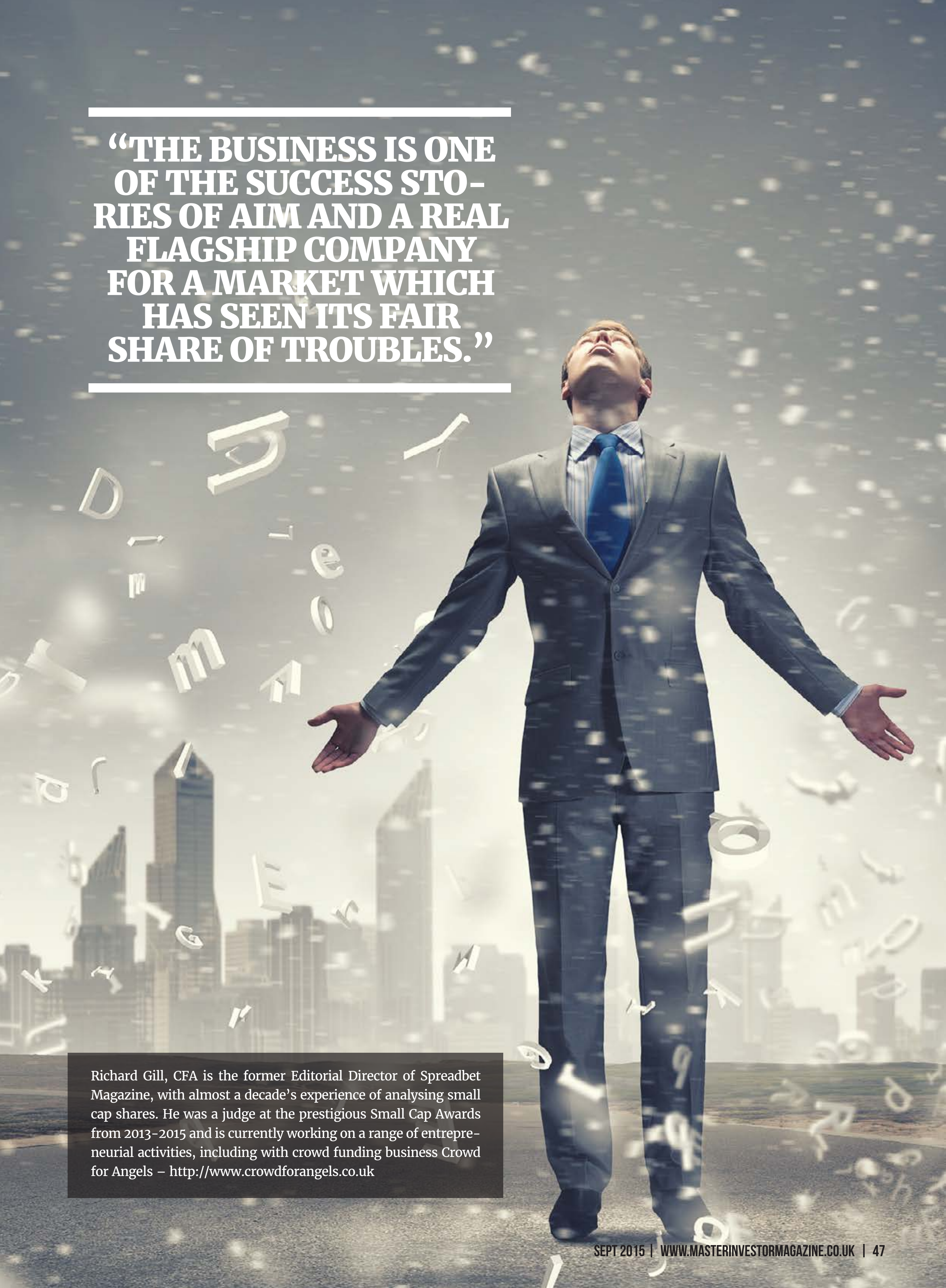
JAMES HALSTEAD (JHD)

The Business

Founded 100 years ago, James Halstead is a leading commercial flooring manufacturer and distributor. The firm operates primarily in the UK and Europe, with recent projects including Cardiff International Swimming Pool and the Daenisches-Bettenlager retail outlets in Germany.

Still run by the Halstead family, the business is one of the success stories of AIM and a real flagship company for a market which has seen its fair share of troubles. Halstead joined AIM from the Main Market of the LSE in 2002 and since then the share price has risen by 1,116%, driven by an almost quadrupling of pre-tax profits. Investors have also enjoyed 40 years of increased dividends and several special payments have been distributed due to the highly cash generative nature of the business and easily coverable capex requirements.

"IT IS RATHER OBVIOUS THAT HAVING PLENTY OF CASH IS A GOOD THING FOR A BUSINESS. BUT THERE ARE MANY REASONS WHY."



"THE BUSINESS IS ONE OF THE SUCCESS STO-RIES OF AIM AND A REAL FLAGSHIP COMPANY FOR A MARKET WHICH HAS SEEN ITS FAIR SHARE OF TROUBLES."

Richard Gill, CFA is the former Editorial Director of Spreadbet Magazine, with almost a decade's experience of analysing small cap shares. He was a judge at the prestigious Small Cap Awards from 2013-2015 and is currently working on a range of entrepreneurial activities, including with crowd funding business Crowd for Angels – http://www.crowdforangels.co.uk

Cash 'underlays' profit growth

While profit growth has been more modest over the past five years, James Halstead has consistently maintained strong cash flow – part of the reason for the share price growth. Numbers for the six months to December 2014, for example, showed pre-tax profits up by 5.3% at £21.4 million but a higher net cash inflow from operations of £24.78 million. This helped to take net cash at the period end to £46.7 million. While the firm has the lowest ratio of net cash to market cap (5.6%) of all the stocks in this review, with consistently excellent cash flow, ceteris paribus, this should steadily increase.

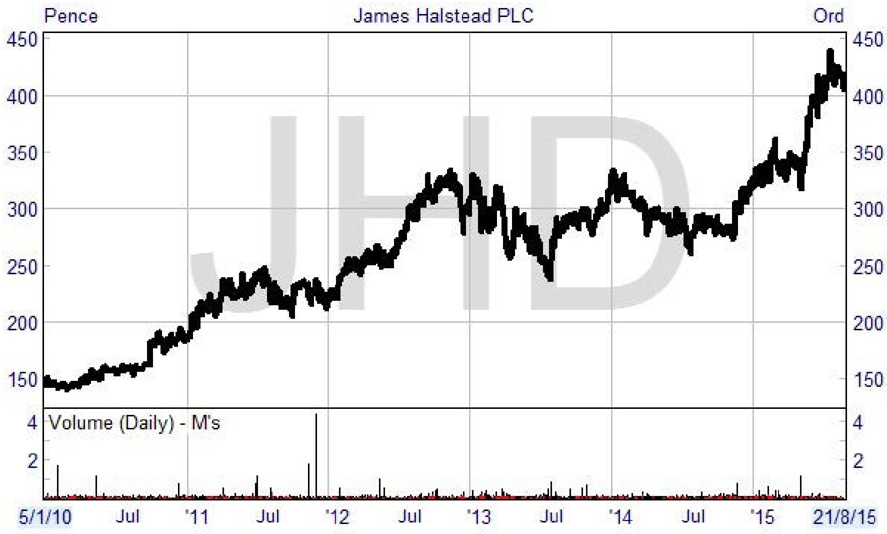
More recently, a July trading statement reported that despite headwinds from a weak euro, pre-tax profits for the year to June will be ahead of last year, in line with market expectations and again at a record level.

Valuation

The current share price of 405.25p is slightly short of the all-time high of 439.5p seen in July, valuing the business at £840 million. This makes James Halstead the ninth-largest company on AIM.

Given the very strong track record, one would expect the company to have a high valuation to reflect its quality. And trading on a multiple of 26 times consensus forecast earnings for the year to June 2015, it certainly has. The yield is a modest 2.65% but the prospect of further special dividends means that investors could be in for an additional bonus.

Overall, with the shares having performed so well as a "buy and hold" over recent years that is exactly what I think investors should do now.



RECORD (REC)

"Record" is a word often used in the James Halstead annual results in recent years given the consistent performance of the business. Perhaps the only company which uses the word more in its reports is Record itself!

The Business

The firm is a Windsor based currency manager and provider of currency hedging services, offering institutional investors such as pension funds and charities a number of specialist investment products. There are three main product areas:

Dynamic Hedging – Record looks to eliminate the impact of currency movements on clients' investment portfolios when they are expected to be negative but not when they are expected to produce a gain. This product section made up 16% of assets under management (AuM) as at 30th June this year.

Passive Hedging – the core business, with 74% of funds under management, where the economic impact of currency movements are eliminated fully or partially from client portfolios.

Currency for Return – Record enters into currency contracts for clients with the objective of generating positive returns.

This article is not large enough to explain how Record does what it does, but be assured that the company is run by some very clever people. As a fund manager, the firm makes all of its income via management fees and (when times are good) performance fees.

Tough times but recovery signs

Record suffered badly from the 2008-09 global financial crisis and its aftermath. Assets under management (AuM) fell from $55.7 billion at the end of the 2008 financial year to $30.9 billion in 2012 as client numbers fell from 141 to 41. Underlying operating margins also tumbled, from 61% to 32%.

However, the firm remained profitable throughout and a recovery has been seen since, with the firm winning a number of new client mandates. As at 30th June this year AuM were almost back to 2008 levels. Results for the year to March 2015 demonstrated the recovery, showing pre-tax profits up by 18% at £7.7 million and notably the firm's first performance related fee for five years.

As is crucial in this review, Record has consistently maintained a very strong cash position and balance sheet. As at 31st March net cash (including £18 million of slightly less liquid money market instruments) amounted to £30.1 million – a whopping 36% of the current market cap! Again, like James Halstead, the position is consistently strengthened by strong cash flow, with the net inflow from operations in 2015 being £6.47 million.

There were further improvements in the three months to June, with AuM rising by $1.2 billion to $56.6 billion. While Record saw clients fall by two to 53 there was a $0.6 billion net inflow of funds. Positive exchange rate movements improved AuM by $2.1 billion on translation to US dollars but global market movements offset this by a negative $1.5 billion. Fee rates remained broadly unchanged but no performance fees were earned in the quarter.

Valuation

Being in the financial sector – and in a rather "exotic" part of it – investors do not seem to be applying a worthwhile valuation to Record at present. I would point out that the shares have hardly moved from levels seen at the start of 2013 despite AuM having increased by 60% since then. If we strip out net cash then the shares currently trade on a historic multiple of just 9.2 times earnings. They also trade at a value of just 0.23% of AuM, when a figure of at least between 1-3% is often considered to be at the lower end of fair value for an asset manager.

"AS AT 31ST MARCH NET CASH (INCLUDING £18 MILLION OF SLIGHTLY LESS LIQUID MONEY MARKET INSTRUMENTS) AMOUNTED TO £30.1 MILLION – A WHOPPING 36% OF THE CURRENT MARKET CAP!"

Onto the dividend and due to the profit falls Record slashed the payment by more than two-thirds in the 2012 financial year, from 4.59p to 1.5p per share. This was increased to 1.65p in 2015, giving a decent historic yield of 4.3%. But with the company being majority owned by management and staff, considering the enormous cash resources, and with trading having improved considerably, there looks to be significant scope to increase the dividend in the coming years.

With both yield and value on offer here the shares look to be worth snapping up for investors with a high risk profile. And as a final point I would add that currency volatility around predicted interest rate rises could also help the business to win new clients.

COSTAIN

The Business

Into a completely different sector now and Costain is one of the most respected engineering services businesses in the UK, operating primarily in the energy, water and transport industries. Specific services provided include engineering design, consultancy, project management and maintenance of large infrastructure projects.

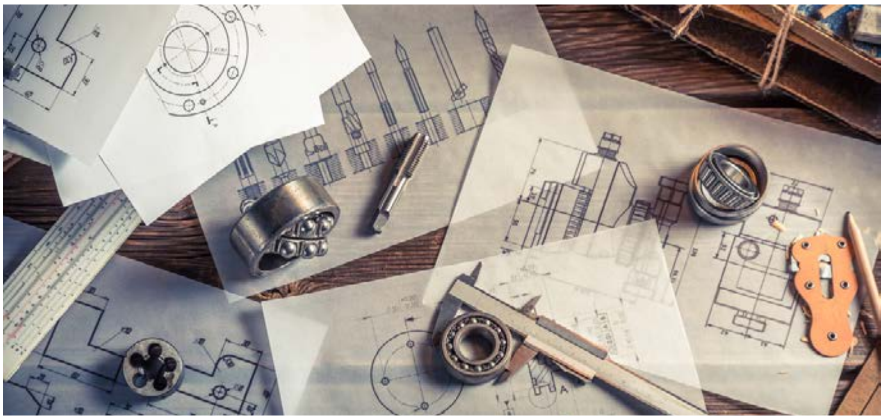
COSTAIN

The company has an excellent track record of delivering on such projects, having worked on the St Pancras Station redevelopment in London and the Channel Tunnel Rail Link. Current projects include nuclear decommissioning work at Sellafield, a multitude of work on the soon to be opened Crossrail project and several projects with the Highways Agency to improvement Britain's roads. To the temporary vexation of thousands of commuters, Costain is also working on the redevelopment of London Bridge Station for Network Rail.

Building momentum

In mid-August the firm released results for the six months to June 2015, showing adjusted pre-tax profits up by 25% at £11.2 million and an increase in the interim dividend by 15% to 3.25p per share. But in my opinion the real highlight of the results was the order book, which increased over 12 months by 16% to a record level of £3.7 billion. This provides excellent earnings visibility for the coming years, with over £1.2 billion of revenues (pretty much all of consensus market forecasts) already secured for 2015. Also, over £950 million of revenues (75% of market forecasts) have been secured for 2016. Further, demonstrating the firm's strong reputation within the industry, 90% of the order book was comprised of custom from repeat customers.

The problem with the construction industry is that it operates on wafer thin margins. To demonstrate, despite making revenues of £1.07 billion in the last financial year Costain generated much lower pre-profits than James Halstead – which made revenues of just £223 million. In the first half of this year Costain's net margin after tax was just 1.56%. Due to the low margins, any cost overruns on projects which have a fixed price could potentially have a devastating effect on profits. However, this risk has been significantly decreased over the past five years, with over 90% of the order book now comprised of so called "target cost" contracts, up from 50% in 2010. Such deals lower risks for the company by sharing extra costs if there are overruns but also sharing the benefits of cost savings.



"WITH THE EXCELLENT VISIBILITY FROM THE ORDER BOOK AND WITH A DIVIDEND YIELD OF 3% THE SHARES LOOK LIKE A REASONABLY VALUED PLAY ON THE GROWTH OF UK INFRASTRUCTURE."

Valuation

For much of the current decade Costain has commanded a valuation which has given little regard to the underlying operations of the business. At the nadir in November 2011, after stripping out the firm's high cash balance, the operational business was being valued at as little as £40 million.

However, the shares have gained nearly 50% since last summer following a stream of contract wins and solid trading results. Currently capitalised at £377 million Costain now has an enterprise value of c.£250 million after stripping out net cash of £126.8 million as at 30th June.

On forecast earnings for the current year to December 2015 the shares now trade on an ex-cash multiple of just over 10 times, making them look expensive by historical standards. But with the excellent visibility from the order book and with a dividend yield of 3% the shares look like a reasonably valued play on the growth of UK infrastructure.

HOW TO VALUE JUNIOR MINING STOCKS

BY JOHN CORNFORD

Smaller mining shares are among the most volatile in the market, for good reasons, among which at the moment is that volume is so very low that share traders have a large effect. Institutions, who in the past added some stability, just aren't there in the face of commodity price weakness.

But another reason has always made junior miners interesting for their scope, which is the fact that their earnings cycle – where years exploring and then developing their mines, with many calls for shareholder funding – culminates in a period where high profits have to compensate for the lean years.

So the obvious investment strategy is to catch them just before the lean years come to an end. Easier said than done maybe; but that is how, with good research, investors might hope to make larger returns than in the market generally.

There are around 80 small cap miners listed in the UK (and many more in North America and Canada). But the mining and commodity slump of the last seven years has not only decimated their share prices and almost (although not quite) dried up the funding that many of them need to get their mines into production; it has also dried up the quality research that investors, institutional as well as private, depend on to invest in them.

Not all these juniors have had to slow or stop their projects, however. There is now an interesting set of miners that have made it through commodity price-worries and funding shortages - to the point where investors can see production, and therefore earnings, in the next few years.

"THERE IS NOW AN INTERESTING SET OF MINERS THAT HAVE MADE IT THROUGH COMMODITY PRICE WORRIES AND FUNDING SHORTAGES - TO THE POINT WHERE INVESTORS CAN SEE PRODUCTION, AND THEREFORE EARNINGS, IN THE NEXT FEW YEARS."

The trouble remains that dearth of good research. Unlike companies in other sectors for whom it's not all that difficult for tipsters and journalists to make reasonably good guesses, analysing and producing forecasts for mining companies with just one or two projects calls for much more detail and professional knowledge. For miners, apart from the day-to-day operational risks, there are three main uncertainties that investors have to ponder. Firstly the capital cost; next the returns to be expected (i.e. commodity price worries); and last but by no means least, the price the company (and its shareholders) will have to pay to get its project funded. Unfortunately, the latter often has little regard for the interests of long term holders.

A few specialist brokers publish now and again to their institutional clients, but the private investor has to rely on the occasional sketchy comment in a few investment magazines, or on a few private client brokers whose research tends to be very basic – aimed at generating sales rather than guiding investors toward the correct timing. Otherwise the private investor has to rely on the bulletin boards, where anyone experienced in investment will despair at the often dire level of understanding displayed.

Sites like Proactive Investors are an excellent source of information, sometimes reproducing limited broker research. But it is more of a PR site than a source of solid analysis and recommendation, so investors would be well advised to do their own research, and at least read up the basics of investment as applied to companies with projects.

But here is a guide to help investors avoid buying at those spikes in share prices that the intermittent puffs and promotions by the companies (when they want funds) and brokers (when they want business) bring about.

In later issues I will be applying its principles to the set of companies I think look ripe for a re-rating at some point.

"THE OBVIOUS INVESTMENT STRATEGY IS TO CATCH THEM JUST BEFORE THE LEAN YEARS COME TO AN END. EASIER SAID THAN DONE MAYBE; BUT THAT IS HOW, WITH GOOD RESEARCH, INVESTORS MIGHT HOPE TO MAKE LARGER RETURNS THAN IN THE MARKET GENERALLY."

John is semi-retired after 40 years in City research of one sort or another covering most sectors, and an earlier career in the MoD and management consulting. As well as institutional research he has also long taken an interest in research for private investors, editing the long established and top performing Investors Stockmarket Weekly in the '90s, and later Small Cap Shares. In the noughties he worked for seven years with Hardman and published his own research for institutions via his FourSquare Research. He believes it is scandalous that the FCA's misplaced rules have denied quality research to private investors - leaving them at the mercy of bucket shops and tipsters.

I won't necessarily produce recommendations there and then, but hopefully we can set up readers to make their own decisions at the right time.

Before that however, we must bear in mind some factors regarding the market's current view of junior mining companies:

1) The 'value' of their 'mineral' (copper, gold, nickel etc -) resources 'in the ground' is being almost completely ignored.

2) Also being ignored is the prospect of achieving profitability within a relatively short timeframe.

'How to value a junior miner'

Or

(When a Net Present Value isn't a Present Value – and when (often) to ignore a broker 'target')

One of the most confusing topics for a less than experienced investor (and the most frequently obscured by brokers who rarely produce the calculations) is the correct valuation of a company with a project not yet up and running. Biotechs as well as miners are in this position, but the principles apply universally.

Projects are usually presented to investors with an NPV (a net present value – approximately the long term profit minus the initial cost to build). Inexperienced investors make the mistake of thinking that if the company 'owns' the project, then the present shareholders 'own' the NPV and that, therefore, the NPV is the value of the company.

That is only so if the project is up and running and paid for, or the company possesses the necessary funds to build it. If it doesn't, then to raise them it will have to 'give away' or share a (sometimes extremely large) part of that NPV with the fund providers – whether these are outside lenders or new and existing-shareholders buying new equity shares.

These costs are often glossed over (because they need assumptions in order to forecast) but can be so large as to drastically eat into the real value to existing shareholders. In an example I shall discuss later, a project loan to meet the usual 70% of the capital cost will 'take away' in interest, some 20% of the project's mooted initial NPV, while an even larger part will go to the extra issued shares to meet the equity component of the capex. But some on the bulletin boards (and even this particular company's broker) seem to think that the project NPV already belongs to the existing shareholders, even though no funds to pay for it have yet been raised.

