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HOW TO MINIMISE RISK WITH ALTERNATIVE INVESTMENTS

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THE 'NAKED TRADER' ROBBIE BURNS RETURNS

ISSUE 07 - OCTOBER 2015
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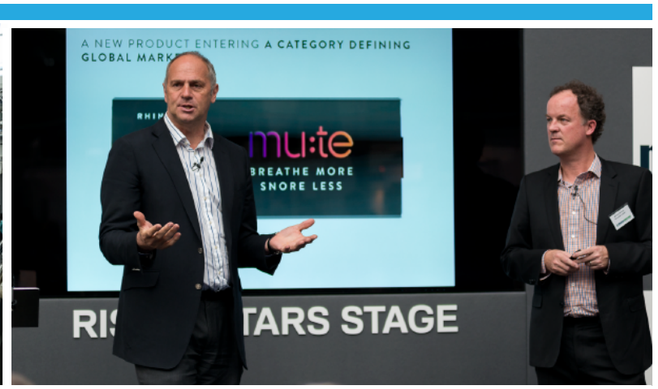
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WELCOME



The Baby Boomer generation – those born between the 1960s and 1980s – hold 80% of the Western world's financial wealth. This makes them better off than any generation that has ever lived, both in relative as well as in absolute numbers. Not surprisingly, Baby Boomers also make up the largest part of our readership.

However, there is another demographic group that's gearing up for not just one, but several records.

The Millennials – those born between the 1980s and early 2000s – are going to shape and reshape the world of finance. Over the coming 40 years, inheritances passed on from Baby Boomers to Millennials will make for the largest transfer of financial wealth in the history of mankind. An estimated $30 to $41 trillion of financial assets will be transferred to the next generation. Millennials as a group currently control just $2 trillion in financial wealth, but that will grow by 350% to $7 tillion within the next five years alone.

What's in short supply, however, is information and advice for Millennials aiming to manage their personal finances. That's why I am delighted that we have signed up Caroline Drewett as our newest contributor. On page 40 of this issue, she begins a series of regular articles aimed at Millennials – so spread the word to your children/grandchildren. Millennials have different financial needs, different preferences, and a different approach to managing money than their parents. That's what we are going to address now with regular reporting.

We couldn't think of a better contributor for this subject than Caroline. She started her own education business at age 22; at age 25 she had accumulated a small central London property portfolio worth seven figures; and at age 28 she now lives in Hong Kong, where she is experiencing the expat lifestyle for a while. What's more, giving opinions and advice about personal finance runs in her family. Her late father, Michael Drewett, was editor of the "You and Your Money" column in the Evening Standard. She grew up reading columns on how to improve financial wellbeing, and Caroline seems to have successfully implemented some of her father's advice. Her reporting will be hands-on advice written with her own generation mind.

Master Investor continues to grow its range of contributors to cover all facets of investing. We are delighted to have Caroline on board, and also urge you to follow her (incredibly entertaining!) social media posts on our Facebook channel **www.facebook.com/masterinvestor.**

Best regards
Swen Lorenz,



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MELLON ON THE MARKETS

BY JIM MELLON



It's summer's end, and I am ready to go off to Hong Kong, away from Ibiza's (for me) innocent charms. Believe it or not, I spend six hours a day here in a local café, where I have a kind of Stammtisch (Germanic for engraved, personal perch), reading and pondering.

These last two months have proved the worth of doing just that. Old certainties, such as the inexorable rise of the Yuan, and the infallibility of the Swiss franc, have been roundly trashed. In fact, as many a hedge fund has found out, there are NO certainties in investment.

Who, for instance would have thought that Volkswagen, the joint top dog in autos, would be exposed for dodgy emission controls in the US – a move which is going to result in BPesque fines and punishments? The VW saga is just starting, and I wouldn't be surprised if grasping governments everywhere try to extract their pound of flesh, severely weakening the company. This is potentially much worse than for BP, where it only lost out in the US. And who knows if other car manufacturers didn't do the same? I have been eyeing my Nissan Qashqai with a faint air of suspicion since the story broke.

Similarly, some idiot from Turing Pharmaceuticals has come out and added noughts and noughts to the price of an ancient drug; this has prompted a flagging Hillary Clinton to jump on the undoubted usury of the specialty US pharmaceutical sector, where drug prices seem to rise for whimsical reasons with no regard to patient costs, or cost of goods.

"OLD CERTAINTIES, SUCH AS THE INEXORABLE RISE OF THE YUAN, AND THE INFALLIBILITY OF THE SWISS FRANC, HAVE BEEN ROUNDLY TRASHED. IN FACT, AS MANY A HEDGE FUND HAS FOUND OUT, THERE ARE NO CERTAINTIES IN INVESTMENT."

I have mentioned this as a key risk in biotech in the past, and now it comes to pass. That's why we like pharma/bio companies where there is little risk of pricing pressure in the world's biggest market, which remains the US. For instance, I would be very wary of owning **Alexion,** which stands atop a US 30 billion market capitalisation with one single drug, Soliris, which serves about 5,000 patients around the world with a $400,000 cost per patient per YEAR! Closer to home, **Shire** might well also come under some pressure for the cost of some of its orphan disease therapies.

So, the message is stick to companies where the drug cost is low, the effect is positive, and there are unlikely to be federal pressures to reduce margins. **Synergy**, recently recommended, is one such company in the US.

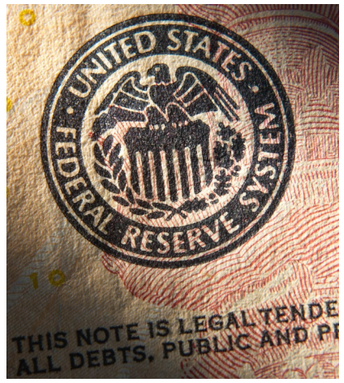
But back to the key point, flexibility is the watchword in successful investment, with some diversification, but most importantly, a careful

MELLON ON THE MARKETS

"THE FED DIDN'T BITE THE BULLET AND RAISE INTEREST RATES (WHICH IT SHOULD HAVE DONE), BUT IT WILL, AND MY GUESS IS IN DECEMBER."

understanding of risk and rewards. NOTHING is certain, and a long term investment is generally a short term investment gone wrong.

So where are we now? The Fed didn't bite the bullet and raise interest rates (which it should have done), but it will, and my guess is in December. It is true that inflation remains ultra-low in the US and in many other economies, but capacity constraints will soon show up in pricing pressures (particularly in wages) and the effect of low oil prices will gradually abate. In addition, the misallocation of capital caused by perpetual ZIRP is something that the Fed recognises – and will address. It is entirely possible that another QE programme could be implemented, this time focussed on buying assets other than government bonds, while at the same time the Fed raises shorter term rates.



For the moment, there is little need for such a move, as the US economy is relatively robust, despite the strength of the dollar and the consequent weak performance of exports. One thing to note, however, is that US corporate profits, rising as a percentage of GDP for decades, may now be going into reverse. This is partly because so much of large US corporations' earnings come from overseas, and these are now pressured by weak Asian markets and the dollar's strength. But it is also a function of the move to "living wages" across many developed countries, including the UK, which seeks to rebalance the share of economic spoils away from shareholders to employees.

"AS I HAVE SAID BEFORE, CHINA'S FICTIONAL GROWTH FIGURES ARE NOW BEING EXPOSED AS TOSH."

This may not be a long lasting trend. Indeed, as wages rise, particularly for low paid workers, we may find that automation and robotics, already in the ascendant, get an additional spur. But for the moment, US corporate profits are under pressure. This makes the equity market even more vulnerable, and a gentle decline, with some violent episodes, is my forecast for the S&P. Bear in mind that the US has exceptionally high rates of corporate tax, and that balance sheets are being eroded by the continual practice of share buybacks, which has sustained earnings for some time.

As I have said before, China's fictional growth figures are now being exposed as tosh. China appears to be growing much more slowly than the commentariat thought, and no doubt this will hurt earnings, along with the need for the banks (a big chunk of the Chinese stock market) to get real on non-performing loans (NPLs).

But, as I wrote in the last letter, this might be a chance for us to establish positions – after all when all around are panicking, we followers of the **Master Investor** creed, with cool heads, are the ones buying!

And we have done just that, focussing on China large company ETFs, although I admit I was a little early on the call.

Similarly with Greece, we bought when the streets were rife with riot and disorder and Merkel was the greatest villain since, well, you know who!

And that has worked out nicely. The stock market is up a lot and remains cheap, and even the economy appears to be stabilising. I have no doubt that Greece will have to leave the euro at some point, but it's some way off and for the moment I would hold **Hellenic Telecomm** and the **National Bank of Greece.** It seems that NPLS may not be as bad in Greek banks as first thought.

A good proxy for China and emerging markets in general is **HSBC.** Its dividend yield of 7.2% (yes, amazing!) is well covered, it has strong capital, and is well diversified. It is run by banking veterans and is surely a good buy. In fact, as I write this, I am going to buy more! As long as a VW/BP type situation doesn't befall it, I think we should be OK with this one. This will be the second time in (and hopefully!) out this year.

In a world of uncertainties, a reasonably certain outcome is a lower **Swiss franc** as a banker (pun intended) and I remain short CHF against the USD and Euro. I remain convinced that, despite the fact that the Fed didn't raise interest rates, crazy low bond yields – and in some cases, negative ones, as in the case of the CHF government bonds – are good sells. What sort of idiot lends money to the Swiss government to receive a negative interest rate of nearly 1 per cent?

Well, there are clearly plenty of them around and I would love to meet some of these gullible lemmings to sell them some of the "long term investments" in my own portfolio.

And on that subject, remember that many of the unicorns (tech titans) of today will be the dogs of tomorrow!

Stay diversified, agile and wary.

September 22nd 2015

Happy Hunting!
Jim Mellon

Click HERE to follow Jim's trades on twitter

What Jim read this month...



Restaurant of the Future? Service with an Impersonal Touch

Usually when an article begins "There's a new quinoa restaurant..." my interest dissipates faster than the next fad-diet, but Claire Cain Miller takes a look at the robotic restaurants taking San Francisco by storm. Here you can order your food and get served without ever having to interact with another human being, presumably also without having to leave a tip. Paradise for misanthropes like us.

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Scientists discover 'flu severity' gene

No, it's not simply a Y chromosome... Scientists at the Wellcome Trust Sanger Institute near Cambridge have discovered a link between the severity of patient symptoms infected with the flu virus and the IFITM3 gene. The gene is thought to strengthen cell walls in certain individuals, protecting against the virus. The discovery could lead to a 'tailored' approach to the winter flu vaccine.

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Uber Would Like to Buy Your Robotics Department

Everyone's favourite Taxi-Taunters are back and this time they've got their eye on the academics, in fact whole departments of them. In what's been called the 'Silicon Valley Talent Binge', Uber has lured away 40 senior employees from the Carnegie Mellon University robotics department to work on their own project at their newly opened Advanced Technologies Center in Pittsburgh.

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The Sardex factor

What do you do when you graduate with a Humanities degree and try to get employment on a Mediterranean island ravaged by the financial crisis? You make your own currency of course. And that's exactly what a group of childhood friends did, creating Sardinia's first local currency, trading €31.3m in Sardex this year alone.

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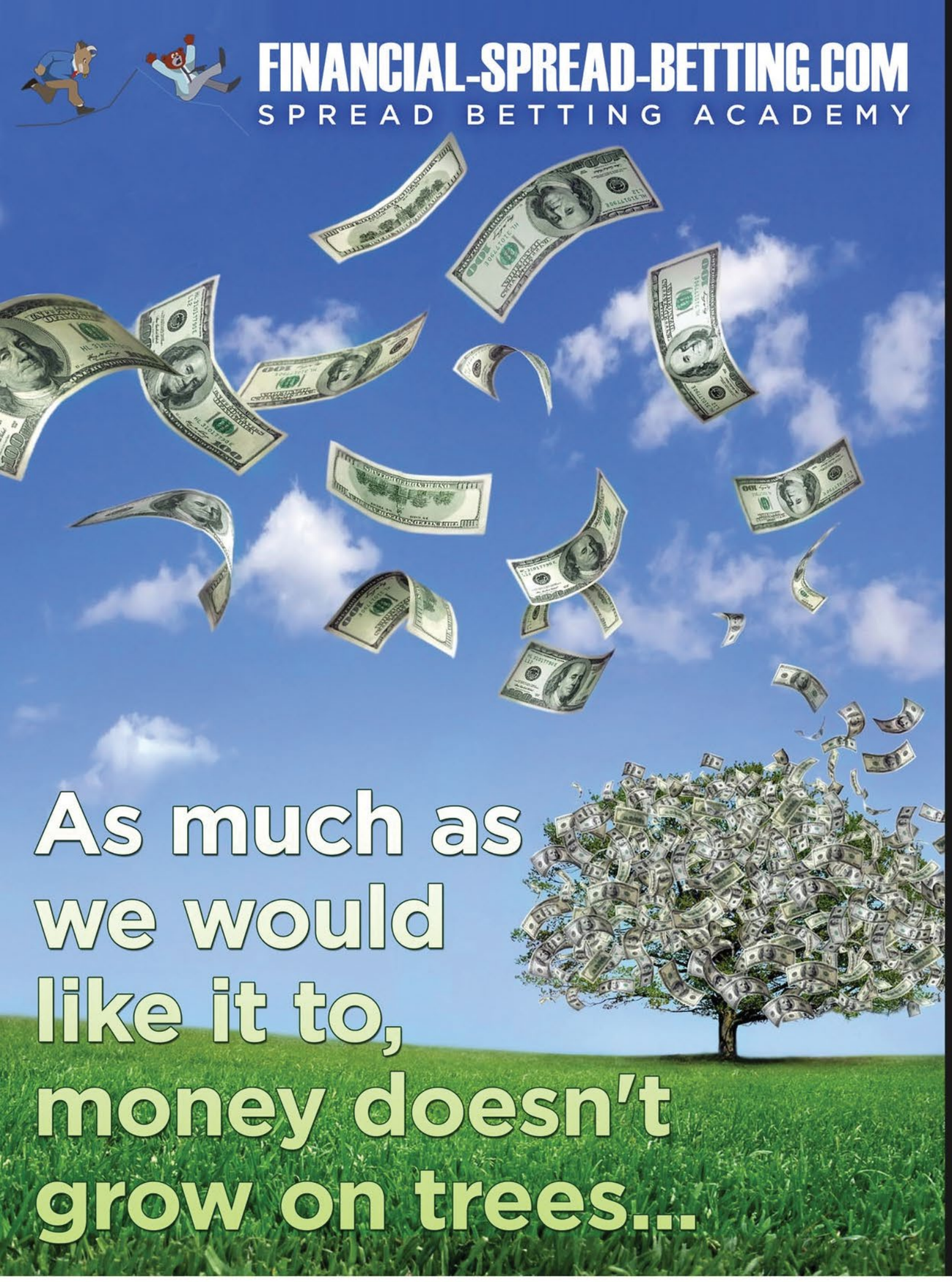


A bridge to the future

We all know that robots will eventually steal our jobs, but construction workers may have a new threat – 3D printers. New 3D printing technology is being developed that means the objects being printed are no longer restricted by the size of the machine. This innovation could pave the way for entire structures to be built autonomously.

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...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.

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AROUND THE WORLD IN A DOZEN PROPERTIES (PART 7)

AROUND THE WORLD IN A DOZEN PROPERTIES (PART 7)

IS IT TIME TO HARVEST AGRICULTURAL LAND IN BRAZIL?

BY SWEN LORENZ



If crisis brings opportunity, then Brazil currently must be one of the ultimate opportunities around.

Until quite recently, Brazil had been the darling of emerging market investors. Its name stood for the "B" in "BRICS" – the fast-growing emerging markets that were grouped together under the now infamous term that also included Russia, India, China and South Africa.

The 7% growth Brazil experienced as recently as 2010 is now all but history. South America's principal economy fell into recession in August and it is expected to shrink by 2% to 3% this year. Inflation is now going on for 10%, the highest rate since 2003, and unemployment has climbed to over 8%. The Brazilian Real has lost about a third of its value against the US Dollar this year alone. Brazilian sovereign debt has been downgraded to junk status and its credit default swaps now make it appear more risky than Lebanon. It would be easy to blame the crisis on the two seemingly obvious factors. Prices for commodities have fallen, hurting Brazil's export sector. China, which so readily bought iron ore, oil and soya beans from Brazil, is experiencing a slow-down. Few countries could sustain such a double-blow without some kind of serious economic fall-out. However, there is more to this crisis than just the woes of global trade.

Exports only make up 12% of the country's economy. The predicted budget deficit of 0.3% of GDP isn't a major problem, especially given how other countries routinely run much larger deficits. As Standard & Poor's noted in its comments about the downgrade, the "internal disagreements" in Brazil play a major part in the current crisis. On top of the challenging economic times, Brazil is also once more going through a crisis of confidence.

"ON TOP OF THE CHALLENGING ECONOMIC TIMES, BRAZIL IS ALSO ONCE MORE GOING THROUGH A CRISIS OF CONFIDENCE."

President Dilma Rousseff, who was narrowly re-elected in October, currently has an approval rating of just 8%. Following the public spending boom of recent years, she has been caught up in the immense corruption scandal at Petrobras, the state-controlled oil company. High ranking officials from her Workers‘ Party are being investigated for what has already been called “the biggest corruption scandal in the history of mankind”. The loss of oil production at Petrobras is so significant that its effects are felt throughout the entire Brazilian economy.

“THE COUNTRY’S CURRENT CRISIS WILL OFFER SLC AGRICOLA AN OPPORTUNITY TO BUY UP MORE LAND, AND TO DO SO AT FAVOURABLE PRICES.”

The story of Eike Batista, formerly Brazil’s richest man – and the 8th richest man on the planet, with a $35bn fortune – now appears like a mere footnote amidst these woes. The group of companies he had built since the early 1980s was involved in mining, energy, oil and logistics. Within just three years, his net worth evaporated and he is now regarded as having a negative net worth of about $1bn. His story is one that attracted a lot of media attention, but millions of other ordinary Brazilians are experiencing similar hardship.

Brazil doesn’t seem to have much going for it these days. However, this could also be why there are now real opportunities to be found for investors that take a contrarian stance. After all, some of the factors that made Brazil such a success will eventually move back to the foreground.

The country has long been known as the bread basket of the world. Indeed, agriculture has for decades been one of the backbones of the Brazilian economy, and quite possibly, this is also where the country’s future lies.

Brazil is a force to be reckoned with when it comes to producing food and other agricultural products, and to do so at a competitive price. What’s more, it has unexploited growth potential. With 100m hectares (250m acres) of undeveloped fertile land, the country has a remaining undeveloped land bank that is bigger than France and Spain combined. Compared to the 75m hectares of land that Brazil is already using for agriculture, it can still grow by 133% simply by employing more land (not counting improvements to production efficiency). Also, no matter how difficult matters may get in Brazilian politics, no one has any doubts that the world’s population is going to keep growing. Prices for agricultural land will fluctuate, but overall demand will only continue to grow. Current projections estimate that demand for food will keep growing at 3% p.a. over the next two decades.

What’s more, agricultural land in Brazil still only costs about 10% to 20% of what it would cost in the US or Western Europe. If there is a bargain opportunity anywhere in the world to buy large quantities of quality agricultural land for a song, Brazil has got to be it.

A company that is set to benefit from the long-term growth potential of the Brazilian agriculture sector is **SLC Agricola.** Founded in 1977 and originally named Schneider Logemann & Cia, the company has historically focussed on producing cotton, soybean and corn. As the first Brazilian agricultural land company listed on the stock exchange, it’s the bellwether of the industry. It’s also one



SLC Agricola

of the most modern and efficiently managed companies in the sector.

SLC Agricola is currently operating 16 farms that are strategically located in six Brazilian states, reducing the risk of natural disaster in any one area bringing down the entire company. Its 460,000 hectares of farmland are utilised “based on a large-scale, modern production system, with standardised production units, thoroughly up-to-date technology and rigorous cost control, underpinned by social and environmental responsibility”, as the company’s website puts its. To put it into perspective, the land bank controlled by SLC Agricola is bigger than the UK county of Kent (and bigger also than Washington (DC).

One of the driving forces of the company’s success has been its strategic approach to land acquisition. Whereas farming the land produces an ongoing yield, SLC Agricola puts just as much emphasis on well-timed buying and selling of land. Between 2007 and 2014, the value of its land bank rose by an average of 22% p.a. The growth of the land’s capital value has slowed down to 7% during the past 12 months, but even that is still a respectable increase in value during what has been a turbulent period.

Shares of SLC Agricola have been largely stagnant for the past seven years when looking at the share price in Brazilian Real, and given the political turbulence of the country, there is probably no urgent need to buy them. However, investors with an interest in real estate investment outside of residential and commercial property in the US and Europe are well-advised to keep an eye on the company, and investors could follow the strategy of gradually building up a position over time.

The country’s current crisis will offer SLC Agricola an opportunity to buy up more land, and to do so at favourable prices. The heavily fragmented Brazilian agriculture sector also offers an opportunity for larger, more experienced players coming in to buy up smaller farms and make them more efficient by combining them. When you have more scale - bigger farms - it is possible to use bigger machinery. In the end, this lowers the cost per hectare or cost per bushel produced. SLC Agricola, with its long-term strategy of expanding its land bank and putting it to use based on best practices, could be one of the biggest beneficiaries of this process. Indeed, over the past three years alone, SLC Agricola has reduced its administrative costs per hectare by 30 percent.

Brazil‘s crisis is reminiscent of the early 2000s crisis in Argentina, when the country descended into bankruptcy and political and economic crisis. At the time, investors with the cash and know how could come in and buy up large swathes of land at bargain prices. A few



cunning investors did so, among them George Soros, the billionaire hedge fund pioneer. Conra-cyclical land investments in Argentina have since had their ups and downs, but overall must have counted among some of the best long-term land investments anywhere in Latin America.

For foreign investors, shares in SLC Agricola could eventually become highly interesting because of two factors being at work simultaneously.

Shares of listed land companies regularly trade below their net asset value during times of crisis, effectively giving investors the chance to acquire some of the assets for free. Right now, SLC Agricola shares are trading at a 50% discount to their underlying net asset value. Put another way, even if the land was to fall 50% in value, shareholders would still indirectly own underlying assets worth the same amount they paid for them. You basically buy for 50 cents on the dollar.

Additionally, the devaluation of the Real has made it much cheaper to invest into Brazil. Whereas SLC Agricola shares have been flat for the past seven years when looking at it from the perspective of a Brazilian investor, for a foreign investor with US Dollars the share price has lost two thirds because of the currency devaluation. The shares were trading at $11 in 2012 and they‘re now down to $4.60.

Brazil, for all that matters, remains a country that regularly goes through extreme boom and bust cycles. What remains a constant during these pronounced swings is the quality of its agricultural land and the global long-term growth of demand for food and other agricultural products. Set up by German immigrants who aimed to build up a portfolio of long-term assets, SLC Agricola has not just survived several similar crisis situations in the past; it has actually managed to utilise them to its favour. Chances are that at some point during the current period of turbulence, the company will once more pull off a few moves that will take it to new heights when the crisis subsides. Timing such opportunities, however, remains rather difficult and investors should only ever put some of their funds to use and keep the rest of their powder dry to buy more at a lower price if the first purchase turns out to have been premature. Or, they might even prefer to stay on the sidelines until Brazil itself reaches a more stable situation.

“RIGHT NOW, SLC AGRICOLA SHARES ARE TRADING AT A 50% DISCOUNT TO THEIR UNDERLYING NET ASSET VALUE.”

SPACE

INVESTING IN THE FINAL FRONTIER

BY SWEN LORENZ AND JAMES FAULKNER





When Neil Armstrong became the first person to walk on the moon, it was (as we all know) "one small step for a man, but one giant leap for mankind." However, it was also a giant leap that for a long time wasn't followed by many other big steps. In retrospect, the 1969 moon landing was more of a PR stunt borne out of the rivalry of two superpowers, throwing oodles of money at government vanity projects.

SPACE: INVESTING IN THE FINAL FRONTIER

"CYNICS DESCRIBED THE SPACE INDUSTRY AS THE MODERN-DAY EQUIVALENT OF A VIKING BURIAL FOR ONE'S MONEY: YOU PUT YOUR MONEY IN A ROCKET, YOU SET IT ON FIRE AND YOU SEND IT INTO SPACE, NEVER TO SEE IT AGAIN."

Commercial applications based on space exploration were few and far between, and space remained the domain of a small number of publicly funded organisations, like NASA in the US. Cynics described the space industry as the modern-day equivalent of a Viking burial for one's money: you put your money in a rocket, you set it on fire and you send it into space, never to see it again. Wernher von Braun's generation had managed to push the boundaries and fulfill mankind's dream of venturing into space, but it came at a tremendous cost and with relatively limited use.

All that started to change in the early 2000s, when the first pioneers of a new generation of space entrepreneurs started to set up their firms. First and foremost among them is Elon Musk, the serial entrepreneur and multi-billionaire. Musk sunk a good part of the funds he received from selling PayPal, the online payments provider, into his "Space X" venture.



Friends considered him mad at the time, but Musk saw a market that was ripe for disruption. Using rocket technology he purchased in Russia, he subsequently managed to build a privately funded organisation for bringing down the costs of rocket launches from $1bn to somewhere nearer $10m - decreasing costs by a factor of 100! Besides cutting costs, he also helped to simply sped up the process. Launching a rocket used to take years of preparations, and can nowadays be done within a matter of months.



Take off with Orbital ATK (NYSE:OA.)

As a direct investment in the future of space travel, you'd be hard pressed to find purer exposure than that offered by Orbital ATK. Formed from the merger of Orbital Sciences and Alliant Techsystems in February, the firm combines satellite and rocket expertise, giving it a key advantage over competitors.

Also of particular note is the fact that Orbital ATK is the only company that is currently involved in two major launch vehicle/spacecraft projects. The Antares/Cygnus combination developed by Orbital Sciences delivers cargo to the International Space Station for NASA; but Alliant is also a major player in developing the Space Launch System, which is essentially NASA's long-awaited replacement for the famous Space Shuttle. This exposure to two major projects gives Orbital ATK a hedge against any potential setbacks or failures, as happen from time to time in the industry.

As for the valuation, the forward P/E is just under 17x (at time of writing), which is by no means a stratospheric valuation for a stock with strong growth prospects. There's also a modest 1.33% prospective dividend yield. Orbital ATK is a more focused investment for those looking for a more direct play on the future of the space industry.

All of this is now receiving more and more public attention, not the least driven by competitions such as the "Google Lunar XPrize", which is asking for a company to successfully land a robot on the moon's surface, travel at least 500 metres, and then transmit images back to earth. Following a bit of a false start in the 1990s, the public's fascination with space exploration is growing again.

"THE SPACE INDUSTRY HAS ACTUALLY BY NOW ENTERED OUR LIVES ON A DAILY BASIS, IF ONLY IN A WAY THAT FEW PEOPLE EVER THINK ABOUT."

It's now obvious that Musk has almost single-handedly started a new wave of enthusiasm for exploring space and developing commercially viable products and services related to space. If rocket launch costs could be cut down to a fraction of what they used to be, which other parts of the space industry could be disrupted and pushed towards making the kind of giant leap that Armstrong did back in the late 1960s?

The space industry has actually by now entered our lives on a daily basis, if only in a way that few people ever think about. Global Positioning Systems (GPS) are built into virtually any mobile device and enable us to use real-time mapping services as a free part of mobile phone services instead of paying hundreds of Pounds for the kind of satellite navigation systems that were popular in the late 1990s and early 2000s. Satellites have shrunk from being the size of a van to the size of a shoebox, and with the decrease in size comes a decrease in cost. Satellite imagery has become so cheap that you can now visit any place on earth using Google, if only with somewhat limited image quality. But all that is going to experience a step change soon.

Satellite stocks map out a path to growth

Those companies that manufacture, operate and manage satellites currently make up the bulk of the space-related industries and together account for around $250 billion in revenue. The satellite industry is therefore pretty hard to ignore if you're seeking some space industry exposure in your portfolio. Thanks to strong demand from firms and governments, the sector has seen double-digit sales growth for the last decade. That trend looks set to continue as wireless data volumes continue to grow exponentially and as the potential applications of satellite technology increase.

Perhaps the obvious choice for UK investors looking to tap this market is FTSE 100 constituent **Inmarsat (LSE:ISAT).** The firm specialises in providing phone access to areas of the planet where there is no mobile phone or broadband coverage, or where those services are restricted by the government. Its customers include businesses, aid agencies and governments – particularly armed services.

Inmarsat shares have been performing well of late on the back of the successful launch of a rocket carrying the third and final satellite of its $1.6 billion Global Xpress superfast broadband programme. Global Xpress will deliver broadband speeds around 100 times faster than its fourth-generation service, and management believe it should help them secure an additional $500 million of annual revenues by 2020.

While satellite operators such as Inmarsat offer some attractive characteristics such as high barriers to entry and visibility of cash flows, in Inmarsat's case we believe these attractions are already, more or less, baked into the price. The shares trade on a prospective FY16 P/E of around 28x (at time of writing), which offers little downside protection against a slower than anticipated rollout of Global Xpress or any other setbacks. The stock offers a reasonable prospective dividend yield of 3.5% for FY16, but this is scarcely covered by earnings estimates.

Luckily for UK investors, there are other options in the satellite arena. **Avanti Communications (LSE:AVN)** is rolling out its own fleet of HYLAS Ka-band which enables it to service the fixed data market at a lower cost than legacy operators. However, the firm carries a high level of debt on its balance sheet and we note that it has disappointed the market several times in the past.

For readers with a higher tolerance for risk, one interesting little company that might be worth investigating is **Satellite Solutions Worldwide Group (LSE:SAT).** This £14 million minnow offers satellite broadband services to rural locations across Europe where it is not viable to upgrade the fixed-line infrastructure for broadband connections. There are estimated to be almost 20 million such households in Europe that cannot access even slow broadband speeds. While the firm does not operate its own satellites, it has agreements in place with three European satellite companies that enable it to offer maximum coverage.