In that same example, in order to raise the capex, the number of shares in circulation might have to expand (at an optimistic issue price) by nearly five times – substantially more than the 42% by which (in this case) the 'Present Value' will increase after the investment has been made. So the 'NPV/share' that some investors thought they were worth will, in reality, be cut by nearly four times. Similar reasons explain why many junior miners are now being valued at less than 1/3rd of their theoretical NPV.

The maths is not difficult, even though there are a number of factors to take into account, which depend on the circumstances. A low share price at which funding is secured, or a low rate of profit on the project in relation to interest costs, will have a severe effect on the ultimate share value. Unfortunately, in the present state of the market, even some projects quite close to production are having to raise the equity component at value damaging (if not utterly destructive) to prices or (e.g. Ormonde Mining) having to accept harsh terms from a rescuing partner.

An NPV is a very imprecise guide in any case. Mine planners only use it ('at the project level, not the 'company' and shareholder level') to give loan providers an indication of the risk of lending to a particular project in relation to their appetite for risk and expectations of long term interest rates. It is not the 'value' today to anyone – let alone shareholders.

That is partly because the NPV calculation is not a 'real' number – being dependent on an arbitrary parameter – the discount rate – which reflects a particular lender's requirement. Hence a wide range of discount rates for the various NPVs reported by companies and by different engineering consultants for particular projects.

To simplify, for those not familiar, an NPV is the 'net present value' of all the cash inflows (profit) less the outflows (investment) year-by-year, over the whole of a project's life, with each cash flow 'discounted' at a rate chosen to reflect the perceived risk.

The lower the discount rate used, the higher the apparent 'NPV', so that a 20 year project's 'value' at 8% would be about half that at nil (i.e. not correcting for the time value of money) whereas at 12% it would be halved again. (The figures are different for different lives).

The rate which accords with how the market is actually valuing projects at present seems to be around 10%, although for those that are near-term and in a benign jurisdiction, that could turn out to be too conservative. In other words, a project might be more valuable to present shareholders than the bare NPV would suggest, depending what financing package is used. The trick is to know when and why that might be.

Reflecting that the discount rate is an arbitrary figure, technical/economic reports on a project usually contain a 'sensitivity' analysis (like the one shown below) showing how the NPV varies with the discount rate and other factors like commodity price, operational costs, and capital cost.

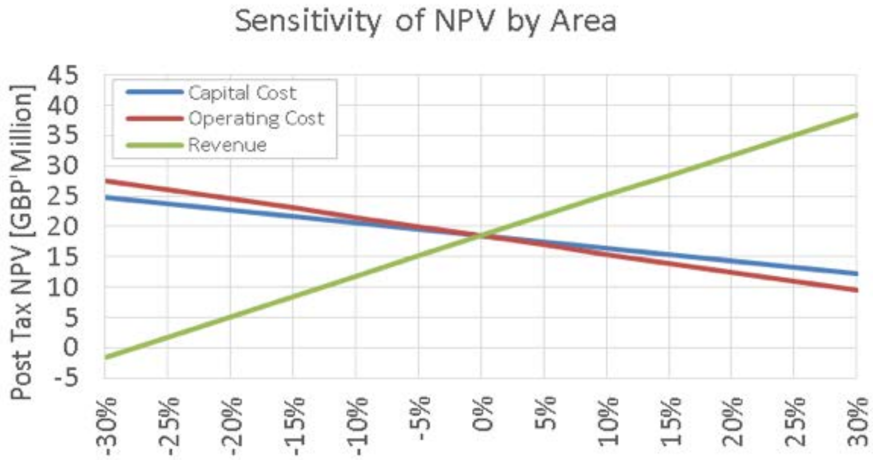
They will also usually give diagrams showing how at a given discount rate, the NPV will vary with factors like costs or revenue.

However, the resulting NPV remains of little use to an investor, who would like to see it translated to the more familiar earnings per share (EPS). This is subject to the biggest uncertainty of all – the financing that will be used to meet the capex and which will take away a large part of that NPV. For the real examples that I will describe in later issues, I will be making my own EPS estimates based on best guesses about the funding arrangements.

Having said that, the NPV is likely to remain the key figure that companies will use when persuading investors; and here it needs to be said that as well as being no guide to shareholder value, an NPV is also no guide to a project's real profitability, or to the desirability (for the shareholders) of their company taking it on. That depends on other measures, the most significant of which is the IRR (internal rate of return - very roughly the rate of return over the whole period on the initial investment) – a figure that is not affected by any choice of discount rate for the NPV.

NPVs and IRRs are therefore two completely different measures which are not correlated in any way, and the size of

PFS Discount rate and NPV sensitivity to gold price (Yaoure project)						
	$1,100	$1,200	$1,250	$1,300	$1,400	$1,500
Post tax NPV ($m)						
0% discount (= cash flow)	311	528	630	733	923	1,127
5% discount	150	312	390	468	613	767
8% discount	80	219	286	353	477	609
10% discount	41	167	228	289	401	522
Post-tax irr%	12%	19%	23%	25%	31%	36%



"A PROJECT MIGHT BE MORE VALUABLE TO PRESENT SHAREHOLDERS THAN THE BARE NPV WOULD SUGGEST, DEPENDING WHAT FINANCING PACKAGE IS USED."

the respective numbers is, likewise, no guide to the real level of profitability on which lenders (and new shareholders) can rely for security. For a good mining project the IRR needs to be at least 30-40% and some are much higher, but others are closer to the 20% which, in my view, indicates an only marginally attractive project – unless for a solid business with guaranteed offtake and prices, like energy generation (but, again, depending on other factors in the equation).

By and large, one can say that the key factors affecting eventual value to present shareholders are the following:

1) The ratio of NPV to a) its capex and to b) the company's present market cap - where for a) a high ratio is good but for b) not necessarily so; and

2) The IRR in relation to borrowing costs.

But within these, the details will be highly relevant. Value to shareholders is certainly never the bare ratio of NPV to present market cap, which brokers often latch onto (in their ignorance – or perhaps in hope of their clients' ignorance) as indicating 'value'. In practice the opposite can be the case – as will be evidenced in our examples.

The valuation picture for a particular company becomes more complicated if, as is usual, it has other assets which, in normal times it would have relied on to prop-up its share price or to sell in order to part-fund its project. Unfortunately, in present markets, juniors are not being given much credit for exploration. Even when they delineate a resource, the market attaches very little value to it, and if and when it is sold – unless it happens to be close to or fills another miner's gap in production or raw ore supplies – it will receive but a fraction of the so-called 'in-ground' value, for which market prices of less than 1% (even for large – and therefore considered economic to mine – resources) are not unheard of.

So, for any miner with a project, it is the 'project financing cost' that will dominate. A few (mostly large conglomerates) might already have funds for the capex. But where, as for most juniors, the only sources are project loans; customer loans in advance of receiving the product; equity share issues; or a rich partner – all can carry a high cost.

A major problem with an NPV calculation is that it might be the small difference (the net long term profit) between two large numbers (the capex and the long term return) which any mathematician will tell you is highly susceptible to inaccuracy in the two big figures. The positive component of an NPV is the unreliable forecast of future cash inflows over the 5-25 year project lifetime discounted at a rate that no-one knows will turn out correct but which will be chosen to be conservative for the lender.

And even the Bankable Feasibilty Study, which is supposed to be the most up-to-date and accurate assessment by experienced engineering consultants, can never be taken as 100% reliable. While for a pre-feasibility study consultants will quote an accuracy of only +/- 30% (which means a cost or a loss could turn out 30% more than stated), that of a BFS is generally quoted at within +/- 10% - still a large margin for error.

In the face of all this uncertainty, it is not surprising that project lenders will demand a high interest rate – and, therefore, investors should also apply their own cautious discount.

But despite the fact that valuing a mining project is a very uncertain exercise, readers shouldn't be completely deterred. Most juniors are currently at such extremely distressed values that while making funding that much more difficult and, when done, more dilutive of shareholder value, I hope to find examples worth looking at, even if others turn out to be disappointing.

A distinct positive to bear in mind is that many projects, while stating a given lifespan, have scope to extend their lives through continuing exploration and later to move on to other things. That is because, to make any project stack up the profits it makes when up and running after a long period of gestation and spending have to be much larger than is the case for most industrial projects or businesses. They will generate largesurpluses of cash over and above loan repayments, which will become available for its owners to expand.

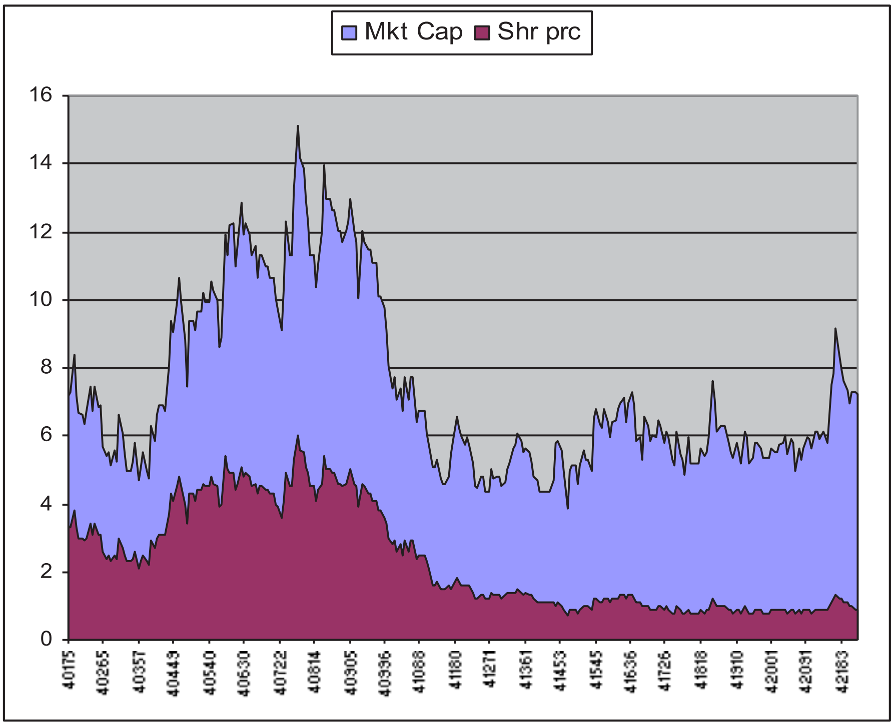
In addition to this is the fact that smaller miners can be less affected by low commodity prices than the multi-national multi-commodity miners who, in order to keep up the scale of their businesses, have to incur 'sustaining' costs – which can be 10-25% of their operational (or cash) costs. That adds considerably to the risk they will report losses if commodity prices fall even lower, while juniors are usually targeting small, niche, mines where costs – without the need for 'sustaining' costs – can be considerably lower. They, unlike the majors, will already be valued to take account of their limited lives, so will be less at risk of falling market ratings. In addition, they will always have that cash flow (not needing to be ploughed back into 'sustaining' costs) to be returned to shareholders as dividends, or used to fund expansion down the line.

NEXT TIME -
Appearance Vs Reality

Appearance – Why aren't my shares recognising closer production?

Reality – They are - but you haven't noticed

The shares here are only 1/6th of their 2011 peak, but the market cap is ½ that peak.

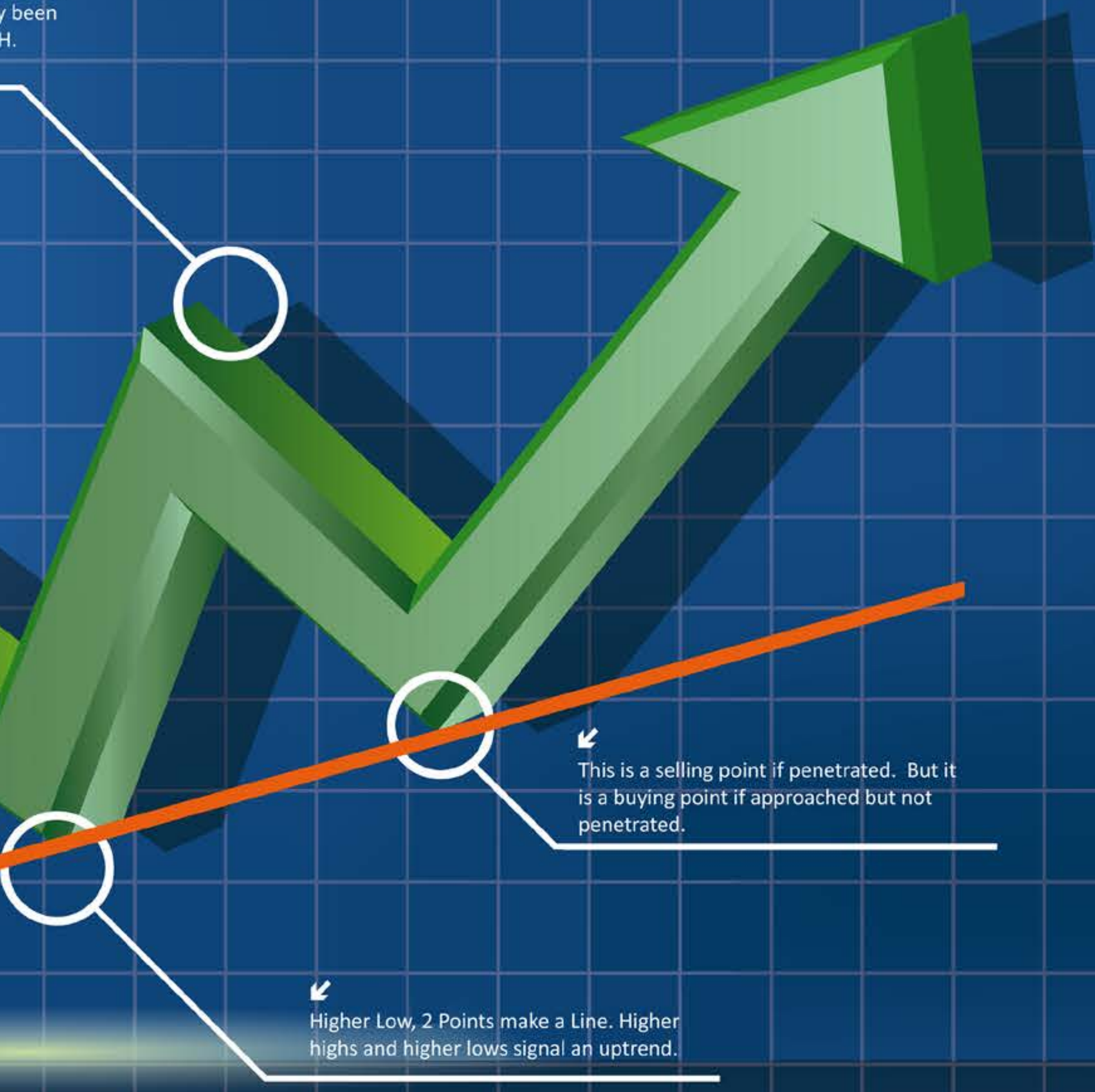


Newsflash! Uptrends don't come in a straight li
The market can go down. The prices are a bit to
to be a buyer now. The easy money has already
made at this point. We BUY LOW and SELL HIG
A good time to take some profits.

Good sell points are when the market nears the top of the channel...a fall to the bottom of the channel is VERY likely at some point.

Clear and Strong Uptrend. An up trendline is a straight line which slopes upwards and is drawn to touch successive low points in an uptrend.

Lowest Low, Start of Trendline Support. When it can be observed that the Bulls step in after pullbacks, it can be assumed a slow steady uptrend will remain in progress. This assessment allows for taking advantage of pattern breakouts that are not being disrupted by a change of the market trend.



FINANCIAL-SPREAD-BETTING.COM

SPREAD BETTING TIPS AND TACTICS TRADING CENTRE

PATTERNS, PATTERNS, PATTERNS! Many chart patterns are based on triangles and trend channels. However, as with all technical analysis, there is no one universal right way that will give you trading success all the time. But you can put the odds in your favour by developing a trading edge.

Visit Financial-Spread-Betting.com for free educational trading videos and technical analysis courses to help you devise a trading strategy.

THE LIMPOPO DISPATCHES

'OIL' HAVE SOME OF THAT!

BY ROBERT SUTHERLAND SMITH

August 2015: in which your correspondent introduces a mysterious old actuary known as "No. 5" and talks of the prospects for oil and gas shares BP and Royal Dutch Shell - finding the 'value investing' fundamentals significantly compelling, amidst all the emotion and panic coming like the sun, out of China across the bay - to quote Kipling.

One of the longer established denizens of our little Limpopo River fraternity is an old actuary (actuaries seem to live longer on average, thus violating the profession's own tables of mortality which they apply to the rest of us). He inhabits a sturdy, plain, functional bower near a plantation of Bongo Bongo trees.

He may be spotted in the evenings with an old, hand driven, mechanical Monroe calculating machine that looks a bit like a cigarette rolling contraption, working out the average age of an idealised defined benefit pension scheme, which exists only as an intellectual hypothesis in the tunnel vision of his actuarial brain, which is long practiced in doing probability and discounted cash flow calculations internally.

It is an interesting statistical fact that most of humanity has never met an actuary. Except the lady in the local bakery who proudly told me only this week that her niece is training to be one. How is that for unexpected obscurantism?

I would like to introduce our old actuary to you by name, but he refuses to divulge it, preferring to be known as number 5 only; mistrustful, as he is, of an identity made of mere letters and words and wishing to merge himself as completely as possible into restful numeracy of actuarial science.

"Just call me '5'", he says, with a faraway look in those old, faded blue eyes. The only concession he ever made to normal human entertainment was to once watch recorded episodes of "The Prisoner", in which the hero (the late and wonderful Patrick McGoohan, who is now regrettably beyond even pensionable age) is addressed as a number, in his encaged, potty world of surreal captivity, from which it is impossible to escape. Naturally, our ancient actuary took to the surreal world of the Limpopo with much aptitude. Like 'yours truly', he enjoys surreally consuming roast beef and Yorkshire pudding, prepared by an African cook, beneath a southern African sky.

Number 5 is a refugee from that now lost golden age of civilized retirement made possible by the final salary pension scheme. His philosophy – as he explained one evening, over a meal of Umbopo's splendid roast beef, Yorkshire pudding, roast potatoes and Brussels sprouts, followed by bread-pudding – is based on the notion that hell is other people and that the best refuge from them is the lone existence of the consulting actuary, who mostly deals with numbers and, thankfully, not people. If it is true that he is one hundred and nine years old (as is rumoured), it is wholly in defiance of actuarial mortality tables and at a sig-

"IT IS AN INTERESTING STATISTICAL FACT THAT MOST OF HUMANITY HAS NEVER MET AN ACTUARY."

nificant cost to his pension scheme sponsored by his old firm of actuarial advisors and employers Messrs "Likely and Approximate partners".

Like many consulting actuaries, he has sat on the advisory boards of pension funds pronouncing on the investment policy of their investment managers. He has been correct with astonishing consistency about investments but sometimes with hindsight. (How many of us have not been one hundred per cent correct, after the event, when everyone is a winner!?)

As he sits, consuming his third pint of fermented coconut juice, I ask him, "Number 5, what are you investing in now, in this great share price slump?" He leans towards me and replies, "The 'winners', my dear man; winners!"

How wise and correct? I think to myself. He then adds, "Think always in the long term if you want to make real money."But in the long term, are we not all dead" I reply, having read my John Maynard Keynes's 'Theory on Prices and Employment'. "Exactly!" says Number 5. "It is just before that event - retirement – when you need the assets. "Look at the unwashed and unloved shares of the market place, where everyone has heard the bad news several times over and there is decent income while you await a recovery," he adds.

"Is it easy to identify such companies?" I ask. "No!" he replies. "That is why is why you should not put all your savings in one basket (or share) – along with the eggs"

No. 5's view on oil major shares

Will the crude oil price keep on heading down?

The Saudi Arabian position: It became evident last year that Saudi Arabia, which has the second largest oil reserves on the planet, is following a policy of preserving its share of the market; presumably, as some argue, because it recognises that hydro-carbons are increasingly being replaced by renewable

"FINALLY BP IS OUT OF THE GRASPING FINGERS OF AMERICA'S 'GOOD OL' BOY' CLAIMANTS, WHO IN PLUNDERING THE COFFERS OF BP - WITHOUT PROOF OF LOSS IN MANY CASES - DISPLAYED ALL THE OPPORTUNISM OF OLD TIME CORNISH SHIPWRECKERS."

sources of energy. We have all been blinded by the fact that the Saudis have such large reserves and such a low cost of production, and have forgotten to ask questions about their government's financing needs. There is the easy and understandable assumption abroad that the Saudi government has tons of money, well in excess of the needs of a country with a small population. Comparatively, it is a small population but one that has grown by six million over the last ten years, to around 30 million now.

That easy assumption was challenged by the fact that in July the Saudi Arabian government joined the queue in the international debt markets this month. It has raised $27 billion for government spending; a story that made the front page of the Financial Times, which commented that the policy of low oil prices has put a strain the kingdom's finances. National debt per capita is low at a reported $857 per head, versus per capita GDP of around $22,160 per head. It has unemployment of around 6%. In short, now that oil prices have fallen, partly as a result of Saudi policy since last year, its government needs to borrow, and it has a rare capacity to do that.

Saudi Arabia reportedly needs a price of $105 per barrel to finance its national budget expenditure. Moreover, it has just reduced production from around 10.5 million barrels of oil per day to 10 million barrels of oil per day. Although this was justified by reduced domestic oil demand in the autumn (less need for air conditioning to keep those 30 million Saudi Arabians cool in summer) it was nevertheless an action slightly out of character. One assumes that as a very low cost producer, it could have sold that extra 500,000 barrels per day at a lower price and still made operating profits. The fact it did not choose to do so, along with its new role as a debt raising nation, may mean that it wishes to go no further in pushing down the crude oil price and return to a more traditional role of managing its price through controlling levels of output. The borrowing may be a straw in the wind.

The return of the Persian Lion: Iran will be returning as a major supplier over the next year or two, as its recently unused oil fields are brought back to technical and economic efficiency. If that means weaker prices, then there will presumably be less fracking and deep sea production, which are high cost operations by comparison. We are seeing big oil companies cutting back on such costly exploration for costly oil production. The industry worldwide is seeking a new equilibrium – the economist's word for balancing production and exploration in relation to price. (One awaits a call for Alex Salmond to apologise to the Scottish people.)

The shrinking China dragon: The main problems in people's minds about oil had been Saudi Arabian production and the awaited return of Iranian production. We now add to those concerns less demand from China, making matters even worse. But the old serpent of economics is a dynamic creature; it bites and then slithers to bite elsewhere.

Objectivity: Panic has set in. Does the investor now join in and sell his shares or think about adding to his investments if he has the cash? Here are some good reasons for adopting the latter course:

· An investment in oil shares is not the same thing as buying crude oil. The dominant characteristic of equity investment is that you are investing in people; the managers of the company. They are paid to anticipate events (not always easy to do) and strengthen the company against deteriorating in the face of them. The combination of management action along with a decline in the share price has a tendency to improve the outlook for a share pretty quickly. That dynamic, I suggest, is already evident in oil shares.

· The crude oil price is in any event very volatile, as history shows. Between 1973 and 1974 the price of oil rose 300% from $3 per barrel to $12 per barrel. A quick inspection of an oil price chart will show this truth about its volatile nature very clearly. In 2010 highly paid, all seeing, investment bank economic oracles were predicting that the price of oil would soon rise to $150 per barrel. Look at what has happened to it since.

· The world economy is not in the state that the stock exchange panic indicates. The biggest economy in the world is still Uncle Sam's, and that has recovered and is doing well. Europe is showing signs of post glacial economic improvement and is expected to grow more than people thought likely a year ago. China is as a matter of fact far bigger than it was this time ten years ago. It is a source of significant demand and potential future demand as it continues the difficult and painful process of growing domestic demand for domestic and overseas goods and services. That said, it clearly cannot keep growing at the sort of rate we have come to expect as it becomes so large. That is a significant change in terms of purchasing power for the new, increasingly domestically driven China. Oil will play its role and you can bet your bottom dollar that oil industry managers will have diversified and rationalised to acclimatise themselves profitably to changes.

· Remember, too, that UK and US equity markets have had a long recovery and run from recession. They had ceased to look obviously cheap and the fidgety hedge fund managers with billions in the bank (there is a limit to the number of status indicating watches you can buy or bottles of fine wine you can swallow) were much more likely to short that situation than buy it. Moreover, this is summertime when markets are thin. Rapid reaction panic and markdowns tend to hold sway over calm objective thoughtfulness, at such times.

So I suggest that oil companies are well worth looking at on these occasions. If the valuation fundamentals look right – as they certainly do, I suggest – then this is a time to buy not sell. Remember big institutions will be thinking exactly in this way, with a view to averaging their historic book costs. When the market reaches a dreaded and awaited big bearish event, it is usually the time to buy.

BP (BP.) at 336p after the results for the six months to 30th June 2015

The BP share price at 336p (last seen) is about 31% below where it was at this time last year. The FTSE 100 fell 11% over the same twelve months. In the previous December, 2013, the shares had been priced at 384p. BP is a big company with equity currently valued at just over £67.5 billion. It is too big to ignore, but it has been a dismal investment over the last few years. As a result of the Gulf of Mexico problems, as well as the collapse in oil prices, the BP share price over the last five years is down over 10%. Over the same five year period the FTSE100 Index rose 18%.

The good news for BP is that the Gulf of Mexico is now history, so far as liability is concerned. Finally BP is out of the grasping fingers of America's 'good ol' boy' claimants, who in plundering the coffers of BP - without proof of loss in many cases - displayed all the opportunism of old time Cornish shipwreckers. Now that, it seems, is finished. The company has settled too with the Federal agencies of the USA. The Gulf of Mexico disaster is history.

Now BP is having to grapple with a much lower oil price. It plans to do that by some big cuts in investment and a rationalisation of the business; the sorts of things that company managers do on occasions like these. But does it have the time and the money? And can it keep on paying the dividend, which at time of writing yields 7.6% historic and last year cost $5.8 billion to pay? Is that dividend unsustainable or is the share price too low if it is?

First and foremost, the latest cash positions reported by BP in their published accounts look encouraging. At the year end, the cash position was a reported $30 billion; in the June accounts that had increased 9% to a reported $32.8 billion. That is 5.6 times the cost of last year's annual dividend payment. On an annual basis, operating cash flow last year was $32.75 billion. Capital spending, which had been $22.5 billion last year, had dropped to $9.2 billion in the first half of the current year; evidence of the management's intention to cut out investment spending, at a time when doing such a thing seems supremely logical, possible and desirable. A balance sheet depleted of a chunk of $22 billion of unnecessary investment spending is going to be a much healthier balance sheet capable of funding the shareholders' dividend receipts.

On the question of cash flow, I point out BP is now selling on only 7 times last year's depreciation charge; around 3 times last year's gross cash flow and 3.5 times last December's year-end cash in the balance sheet.

It is also valued (at 336p a share last seen) at very close to net attributable assets. These were shown as worth $106 billion in the June balance sheet – which I estimated on the basis of an exchange rate of 1.55 dollars to a pound. On that basis, the UK share price of 336p is supported by 325p of net assets.

So, having had a look at the latest accounts, what does the market think in terms of consensus earnings and dividend forecast estimates? Basically, the market in its expert collective wisdom, reckons that after last year's 83% fall in earnings, we are in for a positive change. The consensus estimates an 85% increase in earnings this year, and another 23% increase next. Also expected is a modestly progressive dividend payout. In short, the current market consensus estimates put the shares, at 336p, on a prospective 13.8 times earnings estimates for this year and 11.2 times those estimated for next year. There are prospective dividend yields 7.3% for this year and next.

If I were still a fund manager, I would be averaging down my position at this stage, hoovering up the shares of those foolish enough (or hard pressed enough) to be selling them.

Royal Dutch Shell (RDSA) at 1,620p

The following comments are based on a share price of 1,620p after the great late August share markets collapse. Royal Dutch Shell, the Anglo-Dutch oil and gas company, is on a historic dividend yield of 7% and a PER on reported figures of 12 times earnings. As with BP, it is a handsome dividend yield. Can it be sustained in times such as these? Or is the share price telling us that the market is expecting it to be cut (a usual prognosis of dividend yields at this level)? So amidst the sell off panic of late August, is Royal Dutch Shell equity oversold?

The share price has come down from a five year peak of 2,475p nearly a year ago. Over a year, therefore, the share price has come down by about a third, falling much further than the FTSE 100 Index which dropped about 11% over the last year. Interestingly, over the last week and month its share price has performed only slightly less well than the FTSE 100 market.

Subjecting the Royal Dutch Shell accounts to observations similar to those employed above for BP, one sees that the annual dividend last year cost Euro 9.44 billion. You may reasonably put that cash cost against year end 2014 cash holdings of Euro 21.6 billion and even better, an operating cash flow for last year of 45 billion Euros. Although it is conventional to speak of earnings cover for dividends, it is cash held and produced within the company that is key, because it means money going out of the business.

On these figures, the historic annual dividend cost was covered strongly by cash held; that is to say by 2.3 times on the basis of the last December's year-end cash figure, and 2.8 times by the cash held figure at June 30 (cash held having increased from Euro 21.6 billion in December 2014 to Euro 27 billion by June 30th 2015).

So is the market expecting no earnings growth and a cut in the Royal Dutch dividend? Unfortunately, I am unable to tell you that, because my usual market source does not have such consensus estimates available at the moment. My instinct, given the strength of the last and penultimate (annual) balance sheet is to suppose that when they appear, they will at least show an expected holding of the last annual dividend.

Recent advice from the company talks of an unchanged share buy-back programme with a planned 10% reduction in operating costs in 2016 and Euro 7 billion cut in investment in 2016. The company is, conservatively, planning for several years of weak oil prices by restructuring itself through a Euro 20 billion sale of assets during 2015/16, which the company states it is able to achieve even in weak markets. It also states that its significant new projects are designed to produce material cash flow and free cash flow in the medium term.

I look for No5 and see him beneath the moon with his hand-driven calculating machine working out the life and death calculations for the eternal final salary scheme model he carries in his head. He has left me a message: "Both BP and Shell look significantly oversold and should play a profitable part in any long term portfolio of shares".

"IF I WERE STILL A FUND MANAGER, I WOULD BE AVERAGING DOWN MY POSITION AT THIS STAGE, HOOVERING UP THE SHARES OF THOSE FOOLISH ENOUGH (OR HARD PRESSED ENOUGH) TO BE SELLING THEM."

TECHNICAL CORNER

USING CORPORATION TAX AS A TECHNICAL INDICATOR

BY ADRIAN KEMPTON-CUMBER

As Technical Traders we're always looking for an edge in identifying trends and buying/selling opportunities. Typically, we use indicators based purely on price. The other possible element is volume, although it's overrated as a tool in my view, and most of the time offers no help at all.

This is one of the difficulties of technical trading: knowing which indicators – or more correctly, which combination of indicators – are of value at any given time for the prevailing circumstances. For example, a moving average is not that useful after a period of price stagnation, but volume might be.

It's a good idea to mix things up, and using fundamentals in TA is a great idea. In terms of companies, most fundamentals are often a matter of some choice: how much profit they declare, what reserves they have against contingent liabilities, etc. Accounting and company announcements are very much an art form.

I first got interested in looking at corporation tax because it's been such a political hot potato. All those companies, like Vodafone and Starbucks, that have really borne the brunt of criticism are not at fault. They have an obligation to their shareholders to contain costs. In turn, their accountants have a professional obligation to legally mitigate their clients' tax bills. They can only do that to such effect that their client company tax bill is zero when government creates poorly drafted legislation (as they so often do) leaving, deliberately or otherwise, such loopholes of which companies can take advantage.

This then got me thinking that if a company is paying a decent amount of corporation tax then they still won't be paying any more than they have to. It could be regarded as a sign of the health of a company. So I made a table of the highest contributors to corporation tax. We can see trends here, and it's an easily obtained dataset (a simple job using ShareScope, which is my preference, and freely available on the internet). The important thing with any dataset is

"IT'S A GOOD IDEA TO MIX THINGS UP, AND USING FUNDAMENTALS IN TA IS A GREAT IDEA."

reliability and consistency. ShareScope provides current year and 10 years of historical CT data. I've used the FTSE 350 as the basis for my analysis and in doing so only considered the current constituents of the index for practical purposes. These are the biggest companies listed by capitalisation, so we can reasonably assume that we have all the big hitters in there.

Top 10 CT Payers Last 11 Years

	10 yrs ago	9 yrs ago	8 yrs ago	7 yrs ago	6 yrs ago	5 yrs ago	4 yrs ago	3 yrs ago	2 yrs ago	1 yr ago	Current	All years
1	RD Shell	RD Shell	RD Shell	RD Shell	RD Shell	BP	RD Shell	RD Shell	RD Shell	RD Shell	RD Shell	RD Shell
2	BP	BP	BP	BP	BP	RD Shell	BHP Billiton	BP	BHP Billiton	BHP Billiton	HSBC	BP
3	HSBC	HSBC	BHP Billiton	BHP Billiton	BHP Billiton	BHP Billiton	Rio Tinto	BHP Billiton	BP	BP	Rio Tinto	BHP Billiton
4	RBS	Vodafone	RBS	Vodafone	Rio Tinto	GSK	HSBC	Rio Tinto	HSBC	HSBC	RBS	HSBC
5	Vodafone	RBS	HSBC	GSK	BG Group	AstraZeneca	AstraZeneca	Vodafone	GSK	BAT	Unilever	GSK
6	GSK	BHP Billiton	Vodafone	RBS	GSK	BG Group	Anglo Am'n	HSBC	BG Group	Barclays	BAT	Rio Tinto
7	BHP Billiton	GSK	GSK	Barclays	HSBC	Rio Tinto	Vodafone	GSK	BAT	Unilever	Barclays	Barclays
8	Barclays	Barclays	Barclays	HSBC	Unilever	BAT	Barclays	BG Group	Unilever	Rio Tinto	Glencore	BG Group
9	Lloyds	Lloyds	BG Group	Anglo Am'n	AstraZeneca	Unilever	BG Group	Barclays	Centrica	Lloyds	Std Chartered	Unilever
10	BAT	AstraZeneca	Lloyds	BG Group	Anglo Am'n	Barclays	Unilever	Anglo Am'n	Std Chartered	Std Chartered	SABMiller	AstraZeneca

Obliquely, we could say that high CT bills reflect poor accountancy advice, since a bit of international tax planning would presumably reduce their tax bill like Starbucks. Maybe short the accounting firm responsible if you're a massive contrarian!

A good reality check is to look at things from a reverse point of view. In this case, can we say that because a company hasn't paid CT they aren't healthy and should be shorted? In the absence of any other information, it still depends. There could be a whole host of reasons why. Their business might be highly sensitive to the economic cycle. The construction industry would be a good example of this. We need to see a pattern.

"LOOKING AT BP, I WOULDN'T BE A HUGE FAN OF THE STOCK CHART. IT'S BASICALLY A 20 YEAR REVERSAL PATTERN!"

I've prepared two lists which make interesting reading – the Top 10 CT Payers Last 11 Years and the Top 10 CT Sectors since c.2003. Way out ahead of other sectors in terms of CT paid during that time is Oil & Gas Producers. In fact, the top 2 companies in the list over that time – Royal Dutch Shell plc and BP plc – are both oil companies. They account for the vast majority of the £180 billion paid in CT by the sector. Just to put that in perspective, we do £50 billion in trade with Ireland each year and Ireland is our 5th biggest trading partner, and it also represents more than one third of the FTSE 350 total over the period of a shade of half a trillion. Mining and Banks are the 2nd and 3rd biggest CT payers. Even relatively small players, like mining company Vedanta, contributed almost £1 billion during the period. Vedanta is 51st on the list over the 11 years.

When comparing the CT to the price chart, remember that CT is a lagging indicator – it relates to the previous accounting period so reflects roughly the fiscal year before last at the time, generally speaking. So year 1 on the CT chart would be roughly 2002/3 depending on the company's fiscal year-end date etc.

Looking at BP, I wouldn't be a huge fan of the stock chart. It's basically a 20 year reversal pattern! Superimpose the CT data on it and we have an even less attractive picture. Of course we know that year 7's negative CT was down mainly to the economic crisis. The lower high of year 8 though underpins a reversal. So we see not only a weak price chart, but also a weak CT chart. Even if we see a rise in the CT payable it's hard to see how it could be much above the £4 billion level. The stock chart could reverse this month and that would at least be a higher low than the 2010 one, but it's really not saying much when we're excited about a stock not falling below the lowest point of the financial crisis!

Commodities are generally depressed so let's skip past miners and go on to banks. Barclays' CT chart looks more impressive than its price chart! It's really fairly range-bound but consistent CT payments should be the sign of a stable business. The price chart gives a somewhat different picture. We know banks have been hit with all manner of regulatory fines and other more cheeky charges, which means that it's somewhat impressive they've managed to maintain profitability in order to keep paying CT at the same level. I've said before that I don't like the banking sector while thisera of fines and super-taxes persists, and in any case we've not seen a buy signal on Barclays, but it gives a hint that the underlying business is sound, so once the storm clouds clear after silly season then we could see some really robust growth.

BT isn't even a Top 10 CT payer. I wrote last month about BT and how they're one of the companies actually propping up the FTSE. The CT chart is spectacular

Top 10 CT Sectors since c.2003

	£m	Sector
1	180967	Oil & Gas Producers
2	76551.1	Mining
3	65846.8	Banks
4	33231.3	Pharmaceuticals & Biotechnology
5	14234.4	Tobacco
6	14216.9	Personal Goods
7	13648.4	Life Insurance
8	13456.4	Gas, Water & Multiutilities
9	12871.2	Beverages
10	11130.5	Support Services

in TA terms. Higher lows and it could even be about to break out. It's quite surprising that BT only pays hundreds of millions in CT per year but there it is.

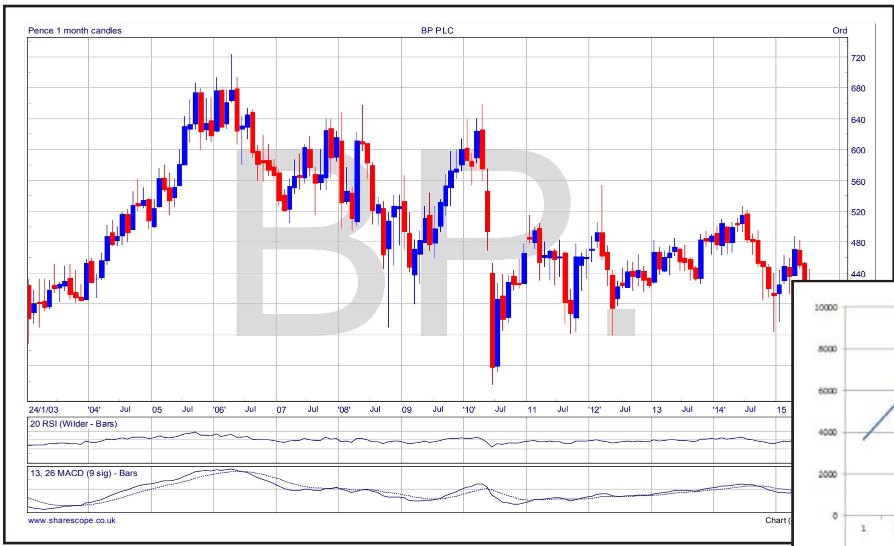
There's a nice upward trends on the CT chart, and the price chart is in a healthy up trend too. A new ATH is looking likely, and this pull-back could be another entry signal for the more aggressive investor.

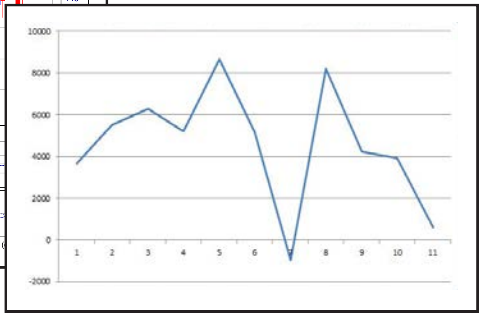
So we can see that CT is a useful indicator when analysing stocks. It's pretty easy to analyse the small data set on Excel for your watchlist. US data would be quite easy to get hold of too, and probably European as well, if you are more diversified.

We Technical Traders need to take advantage of all the tools we can, and especially the ones others are overlooking. I suspect that practically no one is using CT and TA together in this way; it's a competitive edge.

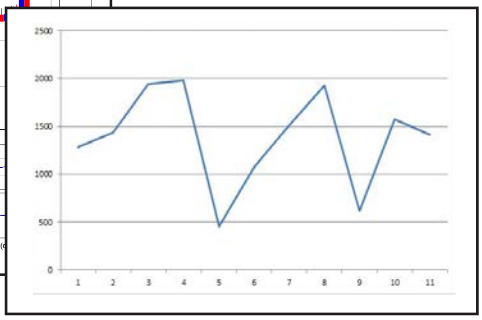
Meanwhile, strap in for a busy autumn, as you'll need to keep on top of your positions/portfolio. Market correction and a possible bear market are afoot. A Bear Market is classified as a market which has fallen at least 20% from its highs. For the FTSE that's just under 5,700 – so not much less than the low of August which was 5,768. For the Dow it's around 14,400. As I've been saying for a while now, the FTSE is much weaker than the US markets and a recalibration between the two is overdue. The FTSE 100 will be in bear mode before the Dow on these figures.