House broker Arden Partners anticipates a loss of £0.9 million for the current year to 31st December 2015, but a profit of £0.8 million in 2016. The firm recently completed its third acquisition since floatation, that of number two French satellite broadband player Sat2Way, which increased subscriber numbers by 65% to c.20,000. Organic growth has also been strong, with recent interims showing a record 528 new customer additions in July. Arden Partners believes there is material upside for the shares on the basis of the market consolidation opportunity combined with an experienced management team and access to capital. Assuming the broker's revenue expectations for FY17 (£33.2 million) are met, the EV/Sales falls to just 0.4x on Arden's forecasts. "If this multiple were to move to 1.2x," notes the broker, "it would imply that the shares could triple on a one to two-year view."

During the next ten years, an unprecedented number of new satellites will be launched into orbit and create the capacity for entirely new data services. For example, GPS will be used for precision farming, enabling huge farms to run on the back of automated machines and robots, and that way increase harvests and decrease the cost of agricultural products.

"VENTURES SUCH AS DEEP SPACE INDUSTRIES COULD TURN OUT TO BE AS PROFITABLE FOR INVESTORS AS THE FIRST FUNDING ROUNDS OF GOOGLE OR AMAZON."

There has been explosive growth in the number of companies that are working on the exploration of space. In 2011, there were only 125 companies trying to find ways to make money in space. Fast forward just four years, and there are more than 1,000 new entrants. Among them are ventures funded by backers with deep pockets, such as the satellite imaging firm Skybox, which in 2014 was taken over by Google and which is another example of the kind of growth the industry could experience.

Skybox is working to launch a network of small satellites, which by 2016 will enable it to take pictures of the entire earth twice a day and at a level of detailed resolution that was until recently unthinkable (and also prohibited because of the potential military use). By 2018, the company expects to image map the entire earth at a resolution sufficient to capture, for example, real-time video of cars driving down the highway. Satellite imaging could then be used for everyday tasks such as directing traffic in the parking lots of Disney World. Companies operating such networks and controlling the data are expected to be extremely profitable.

US defence giants reach for the stars

Many of the major US defence outfits, including **Boeing (NYSE:BA), Lockheed Martin (NYSE:LMT)** and **Northrop Grumman (NYSE:NOC),** have exposure to the space sector, not least through their relationships with NASA.

Of the three, Boeing and Lockheed are perhaps the most obviously associated with space, through their role in the Space Shuttle programme in particular. Boeing is in competition with SpaceX and Sierra Nevada Corporation to build the next generation of NASA space shuttles, which could land the firm with additional revenues of $4 billion per annum. It is also heavily involved in producing rockets and managing launches.

Meanwhile, Lockheed has a stated target to capture 10% of the global space industry by 2030. Crucial to its plans is its role in the development of a new manned craft, the Orion Multi-Purpose Crew Vehicle. However, investors should note that the first mission to carry astronauts is not expected to take place until 2023 at the earliest, although NASA officials have said that their staff are working towards an "aggressive internal goal" of 2021.

Northrop offers a slightly different approach. It has recently been involved in NASA's solar probe mission and the James Webb Space Telescope, which will be 100 times more powerful than the Hubble Space Telescope. A key attraction, we believe, is its Scaled Composites division, which produces experimental aircraft. Scaled Composites is famous for being the first private company (prior to its acquisition by Northrop) to complete two flights that breached the Karman line which marks the beginning of space. Notably, Virgin Galactic plans to use a spacecraft designed by Scaled Composites to provide regular flights across the line.

All three of these titans come with the added benefit that they are also major defence contractors in their own right, which helps to balance out the somewhat riskier space activities. Of the three, we prefer Northrop, which also comes with the added benefit of being a takeover target.



How can investors get in on the growing boom of space commercialisation?

The good news is that there is a growing number of areas where companies are investing with a view to developing businesses related to space. A recent report also mentioned space tourism, robotic servicing of space infrastructure, and even mineral mining in space as potential growth industries. The mining of minerals could be used to produce and maintain infrastructure in space. This in itself is a mind-boggling thought, but one that a number of companies are already working on, with strong backing from venture capital financiers. Among them is Deep Space Industries, a venture that aims to mine mineral rich asteroids near earth to produce feedstock for 3D printing in space.



Their technology is still 10-12 years from being commercially viable, but could one day become a game changer for the entire space industry.

Ventures such as Deep Space Industries could turn out to be as profitable for investors as the first funding rounds of Google or Amazon. Whoever gets in early and gets it right could grow their investment by a factor of 50, 100 or even 1,000. However, there is also one considerable challenge for private investors. Most of the exciting start-ups are not yet public, and funding deals are more often than not agreed between existing networks of investors in Silicon Valley and elsewhere. It's not easy to get in on the act.

Master Investor did a survey of the industry, to see how private investors can benefit from the window of opportunity that has opened in this industry. It's already clear that going forward, investing into space commercialisation will include companies that in the past wouldn't necessarily have been considered space-related. Proprietary data services and data analytics is one area that is bound to benefit hugely from the new satellite networks that are being prepared for launch, and by extension these will also count as being part of the industry. The opportunities for investors will become much more numerous in the coming years. Until then, the companies covered throughout this feature will give you an initial insight into what opportunities you can already access right now.

QinetiQ (QQ.) – James Bond in Space

QinetiQ is perhaps best known for providing Ian Fleming, himself a former British intelligence operative, with the inspiration for "Q" in his James Bond novels. However, since its Initial Public Offering back in 2006, QinetiQ's stock market performance has been somewhat lacklustre. Initial concerns were focused on the Ministry of Defence's 53% retained stake in the company following floatation, which led investors to question what kind of say they would have in the management of the company. However, in 2008, the Government sold its entire stake except for a 'golden' share, which would enable it to block a takeover bid if it so wished. While this allayed corporate governance concerns, the financial crash of 2008 precipitated a tightening of military budgets and the stock halved, but it has since recovered lost ground and is trading around its initial IPO price.

QinetiQ's Space Products business provides satellites, payload instruments, subsystems and ground station services. Early in 2015 it was awarded a contract worth 16 million Euros over three years to develop the computer and avionics for the European Space Agency's (ESA's) Proba 3 satellites that will fly in formation and use an eclipsing mechanism to study the Sun. The business is also playing a vital role in ESA's IXV mission launched in February 2015, as its technology will be responsible for guiding the "space taxi", a smaller version of the US space shuttle, safely back to Earth.

While Space Products is currently a relatively minor contributor to group earnings, there is every likelihood that its importance will grow in future as the company pursues its 'Organic-Plus' strategy. This is aimed at building on the firm's track record of delivering 'more for less' to win market share in its core markets whilst nurturing 'Explore' opportunities to deliver growth particularly beyond defence. Other 'Explore' ventures currently include areas like Cyber Security and Unmanned Aerial Systems and Robotics, all of which clearly position the firm to take advantage of emerging trends.

To top it all off, QinetiQ boasts a strong financial position with net cash of £195.5 million (as at 31st March 2015), some of which was recently put to use in a £150 million share buyback which, along with the 17% increase in the full year dividend, underlines management's confidence going forward. The underlying cash conversion ratio was strong at 103%, as was the book to bill ratio of 1.1x (orders won divided by revenues recognised). Despite all this, QinetiQ shares do not appear aggressively valued on a prospective P/E of around 15x (at time of writing) and offering a prospective dividend yield of 2.5%. They are an attractive buy for investors looking to gain some exposure to the space sector but via the comfort of a more diversified UK business.

AN INTERVIEW WITH THE SPACE FOUNDATION

AN INTERVIEW WITH THE SPACE FOUNDATION

"THE SPACE ECONOMY NOW CONSISTS OF THOUSANDS OF COMPANIES"

Master Investor's CEO, Swen Lorenz, has managed to glean the insights of a space industry veteran. Micah Walter-Range, Director of Research and Analysis at the Space Foundation in Colorado, allowed us to tap into his vast expertise. Micah is also the author of the "Space Report", the authoritative guide to global space activity.

Swen Lorenz: Micah, tell us how you got interested in the space industry and how you ended up being in a position where you have incredible insights into the industry on a daily basis?

Micah Walter-Range: *I was interested in space and science-fiction at a young age, but I didn't expect it to form the basis of my career. When I did a double-major in astronomy and political science, I was often asked "Astrology, right?" At the time, few people could get their head around there actually being a programme for students to study astronomy. George Washington University in DC offered a course specialising in space policy, and after finishing that I managed to get an internship at the Space Foundation. Fast forward a number of years and I found myself becoming the Director of Research at the Foundation.*

What is particularly fascinating about our organisation is that it covers all aspects of space. If it has anything to do with space, we are interested in it!



SL: The space industry used to be synonymous with NASA, government funding, and military applications. However, the situation seems to have changed considerably over the past decade or so, brought about by entrepreneurial companies like Space X. Tell us a bit more about how the industry has evolved recently?

MWR: *I would say there have been three areas of space activity. First, the sector that was completely dominated by governm-nt. This actually involveda lot of private enterprise contractors, but few realised it at the time. NASA was the organisation that was visible on the outside, but much of the actual work was done by contractors.*

Secondly, once people started to see the potential for commercial applications, a new generation of companies emerged. Many of them actually started as inter-governmental agencies and went through a transition period that turned them into private enterprises. Others jumped in with venture capital funding. Of course, a good number of them went bankrupt. Until 10 years ago, that set of companies was the dominant form of operator in the industry.

The third tier started to emerge about a decade ago. Wealthy individuals paid the way for this next generation of pioneers in the space industry, and Elon Musk was one of the drivers behind it. Musk had made a fortune on the back of PayPal, the Internet payment provider. He wanted to use some of his money to send a greenhouse to Mars, which he thought was going to be a fun science experiment. When he realised that there was no one who was willing and able to do this for him, he set out to form Space X, his own space rocket company.



"IT IS TODAY ENTIRELY POSSIBLE TO GET INTO THE SPACE BUSINESS AND BE PROFITABLE, AS ENTREPRENEURS COMBINE THE RAPID TECHNOLOGICAL PROGRESS WE ARE EXPERIENCING WITH THE OVERALL LOWER BARRIERS FOR SETTING UP AMBITIOUS ENTERPRISES."

About the Space Foundation

Founded in 1983, the Space Foundation is a Colorado-based nonprofit organisation that advocates for all sectors of the global space industry through space awareness activities, educational programmes and major industry events. The mission is "to advance space-related endeavours to inspire, enable and propel humanity." It's website is www.space-foundation.org. It also publishes the subscription-based Space Report: http://www.space-foundation.org/programs/research-and-analysis/space-report/

It is today entirely possible to get into the space business and be profitable, as entrepreneurs combine the rapid technological progress we are experiencing with the overall lower barriers for setting up ambitious enterprises. The required investment today is much lower, so a new generation of entrepreneurs is jumping in.

SL: There are now nearly 1,000 companies worldwide that are involved in the "great innovation economy" of New Space, or at least that's the figure I was able to find. Can you give us some facts and figures to help us understand the scope of this emerging industry?

MWR: *The question is what do you consider to be a space company? There are now numerous large companies, but their work cascades down to lots and lots of suppliers. It must be thousands of companies that are now involved in the space industry. Not all of them are space companies in the strictest sense of the word. But I can give you a number that gets across just how much the entire industry has changed and broadened. Even just five years ago, you had fewer than five satellites of less than 10kg each launched into space on a yearly basis. Last year alone, you had 135 satellites of that kind of size launched into space. The miniaturisation of the equipment is really driving this industry forward. Of course, such expansion draws in countless companies as suppliers.*

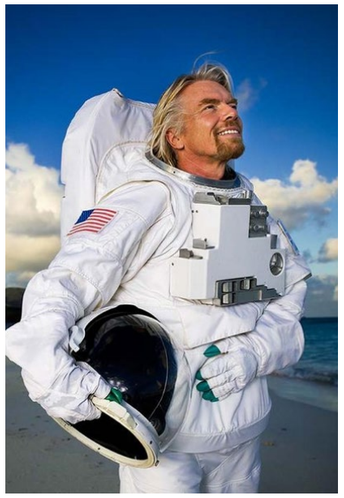
SL: Is the US leading the industry across the board, or does Europe actually play a significant role? Where is the UK in all this?

MWR: *It depends on what area you are looking at. Many people have this concept of focusing on one aspect of the industry. E.g., after the Space Shuttle programme was shut down, there was a widespread notion that all of NASA had shut down. Actually, the Space Shuttle progamme had only been one of the many activities of NASA. The US certainly is still the dominant player. The government budget for the US space industry alone is bigger than the space-related government budgets of all the world's other countries combined. However, Europe has the lead in commercial satellite communication and broadcasting. The majority of large companies in that sector have their HQ in Europe. As to the UK, there certainly is a substantial effort on the part of the government to grow the industry. The UK Space Agency has the goal to increase its share of the global space market to 10%. I am not entirely sure what exact figure this 10% relates to, given how there are different definitions of what the industry encompasses. In any case, this goal speaks to the ambition of the UK government. It wants to encourage growth, and it recognises there are opportunities.*

SL: Opportunities such as…

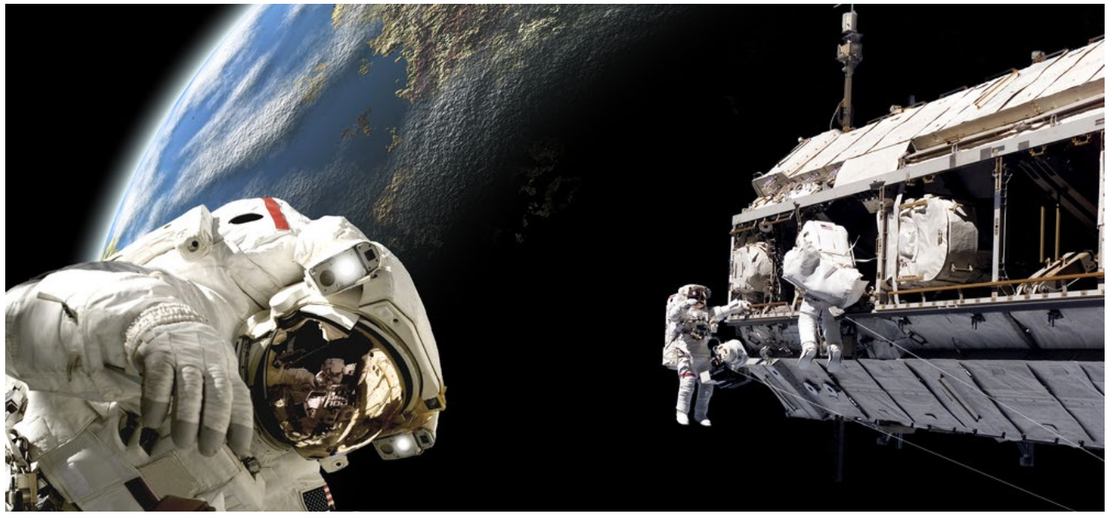
MWR: *What do you do with all the data that is flowing from space to earth? Entrepreneurs will find entirely new ways to utilise all this data. Who would have thought of Uber and how it manages its fleet? Well, actually, someone did think of that a lot earlier than Uber did. Years ago, in the Space Report, we wrote about a similar system in France, used for busses in rural areas. It took a while before someone figured out a way how to use it commercially. No one knows what will be next. Maybe guidance signals for the blind, transmitted from space? It's certain that there is a lot of room for new applications. European companies are actually very good at recognising such opportunities.*

SL: No interview about space and the UK industry would be complete without mentioning Richard Branson. He aims to make space tourism a viable industry. A pipe dream?



MWR: *Space tourism has been "imminent" for a long time. During the past five years, it's only ever been "1-2 years away" if you followed the press releases of the companies involved. Of course, things usually get delayed, that's the norm in any industry. Last year, we saw the loss of one of Branson's crafts and its pilot. One of the reasons for these delays is also the desire to make this technology as safe as possible. For as long as Branson keeps funding his company, hopefully these 1-2 years will now turn out to be the right prediction. However, for as long as further delays are due to further improvements to safety, then it's all worth the wait.*





SL: The concept of space mining keeps popping up in the media. This seems utterly futuristic and it's a mind-boggling concept to think of minerals being mined on an asteroid and then shipped back to earth. However, I have now read of plans to try and use these minerals in space, for the purpose of 3D-printing equipment in space. That makes more sense to the naive layman. How realistic is it to expect that any of this will ever happen?

MWR: *The concept of space mining is challenging on so many fronts. There are challenges that can be dealt with through technology, but then there is also the question of what is financially feasible. That's not even to speak of the current bout of resource prices. The question is whether or not it is all worth it? This also depends on what people think about the broader future. E.g., Elon Musk wants to go to Mars. Presumably, other people also want to go. A recent call for applicants for a one-way journey yielded a surprising amount of interest. There is this desire to be among the first and to see what life is like on a different planet. When you have a group of people going to a new planet, they will need stuff! Will you want to ship it? Why not produce it in space? Mining materials on asteroids is something that does not seem outlandish, and it could be used for populating Mars, or the Moon. A potentially more interesting question is which of the technologies developed for such a purpose will also be useful on earth? The investment period required for making space mining feasible is very long, potentially decades. A blended investment model that envisions a use of technology both on earth and later in space can make a lot of sense. It could also help to ultimately make space mining possible.*

SL: Finally, we have just learned about the likelihood of water existing on Mars, and we have Matt Damon hitting the big screen with "Martian". How long do you think we will have to wait before man steps onto Mars? Will it happen in our lifetime?



MWR: *I do think that we are looking at another decade at the very least. There are some exciting new developments for propulsion technologies, and those may significantly shorten the time it will take to get to Mars. A shorter time to get there would make it so much easier. It'd require less shielding to protect the astronauts from radiation, and less food supplies. Even just a handful of innovations could dramatically reduce the time it takes to get to Mars. But if these developments fail, and no alternatives are found, it could also still take decades before man sets foot onto the red planet.*

SL: Thank you, Micah, for these fascinating insights. Our team at Master Investor will sure be on the lookout for new, exciting investment opportunities in this rapidly growing industry.

"EVEN JUST A HANDFUL OF INNOVATIONS COULD DRAMATICALLY REDUCE THE TIME IT TAKES TO MARS. BUT IF THESE DEVELOPMENTS FAIL, AND NO ALTERNATIVES ARE FOUND, IT COULD ALSO STILL TAKE DECADES BEFORE MAN SETS FOOT ONTO THE RED PLANET."

THE HOT SEAT

AN INTERVIEW WITH

KLAUS HEIDRICH

CEO OF SCISYS

James Faulkner: Thanks for taking the time to speak to Master Investor. Could you begin by giving our readers a brief overview of SCISYS and what it's all about?

Klaus Heidrich: *The SCISYS Group is a leading developer of software and related services. Through building successful and long-term partnerships over the decades we now serve a broad range of household name customers spanning the media broadcast, space, government, defence and commercial sectors. Our customers look to us to solve their challenges requiring bespoke systems or customisable products, which we deliver through software engineering, IT-based solutions, and support services, as well as through our work in web and mobile application development. Largely these software solutions sit at the core of our clients' business making them vital for their efficient daily operation. We have successfully worked for a wide range of customers over the last 35 years. It is likely that most of your readers will have come across SCISYS' solutions in their daily lives without even knowing it.*

For example, when listening to any of the BBC's radio programmes, these are produced and broadcast using SCISYS software solutions. When the BBC was looking into renewing its audio editing and playout systems using one harmonised system, they chose SCISYS as their exclusive partner based on the credibility and trusted relationship we had established with them, having worked with them since 2001. That is just one prominent example of our Media and Broadcast activities.



Another great example is the Royal National Lifeboat Institution, or RNLI. SCISYS is currently delivering its latest software technology for use within the RNLI fleet. Our MACSYS suite is used to operate their latest, most advanced lifeboats, the Shannon class. Upgrading the on-board control systems for the boats is a mission-critical challenge for the RNLI – solving these types of challenges is what we excel at. Interestingly, the underlying technology used in the RNLI example was first applied to the Warrior Capability Sustainment Programme, which we are delivering to the UK Ministry of Defence as a subcontractor to Lockheed Martin. Having taken the Warrior technology and applied it to the RNLI solution, we have since started to sell our MACSYS suite to increase our presence within the broader maritime sector. This is just one of many activities in our Enterprise Solutions & Defence Division.

And finally – we'll look at this in more detail shortly – there is our business in the space sector. Be it earth observation data as you will have seen it on the weather news; Europe's move into sophisticated satellite navigation by means of the European Galileo programme; or the European Space Agency (ESA) recently landing a spacecraft on a comet. SCISYS' Space Division has contributed to those missions by providing software to the satellite control centres, on-board software for the satellites or in supporting our customers' enterprise operations.



SCISYS

"THE SPACE MARKET IN EUROPE HAS GONE THROUGH REMARKABLE CHANGES OVER THE LAST DECADE."

JF: Given the theme of this month's magazine, we're particularly interested in the space division. Can you give us some more detail on this segment and its prospects for growth?

KH: *The space market in Europe has gone through remarkable changes over the last decade. Importantly, the British and German governments have increased their financial contributions to space, recognising the added value that the sector delivers, which is relevant for SCISYS given our office locations in both of these countries. Furthermore, the European Union has taken on major programmes, namely Galileo (Europe's own satellite-navigation system), Copernicus (Europe's earth-observation Infrastructure) and Horizon 2020 (Europe's framework programme for research and innovation). While SCISYS is already substantially involved in the Galileo programme, we are now starting to exploit Copernicus data to offer value-added services to new customers. With the growth of European budgets, the SCISYS space division has grown in a commensurate manner over the years – therefore beating others being affected by the financial crisis.*

"HOW MANY PEOPLE CAN TELL THEIR GRANDCHILDREN THAT THEIR SOFTWARE CONTRIBUTED TO MAKING A ROBOT NAVIGATE ON MARS?"

JF: SCISYS is tasked with providing the rover vehicle visual localisation flight software (VISLOC) for the European Space Agency's 2018 mission to Mars. It must be exciting for you to be involved in such an important mission! What does this contract entail and what makes SCISYS so uniquely positioned to deliver on contracts such as this?

KH: *Due to confidentiality agreements, we are not permitted to talk about the project itself but we can confirm our involvement in the space mission and that we all want to see our software actively contributing to the exploration of Mars. How many people can tell their grandchildren that their software contributed to making a robot navigate on Mars? You can therefore imagine how keen and motivated our engineers are to be involved.*

SCISYS was already involved in this area 10 years ago with the UK-led Beagle 2 mission, but the missing touch-down verification of the lander in December 2003 had caused leading scientists to believe that the lander had crashed. Most recently, in January this year, the lander was spotted with a camera from a NASA spacecraft. The analysis of the images suggests that the Beagle 2 indeed survived the entry, descent and landing sequence to touch down inside its target landing area. Albeit belatedly, the results show our contribution to the mission was a success.

Getting involved in these types of exploration programmes requires solid technical expertise and an ability to deliver. In this regard, SCISYS has both a long track record in the field, as well as mission-proven technologies that are absolutely essential in a sector where there are often no second chances. Being able to sustain the timescales and nature of the space business is also what enables SCISYS to participate in these long-term, visionary programmes, such as missions to Mars.

JF: With the advent of Virgin Galactic and SpaceX, the world seems to be rediscovering its love of space exploration. What are the business opportunities for SCISYS in this new age of discovery?

KH: *There are several areas within the space sector that are potentially entering into a renaissance period for the industry. Examples are both the access-to-space and the satellite hardware sides, where the procurement of large volumes of launchers or satellites is envisaged at very low prices. This will be feasible only by moving from manufacturing in small batches to mass production. Mass production, however, is not the only response to the substantial need for cost reduction – there are many new ideas and innovations required to make these visions happen.*





As a software company, SCISYS can add value by realising these innovations via its – often bespoke – software solutions. The envisaged large spacecraft constellations, for example, face the challenge of controlling hundreds of objects in space, which can only realistically be achieved through software automation. SCISYS has successfully delivered planning and automation solutions to its space customers for several years, as well as building a new product solution for satellite control including constellations (e.g. Galileo). Through our extensive spacecraft-operations experience, we assist our customers in developing credible operational concepts to command and control these objects.

Space X and Virgin Galactic are synonyms for these new privately funded, visionary space programmes, and many other exciting ventures are starting up. We strive to support these venture companies as a software technology partner for realising mission infrastructure, as well as engineering support services. Participating and benefiting from the underlying business cases for these large constellations needs investors with deep pockets and patience.

JF: The company suffered a major setback in June this year when it was revealed that a fixed-price development project was experiencing cost overruns. What has been done since then to mitigate the risk of this happening again in future?

KH: *First and foremost, we undertook a comprehensive review of our other contracts to ensure that there was no risk of the same outcome from further contracts that SCISYS was in the process of delivering. I am pleased to report that we are confident that this troublesome contract was a one-off. In general our controls are appropriate and there was no systematic failing.*

Having satisfied ourselves that this was an isolated case, equally importantly, we took steps to limit the risk of such cost overruns occurring again. The contract in question fell below a threshold, which would have automatically required it to be reviewed at Board level. Due to the error of judgement in this case, we have now revised the review criteria to ensure that a broader range of contracts are stress tested prior to being signed off.

SCISYS has a long history of successfully delivering contracts profitably, so we are confident that this was an exceptional case. Naturally, when something like this happens it makes you tighten procedures and double check your assumptions. However, we have a senior and experienced team in the business so this is more about refining our processes than it is about forcing revolution.

"WE SEE A VARIETY OF ELEMENTS WHICH WE HOPE WILL HELP US GROW OUR MARGINS TO DOUBLE-DIGITS."



One spin-off of the remedial works meant that the mandatory recognition of uplifted future project costs in our June accounts created the temporary issue of a banking covenant breach. However, SCISYS enjoys strongrelationships with its lenders and their confidence in the company was underlined when we announced in early September that they had waived the breaches and relaxed covenant thresholds to the end of 2016.

JF: In 2007 SCISYS sold its HQ in Chippenham for £9 million, which was clearly a savvy move given what happened to the property market in the following years. To top it off, you even bought the same property back in 2011 for just £5 million. Are there any plans to sell again now that the property market is recovering?

KH: *It is true, we are very pleased with the sale and subsequent repurchase of the Chippenham HQ. It remains, however, that we do not see ourselves as property developers so I do not think that we would be trying to repeat this. The real advantage of having ownership of our own building is that we do not have any restrictions over how we use the space. As a result, we now have a number of tenants who have further reduced the cost of our workspace. When we were tenants ourselves, in the building that we had sold to the investment company, we were unable to sublet and therefore quite restricted.*

JF: SCISYS is exposed to currency risk given that the majority of its cost base is in sterling and most of its revenues are euro denominated. In light of the strong pound, what steps are being taken to manage this risk?

KH: *We do have a currency exposure, and to a degree the strong pound devalues our euro-denominated business. But we also do have an element of natural hedging because we have both revenues and costs in both sterling and euros. We have German offices in Bochum and Darmstadt, where we have approximately 180 staff. Currency exposure is a risk for all international businesses so we have to be aware of it and manage it as best we can. SCISYS mitigates its net foreign exchange risk by taking out currency options or forward contracts in advance to convert surplus euro receipts into sterling, holding German cash deposits in sterling accounts and by utilising euro-denominated borrowing-facilities in the UK.*



JF: In light of the significant public-sector exposure, how has the company coped with European austerity?

KH: *Many of our customers are public sector in one way or the other, and most of them have been for more than 10 years. SCISYS – like many other companies – has been through tough times during the past few years but we always rely on well-established customer relationships.*

Based on these, we have been able to weather the crisis better than many others but no doubt we have suffered from deferred procurements and even the sharp decline of sub-sectors where we have been very successful, like the environmental sector. It proves the underlying solidity that we have been able to compensate for such knock-backs even in difficult times.

We have learnt and we know how to manage public sector exposure. Being responsive to the ever changing market environment is one essential aspect, and the diversity of our business adds a great deal of stability. But we are also looking to extend our involvement with commercial sector clients. Our recent acquisition – a small Leicester-based company called Xibis – serves as a good example, with its strong foothold in commercial and private sectors.

JF: SCISYS is targeting operating margins in the double-digits from around 8% currently. How will this be achieved?

KH: *We see a variety of elements which we hope will help us grow our margins to double-digits: growing the business is one, as we will benefit from an economy of scale, and overheads will not need to increase at the same pace. Increasingly looking for re-use is a second one, the MACSYS product is a good example of that in practice. We will remain an IT services and software-solutions company because that is what we do best but we progressively aim to take advantage of re-usable software where we own the intellectual property. This is consistent with an increasing demand for software-based services. Thirdly, we will continue to optimise our value strategy; competing at the commoditised end of market is not our aim, and we are most successful when creating real value for our customers.*

JF: As a technology business, how big a role does R&D play for SCISYS? Does the firm own any proprietary technology, and if so, how is this accounted for on the balance sheet?

KH: *We have a great track record of highly innovative projects and applied technologies. Innovation is fundamental across our business and I prefer to call it "innovation" instead of "R&D". We also seek to drive innovation together with our customers to ensure it has a real benefit and an appropriate return. This also encompasses the possibility of creating our own technologies and products. Our Media and Broadcast business relies largely on our own dira! product suite, our Space Division habitually uses its own software frameworks, and I already mentioned our MACSYS product, which helps to establish SCISYS in the maritime sector. None of these IPR elements are capitalised on the balance sheet, as they were generated within customer-funded projects.*

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Trade Up

ROBBIE BURNS' TRADING DIARY



This summer was a horrible one to try to make money. In fact every summer is difficult in the markets. Participants are away, it's not very liquid. Best to stay out!

Summer for me is being lazy, lying by the pool sitting with mainly defensive shares. And sitting with a cocktail... and a paperback... and a masseur... Any more than that and it's definitely Too Much Information... (No pigs though, promise).

I also had an indices short open. As every summer these days there is almost inevitably a major tankdown.