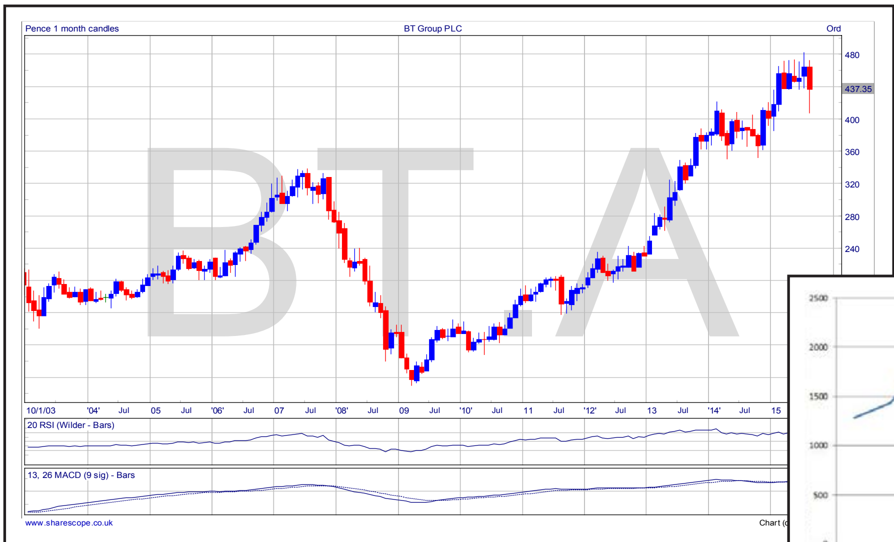
The summer's over, but be prepared: you may have to put your shorts on!

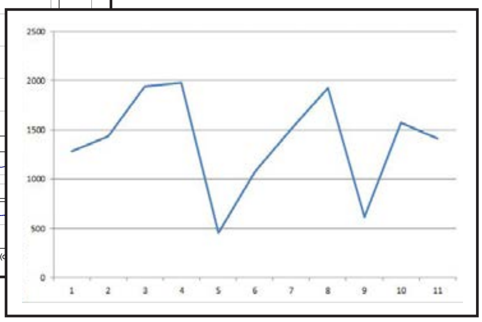

Pence 1 month candles
BP PLC
Ord
720
680
640
600
560
520
480
440
BP.
24/1/03 '04' Jul 05 Jul '06' Jul 07 Jul '08' Jul 09 Jul '10' Jul 11 Jul '12' Jul 13 Jul '14' Jul 15
20 RSI (Wilder - Bars)
13, 26 MACD (9 sig) - Bars
www.sharescope.co.uk


10000
8000
6000
4000
2000
0
-2000
1 2 3 4 5 6 7 8 9 10 11


Pence 1 month candles
Barclays PLC
Ord
750
700
650
600
550
500
450
400
350
300
BARC
5/3/03 '04' Jul 05 Jul '06' Jul 07 Jul '08' Jul 09 Jul '10' Jul 11 Jul '12' Jul 13 Jul '14' Jul 15
20 RSI (Wilder - Bars)
13, 26 MACD (9 sig) - Bars
www.sharescope.co.uk


2500
2000
1500
1000
500
0
1 2 3 4 5 6 7 8 9 10 11


Pence 1 month candles
BT Group PLC
Ord
480
437.35
400
360
320
280
240
BT.A
10/1/03 '04' Jul 05 Jul '06' Jul 07 Jul '08' Jul 09 Jul '10' Jul 11 Jul '12' Jul 13 Jul '14' Jul 15
20 RSI (Wilder - Bars)
13, 26 MACD (9 sig) - Bars
www.sharescope.co.uk


2500
2000
1500
1000
500
0
1 2 3 4 5 6 7 8 9 10 11

FUND MANAGER IN FOCUS
CHRIS HOHN

BY FILIPE R. COSTA

"Banks are inherently difficult to analyse, opaque, highly levered and speculative – we don't want speculations, we want investments."
– Sir Christopher Hohn

An new kind of obsession

All the regular readers of this column at MI Magazine are certainly aware of the extravagant, exquisite and sometimes lunatic way of living hedge fund managers usually espouse. Many of them quickly run through the ranks of life to spend what they can and cannot, purchasing fine arts, expensive wine, and luxury apartments overlooking Central Park, while living an unbound life. But we also have those who have a strong commitment to what they do and for whom life is all about adding value – forever. Leon Cooperman, featured in last month's column, is an example of this. You would most likely find him commuting on the ferry to NYC or sharing a taxi with someone rather than drinking champagne inside a limousine while travelling to an apartment at 432 Park Avenue.

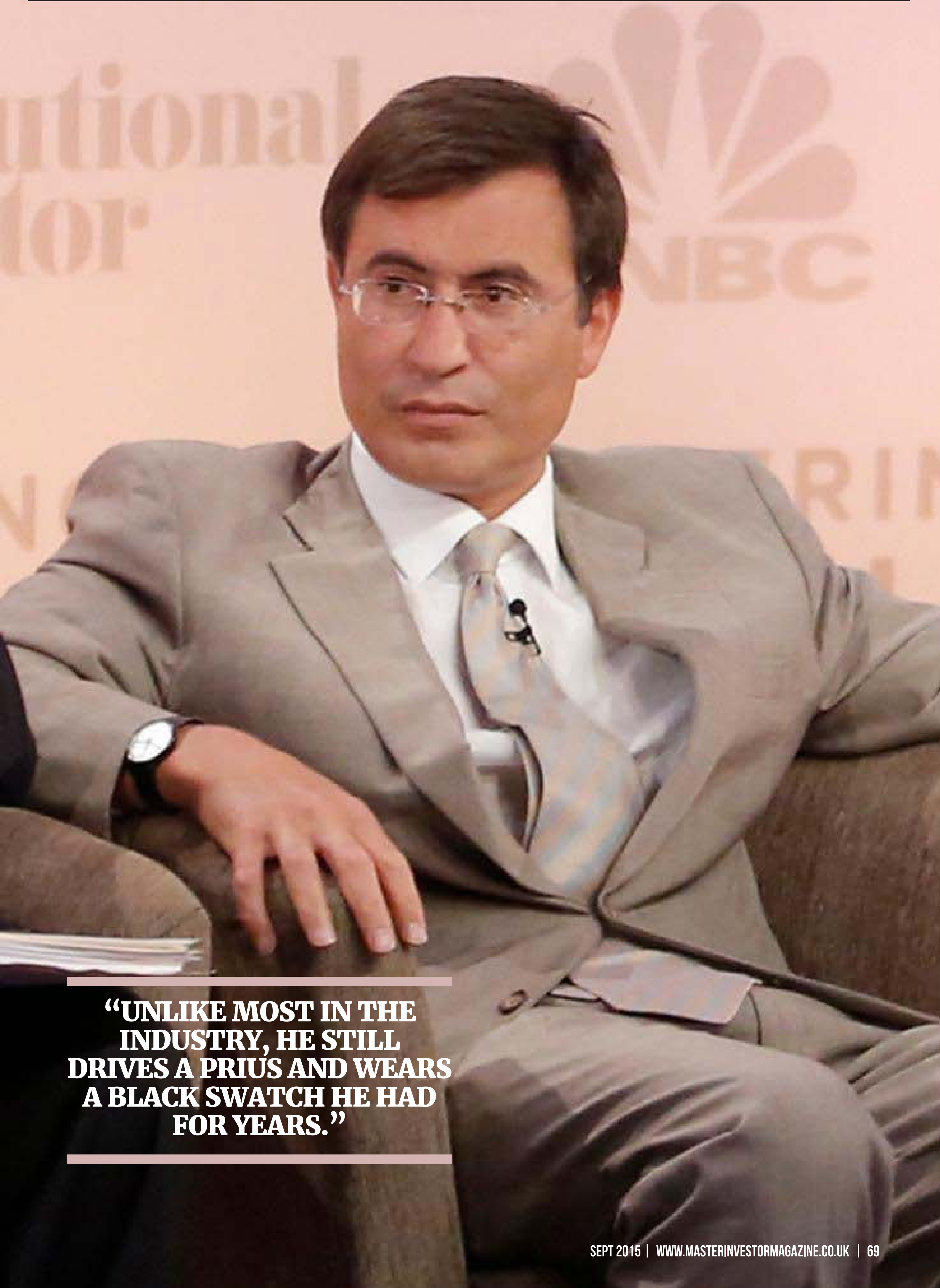
While the differences between hedge fund managers are huge, there is one common point between them: they all have their own hedge fund business, of course. And there is also another common point for those who make money from it: they all become philanthropists, frequently donating to charities and often running their own foundations.

This month's featured hedge fund manager, Christopher Hohn, is a shy man who doesn't like much publicity. Raised in the UK from a modest family, he made it big and entered Forbes´ Billionaires List. However, unlike most in the industry, he still drives a Prius and wears a black Swatch he has had for years. But what makes Christopher Hohn different from all the others is the manner in which he conducts his philanthropic activities. In 2002, in his mid-30s, he created the Children's Investment Fund Foundation, a charity with the aim of helping children in developing countries. The year after, he founded The Children's Investment Fund to make money to fund the charity he created. Unlike the other fund managers, it was not the money that turned him into a philanthropist; it was his "obsession" to donate that led him to make money.

The Children's Investment Fund

Chris Hohn, or Sir Chris Hohn KCMG, to give him proper credit, was born in Auddlestone, Surrey, UK, in 1967. Son of a Jamaican car mechanic of European descent and of a legal secretary fromEast Sussex, Hohn was educated at a state school. He then attended Southampton University, where he graduated in Business & Accounting with a First Class Honours in 1988. Urged on by his tutor at Southampton, he applied for Harvard in the US where he concluded an MBA in 1993. He graduated among the top 5%. While at Harvard, Hohn met Jamie Cooper, whom he would marry in 1995 and have four children with (including triplets).

His professional career in finance started soon after graduating from Harvard, at the private equity group Apax Partners. Two years later, he landed a job at Perry Capital, a hedge fund on Wall Street, where he was able to run an investment strategy. In 1998 he was made head of Perry's operations in London. During his tenure at Perry he made around £75 million, ample money to retire, if he so wished. Earlier, at the age of 20, when he travelled to the Philippines he saw real poverty among children and vowed that if he ever made enough money to help poor children he would. In 2002 his desire would become a reality when he and his wife founded the Children's Investment Fund Foundation (CIFF), a charitable organisation headquartered in London with the main aim of fighting poverty, particularly poverty affecting children. He then set up The Children's Investment Fund (TCI) with the main



"UNLIKE MOST IN THE INDUSTRY, HE STILL DRIVES A PRIUS AND WEARS A BLACK SWATCH HE HAD FOR YEARS."

aim of giving a proportion of its profits to help children in developing countries and this way fund CIFF.

In the beginning, the hedge fund business was connected with the charity by a legal contract requiring the hedge fund to transfer 0.5% of its assets each year plus a further 0.5% of assets for every year during which the fund achieved returns of more than 11%. According to a rare interview Hohn gave to The Telegraph, the main reason to establish the formulas was to give a clear motivation for the fund to outperform. While Hohn was managing TCI, his wife Jamie was managing the CIFF.

A setback in life

While the Jamie-Chris partnership worked well for 18 years of marriage, the couple announced in 2013 that they were seeking a divorce, and the whole process was completed in December of the following year. With £1 billion at stake, his wife was looking for half of the wealth, arguing the family fortune was created as a result of their partnership, with Chris contributing at TCI while she ran the charity foundation and took care of the kids. But the judge concluded that Hohn was a "financial genius" that made a "special contribution" to the creation of the couple's fortune and split the wealth unequally, awarding Jamie Cooper £337 million (36% of the total wealth). Nevertheless this was one of the biggest divorce settlements in the UK.

Between 2006 and 2011, the Children's Investment Fund Foundation received around £1 billion from the hedge fund. Hohn's wife said he was "obsessive" about giving to the foundation. The accumulated donations made him Britain's most generous philanthropist ever. In 2008 he gave £466 million to the foundation, which was the biggest donation given in a single year. To some extent the Cooper-Hohn's revolutionised the way a charity works as they applied a hedge fund-style performance targets to the foundation's projects to assure that the donated money would achieve long-lasting effects. Today, the

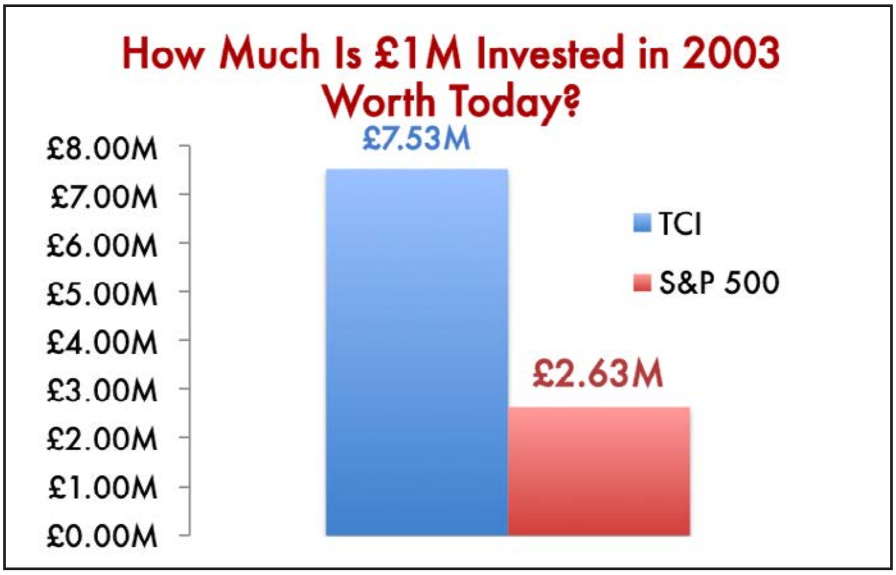
THE CHILDREN'S INVESTMENT FUND U.S. PORTFOLIO HOLDINGS

Security	Ticker	Value (x$1000)	% Port.
Time Warner Cable Inc	TWC	$2,250,993	81.71%
Moodys Corp	MCO	$453,284	16.45%
Charter Communications Inc	CHTR	$2,510	0.09%
Ambac Fini Group Inc	AMBC	$48,056	1.74%

Source: 13F-HR Filing 1Q2015

foundation has more than £2 billion in assets and is one of the biggest success stories in philanthropy.

Unfortunately, with the divorce things changed. In 2013, TCI returned 47% but didn't give any money to CIFF for the first time. The firm paid out £26 million in a pay deal to staff including Hohn but kept the rest of the profits. TCI announced it would stop donating to the foundation because its endowment was "large enough" at £2 billion. Any future donations would be discretionary rather than automatic. Besides, TCI still returns money to the foundation as it manages its money like it does for other outside investors. But the divorce certainly weighed on the decision to end any automatic contributions. Hohn's obsession with giving money away to charities seems as strong as ever, as he set up a new charity - the CH foundation - aimed at helping alleviate poverty and the effects of human trafficking and organised crime in the Indian subcontinent and at promoting health and education in Jamaica.

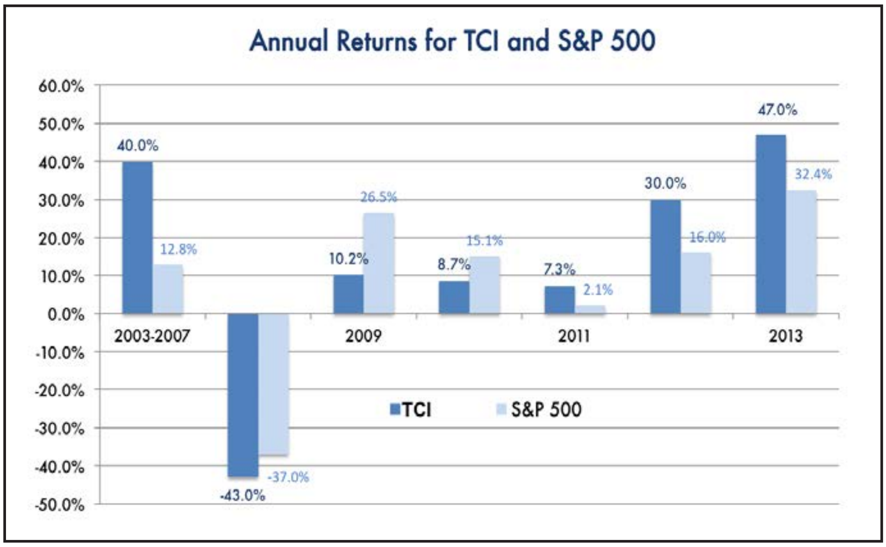


An Activist Strategy

The Children's Investment Fund Management was founded by Hohn in 2003 to help the charity. The firm invests globally and focuses on the longer term. It used to require investors to commit their capital for multi-year periods but, during the last few years, some of the requirements were relaxed. Nevertheless, the firm still focuses on managing its investors' funds for the long term. Investors who agree to one-, two- and three-year lock-in pay 15% in performance fee only when returns exceed more than 5% a year and at the end of the lock-in period.

Hohn is an activist who isn't worried about incurring high risk through leveraged positions, concentrated in just a few companies. He has a narrow but sizeable portfolio, which he keeps for years while pressing the companies he invests in to make changes in corporate governance. Because of the activist nature of the fund, Hohn gained a reputation for aggressive shareholder activism and has often been criticised for pursuing his own agenda when using his large stake to force companies into taking action. Some like to call him a "locust", as they see his actions as a plague that devastates everything. One can sense a touch of envy in such comments, as Hohn clearly enjoys the kind of fame most other activist funds would like to attain.

A few years ago, TCI acquired a major stake in the German Stock Exchange Deutsche Borse and forced the resignation of its CEO after it attempted to take over the London Stock Exchange. In 2007, after acquiring a 1% stake in the Dutch Bank ABN Amro, TCI demanded the bank split itself up and sell its assets to increase shareholder value. The bank ended up in the hands of RBS, Banco Santander and Fortis Bank, and Hohn was aggressively criticised. During the same year TCI ventured into Japan but with much less luck. In a country where corporate management has built an opaque barrier that shareholders are unable to penetrate, TCI was unable to seduce J-Power to increase its dividend and ended up giving up. In India, the company committed the same mistake when it accumulated a stake in the state-owned Coal India expecting to been able to force the government to become more shareholder friendly. Even though TCI pointed to a bilateral trade agreement between India and the UK when claiming the government should not interfere with coal prices and allow Coal India to increase coal prices, the Indian government did not change anything and TCI eventually sold its stake.



Later, and with a lesson learned the hard way, TCI returned to Japan to buy Japan Tobacco. This time they not only urged for change but they also kept in close contact with management, working on the changes instead of demanding them. Since May 2011, when the fund first met with Japan Tobacco's management, the shares have risen 180%. In March the company lifted its dividend payout ratio from 29.7%, three years ago, to 50.1% and even announced a share repurchase plan worth JPY100 billion. At the same time, the company announced the sale of its beverages unit, something TCI had been arguing for. This time TCI was very successful in Japan.

The list of successes is huge. The main target of TCI has always been to acquire stakes in companies it considers to have been heavily discounted because of concerns over their governance structures. The idea is then to force changes and increase shareholder value. News Corp and QR National are two additional examples where the fund made money.

Annualised gains above 20%

Since its inception in 2003 TCI has made money every year except in 2008 when it lost a huge 43%. But with annual gains averaging 40% in the period 2003-2007 the firm had enough cushion to absorb the heavy losses. Not that it wasn't a huge setback, but Hohn was able to learn from it, increase the fund's awareness of certain risks and return to profits.

In 2008 a few high-profile partners departed from the firm to join other firms or to create their own hedge funds. When asked about the episode, Hohn claims they departed because TCI no longer wished to focus on financials since the financial crisis. TCI now stays away from banks and Emerging Markets as Hohn perceives a higher risk coming from both. He is very critical of the banks' willingness to incur risk and thus banned the sector from his potential investments.

A Few Final Words

Sir Chris Hohn was appointed Knight and Commander of the Order of St Michael and St George (KCMG) in the 2014 Birthday Honours list, mostly due to his services to philanthropy and international development. His "obsession" to give led him to adopt an aggressive stance as a fund manager but at the same time to keep a simple lifestyle and give most of his profits back to society. Having won the Eurohedge's European Hedge Fund of the Year award in 2004, 2005 and 2013, and dubbed a "financial genius" by the divorce judge, the last words go to the publicity-shy Hohn: "There was a question [mark] over me when people left [in 2008]... Who was responsible for [making] the money, me or them? I've answered that question."

DEMYSTIFYING "IMPACT INVESTING"

BY SWEN LORENZ

It was recently prominently reported on in the Financial Times and Fortune magazine; asset management giants like Credit Suisse and Cheyne Capital launched funds dedicated to it; and the private equity guru, Sir Ronald Cohen, called it the area of finance he'd join to make a fortune if he was a young man once again. No doubt, "impact investing" is getting more and more attention. But what is it? Our editor, Swen Lorenz, tries to bring some clarity into a subject that is still little understood, but growing rapidly. As he discovers, it may well offer some exciting investment opportunities to those who know where to look.

The term impact investing has been around since the 1970/80s, but really only started to enter wider use from 2007 onwards. It aims to describe investments that aren't just geared towards providing returns to shareholders, but which also consider social or environmental outcomes. The World Economic Forum defined it as "investing based on achieving both financial returns and public benefit."

In retrospect, the early proponents of this approach should have made more effort to avoid problems of definition. For a start, it didn't help that this definition partially overlapped with an existing niche of investing generally described as green or ethical investment. It also had some overlap with the concept of companies running some kind of corporate social responsibility programme. Confusion ensued and impact investing was generally seen as an extension of afore-mentioned concepts, never getting any further than existing within a tiny niche of global finance.

Adding to the confusion was the fact that there are different shades of grey. Some investors seek to combine the highest possible return with backing a venture that also has positive social and environmental aspects. Others put returns second, and may even be satisfied with having no upside at all but being repaid so that they can recycle their capital for another worthwhile project. Each of these approaches works for certain ventures and certain investors, but when different approaches and audiences get mixed, it tends to get messy.

"HAVING ALL OF THESE DIFFERENT APPROACHES UNDER THE SAME UMBRELLA TERM - IMPACT INVESTING - MADE IT DIFFICULT FOR MEDIA AND INVESTORS ALIKE TO GET A CLEAR VIEW OF THIS EMERGING INVESTMENT MARKET."

Having all of these different approaches under the same umbrella term - impact investing - made it difficult for media and investors alike to get a clear view of this emerging investment market.

Early efforts generated lots of PR but whether they succeeded is hotly debated

Neither did it help that the first actual investment propositions were often exotic, complex, or too close to charity for those 99% of investors who are primarily return-orientated. For instance, the first bond issue based on impact investment criteria carried out in the UK provided the funding for intensive support to short-term prisoners from Peterborough Prison. Any prisoner who gets incarcerated for re-offending is a huge financial burden on the state, which is where one pioneering impact investment firm spotted a niche.

The funds raised through the financial vehicle were funding a programme designed to reduce the number of re-offenders, and for which the UK government did not have sufficient funds available at the time. The subscribers of

the social impact bond would participate in cost savings for the government, provided their investment led to a reduction in the re-offending rate of at least 10%. In the best case scenario, bond holders would see a return on their investment of 12% p.a. Society as a whole would be a huge beneficiary, too, through lower re-offending rates and lower costs, making the investment clearly count as having positive social impact.

Huge media interest ensued, and for many British investors the term impact investment still conjures up the memory of the prison bond. Peterborough became the grand-daddy of all social impact bonds (which, to the confusion of the public, were also called "pay-for-success schemes" by some – but not all pay for success vehicles are structured as social impact bonds.)

Unfortunately, the investment didn't live up to expectations, or at least, that's what Whitehall would like you to believe. The project they funded "only" achieved an 8.4% reduction in re-offending rates in year one. (Year two results are not available yet.) Given that reducing reoffending rates is one of the world's most intractable problems, such a reduction would have been seen as a stellar success under normal circumstances, despite missing the 10% hurdle rate. However, two thirds through the bond and with sufficient time left for the project managers to reach the 10%, the government decided to take up the solutions and institute them across the board, which made it technically impossible to fulfill the target as it left no control group. This is actually part of the point of a social impact bond: to create a demonstration effect that can be scaled by the public sector.

However, in the public's perception, the bond currently isn't seen as a success. The fact that the project missed the 10% reduction in re-offending rates meant the bond holders didn't actually get an interest payment. Subscribers to the £5 million bond issue had mostly been foundations, and they will be happy with having achieved a notable reduction in re-offending rates and a full return of their capital, besides seeing the government implement a more effective solution across the board.

In order for impact investments to become scalable and generate deals with £50 million, £500 million or £5 billion of funds, not only does an attractive risk/reward ratio and a competitive return need to be achieved, but the aims of all parties involved also need to be aligned.

In summary, the British prison bond didn't provide the success story that the industry needed to break into the mainstream, for reasons that are complex but possibly also not all that surprising. But it is just one of 20 schemes that are happening in the UK right now.

An easy, clear way for defining impact investment

Outside of tough lessons learned, there has definitely been progress with making impact investment easier to define.

Any company, organisation or financial instrument that intentionally creates more value than it destroys for mankind as a whole can be described as an impactful investment. The important thing is to count all long-term effects of a company and not just what it achieves in the short-run for its shareholders. In other words, consider so-called externalities. And consider intention.

A producer of fizzy, sugary drinks? The subsequent healthcare burden placed on society through raising an entire generation of obese, diabetes-ridden children may well be so high that the net overall impact of the product is actually negative. It yields a positive return for shareholders, but for society as a whole, the product is a value-destroyer and a drain on resources. Impact investors consider the whole picture and in such a case, simply don't invest in such a company.

A company that has developed a new education program which covers a subject that state-run schools cannot cover out of their existing teaching resources but which they would pay for if an external party provided it? There'd be a good case

for such a company having a net positive impact overall, through making a profit for its shareholders and contributing positively to society through creating a generation of smarter students. Such a company would tick the boxes of impact investors. On page 86, we introduce a company that falls into this category and which is currently seeking early-stage investment.

"IN ORDER FOR IMPACT INVESTMENTS TO BECOME SCALABLE AND GENERATE DEALS WITH £50 MILLION, £500 MILLION OR £5 BILLION OF FUNDS, NOT ONLY DOES AN ATTRACTIVE RISK/REWARD RATIO AND A COMPETITIVE RETURN NEED TO BE ACHIEVED, BUT THE AIMS OF ALL PARTIES INVOLVED ALSO NEED TO BE ALIGNED."

Companies that enrich both shareholders and the planet

Much as we hate giving kudos to competitors, we have to take our hat off to Fortune magazine. None other than the monthly bible of American capitalists just dedicated its cover feature to the rising influence of impact investing.

What Fortune calls "the next movement in the business world" and "a quiet revolution", can roughly be summarised as follows:

- For decades, companies ignored the social and environmental consequences of their activities, not the least as regulators and legislators let them get away with not paying for the negative externalities their products caused. To make up for their bad behaviour, they sometimes tossed some pocket change to charities, often set within some inflated PR exercises about their philanthropic activities.

- Following huge changes in society and increased public attention, companies are increasingly looking for ways to tackle social and environmental problems, and through finding scalable solutions generate value both for shareholders and the greater good. Put another way, how can the human profit-motive be utilised to solve the big issues facing mankind and the planet? The magic formula lies in aligning personal greed and the greater good.

Can impact investing really create a win-win situation for all parties involved, or would that simply be too good to be true?

> **"THE FINANCE WORLD TOOK NOTICE WHEN IN JULY THIS YEAR GOLDMAN SACHS ACQUIRED IMPRINT CAPITAL, ONE OF THE LEADING FIRMS FOR IMPACT INVESTING IN THE US."**

Goldman Sachs is getting in on the action (after learning its own lesson)

No other name in finance is more closely related to uncontrolled, unadulterated greed at the expense of all and sundry than Goldman Sachs. Equally, few other finance firms are known to be so ahead of the game than the $80 billion giant from New York.

The finance world took notice when in July this year Goldman Sachs acquired Imprint Capital, one of the leading firms for impact investing in the US. Imprint manages $250 million in client money, with an emphasis on the funds having to deliver not just a financial return, but also a social and environmental pay-off.

Compared to Goldman Sachs' client funds of $1.2 trillion, the funds under administration at Imprint seem negligible – Imprint increases Goldman Sachs' client funds by a mere 0.0002%. What the Wall Street giant purchased is first and foremost a track record and brand name, as well as a team for carrying out due diligence on other impact investment opportunities that can then be presented to clients of Goldman Sachs.

It's been widely agreed in the banking world that with Goldman Sachs' acquisition of Imprint Capital, the business of impact investment has moved from a white-papers-and-conferences stage, to becoming a core part of a bank's client-retention strategy and asset-management offerings.

Goldman had to do its share of learning along the way. It backed a prison bond in New York, one that was as high profile as the one from Peterborough. In July, the bond investors pulled the plug on the entire project, as it failed to reduce the re-offender rate at all. Goldman Sachs lost $1.2 million, the foundation of ex Mayor Michael Bloomberg wrote off a further $6 million. In fairness, the New York City experience may say more about the challenges in helping ex-offenders avoid the revolving door back to prison than it does about the efficacy of social-impact bond financing.

Goldman Sachs seems to have taken the experience in its stride. It did provide a talking point to give exposure to the overall idea, and it has a further two social impact bonds outstanding where the verdict has yet to come in.

In the meantime, through purchasing Imprint Capital, the Wall Street firm has filed a strong vote of confidence that impact investment now is a viable, growing market.

To scale up, it'll be all about returns

The initial reputation, as a bit of a do-gooder investment with a small return, is one that is gradually changing as investors begin to perceive that serious, and structurally attractive, returns are available, if that's what they are after.

Master Investor did an informal survey of the industry and found that there are a growing number of impact investments that have already paid off nicely, if not even handsomely, for investors:

- E-Car Club, the UK's first fully electric car sharing club, was founded in 2010 with an initial angel investment of £100,000 and based on having a net positive impact. Several years and funding rounds later, Europcar acquired the company. Terms weren't disclosed, but based on our sources, early investors could end up with up to a 1-5 times return if the company achieves all post-acquisition performance targets.

- Suzanne Biegel, a pioneer in the UK's impact investment sector, has been investing some of her own cash into building a diversified impact investment portfolio. In an interview with Master Investor (see page 82), her portfolio of 15 angel investments and 4 venture funds was designed to yield her an average annual return in the high single-digits or possibly even low double-digits. That's more than your run-of-the-mill life insurance or bond investment would yield at this point in time. Biegel sees the risk of these companies as being lower than for conventional early-stage investments, which she explains in the interview.

- Natura, South America's largest cosmetics manufacturer, has for years taken pride in providing a net positive impact through responsibly sourcing ingredients from the Amazon area and through a variety of other measures. Between 2005 and 2013, investors in the listed company made 6 times their money, not the least on the back of the company's achievements in being a good corporate citizen, leading to more business coming its way. In this case though, the recent woes of the Brazilian stock market led to much of those gains evaporating.

A recent angel investing event to which Master Investor was given access gave us an insight into the kind of entrepreneurs who are currently pitching their net positive impact-orientated ventures to investors in the City of London. On page 86, we introduce one of the companies that presented on the day, and which could become the next example of an E-Car Club style investment if it succeeds.

What's clear, in any case, is that a lack of returns will not hinder the growth of this sector anymore. Impact venture funds are demonstrating real returns. Although, for those inclined to put more emphasis on public benefit and place returns second, there is also a growing market where the UK is actually leading the entire industry.

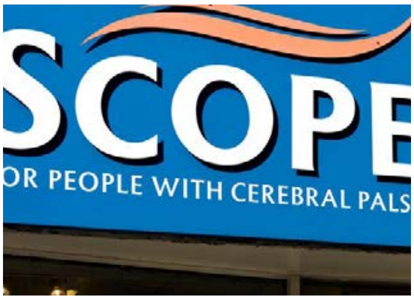
Low return, high impact investing as a sub-sector

Needing to be clearly distinguished from investments like the one described above, are impact investments where investors see returns as secondary, and are willing to accept low or flat returns if they feel the social and environmental impact makes up for it.

For example Scope, one of the leading disabilities charities in the UK, launched a conventional £2 million corporate bond issue in 2012. The funds raised went towards opening a further 20 charity shops, which in turn generate unrestricted income for the organisation - money that is badly needed to complement the conventional donations that Scope receives, which mostly are restricted due to the strings that donors attach to the use of their funds.

Investors received a 2% annual return, which was at the lower end of the return spectrum due to the original investors not requiring a higher pay-off. Among the investors of the bond were ethical fixed income funds seeking both social and financial returns, and foundations such as Esmée Fairbairn who are leading the way amongst foundations looking to invest rather than merely grant in line with their charitable mission.

Earlier this year, Scope repaid the entire bond issue ahead of schedule. Subsequent charity bonds issued by other charities have offered returns closer to market yields. Some are listed on exchanges to access mainstream capital and drive the development of a secondary market. A new bond issue for up to £20 million is being prepared now by Scope.



Neither approach is right or wrong, but where it gets difficult, and risky, is when both of these groups are mixed. You can subsequently end up with some investors pulling one way, and other investors pulling another way. For any venture trying to raise impact investment funds, it's important to ensure that the organisation's interests and goals are aligned with those of the investors.

Once such issues are taken care of, there is actually a fair amount of room for this part of the impact investment sector growing substantially. The recent high-profile failure of Kids Company once again showed how charities cannot rely on conventional donations anymore, and urgently need to build up their own income-generating activities. These in turn require upfront investment, and impact investments like bonds are ideal for raising funds from investors while ensuring that important charities don't just continue their important work, but actually scale it up at a time when the government is cutting back funding in many areas.

Other examples include RAFT, a charity specialising in wound healing, which has spun off a commercial entity that raised £4 million for further research, and the London Early Years Foundation, which raised debt in order to finance commercially-operated nurseries in affluent areas which in turn subsidise nurseries in lower income areas of the UK. Investors in these ventures are excited about the massive net positive impact their funding can have, and returns are generally put second, although could still be substantial in the case of RAFT's spin-off.

In a few years, charities issuing securities and investors making a return on the back of their commercial activities could become a standard procedure. The failure of Kids Company could well turn out to be a boon for the impact investment sector, given that charities are increasingly beginning to realise they cannot rely on conventional donations and government hand-outs, but instead need to earn some of their income through being business-minded. However, it also requires the entire sector to learn from some of its past mistakes and to get its message right.

Millennials as a driving force

Baby boomers have been - and continue to be - the single largest force in the investment market. As a demographic group, they currently control 80% of the UK's wealth. For countries like the US, Germany or Switzerland, the numbers are roughly the same.

As time progresses, this wealth will gradually be handed down to the next generation. The Millennials (ages 18-32) are set to benefit from the single largest transfer of wealth the world has ever seen. In the US alone, the 80 million-strong group of Millennials will inherit $30 trillion over the coming decades. They will likely be the generation that turns impact investing into a mainstream subject.

Currently, Millennials as a group control only $2 trillion in assets. However,by 2020 (i.e. within just five years) more than $7 trillion will be passed on to Millennials. Of those Millennials that have assets to invest, 45% want to use some of their wealth to help find solutions for the problems the planet and society are facing today. The majority of Millennials are themselves facing financial problems, including lower net incomes, rising housing costs, challenging questions surrounding their pension and rising healthcare costs.

However, there will also be a subset with more money than any generation has ever controlled at that age – including high profile examples such as Liesel Pritzker, heiress to some of the Hyatt Hotel fortune, who has already dedicated parts of her $500 million inheritance to the principle of impact investing. Even those with less money than Liesel Pritzker often have a strong desire to produce positive change in the world, and crowdfunding is making virtually any sort of investment available, even to those with little funds to invest. The Millennials are likely to use their wealth in new and innovative ways, and impact investing is right up their alley. It's their generation that will inherit a planet with countless problems, and they will also have no choice but to think about how to solve them.

"IN THE US ALONE, THE 80 MILLION-STRONG GROUP OF MILLENNIALS WILL INHERIT $30 TRILLION OVER THE COMING DECADES. THEY WILL LIKELY BE THE GENERATION THAT TURNS IMPACT INVESTING INTO A MAINSTREAM SUBJECT."

These are long-term changes, but what makes them so powerful is the low base from which all of this is developing. Currently, there is probably only around $50 billion invested in a way that could be describes as impact investing, and most of that through micro-finance projects in third world countries. Globally, financial assets amount to $900 trillion. Even a tiny fraction of the world's wealth being switched into impact investing would lead to this part of the finance industry experiencing explosive growth.

Sir Ronald Cohen takes up the cudgels for impact investing

Sir Ronald Cohen, someone who today counts among the wealthiest Brits, actually arrived in the UK as a young man with just £10 in his pocket. He recognised at the time that venture capital would one day become a part of the mainstream finance industry, and signed up partners to create Apax Capital, at the time a pioneering firm in the virtually non-existent and exotic field of venture capital and private equity funds.

Fast forward 40 years, and Apax is a fund management firm with £40 billion in assets under management. The success of the venture capital and private equity industry didn't seem nearly that certain back in the 1960s, when Ronald Cohen first started working in this area. A couple of decades later, his instinct has earned him a fortune which he manages from his mansion in Holland Park.

Knighted by the Queen, and fostering a strong desire both to do something worthwhile and be involved with the next emerging trend in finance, the man widely described as the doyen of the British venture capital and private equity industry has tipped impact investing to be the next big thing. He is the Moses-like spokesperson for the entire industry, and may have tipped it a few years too early. Based on current trends, however, it appears that he will eventually be proved right.

ClearlySo as one of the UK trend leaders

Cohen's endorsement bodes well for companies like ClearlySo, one of the early pioneers of the British impact investment sector. Set up in 2008 (in the month Lehman Brothers went bust), but with roots going back to 1999, ClearlySo has already facilitated over £70 million in funding for projects with positive impact. The funds the firm mobilised went into a wide range of ventures, including start-ups and charities.

Investors working with ClearlySo would generally be described as primarily return focused; but they also seek other factors, ranging from having net positive impact for society to having an impact on their own lives. ClearlySo, based near London's Silicon Roundabout, has also built a network of 600 angel investors, including the membership group Clearly Social Angels. Our interview on page 82 shows how these angels sometimes seek out active roles in exciting ventures, and that way complement their investment with a role they enjoy and which brings further value to their investment. Impact truly comes in all shapes and sizes.

ClearlySo is run by a young, dynamic and enthusiastic team that is proud to be involved in such a fast-growing area of finance outside the conventional confines of the City. "Our investors can also benefit from the recently-introduced social investment tax relief, as well as the EIS relief, for which most of our direct investments are eligible", explains Clare Jones, Head of Marketing at ClearlySo. "Excluding fundraising for impact funds, we have between £15 million and £20 million in investment deals in the pipeline, and demand is stronger than ever."

Service providers (and success stories) to help overcome the sector's challenges

Companies like ClearlySo help solve issues such as procuring deal-flow, which had previously held back the entire sector. It's not easy for investors to find investments in sufficient quantity and size, which represents an opportunity for companies that can provide both. In the case of investments at an angel stage, personal networks are key for finding deals and founders usually need some external help for getting both their venture as well as their investment pitch into shape. ClearlySo helps with all of that, even by organising monthly Q&A meetings for budding entrepreneurs that need help with developing their fundraising pitch. The company also gets deals in front of the right kind of investors.

Other areas where companies require help to prevent mistakes made in the past, is the measuring of the impact achieved. The methodology for measuring impact has matured over the past few years, thanks also to UK-based experts like Adrian Henriques, who has written a seminal book *Corporate Impact – Measuring and Managing your Social Footprint.* Applying this kind of reporting and applying it consistently and concisely, is something that companies often still need a lot of help with.

Last but not least, service providers for impact investments will benefit from what might be the first generation of venture capital-style impact investments growing to a size where no one can ignore the sector anymore.

One case that could make headlines internationally in the foreseeable future is that of Bridge International Academies. Founded by Jay Kimmelman, a US computer scientist who made a fortune early in his life through setting up an education software company, Bridge aims to become a global provider of low cost private schools. The company operates in countries where large parts of the population live on a family budget of less than $2 per day. There is a $51 billion (and growing) market opportunity for companies providing private education opportunities to children from this demographic group, using technology and standardised learning to keep costs low. For instance, both tuition fees and teacher salaries are paid by mobile phones, to keep transaction costs low and to prevent corruption.

Bridge started in Kenya where it now has 405 academies. It has started setting up operations in Uganda, will get off the ground in Nigeria in September, and is aiming to launch in the Indian market in April of next year. The $100 million that the company raised to fund its expansion attracted investors such as the education publisher, Pearson, as well as Bill Gates, Mark Zuckerberg, and Pierre Omidyar, the Ebay founder. The company is aiming for a stock market listing in 2017 and plans to achieve revenues of $500 million by 2025.

With a few case-studies like Bridge International Academies, the impact investment sector could leave its association with prison bonds behind and grow to a different size altogether.

Performance benchmarks will eventually become more meaningful

Now that the different strands of impact investing become clearer, another challenge stemming from the early days of the industry should also gradually be resolved.

Providing long-term performance data and benchmarking it against other investments hasn't been easy. Private funds don't always make performance data available, there is a limited universe of investments to begin with, and just what actually counts as impact investment and should be included (or not) had been beset by the debate set out above. It recently sparked a fair amount of media buzz, including a somewhat jubilant article in the Financial Times, when a long-term study showed that returns from impact investments outpaced those of many other asset classes.

"Introducing the impact investing benchmark", a study provided by Cambridge Associates and the Global Impact Investing Network (GIIN), could be criticised for only selecting funds that had a target net internal rate of return (IIR) of 15% and higher, and mezzanine funds with a target net IRR of 10% or higher. Also, micro finance investments, which for a long time were the only impact investments available in any form of scale worth mentioning, made up a significant part of these investments.