I reckon the best thing you can do – unless you are at your computer all day, all the time – is actually not trade much at all in the summer.

I hardly did anything. My portfolios didn't make much and thanks to some shorts didn't lose much either.

But the inexperienced who traded and over-traded during the summer? Well my guess is many blew up their accounts.

The worst thing you can do during a period of volatility is trade a lot, especially in the top 300 or so shares where the whole thing becomes like a crazy mad casino where the house will almost certainly beat you and take all your chips (mmmm... chips...).

Here's a trader who wants to share his experience - his summer was so bad not only is he finished as a trader but he can't pay the spreadbet firm he owes money to. Here's what he says:

"I think I broke all rules and because of that I'm done with trading, because if I can't be logical then I will lose money.

I've not had a bad run recently on longs and shorts. Making real money and progress, following the charts and flows of the market.

"IF THE MARKET IS FALLING EITHER STOP OUT FAST OR DECIDE YOU'RE HOLDING. NEVER AVERAGE DOWN. YOU COULD END UP JUST MAKING LOSSES EVEN BIGGER."

But then I decided to invest in a share because it looked cheap. It fell with the China news, but instead of selling I hung on and stupidly averaged down too.

Then on that bad Monday I felt the floor fall away when the markets opened. My positions were closed by the spreadbet firm, any profit disappeared and now I'm in debt by thousands.

I've never felt so stupid, so now I have to write or call them with a heavy heart to find out how to pay them in instalments, if they do that.

I should never have relied on margin as black swan or market moves like this can punish you, if you don't follow the basic rules."

I suspect my reader's story was echoed around the nation.

What basic rules is he talking about? Where did he go wrong?

If the market is falling either stop out fast or decide you're holding. Never average down. You could end up just making losses even bigger.

But above all, don't over-use the leverage given out by spreadbet and CFD companies. On a number of days this summer stocks fell so fast that if you were heavily leveraged you'd have been called or emailed and asked for money.

If you didn't have the money then your positions would have been closed like the trader above and you'd be expected to pay up. If you can't pay up these debts are enforceable by law and injunctions can be taken out against you.

Remember, in effect "leverage" is just borrowing money. It's very seductive trying to make back losses quickly - but the market knows and will punish you.

My plan is to always hold excellent companies with low volatility outside of the FTSE, oil, gas, energy and mining. I get out fast if I got an original entry point wrong and hold for years if I get it right to make the big money.

For example, if you'd held **GB Group (GBG)** the summer volatility wouldn't have hurt - I bought these originally at 20p years ago and recently the shares have touched 240p. I averaged up most of the way getting more in the 60s and 120s and even more recently.

Even a recent buy, **Empiric Student (ESP),** has hardly budged and there's a massive dividend.

Another of my favourites is **Powerflute (POWR).** This one simply stayed still or went up over the summer and I recently bought a load more at 80p, even though I've more than doubled on it already having bought at 34p.

All these companies quietly and steadily build their profits over time, are under the radar and so aren't volatile.

If you've got something with gas, oil, gulf, power and/or resources in its name... well, you must expect to be whipsawed out. Perhaps what I am saying is, *don't play with hard-to-value volatile shares in the summer - and maybe not at all.*

"MY PLAN IS TO ALWAYS HOLD EXCELLENT COMPANIES WITH LOW VOLATILITY OUTSIDE OF THE FTSE, OIL, GAS, ENERGY AND MINING. I GET OUT FAST IF I GOT AN ORIGINAL ENTRY POINT WRONG AND HOLD FOR YEARS IF I GET IT RIGHT TO MAKE THE BIG MONEY."



Turning to insuring your portfolio during a summer of volatility, the best way is an indices short using spreadbetting.

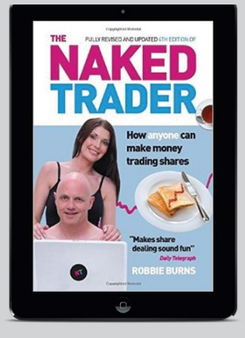
The main thing here is to keep stops miles away or else the casino will again punish you here.

For example you could have taken out a short at say 6,800 as the summer started that would have produced a massive payout to help balance out any falls in your portfolio. In my case I got a nice profit from 6,800 to just over 6,000.

Or, say, in an ISA you could use Exchange Traded Funds, such as **XUKS** or **SUK2,** which go *up* if the FTSE goes down.

Details on how to use those, FTSE shorts and general ideas on what to do during market falls are in *The Naked Trader.* I'd also suggest reading chapter 18 of my latest book *Naked Trader 4,* "When markets go down".

Happy trading! Robbie



Before you go, why not get the latest copy of my book The Naked Trader, which has just been published! You can get The Naked Trader 4 only from my website and also from Amazon.

The book updates *The Naked Trader 3* which I wrote in 2011 – a lot has happened in the market since then and I cover all the changes. There are tons of ideas, trader stories, psychology, biggest trading mistakes and 20 trading strategies to make money.

It's only £14.99 and the first 500 who order it get a free pack of Naked Trader T bags made from only the best tea! To get *The Naked Trader 4*, click the link at my website www.nakedtrader.co.uk

ECONOMICS CORNER

ECONOMICS CORNER

MINIMISING RISK

WITH ALTERNATIVE INVESTMENTS



BY FILIPE R. COSTA

The traditional approach towards investment consists of allocating money through three different asset classes: stocks, bonds, and cash. Depending on the economic conditions, the optimal allocation between the three varies. The main goal is always to maximise the risk-adjusted return, which means building a well-diversified portfolio to completely eliminate idiosyncratic risk.

The remaining risk is market risk, *one that is impossible to eliminate by adding more assets*, or by changing the proportions of the existing assets. We can mitigate the risk of a crash in some particular company or sector by holding a sufficiently large number of assets in our portfolio, but we can't avoid the risk of an overall market crash.

While minimising idiosyncratic risk sounds like a good strategy, the Financial Crisis of 2007-2009 serves as proof of the shortcomings of this approach. The correlation between portfolio assets – which is nothing more than market risk (in a well diversified portfolio) – is too great to bear. When things go wrong, they may in fact go really wrong as they did in 2007, and market risk may wipe away more than half of a portfolio's value in just a matter of months. While the crash would certainly look like an opportunity to buy for Warren Buffet; for those holding such assets during a crisis it could be fatal. While the market has reversed these losses during the following years, the simple fact that it declined by more than 50% in a very short time period proves that there are still huge vulnerabilities in well-diversified portfolios. ***But what if we could mitigate them?***

"MORE AND MORE INVESTORS ARE NOW LOOKING FOR WAYS OF MINIMISING THE RISK OF A PORTFOLIO BEYOND THE TRADITIONAL VIEW."



More and more investors are now looking for ways of minimising the risk of a portfolio beyond the traditional view. The solution to this problem is to find alternative investments and strategies that are uncorrelated with the market and thus can perform well, regardless of the prevailing economic conditions. With that aim in mind, when faced with an investment opportunity the question an investor should put to himself is:

Will this investment lose value if the financial markets crash?

If the answer is *"Yes"*, then an investor hasn't really found an 'alternative' investment, one that has the ability of reducing risk. If the answer is "No", then an investor may have found an investment worth considering.

What is an alternative investment?

An alternative investment is usually defined as an equity investment in a non-publicly traded asset, which may assume varying forms. Roughly speaking, as far as there are varying cash flow outcomes and a probability distribution can be assigned to them, there is a trade/investment opportunity. If that opportunity is not publicly traded, we have an alternative investment.

In general, the fact that these investments are not traded in an organised market comes with advantages and disadvantages. On the one hand, alpha is more easily found here than in more liquid markets, as there is a premium for the relative illiquidity and lack of information available, which requires stronger skills and expertise from the manager. As a consequence of the lack of an organised market, these investments are less exposed to the same daily movements that the overall financial markets suffer from, which better allows an investor to focus on the longer term. But on the other hand, the lack of liquidity can lead to difficulty in selling and to huge discounts to fair value under adverse conditions. The lack of historical data on prices additionally makes it very difficult to correctly define upside potential and downside risk, requiring in depth knowledge and expertise in those specific markets.

But with manias, panics and crashes occurring systematically in financial markets, more and more investors are looking for these alternatives to minimise the volatility of their portfolios. According to Morningstar, the assets of funds focused on real estate, gold stocks, commodities, and mutual funds and ETFs employing strategies similar to hedge funds soared from $172 billion (£111.5 billion) in 2008 to $506 billion (£328 billion) in 2014.

"THE GOAL HERE IS NOT TO SEEK OUT SOMETHING THAT IS DIFFERENT, BUT TO SEEK OUT SOMETHING THAT IS DIFFERENT FROM THE MARKET."

The word *"alternative"* is tricky because it is often understood as *"different"* or *"exotic"*. *"Different"* means something that lies outside the traditional asset classes of stocks, bonds and cash; and "exotic" means something that is really unusual, bizarre or singular. But the goal here is not to seek out something that is different, but to seek out something that is different from the market. Many investors look for alternative investments to gain alpha, but they usually end up just earning beta on the illiquidity factor associated with these investments rather than real alpha. But, our goal here is to reduce portfolio risk, in particular the risk that a well-diversified Markowitz portfolio bears. We want to reduce market risk.

Investing in fine art, wines, and real estate

As I mentioned above, an investment is anything with a stream of potential outcomes for which a probability distribution can be assigned. With the majority of such assets not being traded in an organised market, there are quite a few alternative investments.

Fine arts (which include paintings, drawings, prints, tapestry, sculpture and many other forms of art) are one of the most seductive alternative investments. When central banks inject money into the economy and purchase assets to keep the yield curve flat, they reduce the compensation savers/investors achieve from low risk opportunities. While the main goal of the central bank is to push money towards consumption and real investment to generate jobs and growth, most of the time what really happens is the excess money just gets directed towards the purchase of financial assets. When too much money is committed to stocks and bonds, and when the yield on the most liquid assets like cash is zero to negative, investors start looking elsewhere for returns. The money then flows to emerging markets, to derivatives, to alternative strategies and to non-publicly traded assets like real estate and fine arts. At the same time, as the emerging world develops, disposable income increases, and savings are directed to the developed world, most of the time to invest in financial assets or assets that were produced in prior periods, as opposed to assets produced in the current period and investment assets that increase future production. With all this in mind, demand for alternative assets seems likely to remain buoyant. Throw in the fact that assets like real estate and fine art have a relatively stable and limited supply, and the prospects for a long-term uptrend in prices seem very strong indeed.

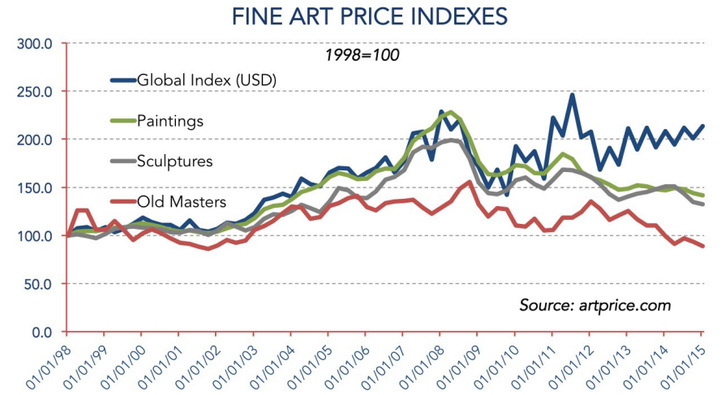
The fact that there is a limited supply is often good. But the fact that there is a central bank messing with returns is often bad, if not ugly. The demand for financial and non-productive assets is highly dependent on central bank policy, if not being wholly a result of it. So, the real question is:

Will fine art prices decline along with a crash in financial markets?

Let's take a look at price indexes for a few types of fine arts provided by artprice.com.

As can be seen from the chart, the overall fine art market (here depicted by the artprice.com index) experienced a steady increase during the 2000s until 2008. The price index rose from 100 in 1998 to 228.7 in the first quarter of 2008. But then it declined dramatically during the next few quarters until hitting 142.4 in the fourth quarter of 2009. That makes for a 37.7% drop in average prices, which means that many art investors actually recorded losses of a larger magnitude on the order of 50% or 60% in a very short time period. Then prices recovered again to peak at 246.2 in the third quarter of 2011. This pattern is similar to the one followed by the stock market. The answer to our key question is then "Yes", the market for fine arts is exposed to the same risks as the financial markets, and thus fine art does not meet our conditions to be selected as an alternative investment.

If we apply the same analysis to the real estate market, wine, and many collectibles we will find that these are more or less exposed to the same pattern experienced in financial markets. Investing in them may provide some diversification but the benefits aren't significant for those already well diversified with publicly traded assets, in particular after considering the relative difficulty in valuing them and selling them at fair prices.



"THE FACT THAT THERE IS A LIMITED SUPPLY IS OFTEN GOOD. BUT THE FACT THAT THERE IS A CENTRAL BANK MESSING WITH RETURNS IS OFTEN BAD, IF NOT UGLY."

There is a world of litigation out there

In July's edition of Master Investor (also published on our website) I wrote about the benefits of litigation finance. While it may sound unfamiliar to many investors, there is a world where plaintiffs (and plaintiffs' lawyers) need money to pay for legal expenses for lawsuits regarding patent infringement and other business-related matters. In order to secure the necessary financing they offer investors some equity: a slice of the lawsuit's potential winnings in exchange for the upfront funds necessary to pay the legal fees involved. The plaintiffs write a call to investors, who pay the premium equal to the legal fees involved, and then seek the upside potential deriving from the case.



There are many companies specialising in this business to ensure investors get a high quality and diversified lawsuits portfolio. They may sell to investors in the form of private equity or as an investment company. **Juridica Investments (JIL)** is a British company specialising in this business, and trades as a closed-ended fund on AIM (and according to my colleague Nick Sudbury, is currently trading below NAV). But we then come to our key question:

Will the price of the litigation finance asset decline with a crash in financial markets?

That's not likely, as litigation is related to the existing law and the quality of the selected lawsuits. A global market crash should not impact the quality of lawsuits, as long as the law remains unchanged. So, by selecting a good portfolio of lawsuits, or even indirectly selecting them via an open-ended fund like Juridica, an investor is truly reducing the market risk in his portfolio.

Why not some sports betting?

If litigation sounds unfamiliar, sports betting may sound even stranger as an investment. But as for the case of spread betting, the name doesn't tell the full story. A sports wager doesn't need to be considered gambling for someone with a sound strategy. By the same token, a trade in financial markets may in fact be gambling if placed randomly or under a poor strategy. Unlike what happens with a casino game where, by the law of large numbers, you don't stand a statistical chance of winning (in the long run), in sports betting you do, because the odds attached to the final outcome are stochastic. You can then attach a probability distribution to these outcomes and turn sports betting into an investment asset just like fine arts or real estate.

Many sports bets may now be placed through betting exchanges like Betfair, or at bookmakers trading in an ever more competitive environment, which means that transaction costs (in the form of commission and fees) have been dissipated and odds turned into fair values. For those who command a good knowledge of particular markets, they can get the edge and achieve alpha. For those with an investment portfolio, we have to ask the same question as before:



Will the price of the sports bet asset decline with a crash in financial markets?

Absolutely not, which means that an investor may reduce the risk in his portfolio by allocating a portion of his funds to sports betting. As sports betting requires knowledge outside of finance, one option is to subscribe to the service provided by tipsters or by allocating the money to a fund specialising in the business.

Bet on mortality

You heard the unfamiliar, then the strange, but now prepare for the morbid. Purchasing the life insurance claims of other people is something that doesn't sound very nice, but it is still an investment asset. Some people just want to surrender their life insurance, because they don't want the burden of paying the premium anymore, or because their situation changed and they prefer to receive some money upfront. Many of them just give up on their policies and stop paying the insurance premiums, losing the policy altogether; others may be able to surrender them to the insurer, but at very depressed values. But again, as there are uncertain future cash flows for which a probability distribution can be attached, this policy claim is an investable asset and many investors are willing to buy these policies at prices that are higher than the insurer wants to pay.

If we look at all the parts involved we can understand why there is a market here. The insurance company's business is to profit from the law of large numbers. On average they know people die at a certain age, and then all they do is build a large portfolio of policies, such that what they lose with some who live longer than average is compensated for by what they gain from those who live less. They don't need to buy any policy from someone willing to surrender it, as their key business is already done at that point, so they offer very little for it. For the policyholder who is faced with getting almost nothing for his policy, he will be willing to sell to someone offering something more. For Wall Street investors, they can achieve a profit by offering something more than an insurer pays up to the real fair value of the contract. They then buy a large number of policies and resell them as securities, often known as death bonds. Investors' profit comes from a statistical bet on life expectancy and there is no need to turn this into a personal issue with an investor just waiting for Mr Ford or Mrs Eastwood to die before time. There's also no need to hire a hit man to *massage* life expectancy rates inside the portfolio. Investors are expected to profit from the law of large numbers, via the difference between the discount they get in purchasing these assets and their true value determined by the average life expectancy.



While this is not a business I like, my interest here is whether this kind of asset is correlated with the market or not.

Here comes the key question:

Will the price of life insurance claims decline with a crash in financial markets?

It does not, as for that to happen life expectancy rates need to increase as a result of a market crash, which would be odd to say the least. Consequently, an investor can reduce the non-diversifiable market risk of his portfolio by adding this asset.

A few final words

At a time when investors understand the importance of controlling downside risk before thinking of the potential upside, it is becoming ever more important to diversify the risk of a portfolio. Contrary to the traditional Markowitz theory claim that all we can do is purchase the market portfolio because market risk is non-diversifiable, the truth is that we can find some alternative assets that are uncorrelated with the market and this way go the extra mile. But with alternative assets I don't mean different or exotic in the sense that they are not bonds, stocks or cash. What I mean is assets that are unrelated to the market and that are able to capture a real different angle. Litigation finance, sports betting, and life insurance claims are just a few alternative assets that can deliver on that goal. Fine arts, wine and many other collectible assets cannot.

"AS SPORTS BETTING REQUIRES KNOWLEDGE OUTSIDE OF FINANCE, ONE OPTION IS TO SUBSCRIBE TO THE SERVICE PROVIDED BY TIPSTERS OR BY ALLOCATING THE MONEY TO A FUND SPECIALISING IN THE BUSINESS."

MILLENNIALS AND FINANCE

WHY NO ONE EVER HAD IT ANY BETTER

BY CAROLINE DREWETT



The future is in our hands. With $2 trillion already in our possession, and $7 trillion of liquid assets to be in our control by 2020, Millennials (commonly regarded as those born between 1980 and 1995) are set to become the richest generation the world has ever known.

And it won't just be monetary wealth; we're rich in education, loaded in culture, and bursting with opportunity. To top it off, this wealth is coming at a time when studying Economics or Business at university is no longer the only way to learn about numbers; free webinars, YouTube videos, and online journals are in abundance – discovering the world of finance has never been easier or more accessible. We don't even need to manage our time well; being permanently attached to our smart phones has turned a time-wasting city commute into a potentially innovatory learning experience through podcast tutorials, TED talks, and the like. Millennials, also known as Gen Y, have the world at their feet. So why is there a resolute acceptance that we will never amount to anything, and that we are unlucky not to have been born in the baby boomer generation?

I recently flew from Doha to London on an early morning flight, leaving behind a very pleasant 34 degrees at 4am only to be greeted by a cold andwet Heathrow with the temperature gauge hitting eight degrees.

"WITH $2 TRILLION ALREADY IN OUR POSSESSION, AND $7 TRILLION OF LIQUID ASSETS TO BE IN OUR CONTROL BY 2020, MILLENNIALS (COMMONLY REGARDED AS THOSE BORN BETWEEN 1980 AND 1995) ARE SET TO BECOME THE RICHEST GENERATION THE WORLD HAS EVER KNOWN."

Eight measly degrees! And all in the height of August's summer! Whilst thawing out at border control, I had flashbacks of growing up in Britain as a child. The cold winters forced us to always be prepared for the annual family camping trip during torrential hail, where no one accepted defeat but insisted on heroically battling against the elements to hold true to our British bravery. As a nation, we pride ourselves on rainy barbeques, damp cricket matches, and making the most of a bad situation: this ability to prepare for harsh climates has been ingrained in us for centuries. So when the 2008 recession hit, rather than springing into action with our natural intuition, why did we Millennials just stand back and watch the financial horror unfold with nothing more than open mouths?

"IN EVERY DISASTER THERE IS OPPORTUNITY; INTEREST RATES FALL, HOUSE PRICES DROP (AND ACTUALLY BECOME AFFORDABLE), AND BIG INEFFICIENT BUSINESSES FAIL, LEAVING SPACE FOR NEW AMBITIOUS ENTREPRENEURS."

At the age of 22, Caroline Drewett started an education business in London. After diversifying into the world of conservation, and the buy-to-let market, at 28 she now lives and works between Hong Kong, London and Ecuador overseeing the company's projects. Clients include governments, foundations and private individuals. Her passion for nature, the outdoors, and exploring the world means Caroline spends much of her time travelling, experiencing new cultures, and identifying new opportunities whilst keeping abreast of global trends in real time.

In every disaster there is opportunity; interest rates fall, house prices drop (and actually become affordable), and big inefficient businesses fail, leaving space for new ambitious entrepreneurs. Combine all this with a lack of employment opportunities, and 2008 was the perfect time to get creative and start a business. And many did. It only takes a visit to London's Hackney, Liverpool's Baltic Triangle or Manchester's Northern Quarter to see how significantly some parts of Britain have changed in recent years. Where Brixton used to be famous for its riots and seedy clubs, it is now littered with yoga studios, florists and crêperies. Impacts 08, a five-year research programme studying the effect of Liverpool's European City of Culture accolade, found that in 2008 the city's visitor rate increased by 34%, and that the title brought in £758.3m for the city. Even during the recession, public optimism within the city was the highest it had been in years. So why were the majority of those starting small businesses and creative enterprises, capitalising on Liverpool's new status, from the baby boomer generation? Why did these individuals, with so much to lose financially, seize the initiative and opt for a career change, 'second wind' or a pioneering new endeavour? And why didn't those who were recent graduates, free from the ties of mortgages and from career stability, grasp the nettle instead?

The key lies in our expectations. The Guardian's daily reminders about how we are all doomed to despair are amongst the main offenders, and which, if you read frequently enough, you start to believe. They claim we'll never get on the property ladder, that we'll be saddled with student debt for eternity, and that it's our fault alone for being born into a generation of inescapable capitalism. In contrast they tell us that during their 20s, baby boomers had it all; affordable housing, good grammar school education, and not a penny of student debt in sight. But did they really? With Labour's 83% tax reigning supreme, baby boomers worked long hours yet kept very little; they worked all week only to spend their weekends navigating their way through the latest union strike. We only need to open a newspaper to realise that Corbyn's election as leader of the opposition has instilled fear into everyone that lived through the 1970s, all of whom seem to be shaking at the thought of Britain being taken back to the dark days of Old Labour and the financial terror it would unleash.

The reality? According to the National Office of Statistics, 60% of Inner-London's working-age population now hold degrees; going to university has never been easier, and the higher the tuition fees, the more government grants become available for struggling families. The problem now is not getting into university, but rather it is standing out from the masses that has proven difficult. 68% of graduates now receive first or upper second-class degrees in the UK; as degrees become less valuable, some companies have started ignoring them altogether. Ernst and Young have recently dropped degree classification and A Level results from their assessment criteria, deeming their own aptitude tests more useful in determining successful candidates. For the adventurous among us who fear academia and all it entails, starting a business should be an appealing challenge and viable alternative. Extremely low interest rates bring positive loan prospects; you'll be paying significantly less in interest now than someone from Gen X would have paid forty years ago to get your foot in the door to your dream business. Or if you choose to avoid the banks altogether, there's crowdfunding on every corner.

So why aren't we all jumping off our chairs and leaving the office photocopying behind us to follow our ambitions of starting a business and taking control of our lives? It can't be a lack of creativity - globally, Millennials have recently engaged in the most bizarre concepts in their quest to succeed in the small business world. Whether it's a filtered water cafe in Brooklyn, a completely silent cafe in Hoi An, or a Japanese wedding planner who only works with single women and holds "weddings for one": if it's different, there's a market for it. With social media now suggesting we document our every move, we want to show the world how interesting we are, we want to experience something unique, if not for ourselves, to show others we are on trend. And slowly, this new global wave of quirky business is reaching Britain, and succeeding. Crowd-funded Lady Dinah's cat emporium in Bethnal Green not only charges £70 for afternoon tea for two, but you're also required to book weeks in advance for the privilege.

"SLOWLY, THIS NEW GLOBAL WAVE OF QUIRKY BUSINESS IS REACHING BRITAIN, AND SUCCEEDING."

Going against the trend in business is something we are beginning to strive for, and do well in, so why do the baby boomers *still* feel sorry for us? For starters, many still judge success by a house, a wife and children by 30. It is time to start celebrating our achievements, our advances in social acceptance and our opportunities as the real successes of our generation. Receiving sympathy from baby boomers just because we haven't followed the same path they did is holding us back. Rather than feeling sorry for ourselves, our bravery not to feel pressured to work in a steady 9-5 profession for someone else should be celebrated, not pitied. In our pockets we are carrying access to virtually every piece of information known to man, so we have never been in a better position to forge our own path and discover a new career, or create one that doesn't yet exist. Now we just need to find the confidence to 'own' our generation and take the plunge.



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OPPORTUNITIES IN FOCUS

OPPORTUNITIES IN FOCUS

THE MARXISTS ARE BACK: SHOULD WE BE WORRIED?

BY VICTOR HILL



The Marxists are back. 2015 will be remembered as the year when they returned to the European political stage, and when their creed recovered its credibility. I want to explore the consequences of this momentous epiphany for your future. For if you oppose Marxism, as I do, you have to understand it.

"WITH THE COLLAPSE OF THE SOVIET UNION IN 1991, A STAKE WAS PLUNGED THROUGH THE VAMPIRE'S HEART. NOW THE VAMPIRE IS BACK."

Jeremy Corbyn, a Marxist, is now leader of one of Europe's most enduring centre-left political parties, the British Labour Party – the one that we were taught *owed more to Methodism* than to *Marx.* (Jeremy is no Methodist - an abstainer perhaps, but a republican atheist).



Down in Greece, Alexis Tsipras is back for a second stint this year with 35% of the vote. In Spain, *Podemos,* another anti-austerity movement with an anti-capitalist edge, has over 350,000 members. In France, where the communist Jean-Luc Mélenchon took nearly four million votes in the first round of the 2012 presidential election, Marxism never quite died. In fact, in a country where philosophical dexterity is prized above all else, it has always been acceptable to describe oneself as Marxist in polite society.

In retrospect, we shall probably conclude that this enduring ideology never went away. Yet just 25 years ago, Marxism, which affected to understand the sweep of history through *scientific socialism,* seemed itself to have been swept away. Marxist governments collapsed like dominoes. As an economic system, the kindest thing that could be said was that Marxism impoverished those who lived in its shadow.

With the collapse of the Soviet Union in 1991, a stake was plunged through the vampire's heart. Now the vampire is back. How did it escape its living death? To answer this we have to consider its history.

Marxism arose in response to the economic and social upheavals of the industrial revolution in Europe. Starting slowly in England at the end of the 18th century, by the 1840s, Western Europe (much of England, Lowland Scotland, the Low Countries, Northern France and the Rhineland) was home to factories and rapidly developing railway lines. The traditional social-economic model, where the land-based peasantry tilled the land owned by their aristocratic overlords, was convulsed by the mass movement of agricultural labour to the new towns and cities. Here they were set to work, often in desperate conditions, for the new wealthy class of capitalist entrepreneurs.

In 1848, the year that the contagion of revolution spread right across Europe, the 30-year old Karl Marx, in collaboration with his wealthy sidekick Friedrich Engels, published *The Communist Manifesto.* This early work contained all of the major themes that would much later be characterised as *Marxism:* the idea that all history is class struggle; that power in society is wielded by those who control the means of production; and the revolutionary notion that social justice and equality could only be obtained by a *Dictatorship of the Proletariat* – a political system where all economic power would be concentrated in the hands of the State on behalf of the masses.

Marx was a remarkable thinker of huge range: he wrote on history, contemporary politics (he was obliged to make a living by writing for *bourgeois* newspapers), philosophy, sociology, psychology and, of course, economics. His economic theories were elaborated in a series of works, many of which went unpublished until after his death in 1883. Namely: his three-volume treatise *Das Kapital* and the follow-up work (often termed the fourth volume), Theories of Surplus Value. These were all written in London, where Marx came as what we would now call an asylum seeker, in 1849.

So what is the *economic* theory at the heart of Marxist thinking?

Marx's Theory of *Surplus Value* (value added) is a theory about how wealth is created. He was not the first to address this problem, but his analysis was enduringly influential. Marx argues that all value added in a capitalist economy



arises from the exploitation of labour.

Imagine a worker in a boot factory who is paid $10 per hour. He is required to manufacture four pairs of boots per hour, each of which is sold for $10. So, every hour the capitalist generates $40 of product while he pays the worker $10. That's $30 of gross profit. Once the capitalist deducts his rent (fixed costs) and operating (variable) costs of, say, $20, he accrues $10 of net profit. This is the surplus value.

The worker has no claim to this surplus value at all. His capacity to bargain over wages is restricted by restrictive laws (which favour capitalists) and the supply and demand for labour. So the surplus value arises because the capitalist has paid the worker less than his labour is truly worth. Moreover, because capitalists seek to maximise surplus value *(accumulation of capital),* they are motivated to force workers to work the maximum number of hours feasible at the lowest rates possible.

This notion that capitalism is inherently *exploitative* would apply, for a Marxist, alike to a Bangladeshi sweat shop and a modern *progressive* capitalist employer like Microsoft Corporation. It doesn't matter that, on the one hand, workers are living in dire conditions and, on the other they enjoy salubrious life-styles. Both sets of workers are being paid less than their labour is worth.

Now most of my readers will find this argument mildly ridiculous. Obviously the capitalist, bloated as he (or she) may be, has gotten off his backside and invested his own capital, plus probably that of others, plus loans from banks, into a production facility (boot factory) which *might fail.* After all, there may not be a market for boots at $10 a pair: what if he can only sell them at $5 a pair?

And yet it took economists a good while to formulate a theory that formally accommodated this insight. The Capital Asset Pricing Model (CAPM, developed principally by Treynor and Sharpe in the early 1960s, but based on the earlier work of Markowitz) explains that the value of any asset (usually a stock, but possibly also a pair of boots) is partly a function of the risk associated with acquiring it (or producing it).

So it's quite natural for us to say that what Marx calls surplus value is actually the return on invested capital commensurate with the risk associated with producing it. Capitalism rewards innovation, good management and risk-taking. Not everyone has the qualities to build a successful business. Outside America, however, this way of thinking only became mainstream relatively recently.

By the time of the First World War, the Marxist way of thinking about economics had become hugely influential in

"IT WAS THE RED ARMY, SWEEPING THE NAZI INVADERS BACK TO THEIR GERMAN HOMELAND, WHICH IMPOSED SOVIET-STYLE MARXIST SYSTEMS ON HUGE SWATHES OF EASTERN EUROPE, NOT POPULAR REVOLUTIONS."

Europe. At the end of the cataclysm the empires of Central and Eastern Europe (and Turkey) fell. Russia was taken over by the Bolsheviks whose official philosophy was *Marxism-Leninism.* Russia became the USSR, a state in which all businesses were owned and controlled by the state. For the next twenty years, the USSR pursued a policy of *Socialism in One Country.*

It was the Red Army, sweeping the Nazi invaders back to their German homeland, which imposed Soviet-style Marxist systems on huge swathes of Eastern Europe, not popular revolutions. Arguably, there has never been a popular Marxist revolution, as Marx had predicted. The victory of Mau's Chinese Communist Party in 1949 was the culmination of long-standing civil war which had only been interrupted by Japanese occupation. And in the 1950s and 60s Marxist governments came to power in Indo-China and in Ethiopia on the back of protracted guerrilla wars.

The *Cold War* was the great geopolitical duel between the US and its NATO allies on the one hand and the USSR and its Warsaw Pact on the other. Yet it was also a great ideological contest in which competing visions of how societies should be organised were put to the test. As late as 1962 Nikita Khrushchev, the Soviet leader, told President John F Kennedy: *We shall bury you.* He didn't mean that the Soviet Union would destroy America in a nuclear war (though that was always a fear) but that the Soviet system would win out in the end over American capitalism.

By the mid-1980s when Mikhail Gorbachev came to power that prospect was looking increasingly unlikely. It had become apparent that the Soviet Union and its allies were falling behind in the economic race. (China was barely on the map at this time). While Americans drove Mustangs, ate pizza and travelled the world, Soviet citizens drove goofy Ladas, queued for bad meat and were overwhelmingly forbidden to travel at all.



It had also become clear to all who had eyes that the Soviet model, even after Stalin, involved extreme political repression. Of course at the time of Stalin's purges in the 1930s (and as late as 1948) millions perished, either by firing squad or starvation under forced labour. Most Western Marxists were either purge-deniers, or, like the late Marxist historian, Eric Hobsbawm, believed, along with Lenin, that you *can't make an omelette without breaking eggs.*

Historians disagree about why the Soviet Union formally dissolved on 26 December 1991. But from the time of the fall of the Berlin Wall in October 1989, still

more the botched Communist coup of 19 August 1991, the entire Soviet system haemorrhaged credibility, even amongst Communist Party stalwarts (like the young KGB officer, Vladimir Putin).

Marxist states had resorted to increasingly bizarre tactics to repress their citizens. East Germany (the GDR) had decreed that Trabant motor cars have concrete pumped into their engine frames, lest they be used to power the microlight aircraft which its citizens increasingly used to escape to the West.

George Bush Senior's *New World Order,* during which the first Gulf War was undertaken, was a world in which America was the unique super-power. Marxism was humbled – a lost cause. When Tony Blair took over the Labour Party in 1994, his first strategic move was to abolish Clause IV – the hallowed paragraph of the Labour Party constitution of 1918 which pledged the party to the Marxist-inspired *nationalisation of the means of production, distribution and exchange.*

By the time that Mr Blair came to power in 1997 on a massive wave of popular enthusiasm, Marxism was a dead religion, universally despised. Even the People's Republic of China was surging on account of *Socialism with Chinese Characteristics* – an authoritarian form of government in which a one-party state monopolised political power, but where individual capitalists were encouraged to flourish with Victorian property rights. (No Health & Safety inspectors there). *To make money is a glorious thing*, intoned Zhou Enlai.

But the vampire had not been wrapped in garlic. I discern five inter-related reasons why it re-emerged from its coffin.

First, the American invasion of Iraq in 2003. Led by President George W Bush and vigorously supported by Mr Blair, after several years of dislocation, this adventure turned out to have been such an incompetent, ill-planned and motiveless assertion of America power, that it exposed the extent to which the Free World (America and its clients) had been everything that the Soviet Union had asserted during the Cold War: an old-fashioned Empire kicking ass for its own interest under the guise of ridding the world of *weapons of mass destruction.* Virtually all of the power structures in this strategic region were indiscriminately smashed, with appalling consequences now apparent.



Second, the Credit Crunch of 2008 and the global recession it triggered. The collapse of Lehman Brothers on 15 September 2008, and the near-collapse of HBOS and RBS in the UK in the following weeks, was the culmination of more than a decade of *casino banking* during which time mortgages (and other loan assets) were repackaged and sold on to third parties as *Securitised Debt Obligations* and other exotic instruments. Banks leveraged up their balance sheets with these illiquid assets of indeterminate credit quality. Their much vaunted *risk models* proved useless. The banking systems in the US and the UK came perilously close to melt-down; and it was only thanks to the two governments pumping huge quantities of *liquidity* (money) into the system that the financial system remained solvent at all.

In the UK, ordinary folk who never previously resented the fat cats of the City were aghast to learn that their Government had used public funds to keep the banks afloat so that the very people who had messed up could continue to receive their gigantic bonuses. If poor old *Fred the Shred Goodwin* was demonised, he still walked away with a seven figure pension. Very few senior bankers were fired. And none executed. Once again, no economist will offer a single clear-cut reason as to why or how this financial earthquake, which precipitated four years of recession, could have happened. Howard Davies (then Chairman of the FSA and recently appointed Chairman of RBS) wrote an excellent book[1] in which he identified nearly 40 critical factors.

They range from inadequate prudential regulation (and he was a regulator!) to short-selling, off-balance sheet vehicles, accounting irregularities, the greedy bonus culture, hedge funds *(a plague of locusts)* and the shadow banking system, inept liquidity risk management and flawed risk models. His conclusion: all of the above came together in a *combustible mixture.* Could it happen again, in Davies' view? Quite possibly.

It is difficult to assess the Credit Crunch without at some point reflecting that there was something very wrong with the system that permitted it to happen. The regulators eventually responded, in Europe but not America, by re-engineering bank capital adequacy regulations (Basel III). But the Left seized on this crisis as evidence of capitalism's inherent contradictions.

"THE LEFT SEIZED ON THIS CRISIS AS EVIDENCE OF CAPITALISM'S INHERENT CONTRADICTIONS."

Third: the resulting sovereign debt crisis in Europe. This arose because European governments were forced to rack up debt to exorbitant levels in the downturn, and because many had to refinance their moribund banking sectors.

When the financial collapse engulfed *les Anglo-Saxons* (as the French call Britain and America collectively) in 2008, José Manuel Barroso, President of the European Commission, sniffed that this crisis had *nothing to do with Europe.* Yet, within 18 months, a swath of Southern European governments (plus Ireland) had hit the financial buffers. The first Greek bailout of May 2010 was a prelude to the protracted saga of how an overly indebted country could continue to function as a member of the Eurozone, which (as discussed elsewhere) has still not fully played out.



Fourth, as a consequence, the extensive welfare systems of the European social model came under huge strain. Right-of-centre politicians like George Osborne understood the need to bring under control the elaborate and often misdirected system of transfer payments which in many countries like the UK now account for more than one third of the national budget.

This has given rise to activists who describe themselves as *anti-austerity.* One can see that they have a case in Greece, where government expenditure has been drastically reduced – libraries, museums and doctors' surgeries closed. It's more difficult to understand their case in the UK, where spending has risen in real terms every year since the crisis. Here, austerity means that previously inexorable increases in the welfare budget *(Housing Benefit* being a case in point) have only recently been checked. Pension spending has continued to rise in real terms, as has spending on the NHS.

"THE GREEN/ENVIRONMENTALIST CRITIQUE OF CAPITALISM HAS BREATHED NEW LIFE INTO THE MARXIST CAUSE."

In Scotland, Ms Sturgeon has shaped the SNP into a party that aspires not just to the independence of an ancient nation, but as the resistor of a wicked regime of austerity imposed from cruel, distant London. The facts that Scotland receives a more generous level of funding per capita than other parts of the UK or that major spending decisions are now taken in Edinburgh are ignored in this narrative. The Scottish Parliament has had the power to raise the basic rate of income tax by a penny since its inception; yet the SNP government has chosen not to use it, for fear of losing votes.

The fifth reason is the rise of environmentalism as a political movement. In the old days, *conservationists,* as they were called, were of the right. Landowners and aristos campaigned for red squirrels. The Duke of Edinburgh became the President of the WWF (World Wide Fund for Nature) in 1981. But, with the rising *consciousness* (Marxist term) of man-made global warming – *climate change* – the green movement began to align with the reds. Caroline Lucas, Britain's only Green MP, has described her self as an *old fashioned socialist.*

The point is that the Green/Environmentalist critique of capitalism has breathed new life into the Marxist cause. They claim that capitalism, by always maximising profit (surplus value) by its very nature denudes the environment. Eminent left-wing writers like George Monbiot have constructed a new critique of the capitalist system from the Green Left, weaving environmental protection with themes of sustainable development, human rights, social inclusion and welfare policy, all under the general banner of *equality.*

Monbiot, by the way, like Mr Corbyn, was an arch-critic of the Iraq War and has even launched a pressure group which campaigns to put Tony Blair on trial as a war criminal. Everything connects.



In popularising the *man-made global climate crisis,* the Green-Reds have managed to expose just how stupid the Right can be, especially in America, where climate change deniers sit alongside racial segregationists and those who denigrate Darwinian evolution. On this side of the Pond we have some respectable climate

change deniers, such as Lord Lawson. But the overwhelming consensus of the scientific establishment is that man-made carbon emissions are causing a rapid rise in mean global temperatures. Though no one agrees by how much temperatures might rise over a given time horizon.

On the academic front, Thomas Piketty's *Capital in the Twenty-First Century,* published in 2013, shows persuasively how the rich have been getting richer at a much more rapid pace than median earners over the last 150 years (with a short interruption during the post-war baby boom years). This, says Piketty, is because the return on invested capital (r) has a tendency within capitalism to be higher than the rate of growth of the economy as a whole (g). This may seem rather dry to non-economists. But it is a very powerful argument in favour of wealth taxes as backed by Marxists; whereas *bourgeois* politicians just tinker with taxes on income.

"HISTORY IS DRIVEN BY IDEAS. HEREON IN, ONLY THE INTELLECTUALLY FITTEST SHALL SURVIVE."

Collectively, these five factors have breathed new life into the Marxist narrative, especially amongst disaffected young people, many of whom have college debts to repay and restricted job opportunities.

Yet it has taken time for all this to translate into electoral success for the Left. Indeed the initial impact of the Credit Crunch and European Sovereign debt crisis was to favour right-of-centre parties (Gordon Brown lost in the UK in 2010, and JLR Zapatero in Spain in 2011). *Syriza* in Greece and *Podemos* in Spain have only lately flourished in the arid soil of desperation that millions of lower middle class and working class Europeans feel, with only the prospect of joblessness and austerity ahead.

Hitherto, across Europe and America, middle class supporters of the status quo have exhibited a higher propensity to vote. But what if the one third of the electorate who refused to exercise their right to vote in the UK in May 2015 were stirred into action? This is Mr Corbyn's dream, and, to some extent, the manner of his own victory in the Labour leadership contest proves that it is possible. If the goby guru, Mr Russell Brand, with his nine million followers on Twitter, could persuade the disaffected to register their votes, rather than propagating apathy, who knows how many millions of votes that could deliver?

Whatever you think of his views, it would be a mistake to underestimate Mr Corbyn. He has two rare qualities in modern politics: integrity and coherence. Right-of-centre Labourites might defect but, after the tsunami of support that brought him to the top, they will not be able to topple Mr Corbyn as Labour leader between now and 2020. Labour Party membership is surging (just as SNP membership surged after Ms Sturgeon took over).

All Mr Corbyn needs to get to Number Ten in 2020 is another economic crisis. This would further erode the credibility of the capitalist system, and of course consign Mr Osborne's spreadsheets to the shredder.

What would a Corbyn government be like? Expect swinging tax increases on anybody earning above £40k, mansion taxes, stealth taxes on second homes, a massive hike in corporation taxes and, oh yes, a new wealth tax beyond even Mr Piketty's dreams of avarice. Banks and railways will be nationalised. Private schools will be closed, their assets sequestered. The pound will plummet, the stock market will crash; gilt yields will soar. The national debt will rocket, at least until such time as national economic statistics are supressed as being *socially obnoxious.* The UK Border Force, together with the armed forces, will be disbanded.



You will try to buy a one-way ticket out, but not to the USA, since after Mr Corbyn flogs our fleet of Trident submarines to the Russians on the cheap our American friends will close their borders to British passport holders. The MI website will be closed down. The national grid will falter; but just before the lights go out your bank accounts will be frozen.

There is yet time to prepare. What we must collectively do to secure the young is to articulate what is the non-Marxist response to financial crises, climate change and the rest. History is driven by ideas. Hereon in, only the intellectually fittest shall survive.

Should we capitalist dinosaurs be scared of the New Marxist asteroid? Absolutely. And scared is exactly where they want us. Round One to the Corbynistas.

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.

1. The Financial Crisis: Who is to Blame? Howard Davies, Polity Books, 2010.

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UNCERTAINTY IS KING AS GOLD LOOKS SET FOR STRENGTH

BY SAMUEL J. RAE



So markets spent pretty much the entirety of the third quarter eagerly waiting to see what Janet Yellen and the Federal Reserve would do about US monetary policy in September. The announcement that finally came on 17th September was probably one of the most widely anticipated interest rate announcements of the last two decades.

Equities markets slowed up in anticipation of steep volatility ahead of the announcement, commodities markets dipped and the dollar strengthened in anticipation of a hike. Then… nothing.

Janet Yellen said she was holding interest rates at zero, and markets pretty much ignored her. All the major indices across Europe, the US and Asia remained pretty much flat as they approached the weekend, and the dollar finished the week at pretty much the same levels at which it started versus its major counterparts. For what was such a hotly anticipated announcement, we got a startlingly dull response. In the interpretation of this response, however, there lies opportunity. Markets doing nothing can tell us as much as markets doing something considerable, and in this instance, it has presented us with a bias forming opportunity. Where? Precious metals. Here's why.

It all comes down to uncertainty. The situation we are currently in is unprecedented. Six years on from the last recession, the notion that we are likely closer to the next than we are the last is a perfectly reasonable suggestion. However, while equities markets have boomed over these six years, underlying economies have not. Growth and inflation remain non-existent and what are surely now overheated equities markets remain propped up by the massive influx of free capital we have seen over the last half decade through zero interest rates and a spate of quantitative easing programmes. When things start to turn to the downside, the Federal Reserve has pretty much no tools with which to counter.

Yes, Janet Yellen could implement a fourth quantitative easing programme, and indeed many analysts expect this to occur early next year, but when we look at things objectively, it is difficult to see what impact this is going to have. The US Federal reserve has spent over $4.5 trillion in an attempt to tease its domestic economy into expansion, yet the threat of deflation remains very real.

Equities markets are well aware of this. If they weren't, the continuation of zero interest rates in the US would have translated to some bullish momentum across the major indices. So how can we use this? Well, as mentioned, precious metals look an attractive option at the moment. An underlying uncertainty should very quickly start to translate to a shift in overall market sentiment, from 'risk on' assets such as equities to 'risk off' assets such as precious metals.

This shift will do two things that we can take advantage of as currencies traders. The first is to present us with a buy opportunity in gold. Those reading this that are already familiar with my currency trading strategy will be aware that I primarily take positions based on candlestick formations on daily charts. However, when an opportunity arises for a longer-term holding on a fundamentally driven bias, I will take it. XAUUSD (Image 1) bottomed out around 1080 earlier this year, and currently trades around 1130. I would love to see a break above the 1150 mark, as this level



IMAGE 1



IMAGE 2

has presented resistance in the past, but short-term volatility aside, long XAUUSD towards a minimum upside of 1250 looks like a nice long-term trade.

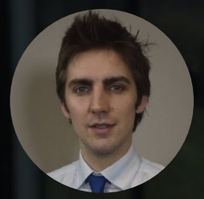
Second, I expect we will see a broad range weakening of the US dollar. This may not be a near-term thing, as an equities market correction could translate to some dollar strength in the short term; however, as the threat of a fourth round of quantitative easing plays into sentiment, alongside further deflationary pressure, the US dollar could struggle. Its current strength really only exists for the lack of a better option – the yen, the Euro and the Aussie all stand to lose strength if the situation in China continues – and as such, we are surely due a correction. Picking the best out of a bad bunch to play up against the dollar, I am looking long cable (Image 2) towards 1.8 flat – levels not seen since the wake of the last recession in 2008.

Of course, these are not the only two opportunities that will come about as a result of what's happening in the US. Silver and platinum spring to mind as immediate safe haven assets, while a weakening dollar and continued loose monetary policy could easily translate to a turnaround in commodities over the medium to long term. Long soybean in particular looks like a nice trade. However, the two trades mentioned above are the two that, in my opinion, have the highest chance of success in what looks set to be very uncertain and volatile markets as we head into 2016 and beyond.

RISKY AIM STOCKS FOR BRAVE INVESTORS

RISKY AIM STOCKS FOR BRAVE INVESTORS

BY RICHARD GILL, CFA



As a whole, investors in the AIM market have not had a good time of things. Since launching in its original form in March 1996 the AIM All Share index has fallen from 1,000 points to 728.89. Even worse, the index is only trading at a quarter of its peak level – 2,924.4 seen at the height of the dotcom bubble in early 2000. And so far this year 242 stocks (almost a quarter of the whole AIM market) have seen falls in value of 40% or more.

While the average AIM investor is likely to have made capital losses, of course there have been notable successes. Those who put just £1,226 into online fashion marvel ASOS at the nadir of 3.25p back in August 2003 now have a stake worth a million pounds. And the potential for making substantial short term gains also exist in the small cap world. According to data from Sharescope, 36 AIM stocks have more than doubled in value so far in 2015, with 117 having gained 50% or more.

So, as ever, AIM is clearly a risky and volatile market to be involved in.

On that note, in this edition I take a look at three AIM stocks which have a higher risk profile than most but which I believe could deliver significant returns if things go well. Of course, if things go badly investors should be prepared for the worst.

MOLINS (MLIN)

The Business

With a history dating back to 1912, Molins is an AIM listed engineering and services company which makes machinery and provides support services for companies in the consumer goods, healthcare and pharmaceutical sectors. Following a recent restructuring the firm now operates via two divisions, Packaging Machinery and Instrumentation & Tobacco Machinery. Business is spread all over the world, with 90% of revenues coming from outside the UK. Reflecting its origins, the firm has a large presence in the tobacco sector, specialising in mid-speed cigarette makers, packing and handling equipment.

MOLINS PLC

Molins moved from the Main Market of the LSE to AIM in June last year, stating lower costs and less strict regulatory requirements as its main reasons. It wasn't a good start to life on the junior market however. In October the shares plunged by around 37% in the days following a profits warning, which was blamed on weaker orders and delayed machine deliveries. This was especially badly received by the market, which only six weeks earlier saw interims to June report that underlying pre-tax profits fell by 60%.

Recent trading

Molins shares currently trade at around half the levels seen before the October profits warning. This is despite some progress having been made since then and a lot of bad news seemingly being in the price.

"MOLINS SHARES CURRENTLY TRADE AT AROUND HALF THE LEVELS SEEN BEFORE THE OCTOBER PROFITS WARNING."

Firstly, despite underlying pre-tax profits being down by 39%, results for 2014 were in line with revised expectations. Then in May the company confirmed the sale of Arista, its loss making US based analytical services laboratory operation, for $0.5 million. Although the loss on disposal was £3.5 million the sale sees last year's operating losses of £2 million removed from the group.



Molins Octave cigarette making machine

Interims for the six months to June were again in line with market expectations but rather a mixed bag. Underlying pre-tax profits from continuing operations for the period were £1.3 million, down by 24%. Net debt increased from £2.1 million to £3.9 million. Nevertheless, the interim dividend was maintained at 2.5p per share, with underlying cash from operations being strong at £1.6 million. With trading being weighted towards the second half Molins remains on course to meet full year market expectations.

That is the better news. Unfortunately there are a number of negatives associated with the Molins investment case.

The elephant in the room here is the company's pension deficit, which as at 30th June stood at a net £9.7 million. Funding of £1.8 million per annum is currently being put in to plug the shortfall. More notable is the huge value of the pension assets (£363.9 million) against the company's net assets (£23.6 million). As such, even a small relative valuation movement in the pension can have a huge effect on the balance sheet.

There is some hope for the position to improve however. Firstly, the triennial pension valuation started on 30th June this year, with new funding rates due to be announced next year – of course this could result in higher payments. Secondly, any increase in interest rates at the Bank of England will result in a fall in the present value of net liabilities, so all other things being equal the deficit will fall.

Other key risks across the business include exposure to cyclical changes in the global economy affecting demand, margin pressure from competitors and the exposure to exchange rates given the firm's large international exposure.

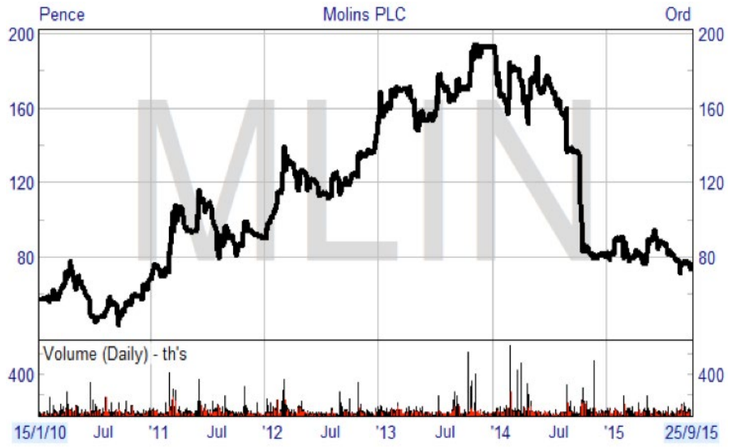
Valuation

At the current (at time of writing) mid-price of 69p Molins shares are trading at their lowest level for around five years. Market forecasts for the current year point to earnings of around 14.8p per share, putting them on a lowly multiple of just 4.7 times. This is well below the wider industrial machinery sector, but clearly reflects the pension issues and recent trading difficulties.

There is also an attractive dividend on offer. The total annual payment has been held at 5.5p since 2012, with Molins historically making generous payments to shareholders. Covered around 2.7 times by forecast earnings for the current year and given the steady cash flows, the payment looks reasonably sustainable. Assuming that the dividend is maintained then the current yield is a chunky 7.97%, one of the highest available not only on AIM but also on the whole of the London market.

"MOLINS IS A HIGH RISK STOCK WHICH I BELIEVE SHOULD BE TREATED AS A "SPECIAL SITUATION" AND RECOVERY PLAY."

Overall, Molins is a high risk stock which I believe should be treated as a "special situation" and recovery play. A trading statement expected in October could provide a catalyst for the shares to regain some ground and I believe a reasonable medium-term target price could be 110p, equating to a 5% yield. In the longer-term if the market applies a PE of 10 to the stock (more in line with the sector), the shares could more than double in value.



AQUATIC FOODS GROUP (AFG)

I mentioned in the introduction that this article was all about the more risky stocks on AIM. And with a terrible track record on the junior market, Chinese companies have risk in abundance. Why? Investors simply have very little trust in them due to governance concerns, a lack of transparency and a number of scandals which have been seen over the years.

For example, sports clothing business **Naibu** delisted in July after its directors went AWOL, refusing to contact the UK based non-executives. Only last week shares in e-commerce provider **JQW** plunged after it was fined and had its operations suspended for a month by the Chinese authorities after a pyramid scheme was advertised on its site. And clothing maker **Camkids** has just had its shares suspended, nominated advisor and several directors resign, after a boardroom bust up.

There remain around 45 Chinese companies listed on AIM. Regarding their valuation, investors tend to group them all together in terms of risk profile, applying what I call the "Chinese discount". If this discount is to be reduced in the long term then the market needs to see a few success stories. In that vein, I present Aquatic Foods Group.

A Fishy Business

Listing on AIM in February this year, raising £9.3 million, Aquatic Foods Group is a China based marine foods and seafood processor and supplier. Focussing on fish, sea cucumbers, cephalopods (octopus, squid etc) and other sea life, the firm operates from a 21,000m facility in Yantai City, Shandong Province. This has the capacity to process 16,000 tons of seafood per annum. Given a number of food scandals in China over recent years, it is encouraging that the company focusses heavily on food safety, sustainability and quality, it having received a number of key international standards certifications.

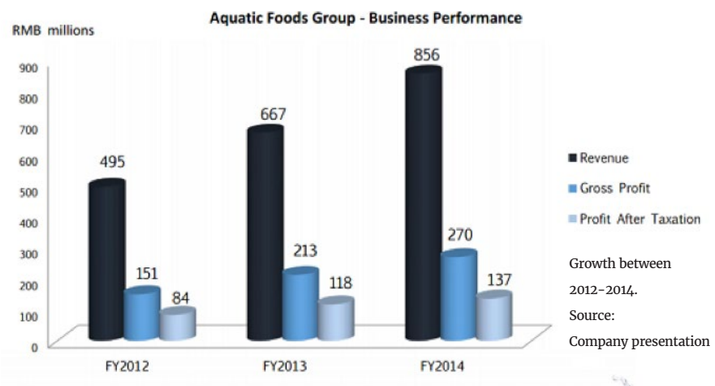
Taking advantage of the growth in disposable incomes, Aquatic Foods targets the domestic Chinese market via its Zhenhaitang brand. Its route to market comes from over 50 regional distributors, covering 16 provinces, municipalities and autonomous regions in the PRC. There are also eight Zhenhaitang branded retail stores, with plans to double the number of stores this year. On the export side Aquatic Foods operates the Yantai Kanwa brand and sells its products to 11 countries, with Japan, South Korea and the USA being its major markets.

Recent trading going swimmingly

Aquatic Foods has a good recent track record, with net profits up by 63% between 2012-2014. The firm has also met all market expectations as a public company. Interims for the six months to June (translated into sterling) showed revenues up by 26% at £46 million and pre-tax profits up by 29% at £10.6 million. Following the receipt of the IPO proceeds and after seeing a very strong £9.2 million net inflow from operations, net cash stood at £38 million. The company also announced a maiden interim dividend of 0.7p per share.

The only minor hiccup since listing was the resignation of UK based Senior Independent Director and Deputy Chairman John McLean, effective following the July AGM.

Aquatic Foods Group Plc



Growth between 2012-2014.
Source: Company presentation

This might not necessarily be a bad thing however given that McClean was Chairman of China Food Company (suspended and delisted from AIM) and Sorbic International (suspended from ISDX in May pending clarification of financial position). Since then Jonathan Quirk, a qualified Chartered Accountant with 40 years' financial services experience, has been appointed as Senior Non-Executive Director.

Further good news came at the end of September when the firm announced that it had signed a $15.4 million, one year deal with US focussed seafood wholesaler Yihe International to supply 11 separate seafood products. The deal should start to benefit the accounts in the fourth quarter of the current financial year, with there being the prospect of repeat business.

Assessment

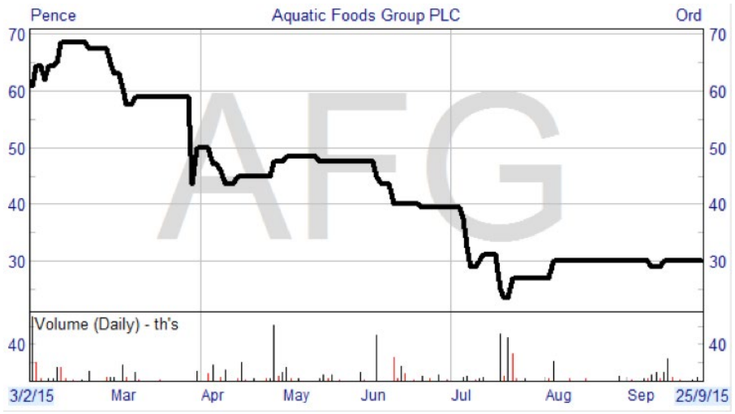
There is a notable lack of interest in Aquatic Foods, both from UK based institutions and private investors. The current mid-price is 30p, the shares having halved since IPO, capitalising the company at £34 million. Unfortunately the spread is huge at 33%, with investors having to pay 35p to buy. If they were to sell immediately at the 25p bid price that would result in an instant loss of 29%.

There are further liquidity issues, with trading volumes being very low. For example, despite the deal with Yihe representing around 11% of historic annual revenues the shares barely moved on the news. In addition, CEO Li Xianzhi has a 45% stake in the business.

To the valuation and Aquatic Foods shares look very, very cheap indeed. Firstly, they trade at a 10.5% discount to reported net cash as at 30th June. Secondly, they trade on a historic earnings multiple of 2.4 times. Regarding the dividend, at IPO the company stated that it intends to make a payment which equates to a 2% yield based on the IPO price of 70p. So at 35p to buy that implies a 4% yield, although the firm has hinted that it may make a higher payment should trading continue as expected.