"THE UK ALREADY HAS SEVEN TIMES MORE SOCIAL IMPACT BONDS OUTSTANDING THAN THE REST OF THE WORLD COMBINED."

As the authors point out themselves - to those who actually read the entire report - at this early stage the research serves the role of framing initial discussions, instead of giving definitive conclusions. Investors can take useful observations from this performance analysis, but need to keep the limitations of the current data set in mind.

Also, the golden thread that underpins impact investing is how the users of social investment report on the social outputs and outcomes achieved by the investment. Whilst social accounting and reliable social data is still at a very early stage, there is growing consensus on how charities and other social purpose organisations can use evaluation frameworks to do this, assisted by the thought leadership espoused in publications such as The Good Analyst and The Good Investor.

London as a leading centre

Growing pains aside, there clearly is growth ahead and all sorts of players are positioning themselves. Among them, are the financial centres that could actually play host to this industry. No clear centre of the industry has developed yet. But the race is on, with London most likely playing a key role.

Price Waterhouse Coopers recently produced a report for the City of London Corporation, investigating in-depth what steps are necessary to develop a global financial centre for impact investing. The "Developing a Global Financial Centre for Social Impact Investment" report provided the UK's financial industry and its regulator with a roadmap for building on what London has already achieved.

The UK already has seven times more social impact bonds outstanding than the rest of the world combined. A small industry of players has already emerged, including Sumerian Partners, Investing for Good, and the Social Stock Exchange. All of them have different approaches, but are based on the same principle of wanting to back investments with a net positive impact. Notably, all of them have some form of impressive backing from individuals with a background in the finance industry!

What's most interesting for investors?

Master Investor is all about keeping investors abreast of the most exciting developments in the financial markets. All the valuable points about doing good for society aside, we have quite simply spotted an opportunity for investors to get in on an interesting trend, and to do so at a time when valuations are still low.

With booming demand for investments in technology companies, life science pioneers, and application developers, valuations for early-stage investments into these kinds of companies have gone through the roof. Quite possibly, many of them are now in bubble territory.

On the other hand, young and growing companies that describe themselves as impact investments do not yet get that kind of public interest. Hence, valuations are lower. That's what your author spotted anecdotally at the aforementioned pitch event, and it's what investors in the sector confirm. Less competition among investors, lower valuations, hence lower risk and better prospects for return!

Following decades of lack of investment into these areas, there are a growing number of opportunities for clever entrepreneurs to exploit. Investors can latch onto the trend by providing angel investment, early-stage backing or, at a later stage, the funds for aggressively growing some of these companies. Many of these markets are huge in size, as demonstrated by ventures like Eyejusters, which addresses eye care in India and other emerging markets, where their potential target market ranges in the hundreds of millions of customers. Lack of eyeglasses is estimated to cost the world economy $220 billion in lost productivity each year.

Within the next few years, the first so-called social entrepreneur will actually end up making hundreds of millions for him- or herself, while providing handsome returns to those who backed an early-stage impact investment aimed at a large market and an unresolved problem that affects society as a whole.

In conclusion, impact investing is growing up, and it is doing so rapidly. Sufficient deal flow and the size of the available deals remains a key issue, but is being worked on by a growing number of in termediaries. The terminology is getting much clearer, with impact investments counting as anything that produces a return for investors without

"FOLLOWING DECADES OF LACK OF INVESTMENT INTO THESE AREAS, THERE ARE A GROWING NUMBER OF OPPORTUNITIES FOR CLEVER ENTREPRENEURS TO EXPLOIT."

producing even greater negative externalities that weigh on society or the planet. As someone in the industry said recently, "One day, maybe all investments will be automatically measured and judged based on their net impact. It really ought to be."

To contact the author: swen@master-investor.co.uk

AN INTERVIEW WITH SUZANNE BIEGEL

OF CLEARLY SOCIAL ANGELS

Suzanne Biegel runs Clearly Social Angels, a group of 35 angel investors, with an extended network of over 500, deploying capital in impact investing. Once a month, members of the group meet to listen to entrepreneurs who pitch their companies. Master Investor was invited to sit in on one of their extended events, and Suzanne gave us the opportunity to pick her brain on angel investing, impact investing, and networking with other entrepreneurially minded investors.

Master Investor: Please tell us a bit more about your background.

Suzanne Biegel: *During the 1980s, I worked for Prodigy, which at the time was one of the first online consumer services. I subsequently joined IEC, a company that did pioneering work in interactive training and communications. We were early adopters for blending the creativity of advertising with professional learning and development, using new media technology to deliver outstanding programs for such clients as Lexus/Toyota, United Airlines, FedEx, Cisco, and Marriott International. IEC was a pioneer in simulation-based learning. After the company was sold, I refocused on managing my own investments and exploring the worlds of philanthropy and social/environmental impact business.*

MI: You now lead a group of investors who represent the single largest group of impact investors in the UK. What made you form and build such a group?

SB: *Just like any investor, I want my funds to yield a return. However, I made the conscious choice that with a part of my portfolio, I'd also like to achieve a social return. During the past 15 years, I have learned that angel investing in the impact investment arena enables me the potential to achieve both, and it also allows me to work with exciting entrepreneurs and like-minded investors.*

MI: Can you please tell us a bit more about your portfolio?

> **"I MADE THE CONSCIOUS CHOICE THAT WITH A PART OF MY PORTFOLIO, I'D ALSO LIKE TO ACHIEVE A SOCIAL RETURN."**

SB: *At this time, I am invested in about a dozen angel deals as well as four venture funds that share the impact investment philosophy. So far, out of the 15 companies I have backed, there have been two that didn't make it, and one solid exit. However, I do expect 3-4 more might not make it, even though the failure-rate among impact investment deals tends to be lower than among conventional angel deals and venture capital. Some of these companies will yield me 2-3 times my investment, and a few might yield me 4-7 times my investment. Overall, through my diversified approach, I am aiming to have a return on this part of my portfolio of at least high single digits, and with a bit of luck it'll be double digits. In other words, I can potentially make a healthy return off these investments, and the social and environmental impact of these companies is just as important to me.*

MI: Speaking of impact, the entire impact investment industry must have received a lot of attention following the take-over of E-Car Club through Europecar Lab?

SB: E-Car Club is indeed a great example for angel investing in the impact investment sector. Their first fundraising of £100,000 was accessible by anyone, since they used crowdfunding. They raised a second round through Centrica's social venture fund. The details of the transaction haven't been made public, but the early investors could see a return of 100% to 500% depending on how the company develops under its new ownership. Part of the impact of this company is that it changes the perception surrounding the entire issue of "Do you really need to own a car? Does electric really drive down running costs and help the environment? And can you use technology in a smart way to manage logistics?" I'd love to see more exits for angel investors where a company simply keeps growing under new ownership and with it also grows its impact. To me, the strongest impact businesses grow their impact as they grow their businesses.

MI: Back to your group of angels. Tell us a bit more about the investors that you have brought together under the umbrella of Clearly Social Angels, and what investors get out of being part of such a group.

SB: *We have business owners, cashed out entrepreneurs, people with corporate day-jobs, and philanthropists joining us. Everyone has access to cash to invest, and the ability to make at least one angel investment per year with a minimum amount of £20,000 is a condition for joining. Typically, the deals we are looking at require funding in the hundreds of thousands of pounds, sometimes £1 million or more. We regularly syndicate deals among us and with other groups, and sometimes one investor decides to do a deal by his or herself. What's very important is that our values are aligned. We are looking for companies that can deliver a net positive impact for the public, besides the financial return we require.*

MI: How does syndication work?

SB: *Usually, through discussion at our meetings and afterwards, one lead investor emerges for each angel investing deal we decide to do. Other investors can then invest alongside the lead investor, or a group of investors, which is a win-win situation for all parties involved. The company gets access to more capital, which also benefits all of the investors. No one really wants to invest in a company that is undercapitalized. The investors joining the syndicate benefit from a team approach – shared due diligence, more influence with more capital on the table – and this can mitigate risks.*

MI: From having spoken to some of your investors at the last event, we understand that there is also the possibility to become very hands-on with the companies?

SB: *There is always the possibility that someone who has sold a business comes across an interesting company and says, "That's the next business I will truly get involved with!" It's not the primary aim of our work, but it happens. When it does, it also leads to the entrepreneur getting additional expertise onboard, which many entrepreneurs would really benefit from. For some of our members, it can represent the start of a new chapter in their career.*

"DON'T ALLOCATE ALL YOUR CASH AT ONCE, I.E. KEEP POWDER DRY FOR ADDITIONAL FUNDING ROUNDS."

MI: Based on your 15 years of experience in angel investing, what advice would you give to those of our readers who are only just becoming involved in angel investing?

SB: *Don't allocate all your cash at once, i.e. keep powder dry for additional funding rounds. Build a portfolio instead of investing into only two or three companies. Risk diversification truly is key, no matter how exciting you might think one or the other business is. Don't be a lone ranger; instead work with other investors to share experiences and to work as a team. Do real due diligence before investing, i.e. don't decide on the evening of the presentation. Have a bias for action – but do your homework.*

MI: Are the companies that are presenting at your events already vetted?

SB: *Clearly Social Angels does indeed run a screening process. To organise one evening with 2-3 companies presenting, we usually have to screen around 40 companies.*

MI: Once you have invested, how much time do you tend to spend on the individual companies?

SB: *It very much depends on the individual case. There are active angels and passive angels, and some investors are very active for some of their portfolio companies and rather passive for others. E.g., I am invested into a few companies that I spend a few hours with*

per month, sometimes more. For others, I spend five hours per year! I also consider carefully to what degree I can actually supervise and manage an investment. For my emerging market investments, I have gone through venture funds so far. That involves paying a fee and a carry, but it helps me to greatly increase my geographic reach, which in turn also spreads my risk and my potential impact.*

MI: Any particular industry you would currently advise investors to look at?

SB: *Look around to find long-term macro trends. E.g., what's changing in the world of education or healthcare, fintech with a social lens, mental health, or ageing, or companies with a positive effect on women/girls, and see where the entrepreneurs are who need capital to exploit these trends. There are probably hundreds of thousands of businesses that do something positive and which need access to capital. There is room for a lot more investors to come in.*

MI: The meeting we attended was in London, but we understand you also have members further up north?

SB: *We actually have investors from across Europe, some of whom fly in to attend our meetings! Clearly Social Angels has also organised events in Birmingham and Manchester, and we'll be doing more events in Manchester starting in October. One member of our team is based there.*

MI: Some final words of advice for our readers?

SB: *Think of impact investing and sustainable investing as part of your diversified portfolio. It can even outperform your "non-impact" portfolio. The potential is that impact investing is less prone to economic volatility, if you choose your investments wisely. It can also offer you a lot of fun and engagement, if that's what you are looking for. There is a lot of innovation happening around the world right now, including disruptive business models that will change or solve longstanding problems and earn money for the early backers. Consider your own needs for liquidity versus patience, and always know that you are taking on risk if you're doing early stage investing. All of this you can learn more about by joining our group.*

MI: Thank you for your insights!

"CLEARLY SOCIAL ANGELS HAS ALSO ORGANISED EVENTS IN BIRMINGHAM AND MANCHESTER, AND WE'LL BE DOING MORE EVENTS IN MANCHESTER STARTING IN OCTOBER."

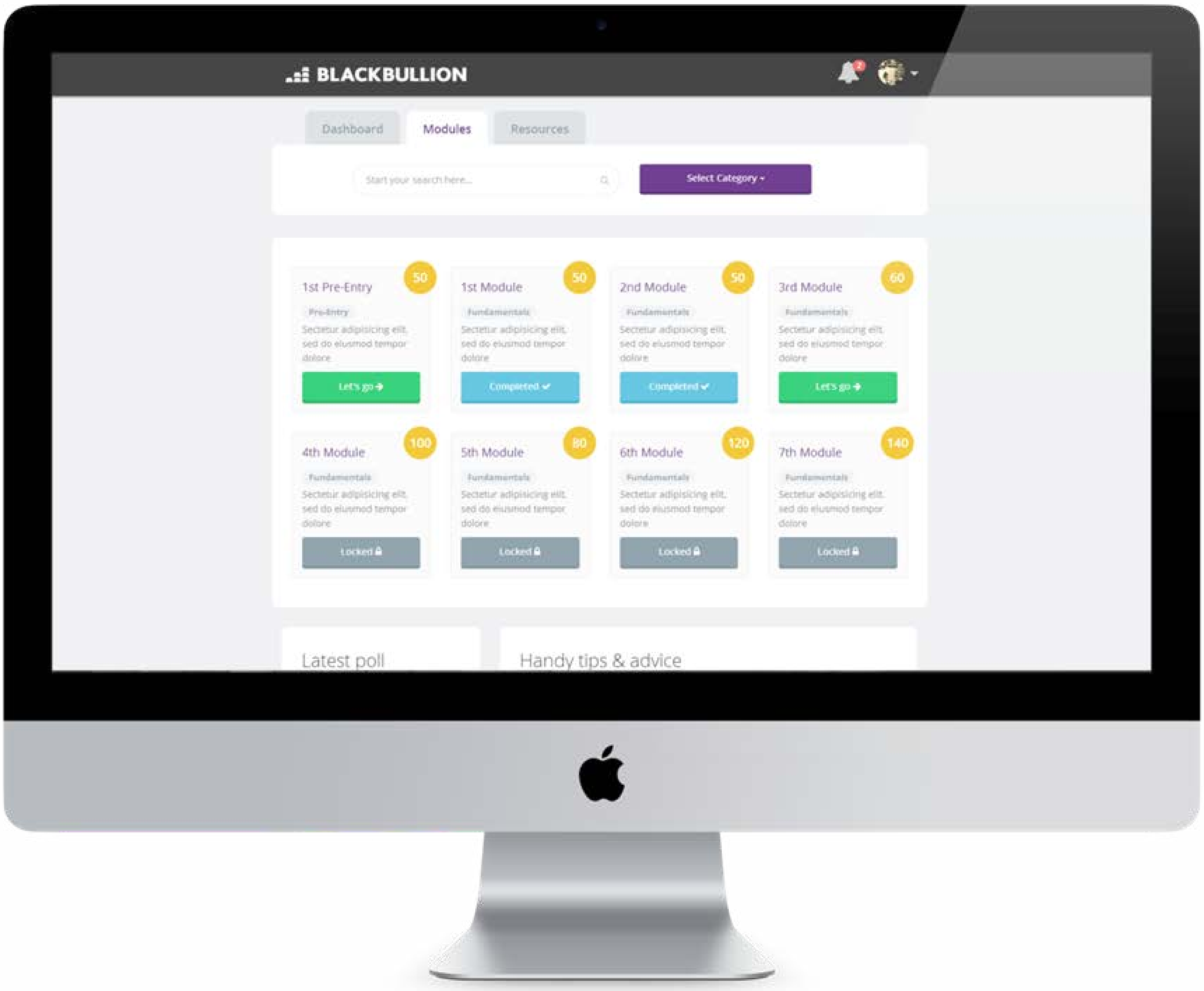
For more information on Clearly Social Angels, please visit www.clearlysocialangels.com or email Katrina Cruz (katrina.cruz@clearlyso.com).

BLACKBULLION

ONLINE EDUCATION SPECIALIST SEEKING TO END FINANCIAL ILLITERACY

BY SWEN LORENZ

Angel investors regularly have to sift through dozens and dozens of investment pitches before coming across an opportunity that is worth pursuing. One company that recently made it through the filtering process of ClearlySo (see page 82), and which presented to investors in the City of London, is Blackbullion. Master Investor reports on the case of an ambitious start-up aiming to tackle the issue of students leaving university without the financial literacy skills they need to get through life.



Government statistics suggest that British students finish university with an average of £53,000 in debt. Today's university graduates face more financial challenges than previous generations: salaries are under pressure; housing is scarce and expensive; and there is a growing need to build one's own pension instead of relying on the state. Unfortunately however, no one teaches graduates the skills necessary to deal with these challenges. As a consequence, 20% of students end up using payday loans and 9% turn to gambling.

"20% OF STUDENTS END UP USING PAYDAY LOANS AND 9% TURN TO GAMBLING."

Vivi Friedgut worked in private banking when she realised the need for a scalable, online-based platform for solving the financial literacy issue of this country. She left the world of high net worth individuals and set up Blackbullion, an online content platform that teaches students the necessary skills to get through life's financial challenges.

Twelve months after launching the product, the cloud-based learning platform is currently deployed in 10 UK universities and is available to 160,000 students. Universities pay a yearly fee to Blackbullion to be able to make the mobile-first platform available to their students. Depending on the size of the university, the fee is usually £7,000 p.a., arguably great value provided there is sufficient uptake among students.

It's early days for the company, but the initial results are encouraging. An independent survey commissioned to test the effectiveness of the program reported that 89% of its users end up feeling more confident about their financial future, 75% are more likely to budget, 73% are less likely to use high interest lenders, and 57% feel more in control of their debt.

The competitive landscape for Blackbullion is noisy, with Massive Open Online Courses ("MOOCs"), various specialist providers, and even charities competing for this space. Blackbullion aims to leap forward by specialising in students, and will initially focus on the UK market. Universities are difficult to access, and building relationships has proved to be a competitive advantage for the company up to this point. The UK market alone is massive, with 2.5 million students. The addressable market in the UK consists of 170 universities and 400 colleges.

To build further on what has been achieved so far, Blackbullion needs to invest to improve its learning platform. The company is seeking to raise £320,000 in equity, based on an indicative valuation of £2.2 million and possibly using EIS tax breaks for investors. The funds would also help the company to explore and develop further revenues sources.

"AN INDEPENDENT SURVEY COMMISSIONED TO TEST THE EFFECTIVENESS OF THE PROGRAM REPORTED THAT 89% OF ITS USERS END UP FEELING MORE CONFIDENT ABOUT THEIR FINANCIAL FUTURE, 75% ARE MORE LIKELY TO BUDGET, 73% ARE LESS LIKELY TO USE HIGH INTEREST LENDERS, AND 57% FEEL MORE IN CONTROL OF THEIR DEBT."

Master Investor verdict: The team behind Blackbullion, driven by a resourceful and passionate founder who has even authored a book about financial literacy, has built an impressive track record. During the next 12-18 months, the company faces the challenge of having to scale-up significantly, before others claim this new market. Angel Investors with an interest in this sector are well advised to investigate further and carry out due diligence.

Contact details:
mathias.wibowo@clearlyso.com
and vivi@blackbullion.co.uk

SCHOOL CORNER

WHICH MARKETS ARE RIGHT FOR YOU?

BY MARIA PSARRA

So which markets are really right for you, ladies and gentlemen? That's the topic of this month's piece – the ninth in the series of my educational articles here in the Master Investor Magazine, all of which are focussed on the best habits of winning traders and investors, the most common mistakes traders make and the best ways to avoid them.

Now what do I mean by "markets"? I mean is it stocks, bonds or forex? If it is stocks, is it the large cap dividend "aristocrats" type, or the young AIM high-risk/high-reward plays? Both? Neither? And even after you have decided which of the aforementioned asset classes you prefer, what financial products should you use to gain exposure to them? Is it going to be cash, equities, bonds, futures, options, CFDs, spread-betting? And is it going to be the UK market, Europe, the US, Asia? Choices, choices, choices!

It's a wild world out there, and these days numerous options are available to you when it comes to how and what to trade and invest in the global financial markets. So how do you make your own personal choice? How do you find what is right for you?

Well, let us start with the basics. First of all, I am sure you will agree that whatever you decide to trade and invest in should be suited to your financial situation, attitude to risk, and level of financial knowledge. It should also suit your personality, your daily schedule, and the amount of time you can devote to researching, executing, and monitoring your trades.

Your first port of call should be an analysis of your financial situation. Prior to investing in anything, you need to determine the level of capital that is available to you for this purpose. When looking at the financial markets especially, this is an amount that, if lost, will not negatively impact your lifestyle. Now, I am not saying or implying that you will indeed lose this money. I am however saying that you should be perfectly fine with accepting this possibility.

Furthermore, any investment carries an inherent risk. As I am sure you will have heard before, the value of investments does fluctuate, and this is another reason why you should only use risk capital for your investments. There is no point in your risking your funds in even the best investment in the world today, if you may need to liquidate it tomorrow morning in order to pay your daughter's school fees. If this is the case, you should not make the investment today; you should wait until you have more capital available.

For this article, we shall assume that you have determined your risk capital to be £100,000. Now you need to decide what sort of financial products (and in some cases, services) are available to you. By default, some things like hedge funds, private equity, government bonds, etc are not available to you, as they require higher initial investments. So the "investment universe" is now a bit narrower.

The next thing you should consider is your financial experience - that is, which markets you have been involved in before, and which financial products you have used for this purpose. For those of you that have worked in the financial services industry, this answer tends to be straightforward. However, for most individual investors, this is usually not the case.