Overall, Aquatic Foods looks like a solid and growing business. In contrast, the shares themselves are very (very) risky given the liquidity issues and China associated concerns. **Nevertheless, they do have the potential to multi-bag many times over should the business continue to perform well and should market sentiment take a positive turn.** Of course, there is also the potential for the stock to go the same way as many of their Chinese peers – to zero.

"AQUATIC FOODS SHARES LOOK VERY, VERY CHEAP INDEED."



POLO RESOURCES

As the often quoted Warren Buffett once said, when attempting to explain his secret to getting rich on Wall Street, *"We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful."* One industry which is seeing fear in abundance right now is natural resources.

Investors will be well aware of the plummeting oil price, which has fallen by 51% over the past year. Copper is down 26%, platinum 28%, zinc 30% and gold 7%. All this had led to share prices collapsing across the industry. Shares in resources bellwether BHP Billiton have halved since last summer and according to my research, of 277 mining and oil & gas companies currently listed in London only 36 of them have seen share price gains in the past 12 months.

Polo Resources

The Business

One company which has been hit particularly hard is the natural resources investor Polo Resources. As it stands today Polo has a range of investments in listed and unlisted companies focussed on the resources sector, in oil and gas, gold, coal, iron ore, phosphate and copper (see table).

Under the guidance of previous management Neil Herbert and Stephen Dattels the company built up a good reputation, delivering several special dividends to shareholders. They stepped back in 2013

Investment	Stake	Activity	Listing
Nimini Holdings	90%	Gold in Sierra Leone	Unlisted
Blackham Resources	10.65%	Gold in Australia	ASX
Signet Petroleum	42%	Oil & gas in Africa	Unlisted
Regalis Petroleum	11%	Oil & gas in Namibia	Unlisted
Equus Petroleum	1.95%	Oil & gas in Kazakhstan	Unlisted
GCM Resources	27.80%	Coal project in Bangladesh	AIM
Ironstone Resources	15.16%	Iron ore in Canada	Unlisted
Celamin Holdings	12.70%	Phosphate in Tunisia	ASX
Weathely International	7.06%	Copper in Namibia	AIM

Polo Resources investments. Data source: Company website

to be replaced by Michael Tang, owner of investment firm Mettiz Capital, as Managing Director. Unfortunately Tang's arrival came shortly before the current resources downturn, with the shares having plunged by 84% to the current 4.25p since his appointment. Tang's decision to purchase an 11.77% stake in Polo (from Stephen Dattels) on his appointment, at 40p per share – a significant premium to the then share price - is notable for its bad timing.

Unsurprisingly, investor sentiment surrounding Tang is not good. While his entry into Polo may have been bad timing, under his leadership the company has made some pretty investor unfriendly decisions. For example, a £1.6 million investment in Namibia focussed copper miner Weatherly International in November 2014 soon plummeted and the shares were suspended for three months after the company hit operational problems. A $22.8 million cash receipt from investee company Signet Petroleum was kept within Polo and not distributed to investors in the style of previous management. Tang himself has been widely criticised for his consultancy business taking a chunky looking $628,000 fee in 2014. And the firm no longer keeps the market up to date with a quarterly NAV assessment, instead only releasing one at the time of results.

What's it worth?

For the purposes of this analysis I will not go into too much detail about Polo's specific investments but go straight to the valuation. The company has had a quiet year in terms of news flow, the last significant statement being the interims to December, released on 27th March. NAV as at 25th March was reported at 27.7p per share but we cannot reliably use this figure given the time passed since then and the downturn in the resources sector.

Instead let's look at the cash

Polo reported net cash of $23.5 million as at 31st December, which equates to £15.5 million. With no announcements to the stock exchange we can assume that spending has not been significant in the past 12 months. I take away £1 million from the cash for corporate costs and then conservatively discount it by 20% to account for any investment spending. This equates to £11.6 million, which more than covers Polo's current market cap of £11.47 million. This means that the company's wide ranging investment assets are effectively been valued at next to nothing.

With low investor sentiment, a lack of value realisation and the industry continuing to struggle, it is easy to see why the stock currently has the valuation it does. But for investors wanting to gain exposure to a potential long-term recovery of the resources sector, Polo Resources seems like a good way to do it.



I end with the words of my colleague Evil Knievil (aka Simon Cawkwell) on the stock, which perhaps sums up the situation perfectly.

"Ever the glutton for punishment I bought Polo (POL) yet again – this time at 4.25p. It is either a fraud or very cheap. My bet is the latter."



FUND CORNER

FUND CORNER

SMOOTH OPERATORS

BY NICK SUDBURY



The main priority for retirees who want to supplement their pension is to find an investment that will generate a steadily increasing level of income without taking too much risk with their capital. For many of them the ideal solution would be a portfolio of investment trusts.

Unlike their open-ended counterparts, investment trusts have the unique ability to set aside a portion of the income they receive each year. This allows them to build up some cash so that when market conditions deteriorate they can use it to maintain or increase their dividends.

UK domiciled investment trusts can transfer up to 15% of their annual income to their revenue reserves. They can then use the money to smooth the dividends so that investors are able to enjoy a steadily increasing level of income. Those domiciled offshore can transfer as much as they want as they are not subject to the 15% upper limit.

Many investment trusts have made good use of this flexibility and increased their payments every year for decades. Even during World War One over a third of the sector was able to grow or maintain its dividends through what was the worst financial crisis in memory.

There is no equivalent smoothing facility available to open-ended investment companies (OEICs) domiciled in the UK, as all the income received in the year has to be paid out. This means that there is more chance that investors could experience a sudden and unexpected fall in their investment income.

Tried and tested

Investment trusts are the oldest form of collective fund with some dating back more than a hundred years. They are structured as publicly listed companies with their shares quoted on the London Stock Exchange.



When an investment trust floats on the stock market it issues a fixed number of shares, which is where it gets the capital to invest. Investors can then buy or sell the shares whenever they want on the stock exchange without disrupting the underlying portfolio.

The closed-ended nature of the fund can be an advantage because the purchase or sale of the company's shares does not result in any cash flows to disturb the assets. This allows the managers to take a longer term view than their open-ended counterparts and ride out any short-term volatility.

The price of the shares depends on the performance of the portfolio and the prevailing sentiment. Unlike an open-ended fund, they can trade at either a premium or discount to their underlying net asset value (NAV), which means that you might be able to pick them up for less than they are worth, although it can also work against you.

"EVEN DURING WORLD WAR ONE OVER A THIRD OF THE SECTOR WAS ABLE TO GROW OR MAINTAIN ITS DIVIDENDS THROUGH WHAT WAS THE WORST FINANCIAL CRISIS IN MEMORY."

Another factor in their favour is the gearing. Most investment trusts are allowed to borrow up to a certain limit and then use the money to invest. This can increase the returns in a rising market, but can detract from the performance when prices fall.

Investment trusts have tended to be cheaper than their equivalent open-ended funds, although it has now become more of a level playing field. There is no clear evidence that one format performs better than the other, which means that you have to look at it on a manager by manager basis.

Rising dividends

The fund with the longest record of increasing its dividend is the **City of London Investment Trust (CTY),** which has raised its annual distribution every year for the past 49 years. It is managed by Job Curtis from Henderson Global Investors and is currently yielding just over 4% with quarterly distributions of 3.9 pence per share.

City of London aims to provide long-term growth in income and capital by mainly investing in UK equities. Over the last decade the shares have risen 143% compared to the 76% increase in the FTSE All-Share benchmark. It has a diversified portfolio with the £1.2bn of assets divided between 112 holdings and the top ten only accounting for 27% of the fund.

Curtis has a conservative, value approach to stock selection and a preference for higher yielding stocks with his largest holdings being British American Tobacco, HSBC and Royal Dutch Shell. It is one of the biggest funds operating in the UK Equity Income sector, has low ongoing charges of 0.44% and an attractive dividend yield that is fully covered by the annual income.

There are also three funds that have increased their dividend every year for the last 48 years. They operate in the Global Sector and are **Bankers Investment Trust (BNKR), Alliance Trust (ATST)** and **Caledonia Investments (CLDN).**

Bankers is managed by Alex Crooke of Henderson Global Investors and is benchmarked against an equal-weighted combination of the FTSE All-Share and FTSE World ex-UK indices. It aims to achieve long-term asset growth along with regular dividend growth.

At the end of August the largest allocation was the 36.1% invested in the UK, with a further 22.7% in the US, and 10.8% in Japan. It is well diversified as the £661m fund is divided between 189 different holdings with the European, American and Chinese portfolios run by separate specialist managers.

Over the last five years the shares are up well in excess of its benchmark and the fund is now yielding just over 2.5% with quarterly distributions of 3.9 pence per share. The ongoing charges are 0.48% and the shares are trading on a 2% discount to NAV.

Alliance Trust attempts to generate a real return over the medium to long-term and is designed to provide a core investment. It is benchmarked against MSCI World, but has attracted criticism from the US activist investor, Elliott Associates, which is unhappy with its poor performance record.

There are no such issues with Caledonia Investments, which aims to deliver



long-term growth in capital and income by investing in a portfolio of listed and unlisted equities. It is benchmarked against the FTSE All-Share and over the last five years the shares are up 54%, giving it an excess return of 14%, although it has lagged behind the index over the past decade.

About a third of the fund is invested in unlisted equities, which makes it more risky than the others and this is reflected in the larger discount to NAV of 17%. The shares are yielding 2.26% with semi-annual distributions. It has gearing of just 1% and relatively expensive ongoing charges of 1.22%.

UK Equity Income

There are 28 investment trusts operating in the UK Equity Income sector with the yields ranging from just over 2% up to almost 9%. A good example is the **Merchants Trust (MRCH),** which has increased its dividend for 33 consecutive years and is now paying a remarkable 5.7%.

Merchants was created in 1889 and is now run by Allianz Global Investors. The £470m fund aims to provide an above average level of income and capital growth by investing in high yield companies in the FTSE 100. It has a total of 46 holdings with the top ten accounting for 45% of the assets. These include the likes of Royal Dutch Shell, HSBC, Glaxo and BP.

The fund has much higher gearing than most of its peer group with the current figure being 20%. This enables it to boost returns in a rising market but could be a problem in more difficult conditions. It also writes options and uses the premiums to increase its income. Over the last 10 years the portfolio has returned 86%, which is 10% ahead of the FTSE All-Share.

Murray Income (MUT) is yielding a more modest 4.8% and has increased its dividends for each of the last 42 years. The trust was created in 1923 and aims to achieve a high and growing income with capital growth via a portfolio of UK equities. It has 52 holdings with the largest being British American Tobacco, Unilever, AstraZeneca and Glaxo.

The fund is run by Charles Luke of Aberdeen Asset Management and he has built up a good track record with a ten year return of 80.5%, which is about 4% ahead of the FTSE All-Share. Net gearing is a moderate 6% with the dividend paid each quarter and ongoing charges of 0.73%.

Another option worth looking at is **Temple Bar (TMPL).** It was created in 1926 and is now managed by Alastair Mundy

"THE FUND WITH THE LONGEST RECORD OF INCREASING ITS DIVIDEND IS THE CITY OF LONDON INVESTMENT TRUST (CTY), WHICH HAS RAISED ITS ANNUAL DISTRIBUTION EVERY YEAR FOR THE PAST 49 YEARS."

from Investec. The £718m fund aims to provide growth in income and capital with a long-term total return greater than that of its FTSE All-Share benchmark.

Mundy mainly invests in companies from the FTSE 350 and he has put together a highly concentrated portfolio of 35 shares and five bonds, with the top ten accounting for 62% of the assets. These include HSBC, Glaxo, Royal Dutch Shell and BP. Mundy looks for companies with strong balance sheets and cash flows and will normally only invest once a share has fallen at least 50% from its seven year high.



Temple Bar has a good long-term performance record with a 10 year return of 110%. It has increased its dividends each year for the last 31 years and is currently yielding 3.8% with the payments distributed on a quarterly basis. Gearing is 15% and the ongoing charges a competitive 0.48%.

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This is a selling point if penetrated. But it is a buying point if approached but not penetrated.

Higher Low, 2 Points make a Line. Higher highs and higher lows signal 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.

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HOW TO VALUE JUNIOR MINING STOCKS (PART 2)

BY JOHN CORNFORD



HOW TO VALUE JUNIOR STOCKS

"BEWARE THE PHRASE "COMPANY MAKER". A PROJECT OR ACQUISITION MAY EXPAND THE 'SIZE' OF THE COMPANY. BUT IF ACHIEVED WITH EXTRA SHARES, ITS MARKET SIZE MAY WELL INCREASE WITHOUT MUCH MOVEMENT IN THE SHARE PRICE."

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 Four-Square 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.

Dilution, Dilution, Dilution - The Good, the Bad and the Downright Ugly

This is the second in a series of in-depth articles regarding the selection of risky, but potentially highly rewarding, junior miners. Our analysis will principally cover the financials: the progress/prospects – and implications for shareholder value – of finding the funds for their various projects. Limited space means we won't necessarily describe in detail their operations or the hopes and plans spelled out on their websites and presentations. Readers should refer to them for the details. We will try to fill in the gaps.

For example: Investors might swallow the yarn "we are all in this together - to achieve 'value' for our shareholders". Not necessarily. Company management does want to achieve the hopes they sell to investors. But they are "selling" them. They won't tell you the hurdles they need to jump - including persuading (bamboozling for the sceptical) investors to drive their shares higher during the long period before their mines come to fruition - so they can be tapped, again and again, for the funds to keep going.

"PARAGON HAD BEEN DULL AND BORING, TOYING WITH VARIOUS UNEXCITING PROJECTS UNTIL, IN 2013, IT FOCUSSED ON THE MORE PROMISING, BUT IDLE, 80% OWNED LEMPHANE OPEN CAST KIMBERLITE DIAMOND MINE IN LESOTHO."



It's a poker game. The company will make announcements to try to keep the shares flying. But they need the money and they're going to get it - by hook or by crook (for 'crook' the sceptic will read 'the PR spin doctor or broker who tells you the story').

Likewise, beware the phrase "Company Maker". A project or acquisition may expand the 'size' of the company. But if achieved with extra shares, its market size may well increase without much movement in the share price. Long term shareholders will have been... well, you know the word!

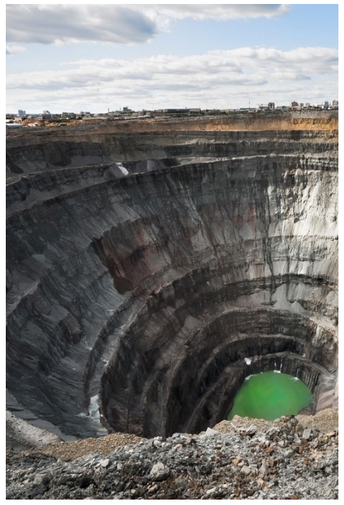
Paragon Diamonds

One of the more exciting stories in the junior mining space right now is **Paragon Diamonds (PRG, market cap £15m @5.3p).** For most of the time since listing in November 2010 at 20p (catching the then short-lived mining spike) Paragon had been dull and boring, toying with various unexciting projects until, in 2013, it focussed on the more promising, but idle, 80% owned Lemphane open cast kimberlite diamond mine in Lesotho, the world's main source of exceptional value gem diamonds.

But, lacking funds to jump start Lemphane, the shares languished in the 3-5p range until, in August 2014, experienced hedge fund manager Philip Manduca brought his Titanium Capital Investments and himself onto the Board and within two months - with Titanium Capital's help - had heaved off Paragon's back the unhealthy Lanstead Capital equity swap (aka 'death spiral' financing) that had been all the funding it could find. Next, in December, Manduca brought in Dubai's International Triangle General Trading Ltd, with a promise of funding to buy a 75% stake in the slightly smaller but higher grade Mothae mine nearby whose plant PGD had already acquired to help develop Lemphane. Now, the Mothae acquisition is almost complete and further funding is being negotiated to start it alongside Lemphane, so that Paragon is in sight of profits.

PARAGON DIAMONDS Limited

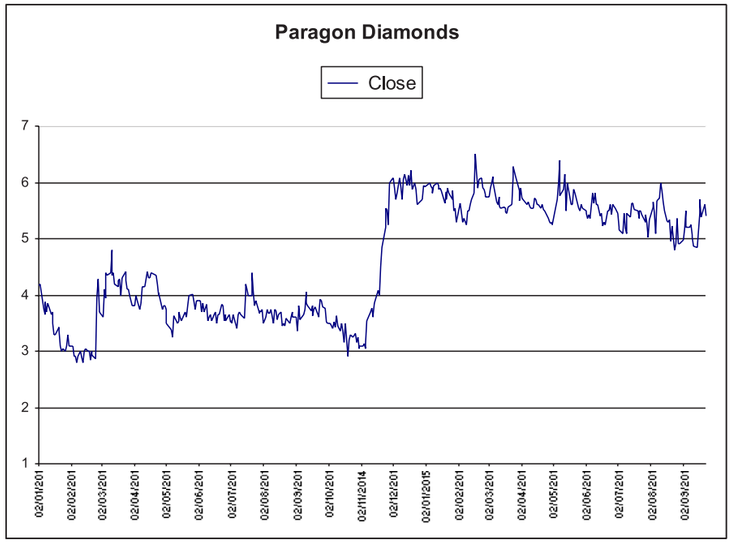
That is not the only reason why investors should take more notice. For, unlike in many mining projects, the nature of the funding already offered and being negotiated looks likely to avoid much of the share dilution that is the bane of long term mining investors. Manduca, as a long term professional investor, has stated an intention to use non-dilutive loans as much as possible to avoid excessive share issues, facilitated by the high level of profitability expected once the two mines are operating fully. While the initial funding promised by Titanium and ITGT looked attractive enough,



recent studies have shown better economics for Mothae, enabling Paragon to broaden talks to other providers who it says might provide even better terms.

Before Mothae, Paragon's plan was to use $12.1m of ITGT funding to start a Lemphane two-year stage one programme, as a trial before starting the more serious stage two, calling for further funding around $66m to ramp up production towards revenues around $100m pa for an 8 year mine life, and expected cash generating margins of nearly 60%.

So far, only house broker Northland Capital has attempted partial sums for Lemphane and although there is a technical/economic report for Lemphane stage one and internal forecasts for stage two, it is only in the last few weeks that Paragon has released a more bullish update for the original outline economics it had published for Mothae. (Note that original owner TSX listed Lucara Diamonds, says it is selling Mothae 'because it doesn't meet its internal targets for return on capital investment'. We can't know what those are, but it doesn't mean that Paragon can't achieve its own aims, with economies expected from running the two, adjacent, mines together - when total revenues (for what is currently a £14m market cap company) are expected to reach over $150m pa within five years.



"THAT IS NOT THE ONLY REASON WHY INVESTORS SHOULD TAKE MORE NOTICE. THE NATURE OF THE FUNDING ALREADY OFFERED AND BEING NEGOTIATED LOOKS LIKELY TO AVOID MUCH OF THE SHARE DILUTION THAT IS THE BANE OF LONG TERM MINING INVESTORS"

Although Northland has said it is too early to factor in Mothae to its forecast for PGD with only Lemphane, these were so exceptionally bullish (even after highly conservative assumptions) as to prompt us to make our own forecasts including Mothae. In fact, Northland, just for Lemphane, was forecasting an NPV10 per share of 57p - almost properly calculated after funding (some brokers and analysts skip this inconvenient step) - on an estimated 423m shares in issue after the first funding, compared with 275m now, and having made the further conservative assumption of shareholder funding rather than via the loans that an exceptionally good 68% IRR should facilitate – even after some further conservative assumptions as to average prices achieved for its diamonds.

In practice, Northland, in addition to using a modestly cautious 10% discount rate to calculate the NPV, has also deducted an exceptionally cautious 75% risk factor in arriving at its published 'target' of 12.9p a share (i.e. 1/4 its value before deducting 75%).

So it is worthwhile to add our estimates for Mothae to Northland's Lemphane only valuation, to judge whether - although the funding issue is still outstanding as we write - the shares are worth buying at this point in the story. Since doubling on relief from the Lanstead Capital deadweight a year ago, they have been drifting pending Mothae's completion (promised by end September) - not helped by developing weakness in the diamond market generally, although not necessarily in the investment and gem grade diamonds that Paragon will be targeting.

Paragon's latest annual statement in June sketched out its then plans. Firstly it should be said that large and exceptional value diamonds in kimberlite 'pipes' are found randomly at intervals, so forecasting only becomes reliable



with more sampling and drilling than required for other precious minerals. Having said that, the available competent persons technical reports for Lemphane estimate that one larger than 100ct diamond (valued at around $10,000/ct) will be found per million tonnes of ore (i.e. every four months of mining on Lemphane's plans) while bulk sampling has already shown that 10% of recovered carats were of greater than 10 carat stones.

The different characteristics of diamond mining - as at Lemphane and the nearby highly productive Letseng mine owned by Gem Diamonds - show in the average prices per carat expected. Two large diamonds found at Letseng have just been sold at over $50,000/carat and of the twenty largest high quality white diamonds found worldwide in the last nine years, four were found at Letseng.

For example Petra Diamonds, the large conglomerate operating five major mines mostly in South Africa, produces some 3.2m carats per year, but at an average value of only between $100 and $300/carat (including both low value 'industrial' diamonds as well as gem diamonds) whereas Paragon expects Lemphane stage two to produce around 70,000 cts/annum, but at an average value (including the infrequent large high value diamonds) in excess of $1,500/ct. Mothae is expected to achieve an average of over $2,000/ct.

"PARAGON THINKS THERE IS NO REASON WHY LEMPHANE AND MOTHAE CAN'T FIND DIAMONDS IN THE SAME LEAGUE AS LETSENG."

Likewise even high quality diamond mines vary markedly. Firestone Diamonds' Liqhobong kimberly mine is due to start producing by end 2016 (a year or two before Lemphane) and is located between Lemphane and Letseng, yet quotes its diamond reserve at 33 carats/100 tonnes of ore (cpht) whereas Lemphane expects only 2.7cpht but at much higher value. Comparisons can't easily be made therefore, except that for all these gem quality diamond mines the IRRs tend to be well above 50%, explaining why Firestone, as Paragon also hopes, has been able to easily fund the $185m needed for its mine with a large element of loans.

So seeking high value diamonds as Paragon is attempting, is a riskier, higher reward business than for the larger diamond miners. Having said that, Paragon thinks there is no reason why Lemphane and Mothae can't find diamonds in the same league as Letseng.

Lemphane stage one (financed by the initial $12m Titanium investment) will be for two years, mining 1 million tons of ore annually, and targeting 20,000 carats p.a. with average sale values between $900-$1,000/ct, generating $9-10m p.a. revenue, with Northland estimating a $10m operating loss in the first six months and break-even in years 2 and 3. Stage two - at a further $66m estimated cost - is planned to ramp up to 3 million tpa with a > 15 years life, expected to generate $60-$70m of cash flow p.a. at an assumed $1,500/ct average sale value.

It is this estimate for Lemphane that Northland uses to calculate its NPV[10] of $341m excluding the first two year's losses and before that 75% risk discount, and also neglecting a planned downstream diamond cutting, polishing and retailing operation that Paragon is planning with the Dubai based ITGT to cut out the traditional Amsterdam and Tel Aviv middle men. More important, the IRR (not affected by a risk discount) on these projections is over 55%, which is what should enable loan financing of the $66m investment instead of the share issues that Northland has allowed for.

Not that the - as long as a piece of string - NPV will help ordinary investors. While a very long term investor (or a lending bank) might count on it, it is the expected annual earnings per share the former will want, so we always try to convert what underlies the NPV calculation to annual cash per share - although that would not be accurate if the cash generation timetable is not known or not spread evenly across the whole period.

Calculations on Northland's conservative revenue assumptions show Paragon's 80% share of Lemphane cash flow at an initial $50m pa before reducing after three years on a full tax charge to around $35m, which on the pessimistic assumption of funding via share issues and a total of 826m shares in issue, produces annual cash flow per share of 6.1p reducing to 4.1p. Funding via loans at around 10% over 7 years instead of via equity would increase that cash flow/share by between 75% and 90%.

Mothae will be on top. Initially, for a development cost Paragon also estimated at $66m, it expected additional revenues from Mothae of $60m pa over a 12 year life, generating a NPV12 of $115m (at the same 10% discount as Lemphane it would be $140m) and promised an independent technical report to confirm this. In the last two weeks however, Paragon has released more detailed independent results (based on a full technical report prepared for Lucara in 2013) by consultants MSA Group in advance of a full preliminary economic analysis, showing potential for an increased NPV, although it has not disclosed the details including any revised capital requirement. In any case it says the potential is to produce 42,000 carats/annum over 12 years at an average above $2,000/carat.

To arrive at the originally estimated NPV for Mothae, assuming its $66m capex is accurate, we calculate that annual cash flow (i.e. before depreciation) would have to be more than $35m pa (which generates a 43% IRR) and while in the absence of the detail (and not allowing for what Paragon says is an increase in Mothae's NPV) this is a crude estimate, we have used it to calculate the cash flow profile for Paragon as a whole and so produce an estimate of group earnings for both Lemphane and Mothae.

This shows a c$80m p.a. after tax cash flow up to 2030 which, on the assumption that half the $132m capital investment needed in 2017-2019 is via 10% loans and half in shares issued at 10p (if all goes to plan the issue price should be considerably higher) would result in cash flow/share of over 8p once all is up and running. This, of course, is on the basis of a more conservative assumption regarding funding than we used for Lemphane's second assumption of funding wholly via loans.

"WITH BOTH MINES OPEN PIT AND ALREADY PRODUCING - ALBEIT ONLY FOR TRIAL MINING - AND ON PARAGON'S PLANS FOR NEAR TERM DEVELOPMENT TO A SIGNIFICANTLY SIZED OPERATION WITHIN ONLY 3-5 YEARS, THE SHARES LOOK EXCEPTIONALLY CHEAP."

Our conclusion? In terms of its corporate plans and financing, Paragon is still at a fairly early stage and profit estimates are not yet reliable - although probably in the right ball park - nor is the potential share dilution known if no loan funding transpires for the $132m plus to develop both Lemphane and Mothae. But, with both mines open pit and already producing - albeit only for trial mining - and on Paragon's plans for near term development to a significantly sized operation within only 3-5 years, the shares look exceptionally cheap in relation to the scope (if all goes to plan).

Ariana Resources

A long running mining story on AIM has been that of **Ariana Resources (AAU, £6.8m market cap @0.85p)** whose construction of its western Turkish Kiziltepe gold mine has just started, more than three years late and a good ten years in the making. If any shareholders have waited long enough to see a return for their patience, it would be Ariana's. So let's see whether it's time for others to join them, or whether too long in the fire might not have roasted this particular chestnut into a blackened frazzle.

ARIANA RESOURCES plc

On the surface, although delayed by bureaucratically slow permitting, Ariana looked fortunate to have an experienced Turkish construction partner, who while spending to earn a 50% share in the mine has also attracted 100% loan funding, supposedly shielding shareholders from dilution. First gold is now expected in H2 2016, at a $600/oz cash production cost - healthily lower than the gold price, so one would have expected the shares, after a few false starts over the years, to begin to anticipate the event.

A 2011 Preliminary Economic Analysis for Kiziltepe showed that an assumed mine start in 2014 would produce a NPV$_{10}$ of $24.1m just for Ariana's future half-share (worth 3.8p/share on then anticipated shares in issue) and a projected 1.5p earnings per share annually for the mine's first 4 1/2 years of a short 8 year life. Since then, the assumed $1,600/oz gold price has slumped to $1,140.

Even so, optimism for the shares should have been kept buoyant by excellent exploration results pointing to the possibility of well extending Kiziltepe's mine life, as also for Ariana's 49% joint, free-carried exploration with Eldorado Gold in eastern Turkey at Salinbas - where in April 2015 a scoping study showed that its discovered 650,000 oz gold resource at 2.0g/t could, over a ten year mine life at a gold price of $1,250/oz, produce a $108m NPV$_8$ and a 28% pre-tax IRR after capex of $53.1m.

Further optimism looked warranted because, along with a falling gold price, Ariana has been able to refine its feasibility studies for Kiziltepe, showing better efficiency and reductions in costs. In late 2012 consultants Tetra Tech published interim findings from its more detailed Definitive Feasibility Study (necessary for bank funding) which, although at a then lower gold price, inevitably showed a halved NPV$_8$ ($22m vs $48m), while the vital IRR to persuade the bank held up well at 27.1%. And in June 2013, the full DFS showed a further (like-for-like) improvement, with - at a $1,174/oz gold price - a NPV$_8$ of $24.8m (Ariana's share now $12.7m) and a 30.3% IRR - although at a higher capex of $31.1m vs $28.4m. Meanwhile – and perhaps more reassuring for investors concerned with the declining gold price – cash costs reduced from around $690/oz to $600/oz.

HOW TO VALUE JUNIOR STOCKS

With gold apparently near a bottom, and because the Kiziltepe mine and the funding needed from Ariana has been practically signed and sealed for at least the last two years, some shareholders might have been happy to keep sleeping at the wheel while they await first cash from Kiziltepe. Unfortunately however, it is not only the gold price that has been seeping through the floor while they waited; Ariana has also been getting through damaging amounts of cash. Since 2012 when projections then were for no more than around 400m shares in issue once Kiziltepe was fully funded, the costs of exploration to extend its life have swallowed some £3.5m - fundraising which in less than three years has doubled shares in issue to 802m now, against only 222m five years ago. So, not only has falling gold sharply reduced likely profits from Kiziltepe; severe dilution further reduces its value to those long suffering holders.

Still, perhaps they have been counting on gold resource at Salinbas, hoping that a sale of its share of Salinbas back to Eldorado would produce useful cash - which its paid-for research provider hoped in February 2014 could, with further exploration to extend the present 76% of the resource which is in the inferred category to the more valuable indicated category, be as much as $5-$10m.

Unfortunately again, a current $1,125/oz gold price has pushed Salinbas's NPV_8 down 41% since its reassuring looking $108m NPV_8, to $55m, and the IRR to 18%, which being pre-tax makes developing Salinbas unlikely - in the short term at least. And because the deposit is merely inferred and a long way from any processing plant, and needs over $53m to develop, it probably wouldn't be worth very much on a 'gold-in-the-ground' basis. So shareholders' hopes for realising something there have been evaporating.

And as for Kiziltepe, unfortunately again, and despite those cheap looking cash costs, we can't see it coming up with much joy for shareholders. With gold currently at $1,125 we have re-run the DFS figures and worked back to calculate Kiziltepe's annual cash generation and earnings per Ariana share.

"ARIANA HAS BEEN PAINTING ITS SPENDING TO EXTEND AS MERELY DESIRABLE. IN REALITY IT HAS BEEN ESSENTIAL."

Our figures show that at a $1,125/oz gold price, Ariana's 51% share of kiziltepe's cash flow, before tax and after loan repayments (the loan having met the capex) over 8 years will be around $23m – i.e. an average of $2.9m p.a. or, on the now inflated shares in issue, only 0.5p per share per annum for the first three years - a far cry from the 1.5p/share expected back in 2012. If gold remains level, most of that will be generated in the first four years – i.e. some £10m by end 2019, although shareholders shouldn't count on seeing much of it.

Much work remains before the mine and processing plant can sustain Kiziltepe's output at an economic level beyond the first four years. What the company does not highlight is that the feasibility studies show a falling off of gold grades from year four onwards, to be replaced by silver, and as a result steady production results in considerably lower revenue and higher cash costs per ounce of gold or silver. Ariana has been painting its spending to extend Kiziltepe's resource (mainly by exploring to develop the Tavsan satellite deposit some 70 km away which is planned to follow on from



Kiziltepe) as merely desirable. In reality it has been essential, and there is no certainty that it is nearing an end. So far, to add to the 221,000 oz gold equivalent resource at Kiziltepe, Tavsan has discovered 215,000 oz, while further exploration of what is thought to be a significant resource in the area between Kiziltepe and a smaller resource at Kizilcucur 25 km away (where Ariana believes is potential for over 100,000 oz) has hardly got under way. All in all, although Ariana says it has 'defined' total resources in Turkey of 1Moz (excluding Salinbas) in reality they are all relatively small, scattered deposits, not ready to be incorporated into a plan that will ensure Kizitepe keeps producing economically.

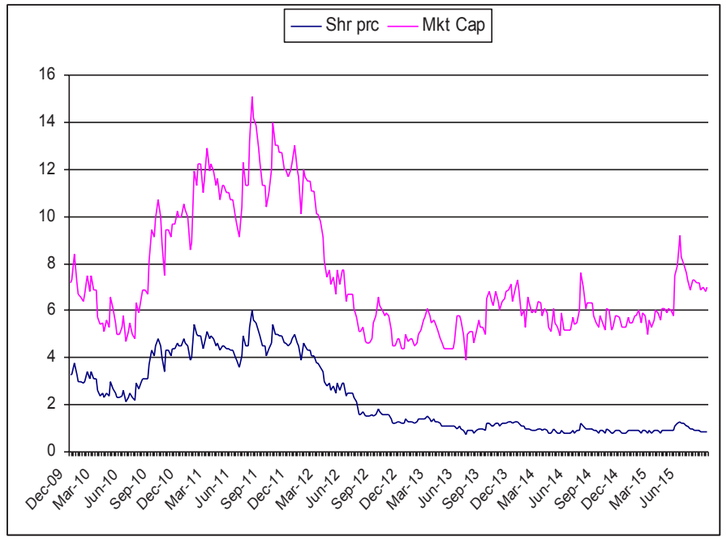
So you could say that Ariana (not to mention its shareholders) has been unlucky. A sharp fall in gold has severely damaged Kiziltepe despite apparently low cash costs and may have rendered Ariana's exploration efforts almost worthless. That's not all because the apparently gung-ho but essential trebling of shares in issue in only three years (not to fund the Kiziltepe project here and now, but to extend its life in the relatively distant future) has badly squeezed those long term shareholders who have put up £3.3m since only February 2013. As if shareholders, having waited long enough already, were willing to wait that extra time!

Remember that chart we showed last month? Ordinary shareholders may not realise to what extent share expansion (and dilution of their interest) has taken place. Such charts (of market cap with time) aren't available (we had to laboriously produce this one ourselves, and asking one of the better known investor information services why they didn't produce them evoked a blank stare). It shows not just the share price performance, but what is never shown and which really counts - Ariana's market cap as a result of share dilution, which is what needs to be measured against any 'value' of a project, and not the share price.

Our conclusion? In about two years from now, and if gold stays flat, Kiziltepe should start generating about $6-7m p.a. for Ariana, but only for two-three years. So the shares might start to anticipate that eventuality, although we don't believe very enthusiastically so. Only if investors think gold is going to recoverpretty sharply should they be tempted into them for very long. (Meanwhile, Lanstead Capital has around 14% from a



£1.4m 2013-14 equity swap arrangement at over 1.2p from which - on present indications - will produce losses for Ariana.)



Ariana Resources - Market Cap (£m) v Share Price (p)

Illusion versus Reality - another example

Are you a chart investor? Which chart would you use to judge whether to invest?

Ariana's chart looks worrying enough. We'll expand on the ugly one above next month.

THE LIMPOPO DISPATCHES

BIG YIELDS FROM BIG PHARMA

BY ROBERT SUTHERLAND SMITH



September 2015: In which your correspondent welcomes the Swiss gnome's gnome Dr. Hans Schnitzel, from a Swiss pharmaceutical company, to join him to hear the last night of the Proms on the radio and, later, to impart to us his views on the major UK pharmaceutical companies, GlaxoSmithKline and AstraZeneca.

It's a long, long time from May to December

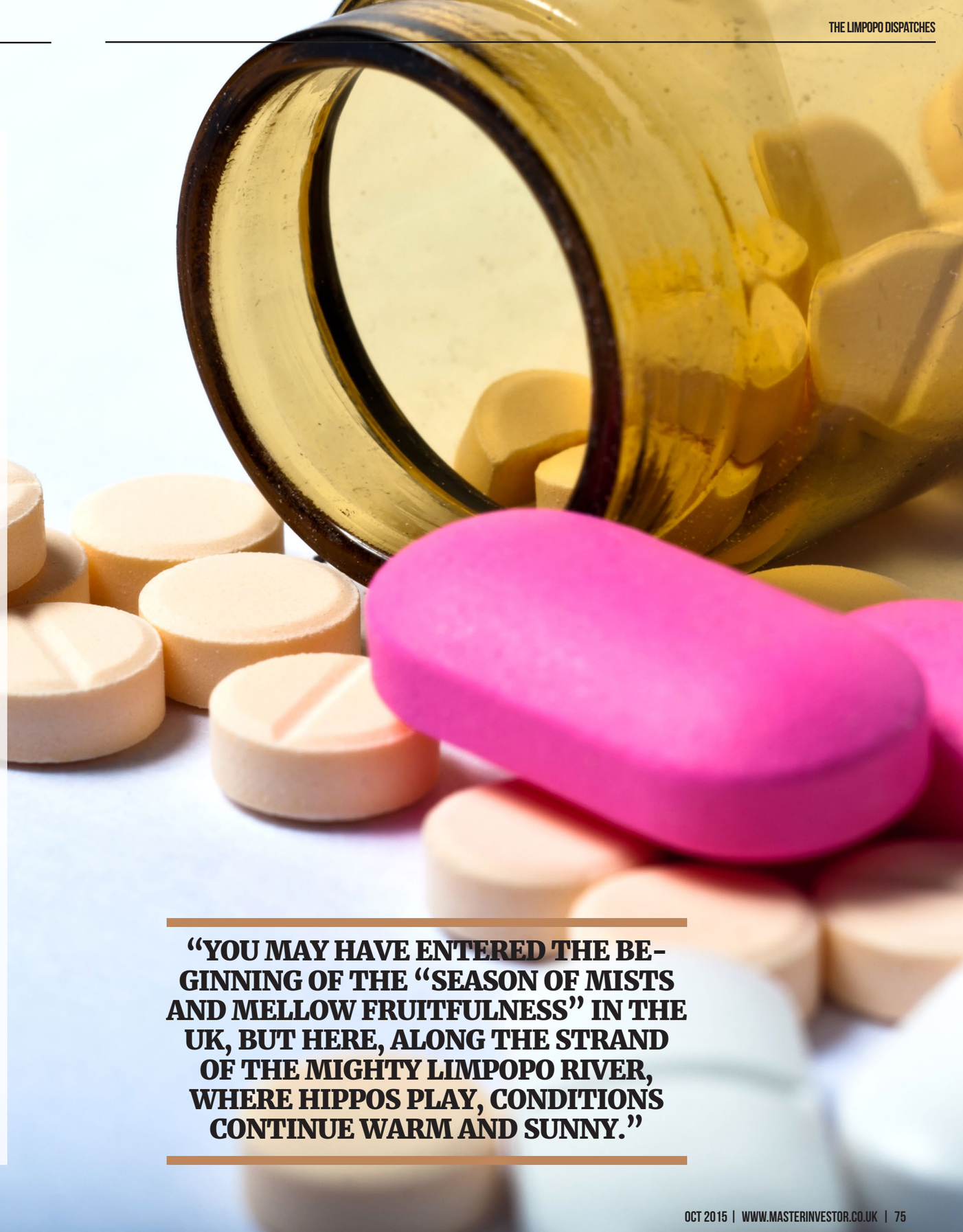
You may have entered the beginning of the "season of mists and mellow fruitfulness" in the UK, but here, along the strand of the mighty Limpopo River, where hippos play, conditions continue warm and sunny. I have played Hoagy (what kind of name is that!?) Carmichael's song (or is it Kurt Weill?) on my old wind up gramophone, on warm evenings, under the Bongo, Bongo trees, but it just doesn't work in this climate. This is not a place for sadness and nostalgia. For that, you need proper seasons, with brightness and summer warmth, giving way to darkness and the chill air of autumn and then winter.

I always think that the 'September Song' is a good one for equity investors, because it takes you from May time, when you should 'sell and go away', and December, generally a good time for share prices. I just cannot help being romantic in that way! The closest I get to nostalgia here is when I don the ostrich solar sun helmet of this area's last British imperial Governor, Sir Timothy Toothbrush Bart (later Lord Bond Street). I sometimes wear his abandoned headgear when I am sitting alone, listening to a scratched old record of 'Land of Hope and Glory' or some other Elgar musical tear jerker. As an exercise in nostalgia it is very efficient and does more for me than the 'September Song' ever could. I try to do that on the Last Night of the Proms at the Albert Hall, which I listen to on my fine old, walnut veneered Fergusson radio - for which I have an inexhaustible supply of 1948 radio valves - on my bungalow veranda; it is far better than the old crystal sets. (You may be able to tell that I am an early mover and one time twentieth-century technology buff.)

I usually invite the local Cambridge educated witch doctor and hedge fund advisor with the Church of Scotland missionary and we sing along, wearing blazers and yachting caps, strewing each other with celebratory multi-coloured tickertape left over from VJ Day (Victory in Japan Day 1946), which I keep in an old leather suitcase marked "Wanted on Journey".

We also play a card game called "Would you credit it?" in which players draw a card on a throw of the dice, with a question to answer. E.g. "What have Goldman Sachs and Jeremy Corbyn (new, Old Labour Islington) got in common?" The correct answer is of course: "A shared belief in welfare economics." In the first case, 'Welfare for Wall Street' (a charity long supported by public funds) and in the second case, 'Welfare for those who do not sitteth at the right hand of the chairman of the Federal Reserve and have not inherited the earth' - as the good book describes it. I think we know which of the two has the better client list.

The philanthropy of the great house of Goldman Sachs was well exampled in the assistance it gave the Greek Government to reportedly mask the true extent of its national deficit, with the help of derivative contracts, enabling it to get into the Euro Zone. No doubt Mr Corbyn will be calling on their services when he gets into government



"YOU MAY HAVE ENTERED THE BEGINNING OF THE "SEASON OF MISTS AND MELLOW FRUITFULNESS" IN THE UK, BUT HERE, ALONG THE STRAND OF THE MIGHTY LIMPOPO RIVER, WHERE HIPPOS PLAY, CONDITIONS CONTINUE WARM AND SUNNY."



in the UK. Most S.E England train commuters, including the Conservative supporting ones, would like to see rail nationalised. All you do is nationalise it and then transform the subsequent national debt into a small derivative contract. At this point I put on a recording of Blake's Jerusalem whilst David Cameron (what is he doing here?) talks to himself in a corner called Europe.

This year I invited Dr. Hans Schnitzel (known as the Swiss gnome's gnome) of a Swiss pharmaceutical company to give us his views on pharmaceutical shares and to join in ticker tape on the veranda, to sing along. They say he has moved here to the Limpopo as a safe bitcoin tax haven. Here they are in translation:

The problems of success and size

In my youth, pharmaceutical companies and their equity were great growth stocks, with many block buster drug therapies emerging from rising sales and rising research and development programmes - usually running at around 14% to 15% of sales revenue. Success grew out of success, as revenues grew to fund ever larger teams of researchers and products entering and leaving the pipeline of therapeutic progress.

As long as sales kept increasing, so did the sums devoted to the research and development of potential new medicines and therapies. It was a virtuous cycle of success that compounded up in terms of scales of economy and profitability, and of course in terms of the market capitalisation of pharmaceutical company equity. That led to the inevitable problem: keeping up such growth and the associated returns to an ever growing equity, once they reached a monumental size. One occasional "blockbuster drug" ceased to be sufficient to keep capital gains growing and cash flow flowing.

Bigger and more numerous blockbusters were required to sustain the linear, long term progress; and that of course required more financial resources to fund the very expensive business of maintaining a long and large enough pipeline of new products.

The R&D expenditure is a hard fact; a new product, always tentative. They are the result of passing through the process of discovery and development, under regulatory approval. Hopefully a candidate chemical entity entering phase I development, will successfully make it to the final phase III assessment, after many years, and then into the marketplace as an approved drug, fit for a well tested and clearly defined clinical purpose.

It is a process that can take up a significant part of a decade, from discovery to prescription. Not all projects are successful and many inevitably fail the generally demanding requirements at each of the three phases of regulatory approval.

Capital and financial resource wastage was built into the process; to have spent more than half a decade in developing a drug for market, only to find that it failed to get over the final hurdles of late stage III approval, is a hugely costly business. The system has to pay for the failures as well as the successes. Finding cancer cures - by way of significant example - is still the quest after many decades of research and development. Hopeful expectation is the fuel of pharmaceutical bullishness.

The arrival of more cost cutting technology has obviously helped, but drug discovery and development remains a demanding and costly business – albeit one in which success can be, in proportion to a pharmaceutical company, as a football pools win is to an individual. The sequencing of DNA was inevitably more promising than it looked on the basis of best expectations. It has led to the clinically desirable outcome of therapies developed to individual DNA characteristics, but probably not for the same scale of economic and financial advantages of the more 'one size fits all' blockbuster drug breakthrough.

The industry has also had to face the arrival of competition in the shape of much lower unit cost competition for generic versions of drugs, once they have gone off patent. The promise of potential new drugs in the pipeline and what they would bring in terms of global sales, cash flow and earnings, have to be offset by the rapid decline in the global sales, cash flow and earnings from those drugs where patent protection is lost.

"THE ARRIVAL OF MORE COST CUTTING TECHNOLOGY HAS OBVIOUSLY HELPED, BUT DRUG DISCOVERY AND DEVELOPMENT REMAINS A DEMANDING AND COSTLY BUSINESS."

For a pharmaceutical company to lose one big drug to patent loss and then face generic competition is comparable to a consumer company losing a large chunk of its market demand in a dramatically short space of time.

Role of M&A activity in investor expectations

Takeovers and mergers have been one obvious method of dealing with the cash flow and earnings generation problem. They are also a focus of attraction for equity investors who would wish to participate in the capitalisation of a share's longer term prospects when a takeover deal is done. The talk of merger or takeover is ever present in a business like pharmaceuticals.

"TREATMENT OF THE BREATHING AILMENT, TOGETHER WITH THE PRESERVATION OF MORE PATIENT LIVES HAS BEEN AN R&D HOLY GRAIL QUEST OF GSK'S FOR SOME TIME."

Asset sharing and swaps

Pharmaceutical companies have chosen to become increasingly more specialist in their range of clinical interests and ambitions, by concentrating on more limited areas of clinical need, in order to improve their scale of economic and commercial advantage. In this they have helped each other by swapping assets between themselves to increase critical advantage in areas where they may once have competed, but no longer do so as a matter of policy. Less diversity opens up greater prospects of success but also, relatively speaking, suggests greater risk if their therapeutic area of choice proves less hopeful and fruitful.

GlaxoSmithKline (GSK) - The technical share price chart; reading the runes

The three month chart tells me that the GSK share price has broken out of its most recent downtrend from just above 1,450p and is moving sideways. That picture is confirmed from a six month perspective. Turning to a three year view, the shares still appear to be on a downtrend at a price that is at its lowest over that period. It seems to my eye that you have to go back to around 2011 to find a lower price.

No doubt part of that weakness is attributable to the relatively disappointing news surrounding its Breo respiratory product for the treatment of asthma and 'smoker's cough' (or 'chronic obstructive pulmonary disease', to be more precise). Breo is one of its big building block products on which much hopeful expectation is placed along with 'Advair', the established respiratory product to which Breo is a successor product. Not only was Breo expected to successfully treat breathing difficulties; it was also expected, through its demonstration in worldwide patient trials, to prolong life as well. Treatment of the breathing ailment, together with the preservation of more patient lives has been an R&D Holy Grail quest of GSK's for some time.

Regrettably, the aforemention ed patient trials found that there was no evidence of what clinicians rather drolly call the 'mortality benefit.'

From the investor's point of view, the implication of the disappointment of such news lies in its undermining of the GSK management's reported forecast of Breo sales at $1.6 billion in 2020. In essence Breo sales seem to be growing more slowly than hoped whilst Advair sales are in decline. On a bullish tack, it seems that the forecast was not built on the assumption that Breo did prove to deliver the much sought after 'mortality benefit'. Moreover, in its stable of research and development activities, GSK has another new drug with which to pursue the Holy Grail of a significant life saving 'smoker's cough' product. Interestingly, the GSK share price showed resistance to the news by falling only modestly.

That may have something to do with the fact that the share price is now so low that its estimated annual dividend yield for the current year is 7.2% - including a special payout of cash received as a result of a strategic asset swap with Novartis. It reverts to an estimated annual dividend yield of 6.4% on a forecast estimated market consensus dividend payout of just under 82p a share for next year (2016) when an estimated market consensus of earnings of 84.5p is mainly paid out to shareholders by way of dividend, leaving very little to go back into the business by way of profit retention. Clearly, the market is assuming that sales will build after that as a means of recovering and financing costs.





The company has a respectable record of dividend growth over the last five years when dividend payouts have grown by about 5% p.a. However, the debt to equity gearing was high at 252% last year.

The company in its accounts for last year reported that operating cash fell £2.1 billion to £5.17 billion. That was insufficient to finance both capital spending of £1.7 billion and the dividend payout of £3.8 billion. Partly in consequence, balance sheet cash fell £1.2 billion.

In the interim report to June, the position appears to have improved considerably as a £6.6 billion contribution from the investment account which implies sales rather than expenditure.

My conclusion is that the dividend yield suggests that the market is discounting a lot more bearish implications which no doubt includes some concern about finance (including, I suspect, a possible cut to the dividend). That event, should it occur, would probably push the share price upwards out of relief rather than down. However, the market consensus is not evidently looking for a cut, no doubt continuing to rely on guidance from the company about the increase in respiratory sales over the next five years to produce some of the means of recovering the cost of the annual dividend. In my opinion GSK should continue to play a part as an investment in a well spread portfolio of shares providing an above average dividend.

"ASTRAZENECA WISHES TO BRING SIX NEW CANCER DRUGS TO THE MARKET BY 2020. THERE IS THE EXPECTATION OF STRONG REVENUE GROWTH FROM 2017."

AstraZeneca (AZN) – The technical share price chart; reading the runes

AstraZeneca
Health Connects Us All

The share price last seen was 4,402p. During the last twelve months, the price peaked at 4,931p last April, before plunging to 3,746p in August, from where it has since risen 17.5%. The three and six month price charts show that the price has been trading within a price range of approximately 4,000p to 4,400p, where it now stands towards the top end. Taking a step or two back to look at the share price from a yearly perspective reveals that the price has broken out from the downtrend that began in the spring; whilst a three year chart read intimates that the share price actually bounced on what looks like a three year support level. As usual, because of the subjectivity of chart reading, I invite you have a look for yourself. Basically, it seems to me that the charts are encouraging.

AstraZeneca is one of the 'smaller' big pharma companies, ranked as the world's seventh largest drug development company by prescription sales. For that reason its attractions include the greater likelihood of a takeover attempt. Last May, Pfizer did exactly that by offering 5,500p a share as its 'final' bid for the company. The share price last seen is 1,100p below that at 4,400p. Clearly, part of the move would have included a significant cost cutting exercise in the tradition of Pfizer as a takeover merchant. So comparing that bid price with the current market price of AstraZeneca is not a simple and straightforward exercise. Nevertheless, the fact that Pfizer was able to identify £55 of value in the company's shares does put some floor under the share price, although this will obviously change with progress (or lack thereof) in the development of the pipeline of drugs, which looks attractive, and has to be to compensate for the big patent run off facing AstraZeneca. It specialises in three clinical areas: therapies for respiratory disease; the functioning of the heart; and oncology/cancer – all large areas of great therapy need. It is in oncology that we have seen some of the best news: first that the company is submitting its lung cancer drug to the FDA for approval; and, second, that its treatment for eye cancer has been awarded so called 'orphan' status by the regulator –that is faster approval time – because there is currently no treatment available. The share price chart seems to be reflecting such optimism.

The latest market consensus estimates for AstraZeneca go out to next year – the year to December 31st 2016. They envisage no big increase in sales revenue within that time span; that clearly lies ahead, after next year. AstraZeneca wishes to bring six new cancer drugs to the market by 2020. There is the expectation of strong revenue growth from 2017 onwards.

Meanwhile, the market consensus values this year's and next year's estimate of earnings on a multiple of 16 times and on an estimated dividend yield of 4.2%; a not unattractive cash payment to shareholders, whilst waiting for the expected build up in new sales out to 2020. The shares look attractive both as a yield stock and as a potential capital appreciation prospect.

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TECHNICAL ANALYSIS CORNER

TECHNICAL ANALYSIS CORNER

HOW TO SPOT A GOOD TRAINER

BY ADRIAN KEMPTON-CUMBER



I'm always writing that the state of private investor training in the UK is appalling, so I thought I'd really lay down what I dislike about it and why, with a guide so you can avoid the pitfalls, including some key questions to ask at seminars.

I first went on a course myself back in 1991. It was about W.D. Gann's techniques and was presented by Fred Stafford, who knows Gann inside out. It took me another ten years to really get on top of the techniques, and I also bought the book from Gann's descendants' store in Spokane, WA, which as I recall cost around $1,000. It was hard going as it's written in early 20th century Wall Street American English! Almost 25 years on now, I have no regrets about that.

It was 2006 before my next foray into private investor training. What I found was really quite appalling: people charging thousands to 'teach' you stuff that is freely available online, if you only knew where to look.

To sum up my main complaint about training it would be that it's unsophisticated, and that it teaches what the tools are, but not what they're for. At that time some courses were alleged to have been ripped off of American courses, so the people presenting them didn't really understand what they were presenting (which is hardly surprising, if they didn't really write the courses themselves!). Not much has changed for practical purposes since then though.

"WHAT I FOUND WAS REALLY QUITE APPALLING: PEOPLE CHARGING THOUSANDS TO 'TEACH' YOU STUFF THAT IS FREELY AVAILABLE ONLINE, IF YOU ONLY KNEW WHERE TO LOOK."

These sorts of courses – ones with either a big price tag to start with, or a massive upsell, sometimes involving taking delegates out of the presentation one at a time for putting the hard word on them – aren't training at all; they're shameless sales seminars. There is one course which, if you follow all the modules, will cost you well over £20,000. You're going to have to be one hell of a private investor to make that kind of money back in short order. Granted you can attend the modules you've already paid for as many times as you like, but really, that sort of outlay is not justifiable, and if you have to keep attending perhaps trading isn't your strong suit, but being gullible is.

What do you get from these sorts of courses? Well a load of either quite simplistic, or black box strategies for which you will need to subscribe to a trading platform or some service – if not a proprietary service then a CFD/spread betting platform. Either way the so-called trainers are very likely getting kickbacks from these companies. This can be quite lucrative. A typical deal on spread bets is 25% of all the spreads you pay on trades... forever! It soon adds up. A lot of the time won't be spent teaching you how the strategy works in the sense of why it works, but rather training

you the mechanics of setting up your screen, and actually placing a trade. Well a monkey can do all that stuff if you train them. You need to be able to make the leap from knowing what all the tools are (a labourer), to being able to use them (a craftsman). You won't learn that there.

If you want to know how to use platforms, whether it's investor software like ShareScope or spread betting platforms, then go to the organ grinder, not the monkey. ShareScope is a very popular portfolio management, charting and data analysis software package (to be precise), and is supported by a very well run customer orientated company. They have a dedicated telephone support team, copious training videos on their website and, if you prefer the personal touch for training, they often do training days at their offices, and can also do remote training for those not close to London. All that is free for subscribers – and ShareScope is quite reasonably priced in the first place. I've been a subscriber for years and it's a platform that caters to all kinds of investors, from fundamental to technical. *Don't pay some dick loads of money to show you how to set up a ShareScope screen, is essentially what I'm saying.*

The training offered by those that are brokers of one kind or another is a little less helpful. Really you need to know not only how, but when to use these different instruments. But if you attend a webinar or seminar on, for example, Soc Gen's Covered Warrants, they'll not really contextualise their product in terms of your portfolio; rather, they'll just tell you what it does and how to use it in isolation – back to knowing what's in the tool box, not how to be the craftsman! And don't forget these companies have a profit motive. They are in a competitive market and want you to use their product in preference to those of competitors.

I think lots of people tend to use the same instrument pretty much all the time. They either buy shares through their SIPP, or they use spread betting, or they trade options (usually not for very long that last one!). The point is you need to have access to as many different products as possible without spreading your capital too thinly. Spread betting/CFDs are excellent for this since they give you access to all classes of assets (commodities, stocks, index futures, etc.) with the one pool of cash, but you still need to have other capital to be able to really manage your portfolio risk properly. (I'll be doing some pieces on how to combine different products to achieve certain investment objectives in my daily blog posts on MasterInvestor.co.uk.)

Given that most training is actually a sales pitch, the format is designed to handle 'objections'. So if people tend to drop out at a given point, or lots of people have the same doubt, then it will be handled and factored into the presentation. They also use a lot of NLP (Neuro-Linguistic Programming) to manipulate group and individual behaviour, just like advertisers do.



There are some good trainers out there, so don't think that they're all a bad bunch. But you will have to put some legwork in to find the gems among the muck. I've devised a list of questions for you to ask at training seminars to help find out which category they are in. In no particular order – you may need to ask some, or all, of the questions, so take them with you!

Trainer Questions

Q. Did you design the strategy yourself?

Further strategy questions:

Do you have an independently audited track record I can see showing the effectiveness of the strategy?

Do the examples you show include trading costs and spreads? (Ask them to show you on their example; don't take their word for it.)

Q. Do you make your main living from trading?

Further pro trading questions:

So I will find your name on the FCA website as being/having been a trader at xyz Bank then?

Are you FCA registered? (If yes: why? There is no reason to be FCA registered to do training courses – bit of a trick one that! Make them squirm a little – it should be no problem for them to answer you, especially if they do have a good reason – be wary if not.)

Q. Do you ever get paid to do presentation work? (Some so-called trainers are actually professional presenters.)

Q. What's the biggest trading loss you've ever incurred? (I like to start with loss, not win. This should be an instant answer – every trader knows their biggest win and their biggest loss like athletes remember their Olympic medals, and they shouldn't be ashamed of losses either – any hesitation or lack of detail = be wary.)

Q. What's your biggest trading win? (Again they should be very forthcoming with detail, even if they don't want to give the actual amounts involved they should remember all the fine detail like prices, times/dates, reason for the trade, etc. as if it were yesterday. If not, be wary.)

Don't be afraid to ask questions. They're not going to be afraid to ask you for money, so it's not putting them out to expect them to justify themselves. If they can't answer properly then don't waste your time – get up and walk out. And by all means tell them Adrian sent you.

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FUND MANAGER IN FOCUS

MARC LASRY

BY FILIPE R. COSTA



"We invest when we have conviction in the credit and we believe it's cheap. If it gets cheaper, then we buy more."
– Marc Lasry

A Hard Beginning

At the age of 55, and with $1.9 billion in net worth, life must seem easy for Marc Lasry. He lives in a luxurious area in New York, his hedge fund offices are located in the expensive 41-story office building at 399 Park Avenue (where Citibank is also headquartered), and he owns a 3-by-4-foot Andy Warhol print of Superman, which he uses to adorn his personal office. But life has not always been that easy, as his parents had to emigrate from Morocco to the U.S. when he was just seven and spoke no English.