So even if you have never invested before, you need to ensure that you choose markets and products that you understand fully and clearly. For example, derivatives products like options or CFDs are less straightforward than equities. So if you are only just beginning to invest, and are planning to do this without any professional training or advice, you are better off starting with "normal" stocks than with options or CFDs on them. You can always move into using derivatives in the future if you wish.

Continuing with our example, we shall assume that you have decided that you are going to use your £100,000 in order to invest in UK stocks. You choose the UK market as you are more familiar with UK companies (in many cases you use their products or services), and want to be able to conduct all your trades over the course of "normal" UK work hours. Also, if you are like most investors, you do not like the idea of your stocks continuing to fluctuate when you are asleep.

Now, you need to determine what sorts of stocks are suitable for you. This primarily depends on two things, namely your attitude to risk, and your investment goal. Let me explain.

"THERE IS NO POINT IN YOUR RISKING YOUR FUNDS IN EVEN THE BEST INVESTMENT IN THE WORLD TODAY, IF YOU MAY NEED TO LIQUIDATE IT TOMORROW MORNING IN ORDER TO PAY YOUR DAUGHTER'S SCHOOL FEES."

Starting with your attitude to risk, you must decide how much volatility you can "stomach", not only financially, but also emotionally. As a rule of thumb, certain sectors of the stock market such as Mining or Financials are more volatile. Also, the lower the trading volume of a stock, the more volatile it tends to be. As follows, FTSE 350 stocks tend to be much less volatile than those listed on the AIM market. So, assuming that you personally dislike "too much movement", you should only invest in FTSE 350 stocks, or even just the "blue-chip" FTSE 100 ones.

Now, to your investment goal... Are you looking for income, capital growth, or even a combination of both? If the answer is income, you must focus on dividend paying stocks. These tend to be the stocks of well-established, successful companies in "defensive" sectors. If on the contrary, you are just looking for capital growth, you should focus on more "exciting", high-growth companies in non-defensive sectors – e.g. Technology.

Having considered all these, we shall assume you have decided that you are looking for capital growth, and are happy to bear some volatility, but not enough to invest in AIM stocks. So now you know that your "investment universe" is FTSE 350 stocks with a focus on fast growing companies.

Finally, you need to decide how much time you can devote to your trading and investing on a daily and weekly basis, and build your trading strategy around it. Obviously, the more time you have available, the more frequent and shorter-term your trades can be. As with everything else we have covered, this is for you to decide. For my part, I hope that my article has made your future investment decisions more straightforward.

Until next month,

Happy trading and happy holidays everyone!

"YOU MUST DECIDE HOW MUCH VOLATILITY YOU CAN "STOMACH", NOT ONLY FINANCIALLY, BUT ALSO EMOTIONALLY."

Maria is Head of Trading at ZAI Capital Markets. In her role at ZAI, Maria determines the company's trading strategy, supervises a team of experienced brokers, and advises high-net-worth individuals on suitable investment strategies. Maria employs different investment styles in order to construct personalised portfolios best suited to the risk and return preferences of ZAI's clients. Typical portfolios primarily comprise of UK and European equities and equity indices, and, to a lesser extent, commodities and fixed income exposure.

Maria appears on Tip TV on a weekly basis providing investment tips and market commentary, writes for a number of financial publications, and is often invited to present her views during conferences such as the London Master Investor Show, the London Trading Show, and the ETFs Europe conference.

EVIL KNIEVIL (AKA SIMON CAWKWELL)

THE BEST OF THE EVIL DIARIES

A big man with a bigger reputation, Evil Knievil famously made £1 million by short selling shares in Northern Rock during its collapse. He also uses his knowledge and experience to buy shares, often resulting in the same devastating effect.

At least three times a week, Evil provides his thoughts and musings on the markets. Now writing EXCLUSIVELY for Master Investor Magazine at http://www.masterinvestormagazine.co.uk/category/evil-diaries/

He doesn't just pontificate on the financial markets in The Evil Diaries; he also comments on politics, current affairs, his favourite horses/sports bets, and the occasional film and book review thrown in for good measure. Here we take a look back on the highlights of Evil's diaries in the month of August.

4th August

In 1968 I saw Witchfinder General, which covered some obsessive puritan who went round fingering alleged witches and then killing them off. I took it as a warning as to what can happen when vile regulators are given excessive authority. And I mention this since I reckon that a later generation of this lot have been having a go at Tom Hayes, now 35, who was yesterday awarded a fourteen year sentence for fixing Libor.

Libor stands for London Interbank Offered Rate and it is not Fibor where for instance the 'F' stands for Frankfurt and it is not Tibor where the 'T', stands for Tokyo. Put another way, Libor is worth protecting as a marketing tool in which the UK has a clear financial interest.

But, true and inescapable as that is, society is not therefore entitled to hound a young man doing his best and believing as he did so that he was engaged in well understood and therefore accepted practice even if it was sharp.

Mr Hayes was accused of fraud. But one of the first features of an aspiring fraudster is that his fraudulent conduct is not widely known by others. Indeed, obtaining a pecuniary advantage by deception (to give fraud its full title) cannot occur if there is little or no deception. And it is clear that Mr Hayes's contemporaries at work and his line managers knew what he was up to. Given this it is hard to finger anybody.

Indeed the authorities' conduct stinks. Take David Green of the SFO: he referred to Mr Hayes as a banker when he was nothing of the sort. He was just a chap who worked for a bank. So why did Mr Green so deploy his dogwhistle? The answer is simple: there are a further eleven accused to be processed and Mr Green seeks to call in aid the public's hatred. By calling Mr Hayes a banker Mr Green assists Mr Green's pathetic misuse of language. It may be effective but it is nothing to do with justice.

5th August

I had my first bet with **William Hill (WMH)** when I was seventeen. It was by post and the envelope had merely been time-stamped by the local Post Office. Cheques were accepted and winnings, if any, came back a few days later in the form of a cheque. I never hounded my fags to work hard at anything since I was too democratic. But I hounded them to get to the Post Office. I had and have my priorities.

“OBTAINING A PECUNIARY ADVANTAGE BY DECEPTION (TO GIVE FRAUD ITS FULL TITLE) CANNOT OCCUR IF THERE IS LITTLE OR NO DECEPTION. AND IT IS CLEAR THAT MR HAYES’S CONTEMPORARIES AT WORK AND HIS LINE MANAGERS KNEW WHAT HE WAS UP TO”

Since then, over the ensuing fifty and more years, I have won and lost at William Hill. However, last week, I won just once too often and the call centre adviser remarked that I had been made an online customer. I immediately withdrew £10,000 from my balance and was told both by the call centre adviser and the online account that my account had been debited with £10,000.

Five days later the money still hasn't turned up and enquiry now reveals that William Hill's "Security Team" are investigating how I came to win. Since it is not likely that I have bribed any employee of William Hill to behave improperly on my account the security team is behaving, as it well knows, solely to delay payment to me simply to irritate me. I think that this is pathetic. If the money does not come through by early next week I shall sue William Hill. I have warned them.

Actually I have also taken the opportunity to consider how online betting works. The fact is that the conduct of these operations is ridiculous. It's one thing to quote in line with just below Betfair but it is quite another to quote way below such a price. The online (and mobile betting) operators know that they can get away with it since they hold a clear record of how stupid the punters are. And the accountants/IT specialists who set these schemes up know that they can get clean away with it.

However, I wonder where all this leads: the fact is that bookmakers, to succeed long term, must be known for taking bets and, in the current climate, they just will not. Given the fact that all the quoted bookmakers's current stock market ratings are based on this unsustainable trading advantage one wonders when the stock market ratings change. I think they will.

6th August

You got to hand it to Rob Terry. As soon as the SFO announced that they were going to work over Terry he graciously commented that he would of course be doing everything to cooperate – as if he had the choice. Anyway, it looks pretty clear to me: Quob Park (whatever that corporate vehicle is) is finished and holdings in the likes of **Daniel Stewart (DAN)** and **Imaginatik (IMTK)** will have to be ditched. So far these share prices have held up – but not, I not very humbly surmise, for long. Needless to add, the lunatics who constitute the Quob Park assembly will feel disenfranchised and sell their holdings as well. Cor Blimey!

Anyway, I bought 200,000 **Quindell (QPP)** this morning at 82.5p. Given the fact that the BoD, a new and reputable group, strongly indicate a 100p payout in, say, three months' time and given the fact that the residue is surely worth well upwards of 50p – probably 80p, anything below 100p now is simply far too cheap.

10th August

Over the weekend government minister Amber Rudd announced that HMG would push through fracking projects on the grounds that the nation's energy security would otherwise be materially compromised. I am surprised that this decision took so long. However, punters should hold back from buying the sector chips willy nilly. For instance, David Lenigas's UK Oil & Gas (UKOG) has serious difficulties to overcome. Not merely is it undeniable that the true availability of gas and oil is still very much open to debate; there will be real planning difficulties. These latter will not only emerge from locals who wish their part of the world kept intact but be accompanied by Ministry of Transport objections to the clogging up of the M25. Apparently, the UKOG project, if successful, would involve hundreds of lorries each night. So it just is not going to happen.

"MARGIN RATES ON EQUITIES ARE GOING UP."

13th August

It's hard to borrow **Mulberry (MUL)**. But why it should stand at 870p is beyond me. 170p would be closer the mark and I think time will prove me right. The devaluation of the renminbi might be the catalyst for the onset of realism.

21st August

I am out of **Quindell (QPP)** to all intents and purposes. But I regret it since this seems certain to rise. The main reason is that the bears will thin out and back off from their dogmatism. QPP is now 105p. The withdrawal of the FCA from enquiries at QPP is bullish for QPP since it suggests that the SFO enquiries are properly directed at financial fraud – and this has nothing to do with current affairs. But it means that the FCA will concentrate upon Terry personally – and here there are questions to answer and civil claims to settle.

That noted, the FCA's withdrawal means to the Quob Park lunatics that all is OK at **Daniel Stewart (DAN)**. This I do not get. Similarly: **Imaginatik (IMTK).** Style point: there is nothing wrong with IMTK; it's just got the Quob Park tendency fantasising in attendance.

Elsewhere, although contrary to the chairman's comments, I am short EUR/USD and this is costing money. And I am rescuing the position by going long DAX on the chairman's advice. Talk about being committed to the chairman.

One thing stands out: margin rates on equities are going up. Goodness knows why they are on the short tack or why the margin rate for a short should be the same as for a long. This is an impossible state of affairs to justify. However, I put it to readers, who may know, to comment: as they say at Which?, more reports please.

Crime ahoy: apparently, paps hide in car boots to get snaps of Prince George. This is of course a job opportunity for dwarves who are very patient. But a bigger threat comes from my wife who has declared that she could eat the little chap. Hint to protection squad: she is 68, has blond hair and blue eyes and usually wears a black hat such as donned by Paddington Bear when he was going through immigration control all those years ago. Do I get an MBE for turning her in?

"DAVID LENIGAS'S UK OIL & GAS (UKOG) HAS SERIOUS DIFFICULTIES TO OVERCOME."

26th August

I appreciate that not everybody is truly absorbed by **Gate Ventures plc (GATE).** However, using the site that I imagine works, I cannot find any evidence that any return of capital issued has been made to Companies House. Perhaps a representative of the youth of today knows where to look. If so, he/she is welcome to contact me and put me right on cawkwell@btinternet.com. Incidentally, The latest fund-raise (concluded after Gate departed this quoted life), claimed to be £9m in convertible loan notes, might or might not have occurred. But the idea that fraudsters would keep the cash in the company for more than a day is risible.

AUGUST 2015

BEST OF THE BLOG

Barclays looks set for rising returns

Summer seems to be ‘a coming in’ to judge from the first half results for the current year; not so much proving that crime and misdeeds pay, but rather that they can be paid for with further provisioning while still producing a rise in profits.

I turn to my previous note on **Barclays (BARC)**, sent out on the 12 May last, when the shares were 260p. I delight in seeing that I had them marked down as a not uncertain buy now that they have reached 285p some ten weeks later; a small but useful capital gain of 9.6% in less than three months; far more than you would have got putting money into a Barclays Bank deposit account. I might add that the bank shares are reviewed positively in the forthcoming ‘Limpopo Dispatches’ contribution to the next issue of the Master Investor Magazine.

Statutory profits before tax, in the six months to 30 June, are reported as £3,114 million. However, that includes non-core businesses that are not to be continued as part of the slimming down of the bank’s risk weighted assets portfolio. To conserve capital the aforementioned portfolio was shrunk from the £75 billion last December to £57 billion by June; a reduction so my calculator informs me, of 24% in six months; pretty impressive! One wonders why Mr. Jenkins had to go, on the reported ground of not reducing costs enough. It may be perhaps that in the great tradition of in-

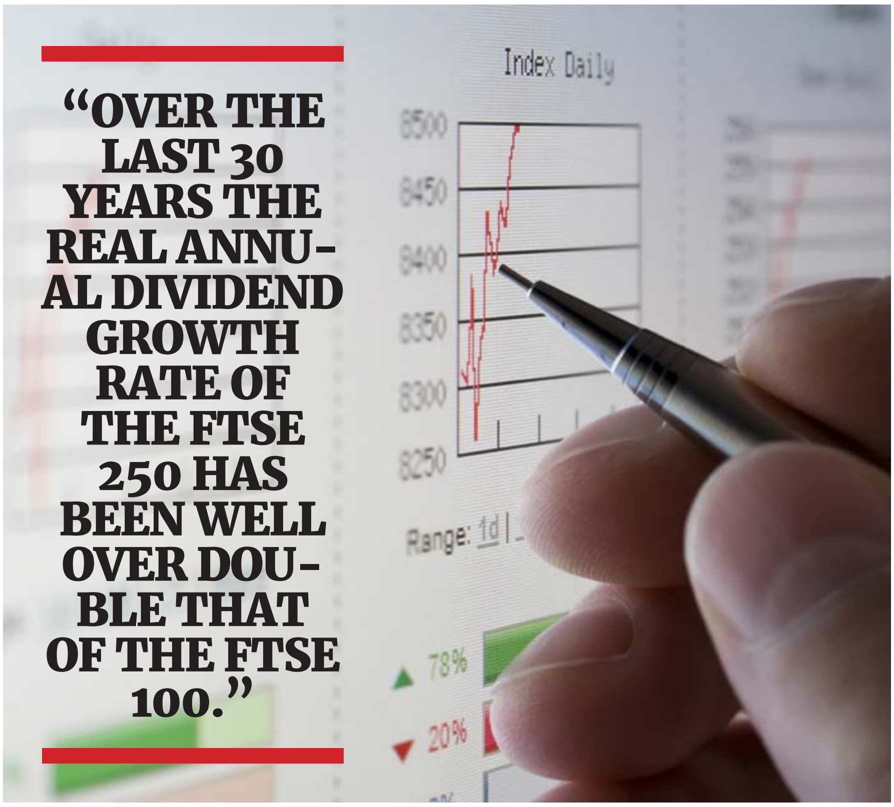
“PERHAPS HE WAS THOUGHT OF AS TOO QUAKERISH IN HIS MANAGEMENT STYLE?”

vestment banking, a traditional deposit taking banker lost out to the traditional investment banking wing of the company. Perhaps he was thought of as too Quaker-ish in his management style?

Anyway, that aside, the risk weighted common tier one capital ratio rose from 10.3% last December to 11.1% in June. It shows how much has to be accomplished to get even that kind of improvement in the capital ratios. The gearing ratio also rose from a decidedly looking sub-par 3.7% last December to a less modest 4.1% in June. To some schools of capital adequacy thought, that is still not generous, though others will argue it is.

By Robert Sutherland-Smith

To read the full article CLICK HERE



FTSE 250 – The hidden investment gem

This is the third in a series of seven articles drawn from my new book, 7 Successful Stock Market Strategies. The focus of these strategies is successful long-term UK equity investment.

The FTSE 250 consists of the 250 largest UK companies after the FTSE 100. While the FTSE 100 gets all the attention, the performance of the FTSE 250 considerably outstrips that of its big brother. Since the beginning of 1986, when the FTSE 250 index commenced, the capital value of the FTSE 250 has grown by over 1100%, whereas the capital value of the FTSE 100 has grown by less than 400% (both figures as at the end of July 2015).

The long-term outperformance of the FTSE 250 can be ascribed to the fact that the companies in the FTSE 250 are smaller, more nimble and faster-growing than the dinosaurs of the FTSE 100. The capital values of shares are largely driven by earnings and dividend growth rates. Over the last 30 years the real annual dividend growth rate of the FTSE 250 has been well over double that of the FTSE 100.

The 2nd strategy in my book exploits the strong performance of the FTSE 250 whilst ensuring that you do not invest when the market price is too expensive. Had you invested in the FTSE 250 at a peak (and very expensive) price of 7150 in September 2000, it would have taken more than 4 years for the market price to recover to your investment price. You can avoid this costly mistake by using the market valuation system described in my book. This system calculates the current intrinsic value of the FTSE 100 to compare with its current market price. If the value is less than the market price, then the market price is expensive. A proven strategy is to buy when the value is at least 105% of the market price and sell when the value falls to 95% of the market price. This FTSE 100 valuation system can be used to time purchases and sales of the FTSE 250 because the market turning points of the two indices are very similar, as can be seen from the chart below:

By Glenn Martin

To read the full article CLICK HERE

Is Glencore sitting on copper or TNT?

Panic begins to grip the market, but Glasenberg is muscling in on new assets...

The market is losing confidence in Glencore. On rising volume, its shares have fallen 45 per cent this year, touching a record low on Wednesday of £1.59, as investors increasingly fret over its gross debt load of $50bn.

Earnings are falling faster than debt and the profitability of its trading business depends on maintaining low borrowing rates. Glencore also announced the sale of three non-core assets last week for $290m, fueling fears that it is entering a vortex of downgrades, dividend cuts and mine sales at the bottom of the market. "The first thing to go will be the dividend," according to analysts at Liberum in London, "then assets, then the credit rating."

Even more alarmist is a theory by JP Morgan that as Glencore lowers leverage by unwinding its trading book, it will unleash a $16bn wave of metal onto the market. "If Glencore went down it could be to industry as Lehman Bros. was to finance," broker SP Angel told clients this week.

Marked TNT

A four-year view gives a very different perspective.

Recent figures published by the London Metal Exchange show that Pacorini Metals, Glencore's warehousing business, stores a whopping 56 per cent of the world's registered metal.

The market has taken Glencore's plunging share price as proof that it has no better view of metal dynamics than its peers

"CENTRICA IS ONE OF THOSE COMPANIES THAT SET OUT TO CONQUER THE WORLD."

across the industry. The company is "the puppet" of free markets, wrote the *Financial Times* this week, "just like everyone else." It is a "misshapen giant", according to London's *Evening Standard,* "a big wooden box marked TNT."

There is an alternate reading. Glencore's share price suggests it is little more than a leveraged play on copper, the biggest source of profit for its giant mining division. And the company's board listed the business in May 2011 at the highest ever point in the copper price. "The timing of their IPO shows they're not bad at reading these things," one fund manager says. "The key is to watch what Glencore is doing, not what others are saying."

By Alex Williams

To read the full article CLICK HERE

Why I bought a small initial holding in Zegona Communications

Zegona Communications (AIM listing, ZEG.L, Market capitalisation £47m but after deal about £290m, 165p and 1.0% of JIC Portfolio): Whilst sifting through the holdings in Neil Woodford's Equity Income Portfolio last week, there was one holding which particularly caught my attention. Zegona Communications came to market in March through the placing of 25m shares at 120p raising £30m. It is a new company which was established to acquire and operate businesses in the European Telecommunications, Media and Technology sector, focusing on network-based communications and entertainment opportunities. Its targets for investment are "strategically sound businesses that require active change to realise full value, creating significant long-term returns through fundamental business improvements".

Topically, given Tuesday's announcement from Melrose Industries, Zegona's "Buy, fix and sell" strategy is similar to the "buy, improve and sell" strategy of Melrose which has created so much shareholder value over the years. Ultimately, the success of this type of strategy is all down to management; do they buy well, can they achieve the operational and financial improvements and do they sell well? Melrose's management have proved themselves; it's up to Zegona's to prove themselves in the telecom, media and technology space. Zegona's management, particularly the CEO, Eamonn O'Hare, has a good track record; prior to setting up Zegona he was CFO of Virginmedia from 2009-2013 where he oversaw a substantial improvement in its financial results before its eventual sale to Liberty Global for $24bn enterprise value.

On Monday, Zegona announced its first deal. It is buying TELECABLE DE ASTURIAS S.A. for €640m from Carlyle Group and Liberbank. It says "Telecable is the leading cable operator in Asturias and has installed over 2,400 kilometres of fibre optic cable and 2,600 kilometres of coaxial cable, with more than 450,000 homes passed in 44 municipalities in Asturias. Telecable complements its own network with a network provided by the Principado de Asturias that enables it to offer fibre optic services to approximately 43,000 homes in rural areas of Asturias. As of 31 December 2014, Telecable was the Asturias region's leading "quad-play" residential telecommunications operator, being the largest provider of pay television and broadband services and the second and fourth largest fixed-line and mobile telecommunications provider respectively".