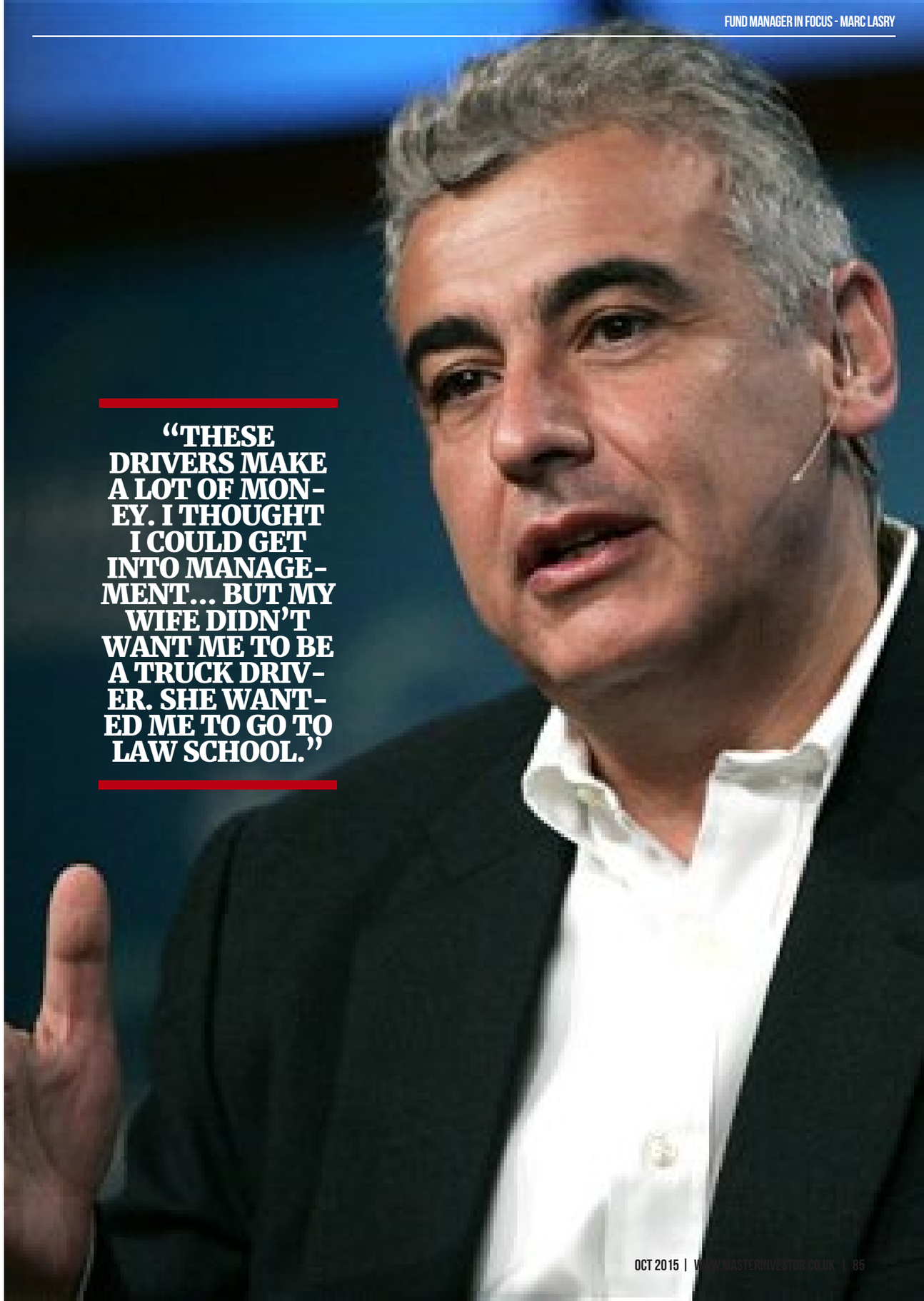
Marc Lasry was born in Marrakech, Morocco in 1960 (or 1961). Living a tough life in Morocco, in 1967 his parents decided to move to the US to seek better opportunities. They moved to West Hartford, Connecticut, where they lived in a two-bedroom apartment. Lasry had to share his bedroom with his two sisters, Sonia and Ruth. At first, he attended a state school, but when his mother picked a job as French teacher at a private college he also moved there. Life wasn't easy. His mother worked as a teacher, his father worked as a computer programmer and both still had to work a second job at night, selling Moroccan clothing to boutique stores.

With the help of scholarships and loans, Marc made it to university and received a BA in History from Clark University in Massachusetts in 1981. In need of money, he then landed a job at UPS as a truck driver being paid about $30,000 to $40,000 a year. The compensation was so good that it was only with much persistence that his mother and his future wife, Cathy, were able to convince him to enrol at law school to pursue a JD. *"These drivers make a lot of money. I thought I could get into management... but my wife didn't want me to be a truck driver. She wanted me to go to law school"*, Lasry remembers.

Forbes - The World's Billionaires

Rank	Name	Net Worth ($ Billion)
#4	Warren Buffet	62.50
#21	George Soros	26.00
#54	Ray Dalio	15.50
#89	Steve Cohen	12.00
#98	John Paulson	11.40
#328	Paul Tudor Jones, II	4.70
#507	Leon Cooperman	3.40
#908	Paul Singer	2.10
#992	Marc Lasry	1.90
#1059	David Einhorn	1.80

Source: Forbes



"THESE DRIVERS MAKE A LOT OF MONEY. I THOUGHT I COULD GET INTO MANAGEMENT... BUT MY WIFE DIDN'T WANT ME TO BE A TRUCK DRIVER. SHE WANTED ME TO GO TO LAW SCHOOL."

In 1984 Lasry finally received a JD from the New York Law School. During that time, he also worked as a clerk for the Chief Bankruptcy Judge of the Southern District of New York. The persistence of his mother and wife would start paying off, as the expertise in law he acquired would lead him to huge success.

Becoming a Distressed Debt Expert

Working with the Chief Bankruptcy Judge was key in bringing direction to the law studies Lasry had completed. It launched him into a world of unexplored opportunities.

It all started at Angel & Frankel, where Lasry worked for a year practising bankruptcy law. Then he moved on to Smith-Vasilion Management Co where he invested in trade claims (rights to payments from debtors that have filed for bankruptcy). While at Smith-Vasilion, he went through hundreds of filings and financials of distressed companies. He learned everything about distressed debt and how to profit from it, a large and relatively untapped market where competition was scarce.

Later, Lasry went to Cowen & Co where he was given a big position, managing $50 million in partners' capital to trade distressed securities. At a point in time, Lasry was in need of an assistant. In a relatively untapped market, finding someone with a good knowledge of distressed debt was difficult and eventually would require hiring someone from the competition. But Lasry wanted someone he could trust. By then his sister Sonia Gardner had just graduated in law and he decided to hire her. Since then the two have been working together across jobs and companies, from success to success.

From the beginning, Lasry and Gardner learned that to gain an advantage over the competition they needed to seek out the opportunities instead of sitting in the office waiting for them. At a time when computers were scarce, the only way to get the list of creditors for a distressed company was by physically going there and printing documents. Gardner was flying from one place to another to get those lists from the beginning and purchase the trade claims from creditors sooner rather than later, while the competition was waiting weeks or even months for the court to hand over the documents, print the lists and send them. By then, Lasry and Gardner would most likely have bought what was worth buying.



They had a massive advantage there. They were the first ones in the market buying the trade claims, which creditors were more than happy to sell. Faced with a lengthy bankruptcy process and with the possibility of being attributed shares or other claims in the distressed business instead of being paid for their merchandise, creditors were more than happy if they could recover the cost of their merchandise in full, let alone any profit margin. By offering them cash for the trade claims from the very beginning, Lasry and Gardner were getting steep discounts on the claims' face value, purchasing for 40c or 50c on the dollar, claims that many times ended paid in full during the bankruptcy process.

From Amroc to Avenue Capital

Being so successful, the siblings began to attract attention. Robert M. Bass Group, a client of Cowen, offered $75 million for Lasry and Gardner to invest in trade claims, bank debt, and junk bonds. They accepted the offer and named the new enterprise *"Maroc"*, the French word for Morocco. But, advised to start the name with the letter *"A"* to be on top of distribution lists, they then changed the name to *"Amroc"*, an anagram of the first name. The new venture, Amroc Investments, raised another $75 million and established itself as one of the largest distressed funds in the U.S. at that time.

Even though the siblings were very successful and worked under very good compensation schemes for one of the first billionaires in the U.S., they still found an opportunity to move on and decided to create their own business. At that time, Michael Milken, the "Junk Bond King", was indicted for securities fraud, which led to the collapse of Drexel Burham Lambert, and helped to further depress the price of distressed debt. The opportunity to buy was epic and Lasry and Gardner opened a distressed debt brokerage firm in 1990 with $1 million of their own capital to take advantage of it. They kept the name Amroc Investments and hired a secretary. For some time there was only three in the new establishment and Lasry and Gardner remember they were working 14 hours a day, 7 days a week.

In a short space of time, the new venture was so successful they were returning 50% annually and quickly expanded to 50 employees. But competition among distressed debt brokerages grew and the siblings had to move on to open their first fund of distressed debt. They created Avenue, another "A" name to be on top of lists, with $10 million. The fund grew to $1 billion over the following five years. This huge success led Avenue Capital, the parent company of the fund, to embrace many other funds the siblings have created since then.

AVENUE CAPITAL GROUP®

In 2001 they decided to close the brokerage business and concentrate on the funds business. At one point in time, Avenue Capital had $20 million in assets under management. Currently it manages around $13.9 billion. During the financial crisis there were some withdrawals of funds but the main reasonwhy Avenue now manages much less than it did at its peak is because Lasry closed one of his funds and returned $9 billion to investors when he believed the special purpose for which that fund was created was no longer an opportunity. In a way, the decrease in assets under management has been more the result of success than of failure.

AVENUE CAPITAL PRIVATE EQUITY PORTFOLIOS

Portfolio	Country	AUM (in $ million)	Inception
Avenue Special Situations I	US	133	1998
Avenue Special Situations II	US	520	2001
Avenue Special Situations III	US	628	2003
Avenue Special Situations IV	US	1680	2006
Avenue Real Estate Fund	US	166	2007
Avenue Special Situations V	US	6000	2007
Avenue Special Situations Fund VI	US	1900	2011
Avenue Energy Opportunities Fund	US	1300	2014
Avenue Asia Capital Partners	ASIA	126	2001
Avenue Asia Special Situations II	ASIA	275	2001
Avenue Asia Special Situations III	ASIA	628	2003
Avenue Asia Special Situations IV	ASIA	3000	2006
Avenue Europe Special Situations Fund	EUROPE	1500	2008
Avenue Europe Special Situations Fund II	EUROPE	2780	2012
Source: Wikipedia			

The King of Distressed Debt

If Milken was the "King of Junk Bonds", then Lasry is certainly the "King of Distressed Debt". The non-English speaking kid from Morocco has established himself as the head of a very successful hedge fund, now employing both his sisters. He is thankful and credits the U.S. with providing the opportunities that made him a billionaire: *"I've been phenomenally successful, and this is the only country I could have done it in"*.

Lasry saw an opportunity and blazed a wild trail like no one before him. He has sought out value from the beginning, not being afraid of taking positions in depressed claims and securities no one else wants. Avenue Capital is all about value investment, being rational whenever all others behave irrationally. They buy discounted claims that are at the top of the queue, and have the guts to wait for the right opportunity to sell them, even if sometimes that means going through a tough path of seeing value decrease before finally rising. Value equity investors see financial crises as an opportunity to buy shares (equity claims) at depressed values. Lasry's philosophy is similar, but he buys debt claims instead.

"I'VE BEEN PHENOMENALLY SUCCESSFUL, AND THIS IS THE ONLY COUNTRY I COULD HAVE DONE IT IN."

AVENUE CAPITAL TOP PORTFOLIO HOLDINGS

Security	Ticker	Value (x$1000)	% Port.
Houghton Mifflin Harcourt Co	HMHC	$119,401	13.00%
Gener8 Maritime Inc		$98,311	10.70%
Meritor Inc	MTOR	$94,562	10.30%
Y R C Worldwide Inc	YRCW	$94,406	10.28%
Scorpio Tankers Inc	STNG	$60,353	6.57%
Dynegy Inc New	DYN	$59,037	6.43%
Euronav Nv Antwerpen		$56,745	6.18%
M G I C Investment Corp Wis	MTG	$48,208	5.25%
Mgic Invt Corp Wis Note 2.000% 4/0	MTG	$40,838	4.44%
Magnachip Semiconductor Corp	MX	$31,567	3.43%

At first, trade claims seem much more volatile and riskier than shares, but that need not be the case. Lasry explains that he only acquires claims on debtors that will be able to repay them. He acquires senior claims that are at the top of the queue, usually trading at a steep discount near 30c, 40c, or 50c on the dollar, but not those subordinated junior claims trading on single-digit decimals that will most likely never be repaid.

Unlike what many may believe, Lasry is a conservative value-seeker for whom downside protection comes before the upside potential. As he puts it: *"I don't want to hear how great the investment is - I want to hear how we could get hurt. Once we know that our downside is protected, then we look at the upside potential"*. When asked about leverage, Lasry is assertive and pragmatic: "A leveraged portfolio forces you to act irrationally when markets are irrational, as opposed to acting rationally when markets are irrational". It was exactly this way of thinking that led him to record a huge profit with the investment he made at Ford during the turbulent 2008-2009 period when the auto industry was on the brick of a major bankruptcy. By then the auto industry had been severely battered by the financial crisis and was at risk of collapsing. But Lasry and Avenue analysts reasoned the U.S. government would never allow the automakers to liquidate in a disorderly way because it would lead to huge systemic risks turning what was an already ugly situation into a nightmare. They decided that Ford was the better positioned automaker and accumulated trade claims on the company at huge discounts on their face value, totalling $500 million. The U.S. government ended bailing out Chrysler and GM, which gave a boost to the whole industry. Ford was even able to avoid a bailout, which was seen as a strong corporate signal. Avenue ended selling the Ford claims in 2010 at 80c/90c on the dollar.

Final Remarks

Starting in 1995 with $1 million from family and friends, Lasry and Gardner were able to make it to the billions and establish one of the most successful distressed specialist investment companies in the world. The siblings are proof that it pays to think out of the box and look for opportunities where others don't. Markets behave erratically and irrationally. Seeking value means opposing the market; and to oppose it one cannot depend on leverage. In a world where leverage is taken out of bounds, only those who skip it are able to gain an advantage.



Speaking of value... it exists everywhere, it seems! When value is depressed, there's only one way to go! In 2014 Lasry bought the NBA team Milwaukee Bucks for $550 million, at a time when the team was struggling, ending the season out of the playoffs and with its worst franchise record ever of 15-67 (wins-losses). But this awarded the club the second overall draft pick, allowing it to reinforce its team. This year the Bucks improved to a 41-41 record while achieving a playoff spot. If Lasry's record is worth something, I would bet the Milwaukee Bucks still have a way to go...

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SCHOOL CORNER

SIZE DOES MATTER

BY MARIA PSARRA



Now ladies and gentlemen, I am sure you have heard (and perhaps even uttered) the expression "size matters" many times in your life. I know I have. But before we get over-excited and start thinking of potentially more amusing but certainly irrelevant matters, let me clarify that I am in this instance solely referring to the size of the companies whose stocks you invest in.

This is today's topic, and the tenth in my series of educational articles for this publication, 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.

We discussed "Which Markets are Right for you" in the September edition. Today we shall take this one step further, and look at which stocks are right for you, from an issuing company size perspective. What I mean by this is whether you should be focussing your investments on large caps, small caps, or both.

So how do you make your decision? Let us take a look at the things you should take into account.

1. Risk

This is your personal attitude to risk. In general, investing in large, well-established companies carries less risk than investing in their smaller, younger counterparts. When looking at the UK stock market, this means that investing in companies whose stocks are listed on the FTSE 350 carries less risk than investing in stocks listed on the AIM market. There are three main reasons for this. The first one is obvious in the sense that the longer a business has operated for and the more successful it has been, the less likely it is to succumb to failure.

"Yes", I hear some of you say, "but even big UK banks like Lloyds almost failed during the last financial crisis." You are right. However, regardless of your opinion on government bailouts, you cannot possibly ignore the fact that at least these companies were important enough for the government to step in and provide a "lifeline". It is unlikely that the UK government will ever step in to "save" a junior oil explorer, for example.

"LIQUID STOCKS ARE EASY TO TRADE IN AND OUT OF FOR INDIVIDUAL INVESTORS AS THERE IS ENOUGH AVAILABLE VOLUME IN THE MARKET TO FULFIL THEIR BUY OR SELL ORDERS."

The second reason why investing in FTSE 350 constituents carries less risk is that these are more "liquid"; that is, there are larger volumes of their shares traded on a daily basis. This makes these stocks less volatile; that is, they tend to move less, and are less prone to sudden large price moves. Furthermore, liquid stocks are easy to trade in and out of for individual investors as there is enough available volume in the market to fulfil their buy or sell orders. This is often not the case on the AIM market, where one often has to ask brokers to "work" on filling one's order by sourcing liquidity from other investors and market makers, and where, consequently, one should be flexible with regards to the price and time required for orders to be filled.

The third reason is that the LSE's requirements for a company to list on the Main Market are stricter than those for AIM. By requirements, I mean both the capitalisation (market value of a company) and the level of detail and accuracy with which a company reports its financial performance. It is important to understand that "what is missing" from the additional reporting requirements increases the risk of investing in a company, as there is a lot that an AIM-listed company does not have to disclose to the investing public.

Now, please do not regard the above as an attempt to discourage you from investing in the AIM market. It is not. I do myself advise clients on investing in AIM shares. The above is rather my attempt to make you correctly assess the risks inherent in investing in different types of stocks.



2. Income vs capital growth

Are you looking for dividend income, price appreciation (or alternatively depreciation when short a stock), or both? As a rule of thumb, mature, profitable companies tend to pay higher dividends than younger, less profitable companies. However, a company's dividend policy ultimately rests with its management, and is based on several things, including the company's future expansion plans, which can divert cash away from dividend payments and into acquiring smaller rivals, building additional factories etc. As follows, a lower dividend payout does not necessarily mean that a company is doing worse than one with a higher one. It does mean, however, that if you are looking for income, your money is better invested elsewhere.

"I HAVE HAD PLENTY OF ARGUMENTS OVER THE YEARS ABOUT NOT BEING ABLE TO TRADE CFDS ON CERTAIN STOCKS, BUT I HAVE TO RESPECT THE CLEARING BROKERS' ARGUMENT."

Furthermore, when looking for income, it is important to assess how "safe" and stable the dividend is and may continue to be. I shall not go into details of how such checks are performed here, but please bear in mind that this is an important parameter to take into account. To conclude, if you are indeed looking for dividend income, you should focus on investing in the dividend aristocrats of the FTSE 350 instead of in their AIM counterparts.

3. Investment horizon

How long do you wish to hold your investment for? In my view, one should have a longer term horizon when investing in AIM stocks. This is because



these are often younger, higher growth companies that are looking to expand more than their large cap counterparts. As anyone, myself included, who has ever worked for a young company can testify, expansion tends to take more time than management expects. So you should only invest in such companies if you have the patience and financial flexibility to stick around to see them grow and succeed.

4. Products to use when trading

The financial products you use for your trading and investing should be suited to your attitude to risk and your experience. In the case of individual UK stocks, your choices are Cash Equities, CFDs, and Options. I have deliberately left Spreadbets out of this discussion as they are not classified as a "financial product" by the FCA, and I do not advise clients on them.

The smaller a company is, the more unlikely you are to find CFDs or Options on its stock offered by clearing brokers. As follows, if your trading strategy is based on using such products, you'll probably have to focus on large cap stocks. Furthermore, when it comes to CFDs, you should be aware of the fact that not every UK-listed stock is shortable, either due to regulatory restrictions or clearing brokers' own limitations on the size of companies (and average daily traded volume of their stocks) on which they offer CFDs.

Personally, I have had plenty of arguments over the years about not being able to trade CFDs on certain stocks, but I have to respect the clearing brokers' argument, and so do you. Having said this, I tend to oppose the use of CFDs for investing in small AIM stocks, as their volatility is already sufficient for my personal risk profile and trading systems. In general, I tend to think that when one is investing in AIM stocks, one is better off just simply buying and holding.

This concludes my article for this month. I hope you enjoyed it.

Until next month,
Happy trading everyone!

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.

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BUILDING A FINANCIAL PLAN WITH LEGO

BY WILLIAM REED



From the outside, a child's building toy may not seem like a stable vehicle for an investment; but, over the last two decades, the secondary market has proven to yield consistent returns. Part of its success has to do with the collectible nature of the toy. In general, dealing in collectibles is very risky due to the uncertainty of the buying market. However, unlike other collectible markets, LEGO elements get retired on a regular basis.

This concept of retiring old pieces applies to both the piece shape and the piece colour. Given a worldwide audience that uses the elements for personal/public projects, it gives an inherent sense of value to the little plastic bits. This translates into a worth to the base materials that is roughly £20 for every 1kg. This measurement may vary based on the quality of the parts and rarity that can be identified. This is not an example of where the profit is; rather it represents the underlying stability of these assets. In order to make profit, a better understanding of the history and process is required.

A brief history of LEGO as an investment

The LEGO Group has been making its plastic bricks since the mid 1950s. Using these sets to turn a profit has only been going on for roughly two decades.

Essentially, the reason for this comes down to two major factors. The first is the internet. Connecting electronically proved to be the most efficient method of putting collectors in touch with one another. The second factor is the Adult Fan of LEGO (AFOL).

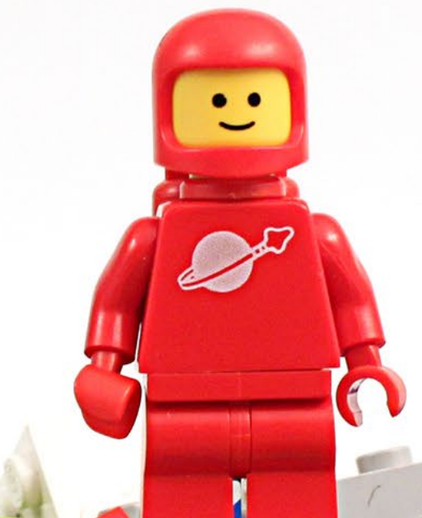
Any investment lives and dies by the money put into it. Therefore, it follows that those who control the money are more likely to create an investment situation. However, it might seem strange that although LEGO has been producing sets since the 1950s, adults only really became involved in the 1990s.

The reason for this has to do with the change that was made in the late 1970s. Before that time, most of the pieces made were very basic in design. Sets were missing a sense of narrative so the desire to collect these pieces was very small. In 1978, LEGO finalized their iconic "minifigure" and introduced theme lines. Castle and City were the first to arise from this change, which allowed children to form a nostalgic connection.

Over time, most children that play with the building toy will put it down and never think about it again. Fans in the LEGO community refer to this time as the person's Dark Age. Many adults never come out of this phase while others transition back into the hobby. This is what gives birth to many AFOLs. This is partly why a gap of time exists between the late 1970s and mid 1990s: people literally needed to grow up.

Knowledge is money

As with any investment, each fragment of information will help in making wise decisions. A good place to begin is by understanding the risks in investing in LEGO parts/sets. First, know that much of the investment process is about waiting.



"THE LEGO GROUP HAS BEEN MAKING ITS PLASTIC BRICKS SINCE THE MID 1950S. USING THESE SETS TO TURN A PROFIT HAS ONLY BEEN GOING ON FOR ROUGHLY TWO DECADES."

Second, it is important to realise that every set takes up space, which means there is the cost of storage. It then takes time for the set to be retired officially; this adds additional storage time since some of the higher priced sets may retire at different intervals. After a set retires, there is a point in which the price will mature. Put simply, supply and demand will inform an investor on how valuable a set really can become. When all is said and done, it may take a full year before you know the extent of a set's potential worth.

Another crucial factor is to understand that sets will have a ceiling to their value. This is due to the fact that all the parts are interchangeable. So if a fan can build an exact copy of a set for a consistent price that will help gauge where the ceiling value is for a given set.

Another point to consider is that manufactured rarity exists. Even though LEGO produces toys for hundreds of countries, they will still divide up the world into regions. Within those regions they may produce specific sets only for those markets. Additionally, LEGO has, from time to time, created limited edition sets that may be individually numbered. This forced supply shortage is always worth taking advantage of if you have the means to capitalise on these opportunities.

About William Reed

William is a freelance writer who has been specialising in LEGO related articles for over five years. Among the hundreds of articles he's written, many are found onwww.thebrickblogger.com. In 2014,, he wrote content for the LEGO Discovery Centers and does a regular LEGO podcast segment on www.AllUsGeeks.com. He has a BA in Mass Communications and lives in California in the United States.

Sets often retain their initial value. The average set will typically double in value after the price has matured. However, if a set is heavily targeted towards children, it may only increase a little above what it originally sold for. This means it covers the cost of fees associated with selling online, but it will have no return. In these cases, only time was lost.

Finally, the most important knowledge is that price matters. Keep in mind that adults present the greatest investment opportunity since they have the money. Therefore, as a rule of thumb, the sets that are made to entice an older fan are the sets that show the highest return. Most of the time, this takes the form of larger more expensive sets. Sets that cost £100 and up are the average benchmark for sets with a high yield.

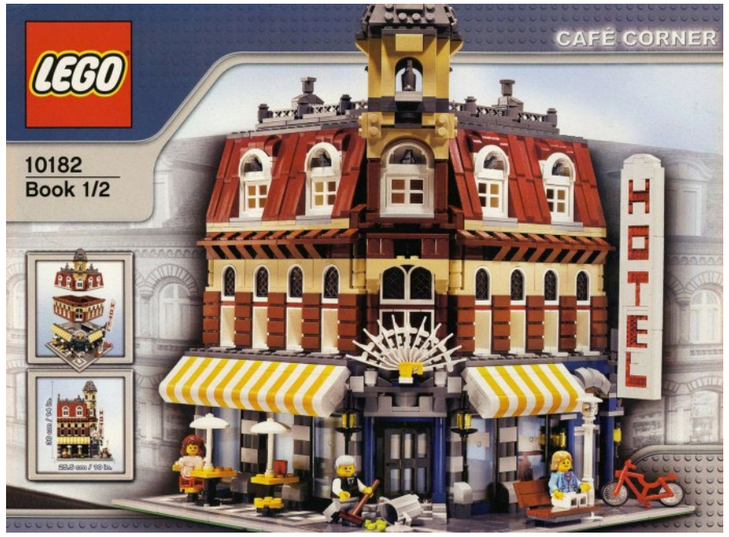
Starting the process

The investment process begins by choosing a platform to sell your assets. Those starting out often use eBay due to its high profile and decent market size. Those looking for more consistency in their market will use a specialised site like Bricklink. In either case, a good understanding of how the platform works will go a long way in determining your success.

The next step is selecting an inventory. On average, smaller sets have lower returns but they sell faster than large sets. Depending on storage capabilities, moving volume quicker may prove to be a better solution. It should be noted that clearance sets can be bought cheaply, but they often make it to the clearance bin because the demand is so low.

For some, parting out a set is a possibility. It generates the most profit, but increases the amount of work needed to maintain. In addition, a person must be able to identify small details like the many shades of green or specific mold type. This level of investing is more for those who heavily engage in the hobby.

Once the inventory is selected, watch the prices. There are two sites that can help investors keep track of the market. The first site is BrickPicker. This site not only gives advice to what the prices are doing, but also gives suggestions on sets that show promising returns. Another option is to go to Bricklink and find the particular set in their Catalogue and use their Price Guide feature. This gives information collected specifically on that site that can give an investor a snapshot image of how well the set is selling.



The final part of the process is to allow for room to negotiate. At the end of the day, LEGO sets have subjective worth. An investor that prices things a bit high, but low enough to entice a buyer has a better chance at closing a deal because there is room to decrease the asking price. Ultimately, no matter what the item is, for it to be an investment it needs to sell.

Examples of good and bad investments

Out of all the sets LEGO produces, AFOLs agree that the modular buildings in the Creator line are some of the best. In order to show the potential of these sets, it will be necessary to compare three sets from this line. As a sample size, the oldest set will be matched up against the set most recently retired and the newest set in the series.

Café Corner was the first set in the modular line. It was released in 2007 and had a retail price of £88.09. The price has fully matured and is now listed for €1,450.00. Currently, no one in the United Kingdom has a new copy for sale. So the nearest and cheapest price is in Germany.

The most recent modular set that has been retired is the Town Hall. Its RRP was £149.99 when it was released in 2012. It has been retired for about one month at the time this was written. It now sells for £425.00 in the UK. This is the lowest price on Bricklink for a new set.

Currently the newest modular building is the Detective's Office. It was released in 2015 for £132.99. Very few are sold on the secondary market right now. This is primarily due to LEGO preventing discounts from being used to buy these higher end sets. Investors can find the occasional €145.00 sold out of the Netherlands, but this is more to help out any people unable to buy a set because of where they live. Those picking up this set now will need to wait three to four years before the set retires.

At the opposite end of the spectrum, there are small sets geared towards play, which do not make good investments. An example of this is Skeleton Mummy Battle Pack. It was released in 2012 for £9.99. Currently it sells for £8.00. What is not seen is the fact that before it was retired, the price was reduced by 75% in some stores. It also has a theme that AFOLs were only lukewarm towards at best. The market for this set might exist in another six to ten years when the children who liked the set grow up, but that is a poor investment.

Now here's an example of a middling investment. The Millennium Falcon set released in 2011 was also recently retired. It retailed for £132.99 and has been retired since the end of 2014. It currently sells on the secondary market for £160.00. It should be noted that the rate of growth is much slower than the Town Hall. This is due to several factors. First, if the licence a set is attached to is moving slowly then the toys connected to the licence also moves poorly. Second, this is not the first or last version of this set. Over the years, this ship has been redesigned numerous times. Third, more copies of this set were created so the supply is much larger. This is why it is important to use sites like BrickPicker to keep tabs on a set's worth.

"LEGO HAS SURVEYED CUSTOMERS AND FOUND THAT ADULTS MAKE UP 20% OF THE OVERALL MARKET."

In conclusion

LEGO has surveyed customers and found that adults make up 20% of the overall market. These are individuals who purchase sets for their own purposes, like investing. Given that over the last few years LEGO has grown and this number stays the same, it could indicate that the investing market is expanding. Adults are the key factor in this equation.