By John Rosier

To read the full article CLICK HERE

READ TO SUCCEED

ELON MUSK: HOW THE BILLIONAIRE CEO OF SPACEX AND TESLA IS SHAPING OUR FUTURE

BY ASHLEE VANCE

A BOOK REVIEW BY SWEN LORENZ

Harper Collins. Available on Amazon, £13.60

Probably the highest accolade and one-sentence summary any book can get consists of "I read it all in one sitting". Such was the case, for me at least, for the first and only authorised biography about Elon Musk, the multi-billionaire, multi-company entrepreneur who more than anyone else alive is tipped to change the course of humanity.

Often compared to Thomas A. Edison and Howard Hughes, Musk has risen from locally known Internet entrepreneur to being one of America's most influential industrialists. That is, at least for now. His tendency to go on grand quests for improving the fate of mankind tends to involve such high risks that no one would be surprised if he ended up bankrupt in a few years. He's had previous brushes with bankruptcy, such as nearly going bust in 2008 and having to sell out to Google, when Tesla required more funding to make it through the start-up phase. The same Elon Musk who had made $22 million by the age of 27 and who had assets worth $1.5 billion by his early thirties, was at risk of losing it all and even had to sell some of his toys to scratch together liquidity for paying salaries.

It took Ashlee Vance more than 18 months of unauthorised research into Musk's life before the South African-born entrepreneur embraced the idea of having a book written about him. He came to respect Vance's perseverance and eventually granted her unlimited access to all of his executives, friends and family members. Her account of Musk's rise, his near-bankruptcy experiences and his vision for growing not just one but several companies into multi-billion dollar global enterprises, make for a book that is hard to put down.

Musk had arrived in the US virtually penniless and started working odd jobs such as cleaning out the inside of boilers. In the mid-1990s, he latched on to the first wave of growth of Internet companies. The company he founded with his brother, Zip2, was a combination of Google and Yelp. He sold it for $307 million, pocketing $22 million in the process.

Despite buying a $1 million McLaren supercar and embarking on a temporary playboy lifestyle, he ploughed most of his newfound wealth into the idea of creating an online bank, primarily because he believed bankers were "rich and dumb" and could easily be outmanoeuvred in the marketplace. The board of his new company, X.com, eventually ousted him as CEO, in a case study of how boards and ambitious CEOs don't always gel well with each other. He remained a shareholder and following X-com's merger with a company called Confinity it eventually became PayPal, the payments provider. In 2002, the sale of PayPal to Ebay made Musk a billionaire.

Next came SpaceX, the rocket builder; Tesla, the electric cars manufacturer; and SolarCity, the renewable energy company. Most recently, Musk added Hyperloop to his set of ambitions, a large-scale pneumatic tube similar to the one used to send office mail around, but aimed at carrying pods with cars and passengers between LA and San Francisco at a speed faster than airplanes. Oh, did I forget to mention Musk's long-term goal of helping mankind to colonise Mars and become a multi-planetary species? Incidentally, Musk has already decided that Mars is the place where he would like to live out his days.

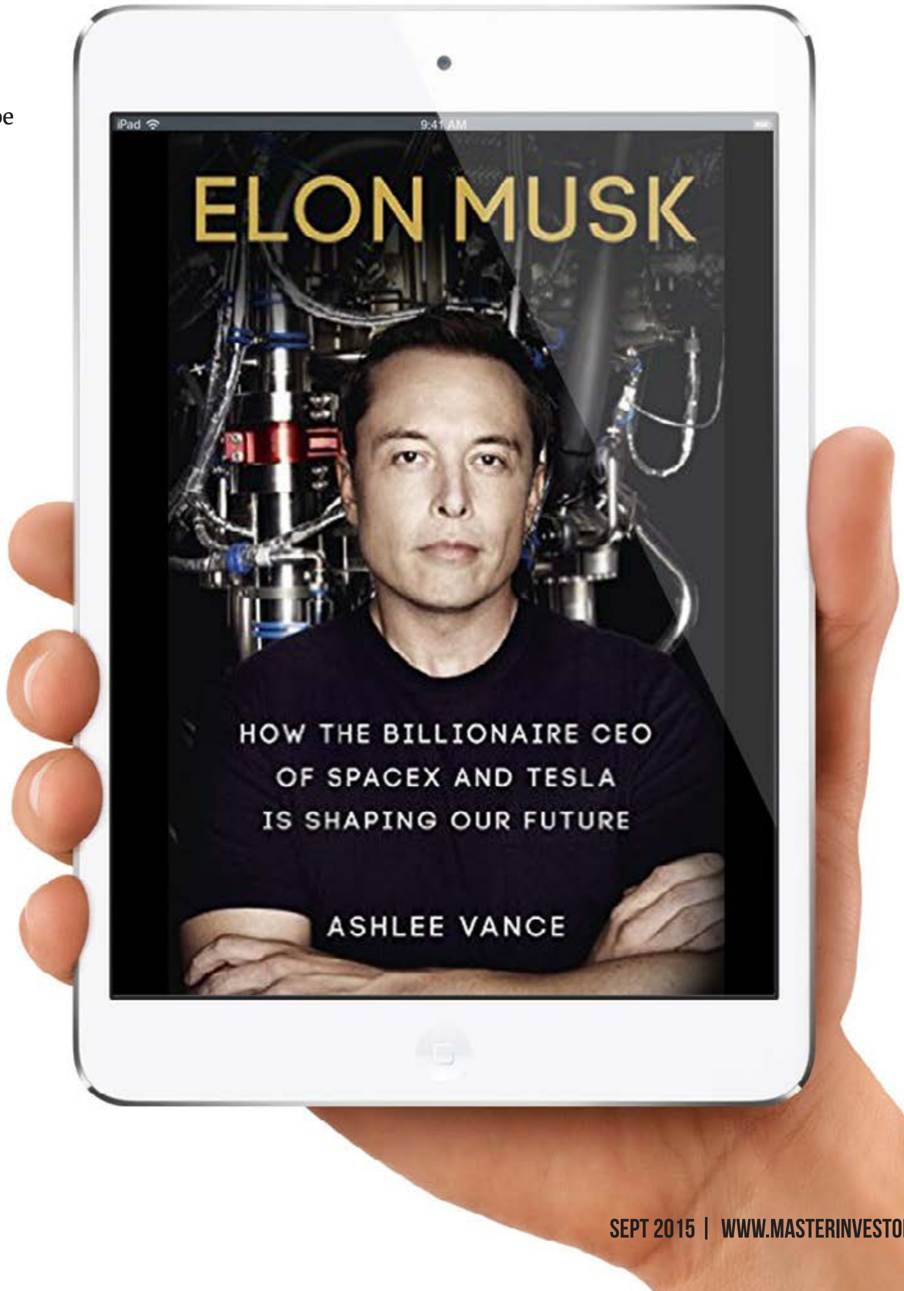
It'd be easy to dismiss Musk as a megalomaniac dreamer, if he hadn't actually already achieved a good part of what he set out to do. With a fortune of around $15 billion, he currently ranks among the world's richest self-made entrepreneurs. Funders are queuing up to back his ventures, and at least for now, he has single-handedly reminded the US and the rest of the world that one determined man can succeed in changing entire industries. He is challenging the US car industry, the aeronautics industry, and even entire countries like China and Russia since they, too, are working on similar plans. Close observers know, however, that Musk's high risk ventures could still fail. The tremendous scope of his ambitions and the risks he manages have turned Musk into one of the world's best-known entrepreneurs with entire websites dedicated to following his work.

Even Tesla, which is now firmly established as the world's hottest car manufacturer, is said to be only ever one botched model launch away from bankruptcy.

"MUSK HAS ALREADY DECIDED THAT MARS IS THE PLACE WHERE HE WOULD LIKE TO LIVE OUT HIS DAYS."

For now, however, Musk is known as the man who led the first IPO of an American car manufacturer since Ford went public in 1956. He enjoys having such accolades to his name and is known to fight any factual errors reported about his personae tooth and nail, to the point of going to war with anyone who distributes what does not match his own version of the truth.

Master Investor verdict: This 390 page account of America's most innovative thinker and his outlandish ambitions is a highly recommended read for anyone interested in entrepreneurship, Silicon Valley's quest for the next big thing, and larger than life characters. In case I hadn't mentioned it before, it's hard to put down.



THE FINAL WORD

WHY A MINIMUM WAGE IS A BAD IDEA

BY ADRIAN KEMPTON-CUMBER

There are plenty of things that we take for granted as a part of our becoming 'civilised', but which are in fact economic phenomena. Human behaviour is very much controlled by economic prosperity or decline. For example, during days of plenty people have an attitude of live and let live.

Once the money starts to disappear, they look around to see who has what they haven't, and start judging who should have and have not. The rise of the (far) right, and the (far) left, is a phenomenon caused by too little money and too much time. Racism is principally a function of a lack of education, and importantly, economic problems. So what the press refers to as a "shocking rise in..." is, in fact, entirely predictable and expected.

We have a pretty dysfunctional relationship with fairness on this island. I'm generalising here of course, and speaking specifically about Brits. We think that nepotism is a terrible thing, with the glaring exception of the monarchy. We think that people in industry earn far too much, but actors and sportsmen who earn way more somehow deserve it. We think it's ok that nurses get £25k per year and palpably less skilled tube drivers get an executive salary of around £55k. There are many other examples. Cognitive dissonance once again!

In the recent budget, George Osborne set about increasing the minimum wage. (Whatever happened to Osborne biscuits by the way? I used to like them.) A minimum wage is one of those things that governments create in order to make it look like they care, and it's ostensibly a fairly cheap vote winner. It creates a feel-good factor in society and, a bit like giving to charity, everyone feels they've done their bit and all's right with the world. No need to think about the poor any more. It's the domestic equivalent of "we gave them the railways".

Is a minimum wage really a good thing though? If we lived in a centrally planned economy like Communist Russia, with fixed goods prices and no inflation or market forces, then maybe it would be. But we don't. A minimum wage has a cost attached to it – and it's not worth paying.

In our jobs market it is usually market forces that decide the value of work, the cost of goods, etc. Over the next five years the minimum wage will increase from £6.50 per hour to £9 per hour – an annual compound rate of just over 7%. Bear in mind official figures for annual wage growth show that it stood at just 2.7% this April, and you can see how that will have a knock-on effect on wage inflation up the pay scale. Wage inflation will lead to cost-push inflation, effectively passing the cost on to all of us.

"WHAT THE MINIMUM WAGE IS DOING IS MARGINALISING THE MARGINALISED."

I suppose you could take the view that government is trying to make employers take up the slack on benefits cuts. But as I explained above, that will be passed onto us through higher prices for goods and services. So basically we're paying for all of it, on top of the taxes we've already paid. Creating inflation, for a government presiding over a fake economy with little real growth, might give the impression of improving times. It's not a bad idea to create some stability in society, but really you only do that by growing the middle class, and a minimum wage doesn't achieve that.

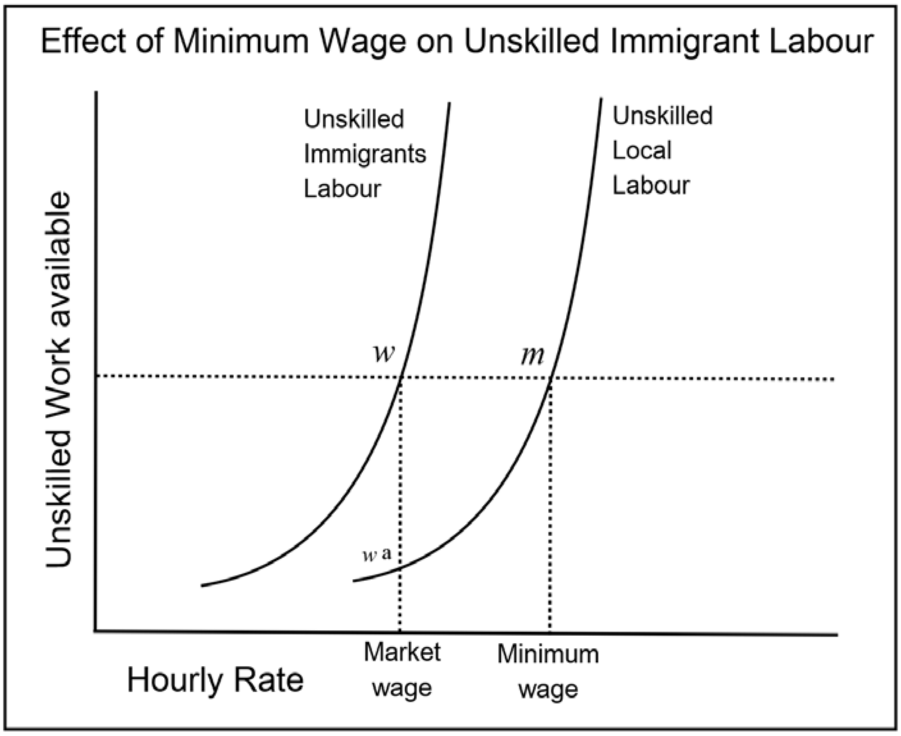
For those on minimum wage, spending expectations will remain the same (or greater), and in a fairly short period of time the companies they buy products from will increase their prices to match the amount of income these customers now have. In other words market forces will restore the balance via inflation, and it will be a constant battle to maintain any differential that a minimum wage might create.

However, there is one key factor that has been ignored in minimum wage policy: people get paid what they're worth. If you have workers that are worth £9 per hour, they won't be the ones that yesterday earned £6.50 per hour. As a result, at a certain point you make the former £6.50 worker unemployable. And that £6.50 worker is likely to be an immigrant and unskilled. Throughout the world, and throughout history it's always been, and still is today, immigrants that work for less, and take up the slack at the lower end of the job spectrum. This is true even in places like Russia, where nowadays they come from former Soviet republics.

I've drawn a graph to illustrate the point. We can see the curve representing unskilled immigrant workers on the left. By this I mean ones with poor, if any, command of English and little education (by our standards), showing how many are available or prepared to work at various hourly rates. To the right we have the unskilled native workers curve, by which I mean those born and educated here in the UK, but with no skills and probably few, if any, qualifications. At point w we see a small number (w^a) of unskilled native Brits are prepared to work at the market wage, with the rest preferring instead to lounge around at taxpayers' expense doing nothing, so the slack up to w is entirely taken up by unskilled immigrant labour. However, once the minimum wage kicks in at m we see there are enough native unskilled Brits available to do that work, and that no unskilled immigrants get employed at all.

On the face of it the native labour force might seem a superior hire, especially at the same price, but in reality they probably have a more militant attitude to work, are likely to be less productive, possibly disruptive and may quit at a moment's notice or simply not turn up one day. The Great British worker! So we're underwriting a fall in output at a greater cost.

What the minimum wage is doing is marginalising the marginalised. It can easily make unemployment worse in immigrant communities, and in doing so it will create an even bigger black market for these workers, who in many cases will be exploited, if they're not already, by their own ruthless countrymen. And as we know, they are arriving daily.



"WHAT ARE WE GOING TO DO WITH 25% PERMANENT UNEMPLOYMENT? WHAT ABOUT 50% PERMANENT UNEMPLOYMENT? HOW ABOUT THE PERFECT SOCIETY: 100% UNEMPLOYMENT?"

Is a minimum wage a good idea then? Well it means wage inflation as higher paid workers strive to maintain their wage differential, companies passing on their extra labour costs to us in higher prices for goods and services, and more unrest and marginalisation in communities that we should be spending money in to integrate into society (whether they want to be integrated or not).

What the government needs to do is forget about tweaking things here and there to gerrymander votes (which in the case of the Tories are hardly needed since there is now, *de facto*, a one-party system and they stand to win all elections for the foreseeable future). We need to be debating, as a society, how we plan to deal with the vast numbers of people for whom there will never be jobs, as we automate more and more.

Machines already work for less than minimum wage. That much is set in stone, or perhaps more rightly, steel. So what are we going to do with 25% permanent unemployment? What about 50% permanent unemployment? How about the perfect society: 100% unemployment? The first thing to do is start looking at unemployment as what it was intended to be: leisure time.

MARKETS IN FOCUS

AUG 2015

GLOBAL INDEXES

Index	Aug %	YTD %
Russian Trading System	-5.4	2.8
S&P 500	-6.3	-7.1
FTSE MIB	-6.6	12.8
Dow Jones	-6.6	-9.9
FTSE 100	-6.7	-7.7
NASDAQ 100	-6.8	-2.2
Nikkei 225	-8.2	4.1
IBEX 35	-8.2	-2.8
Bovespa	-8.3	-9.1
CAC 40	-8.5	6.3
S&P/ASX 200	-8.6	-5.8
Euronext 100	-8.8	4.6
DAX (Xetra)	-9.3	2.1
Hang Seng	-12.0	-10.3

FOREX

Forex	Aug %	YTD %
EUR/GBP	3.9	-5.0
EUR/USD	2.2	-6.7
EUR/CHF	2.1	-9.8
GBP/AUD	1.2	14.4
USD/CAD	0.5	14.1
EUR/JPY	-0.1	-6.6
USD/CHF	-0.1	-3.4
GBP/USD	-1.7	-1.8
USD/JPY	-2.2	0.0
AUD/USD	-2.7	-14.2

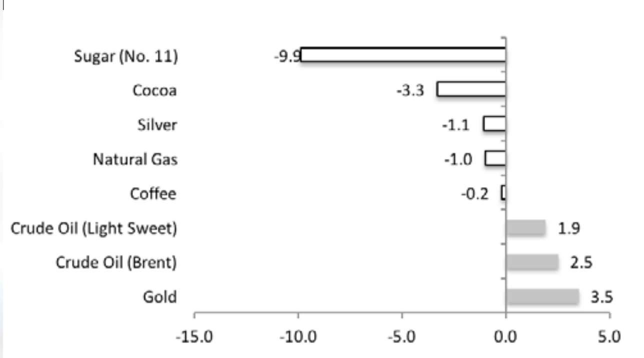
INTEREST RATES

Central Bank	Key Rate	Next Meeting
BOE	0.50%	Sep 10
ECB	0.05%	Oct 22
FED	0.25%	Sep 17
BOJ	0.10%	Sep 15
SNB	-0.75%	Sep 17
BOC	0.50%	Sep 9
RBA	2.00%	Oct 6
RBNZ	3.00%	Sep 9
BOS	-0.35%	Oct 27
BON	1.00%	Sep 24

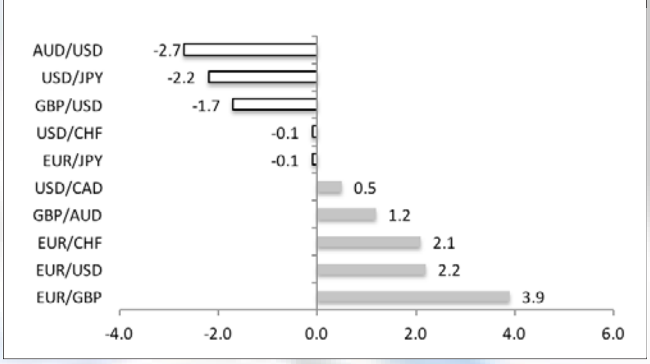
COMMODITIES

Commodity	Aug %	YTD %
Gold	3.5	-3.8
Crude Oil (Brent)	2.5	-12.7
Crude Oil (Light Sweet)	1.9	-14.7
Coffee	-0.2	-26.6
Natural Gas	-1.0	-8.0
Silver	-1.1	-6.9
Cocoa	-3.3	5.3
Sugar (No. 11)	-9.9	-26.3

COMMODITIES 1M%



FOREX 1M%



FTSE 350 BOTTOM

Sector	Aug %	YTD %
Lonmin PLC	-32.7	-81.2
Glencore PLC	-28.7	-55.3
Standard Chartered PLC	-22.0	-24.8
Fidessa Group PLC	-21.8	-20.5
Evraz PLC	-21.7	-54.1

FTSE 350 SECTORS BOTTOM

Sector	Aug %	YTD %
Industrial Metals	-21.7	-54.1
Food & Drug Retailers	-10.3	-2.0
Banks	-10.2	-11.2
Personal Goods	-9.9	-4.2
Mining	-9.4	-32.6

FTSE 350 TOP

Sector	Aug %	YTD %
Vedanta Resources PLC	37.1	-2.4
OneSavings Bank PLC	19.6	67.1
Betfair Group PLC	16.4	75.9
Balfour Beatty PLC	15.6	26.1
Cineworld Group PLC	15.3	40.2

FTSE 350 SECTORS TOP

Sector	Aug %	YTD %
Construction & Materials	1.9	22.1
Oil Equipment, Services & Dist	0.4	4.6
Nonlife Insurance	-0.5	17.6
Food Producers	-0.9	-0.5
General Industrials	-1.8	10.7