Sure an investor could make smarter decisions if they were also a fan of the hobby. However, fans tend to buy more than they make or at best break even. In order to be serious about investing, a person needs to divorce themselves of wanting the sets, but still have enough of an interest to know what they find attractive. As much as LEGO bricks are a child's play-thing, investing in them is all about adults supplying what other adults want. This means words and phrases like Exclusive, Hard to Find, and Limited Edition are what make the difference between a good year and a great one.

Websites
www.bricklink.com
www.brickpicker.com
http://www.ebay.co.uk/

Images
www.brickset.com



THE BEST OF THE EVIL DIARIES

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 September.

3rd September

I was on the dog to Brussels yesterday and, as it has been put to me (I think highly credibly), there is only one way to attempt (there is no certainty in these actions) to start to bring the migrant crisis under control: it is to attack the mafiosos and gangsters of North Africa. This means military action. What is certain is that the current performance cannot continue.

Syria is materially different. Migrants from that benighted country would prefer to stay there. But until stability returns they will leave. This means that European countries have an interest in controlling events there.

This means cooperation of a very high and unprecedented order. I hope this can be achieved. It'll cost a lot of money and blood.

GLOBAL RESOURCES INVESTMENT TRUST
LSE: GRIT

9th September

Time for common sense: I took another look at **Global Res IT (GRIT):** It's not as obvious a slam dunk as I originally thought but I think it has merit. TNAV is 39.5p and that is after deducting £5m of 9% CULS. The convertible aspect is neither here not there. This contrasts with the fact of there being circa 39m shares in issue standing at 10p or a capitalisation of c. £4m. So, on the face of it, attractive.

However, the expenses, including everything, are about £560,000 p.a. to which must be added the CULS interest of c. £200,000. This is one helluva lot of zonking to achieve damn all. After all a portfolio of c. £16m has to perform well to pay these costs before a bean goes back to shareholders. All this is all too clear from the published accounts.

So what's the way forward? The answer must surely be a steady liquidation based on a private status. I think there must be shareholders who would take the money and hand in their hands. Certainly, the present state of affairs is barmy.

For the record there is a portfolio of very ordinary ordinaries and it will not be easily liquidated. Not that this necessarily means anything but I do not recognise any of the holdings. I see that one holding is in any event unquoted – which makes things yet harder.

What is it about Ashley as a first name (not as in Laura Ashley which report

"IF I WERE AN SPD SHAREHOLDER I WOULD WANT PERFORMANCE AND NOT THE WARBLINGS OF CLAXON. LET CLAXON IDENTIFY A BREACH OF FIDUCIARY DUTY AND I'LL BE ORL EARS."

today)? Ashley Madison is for those seeking or proposing to seek to bonk on the side whereas Ashley Claxon (why put in the 't'?), Royal London's corporate governance manager (what do these people do?), is merely bonkers. She claims that **Sports Direct (SPD)'s** Mike Ashley (the Ashley here is a surname) doesn't seem to mind what Ashley, the mad, thinks. Are you surprised? Mike likes to get on with business. Why not avoid board meetings if one holds 57% of the equity and merely refers to one's board for helpful advice? According to Claxon, Mike is naughty because he doesn't do things Claxon's way. If I were an SPD shareholder I would want performance and not the warblings of Claxon. Let Claxon identify a breach of fiduciary duty and I'll be orl ears.

"APR IS STILL LOSING MONEY AND THE BANKERS HAVE YET TO DECLARE THEIR HAND."

11th September

Alex Brummer is presumably a tolerably sensible chap in his private life. But at the Daily Mail he is told to write whatever causes a daily hate even if the text that emerges is palpable rubbish. A very good example is his criticism today of The Mashley when Brummer remarks that "Business history tells us that overweening bosses who refuse to listen to colleagues and investors eventually pay a heavy price". He should have written "history can indicate… may eventually…" but as to the universality of his comment, well, it is just the Daily Mail



engaged in a daily fail. Perhaps not but I suppose that Brummer finds this deeply degrading.

*****

Back on Pantheon (PANR), I tried to get a whiff of how things are going by talking to John Walmsley, the chairman. But this exercise was quite pointless since John, if he will forgive my so remarking, has an extraordinary ability to talk round a subject without in fact commenting at all. He just does not release insider information.

*****

APR Energy (APR) surprise (me at any rate) by this morning announcing that their Libyan assets have been retrieved and that they will be relocated to profit elsewhere. I do not know what to make of this but I decline to close my short. APR is still losing money and the bankers have yet to declare their hand.

*****

Finally, Rugby Union as played seventy years ago: **https://m.youtube.com/watch?feature=share&v=zmG3ng6qBY.**

16th September

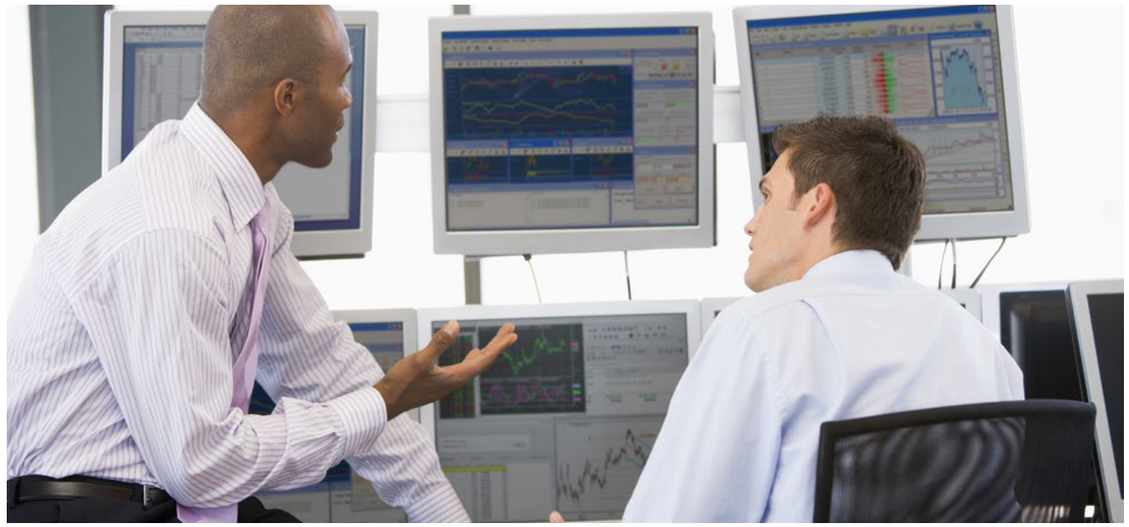
Glencore (GLEN) may have raised £1.6bn at 125p thus inducing the market to judge that 125p is a floor. I doubt it.

Ocado (OCDO), 317p, shows no sign of getting anywhere near justifying its current capitalisation. For a long time the price was held up by the notion that Amazon would bid. But it was never explained why Amazon would bid. In any event, Amazon are now kicking off with Amazon Fresh as a competitor. Perhaps Shore Capital's Clive Black will be proved right – albeit a few years later than I imagine he judged.

Proxama (PROX) today announces another contract win – albeit with no figures. They have signed up a Middle Eastern bank (purchasing officers at home grown banks are a very cautious lot) as their customer in the distribution of PIN numbers. As, I am sure, the vast majority of others, I have found postal delivery of PIN numbers an uncertain service. Perhaps Proxama has here really cut through to fame and fortune. If so, more contract wins should follow. Now 1.35p offer.

Globo (GBO) still has not raised a brass farthing of its E180m at 10% loan. I am not surprised given the shabby drafting of its prospectus (just where is Globo's money deposited?). I may add that the prospectus goes on for a staggering 419 pages. In any event, the punters are getting out – 3m in one go were sold at 25p yesterday. Not much subtlety there.

Mr Spoofer, a.k.a. Rob Terry, disclosed a day or two ago that he and Quob Park have bought a further 1m **Imaginatik**



(IMTK). This morning, cash flow problems, albeit presumably of a very temporary nature, have been solved by Imaginatik raising $110,000 at 10% p.a. off its chairman, Matt Cooper. If of course there is a further delay in receipts there'll have to be a placing at, say, 4p at most. In any event, the shares are not worth more than 3p. Best stay short.

17th September

A longstanding deep throat was on the dog yesterday and he draws my attention to: **Petrofac (PFC).** He doubts the quality of these earnings and more directly the outlook. Now 830p. **Carillion (CLLN)** which to him seems to have mistimed its acquisitions. Now 315p. There is a large short position but this is in part explained by a short against the convertible. And **Optimal Payments (OPAY):** here he refers me to line 4 of page 18 of the recent prospectus. What can he mean? Now 320p.

OPAY is applying for full listing. If they get it the shares will rise. Per contra…

21st September

It has always been my view that government agency after government agency is dedicated quite pointlessly to protecting us from ourselves. This is not a new idea. I have been today passed the

"ALL WE NEED NOW IS FOR ROB TERRY TO POP UP ON THE REGISTER."

following: "The ultimate result of shielding men from the effects of folly is to fill the world with fools." – Herbert Spencer, English philosopher (1820-1903). Herbert forgot to mention that the modern version of foolish intervention would have as a central feature the requirement that the expense of the exercise would be borne by those who never asked for an interventionist to intervene.

Apparently, the directors of **BooHoo (BOO)** took out £200m on the flotation. Interims are on 29th September. The rating looks stratospheric to me.

I had it pointed out to me this morning that **Plus500 (PLUS)** has yet to be taken over at 400p cash by Playtech. My informant wonders what will be the position if further enquiry reveals thatPLUS is to lose on a regulatory review? That'll be 200p+ straight off the price, now 373p.

Meanwhile the finance director of **Mulberry (MUL)** has sold at 895p. I never remotely understood why the shares should be over 250p in any event. MUL are hard to borrow.

23rd September

I can't lay my hands on the exact words deployed in the South Sea Bubble prospectus of the company that claimed that its purpose was so hush hush no one shall know what it is. But this idea is yet again revived by **Concha (CHA)** which today offers a "general update". Central to this statement is that there has been no trade and that after fifteen months of bulls being kept in suspense they'll go on being kept in suspense. All we need now is for Rob Terry to pop up on the register.

BEST OF THE BLOG

SEPTEMBER 2015

BEST OF THE BLOG



“CHRISTIAN BENTEKE’S £32.5 MILLION MOVE FROM ASTON VILLA TO LIVERPOOL IS THE INFLATION ADJUSTED EQUIVALENT OF THREE 1982 DIEGO MARADONAS!”

Premier League investments in the football financial frenzy

I kicked off writing about football and economics back in February, hot on the heels of the English Premier League clubs spending a record £950 million on player transfer fees. I also suggested that if current trends continue, we could well see the first £1 billion player within the next 20 years.

While Gareth Bale’s £85.3 million purchase by Real Madrid has held the record for two years now, and despite the recently introduced UEFA Financial Fair play rules, there appear to be few signs of a slowdown in the huge amounts of cash being pumped into the game.

Records kicked into touch…

According to calculations from Deloitte, Premier League transfer fees in this season’s summer window once again hit an all-time high, up from £835 million in 2014 to £870 million in 2015. Backed by the estimated $1 trillion family fortune of owner Sheikh Mansour, Manchester City were the top dogs, spending £160 million on new players, a record for a single club.

But demonstrating a widespread spending spree, all but one Premier League club (Southampton) spent more than they earned on selling players, with net spending of £467 million also being a record. Total transfer fees across the summer and winter transfer windows surpassed £1 billion for the first time and spending in England was more than double that of any other European League – second was Italy’s Serie A at £405 million.

While the world record transfer fee for a single player remains unbroken since 2013, the number of large transactions in England this summer was noteworthy. For example, Christian Benteke’s £32.5 million move from Aston Villa to Liverpool is the inflation adjusted equivalent of three 1982 Diego Maradonas!

Of course, spending huge amounts is no guarantee of success on the pitch. Just look at Chelsea’s 4-2 defeat to Bradford City in the FA cup last year. Billionaire Roman Abramovich’s side had put been together for around £200 million, while Bradford’s team cost just £7,500 – less than Chelsea star Eden Hazard earns in six hours!

By Richard Gill

To read the full article CLICK HERE

Head and shoulders reversals – necklines are for P*SSIES

As regular readers of my articles will know, I believe the UK generally has highly unsophisticated private investors. I would expect a majority of people who have tried spread betting did no study whatsoever, and thought they could just wade in and somehow, by osmosis presumably, they'd be really good at it. Sticking your finger in the air is a good idea if you want to know which way the wind's blowing, but not to decide whether to buy or sell an investment.

"CHART PATTERNS ARE TAUGHT AND UNDERSTOOD IN AN ENTIRELY SUPERFICIAL WAY, WITHOUT UNDERSTANDING THE REAL MECHANICS BEHIND THEM."

Those that have been on training courses are often attracted to the two most visual chart patterns: the Head and Shoulders and the Cup and Handle. Chart patterns are taught and understood in an entirely superficial way, without understanding the real mechanics behind them. I've never used Cup and Handle. Look more closely: it's a significant Higher Low after a significant bottom. A significant pattern doesn't have to look like something from an ABC book to be valid. I always thought that pattern dubious, and likely to make you miss others because they don't look quite right.

The Head & Shoulders is slightly different, although people do debate endlessly about where neck lines are, and "that looks like a shoulder", and so on. Ok let's examine the basics as they are taught.

A Head and Shoulders is a reversal pattern, and in the example I've shown the conventional view in black, and my notations in blue. The idea is that you wait for the pattern to complete and go short when it breaks the neckline after the right shoulder. The distance (x) from the top of the 'head' to the neckline gives you your price target beneath the neckline. All fine and dandy, and looks so simple in a seminar. In reality it is unsophisticated. It's important to understand what is causing any phenomenon in trading to make the best use of it.

By Adrian Kempton-Cumber

To read the full article CLICK HERE

Attractive entry level for specialist litigation fund Juridica Investments

The market often overreacts to bad news and where this is the case it can create a decent buying opportunity for long-term investors. A good example is the specialist litigation fund, Juridica Investments, which trades on the London Stock Exchange under the ticker JIL. My colleague, Filipe R Costa, looked at the diversification benefits of litigation finance investments earlier in the year, but a recent fall in the share price of Juridica has provided an opportunity to buy into this unique and uncorrelated type of exposure.

Juridica Investments is a closed ended investment company registered in Guernsey and listed on AIM. Its objective is to generate income and capital growth through direct investment in litigation and arbitration cases, claims and disputes.

The fund is managed by Juridica Capital Management, which employs a team of experienced lawyers whose main expertise is in business to business cases brought in America in areas such as intellectual property, contract disputes, antitrust, insurance, and shareholder disputes.



Juridica provides third-party funding to allow these cases to be resolved, but will only do so where there is a clear economic benefit that is likely to be settled in an acceptable timeframe. It leaves the management of the claims and the settlement decisions to the claim holders and their lawyers.

JIL was admitted to AIM in December 2007 and by the end of June 2015 it had generated net cash proceeds from settled claims of $222.5m from an initial investment of $167.7m. This represents a net return after tax of 33%. Total dividends paid to date amount to $98.8m, which is equivalent to 59p per share.

At the end of June the fair value of the remaining unsettled cases was $101m and there was a further $46.3m in cash and receivables. Added together these were equivalent to a net asset value (NAV) of 86 pence per share.

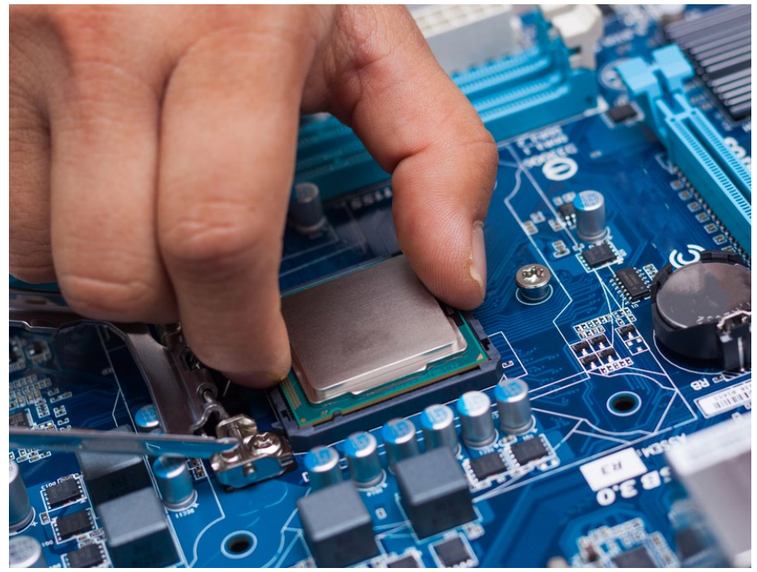
By Nick Sudbury

To read the full article CLICK HERE

Will ARM Holdings cash in its chips?

Way back in the early spring, Arm Holdings, the Cambridge 'chip' (semiconductor) company met the big 'OR' of overhead resistance. It tried to break through the 1,200p level on several occasions but unlike the panzers in the Ardennes, in the 1940 battle for France, it did not pull it off.

"THE COMPANY MAY HAVE MORE CASH THAN IT NEEDS FOR OPERATIONAL PURPOSES AND ENOUGH TO KEEP SHAREHOLDERS HAPPY AND LOYAL."



Having failed to get into new share price territory at the commencement of the current year, the share price headed south, bottoming out in August at around 850p or so, having refused to go to the low point of 778p reached last October. Last seen, the share price has bounced up to 980 – a 15% jump from the August low point.

The chart looks interesting. Although the share price is arguably still within the downtrend that began last spring (that depends on where you draw the upper and lower out-swings from the central trend – a bit of subjectivity, which makes charting as much an imaginative art as it is a 'science'), the energy and power of the recent bounce invites reasoned interest. On Tuesday 15th September, the company had its annual institutional analysts get together.

Will that provide the dry tinder for further bullish conflagration? Is there real fundamental fire behind the smoke of Monday's 1.5% increase in the share price, prompted by the weekend news of strong Apple iPhone sales? My interpretation of the share price chart (a bit more subjectivity, so have a look for yourself) is that 'technically' the share price will need to move up to somewhere near 1,100p to establish a breakout from the recent downtrend that began at the beginning if this year. On the way to that prospect, the shares have broken out of three month and six month trends.

If it does break out from the last year's downtrend, it would be reasonable to conclude that the share price should-head north, breaking through the previous resistance at around 1,200p. So what do we have in the way of evidence to make that a reasoned prospect? Or to put it another way, is there enough value in the shares to justify a purchase? One hearsay bullish view is based on market estimates of the company's ability to generate cash flow. Some of the reported estimates are of a next year's estimated cash flow as a 3.5% (based on a recent share price, I assume) cash flow yield, rising to 6% by 2020. That puts the current dividend yield of under 1% in a much more attractive context, suggesting that the company may have more cash than it needs for operational purposes and enough to keep shareholders happy and loyal, should the boys in the corporate finance departments attempt to flog off Arm to a Chinese entity, to generate bonus money.

By Robert Sutherland-Smith

To read the full article CLICK HERE

READ TO SUCCEED

RED NOTICE HOW I BECAME PUTIN'S NO. 1 ENEMY

BY BILL BROWDER

A BOOK REVIEW BY SWEN LORENZ

Transworld Publishers, Hardback, £17.99

A Facebook recommendation, an upcoming movie, and a rapidly declining Russian economy: these are the excuses I'll use for reviewing a book half a year after it was first published. Recent events pushed the book onto my radar screen, and following a few fascinating evenings of reading, I wanted to point out a biography cum crime novel that's now probably even more current and relevant than when it first came out.



Much ink has already been spent on the fate of Bill Browder, who has been marketing himself as a victim of Russia's government ever since he was first denied entry to the country in 2005. At the time, he was running an investment firm with $4.5 billion in assets under management and a gilded track record. Since 1996, investors in the funds of Hermitage Capital had made a stunning 1,500% return. Ten years ago, Browder was at the pinnacle of his success.

His success was largely derived from being an activist shareholder. Russian companies had billions of dollars stolen from them by corrupt officials and criminal major shareholders, and no one else was as vocal in exposing them as Browder. His particular style of activist investing made his clients (and himself) a fortune, but it greatly upset the powers that be. In November 2005, when returning to Moscow from London, the Russian authorities denied him entry.

What followed then made for a real-life crime novel worthy of Tom Clancy. Browder was accused of tax evasion and convicted in absentia to nine years in a Russian prison. One of his lawyers ended up in a Russian prison, where he was first tortured, then beaten to death. The Russian government has tried to extradite Browder through Interpol, a request that the international police brushed aside as being "mostly politically motivated".

Not only does Browder's book chronicle all of the above in breath-taking detail, crucially, it also gives investors a unique insight into the workings of Russia, and how the country's political system can affect investments in the country. That's why it's worth putting the book back onto the radar screen.

The recent collapse of the oil price has already badly hurt the Russian economy, and Bloomberg recently spoke of a crisis that echoes that of the Soviet Union's collapse. The Russian economy is now set to shrink by 3.4% in 2015, a worse contraction than that of any other emerging market and a stark reversal from the 7% p.a. growth that had made Russia rich during the 1999-2008 period. For a country where living standards are just 40% of those in the US, such a shrinking economy is a disaster not just economically but also politically. It threatens everything, even Vladimir Putin's position.

During the 1970s, a soaring oil price contributed significantly to keeping the Soviet economy in a good enough state to survive despite all the failings of the socialist system. With the decline of oil prices during the 1980s, out went the Soviet Union. The question whether something similar will happen now is one that has great relevance for anyone looking at Russian shares.

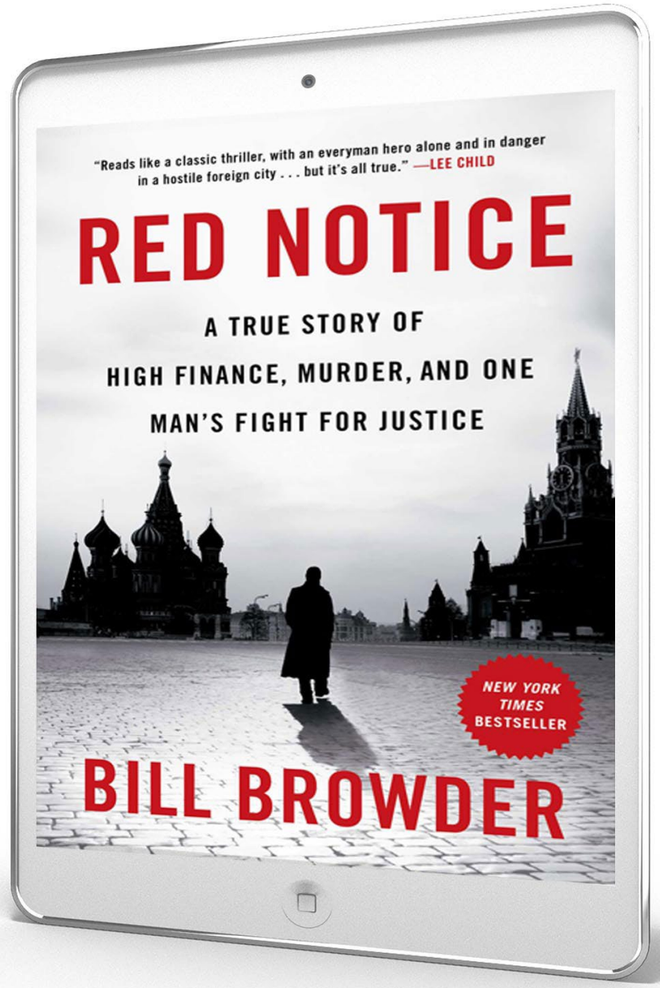
On paper, the Russian stock market is now among the cheapest on earth. The combined valuation of all public Russian companies is now less than the value of Google. That's despite the fact that Russia is sitting on more natural resources than virtually any other country on the planet. For all intents and purposes, Russia is now the world's cheapest stock market, at least on the surface of it.



"ON PAPER, THE RUSSIAN STOCK MARKET IS NOW AMONG THE CHEAPEST ON EARTH. THE COMBINED VALUATION OF ALL PUBLIC RUSSIAN COMPANIES IS NOW LESS THAN THE VALUE OF GOOGLE."

For Browder, recent developments in Russia are a cautionary tale for investors. As he stated in a YouTube video, "Anyone who would make a long-term investment in Russia right now, almost at any valuation, is completely out of their mind." His view of Russia is one where the daily abuse of power that he experienced will continue to work to the detriment of investors. The political system that's in place will now fight to stay in power, and that doesn't bode well for anyone looking to invest in Russia.

"Stories from Russia", an old saying goes, "rarely have a happy ending." Anyone tempted to invest in Russian shares, or who has Russian shares in their portfolio already, is well advised to get out a copy of Browder's book. I did so on the back of a friend's recommendation – someone who never posts about his reading on social media, but who for this book made a rare exception! Soon, you'll not only hear about this book on social media and through delayed book reviews like this one, but also on the big screen. Red Notice, I hear, is set to be turned into a movie. Personally, I can't wait!



THE FINAL WORD

HOW TO SOLVE THE MIGRANT CRISIS



BY ADRIAN KEMPTON-CUMBER

Most people want solutions that are all fluffy and let them sleep at night. Well there aren't many (if any) of those that apply to real problems – and certainly not in this case! When you get a real, workable solution there will be winners and losers and it's probably not going to be pretty. In any case, it's not pretty now, so what's the difference anyway?

We were rubbish at dealing with immigration in the past. You can go back to any point in history and there were people coming here from Holland, or 'Bongo Bongo Land', or really anywhere that's somewhere else, and "stealing our jobs". Or there were people coming here to do jobs at wages we wouldn't want to work for. Or there were people coming here because, like the West Indians who came on the Windrush, we invited them to do jobs that were going begging. Generally speaking immigrants can't steal your job because you have a competitive edge. If they do then you're a bit rubbish at your job. Either way we have had an age old tradition, in England at least, of making newcomers as unwelcome as possible.

We look down our noses hypocritically at Hungary's ostensibly un-European response which has been to advertise in Lebanon to the locals not to come to Hungary or they'll be locked up, and changing their laws to resist the influx militarily. Remember, we wanted Eastern Bloc countries in the EU to keep them close, so they wouldn't revert to the East and Russia. And in any case they might not seem so extreme once western European countries like France and Holland have elected the Far Right at their next opportunity.

"THE FACT IS WE HAVE A QUALITY OF LIFE THAT MAKES PEOPLE WANT TO COME HERE. YOU DON'T WALK FROM DEEPEST DARKEST AFRICA TO EUROPE IF THE COUNTRY NEXT DOOR HAS THE SAME STANDARD OF LIVING WE ENJOY IN EUROPE."

The fact is we have a quality of life that makes people want to come here. You don't walk from deepest darkest Africa to Europe if the country next door has the same standard of living we enjoy in Europe (socially and economically speaking). And people go on and on about whose fault it is the migrants are coming. Have their native countries been destabilised by western interference? If we bomb their countries what do we expect? It's a bit like global warming. It doesn't really matter who's caused something; if it needs fixing then we need pragmatism to get it fixed. Let the historians work out the details later.



What we do know is that the migrants are coming from countries where democracy has failed, or not even been tried, ever since the War. And there is the answer as to what's gone wrong. Like it or not, we in the First World have set the global standard and they can't uphold it. And I'm not convinced democracy can work in any case where you have a population which is polarised into two groups of unequal size. That's just mob rule with impunity.

"PEACE DOESN'T BREAK OUT, IT HAS TO BE IMPOSED."

Now many people think the solution to the migrant crisis is to accept all the people who come. "Give them hospitality", I imagine particularly until that involves having a migrant turn up at their own doorstep wanting the spare room and cooked meals for no rent. I don't think the politically correct would be so PC when that happens. They just want to say they would to make themselves feel better, like they've given something to charity. They are fake and haven't really got an opinion at all, mainly because they say what they think other people think they should say. They are social puppets.

The migrants are coming because traffickers are making fortunes out of sending them here. And don't think they're not organised. These are the slaves that will be working in this country until they've paid off their debt, which as we all know is sometimes never. So in fact by welcoming them we are sentencing them to slavery, not offering them freedom. So not so much a sticking plaster even, as a crack pipe!

The problem of people trafficking is huge. It was estimated in a report recently that there are 30,000 trafficked individuals now in sex slavery alone in Europe. That will be a drop in the ocean compared to the numbers we will see enslaved here if things carry on as they are. The infrastructure for trafficking and slavery is in place because we refuse to decriminalise drugs and legalise prostitution. As a result there are highly organised trafficking operations with the experience and mechanism to take advantage of the migrant crisis.

And are we really saying we're offering a home to anyone who can survive the journey? There are around 60 million refugees in the world today. What's the plan then? Milton Keynes? Those deserted villages in Spain? Give them a whole country in Europe? Not to mention the integration problem (and we're still struggling to integrate some former migrants that have been here for decades). They don't broadly share our values. Apparently even Hungary doesn't broadly share our values!

What we have now is a sort of Leaky Boat Lottery Game Show with death to decide who gets the prize. And the more winners there are the more contestants there'll be. This problem is much too large to deal with piecemeal.

Fear not, because there is a solution. Peace-keeping recolonisation. Now if that thought makes you foam at the mouth in a knee-jerk reaction programmed by the media, then how come none of you have come up with a better solution? You can be PC or you can be kind, but you can't be both if you want to free millions from their own tyranny. Syria (they've never had democracy), Libya (they are clearly not ready for it), Iraq, and many other problem nations. Developed nations, either in co-operation or individually, need to recolonise these places, provide a stable economy and social environment, and enforced peace. Yes of course there'd probably have to be marshal law for a time, and there'd doubtless be some violence. Well guess what? There already is. That's a zero sum game. Colonisation has to pay for itself, and rebuilding the economies of these countries will solve that. And I'm talking about remaining there for several generations. 100 years. We can't have this sort of destabilisation in the modern world, and the only way to resolve it is to get in there on the ground. Not an occupying force, but a peace-keeping colonisation.

We need solutions not based on emotional responses, but on rational, pragmatic workability.

There's no support from super-rich nations like Saudi, who offered to build not homes, but mosques, for Germany to accept migrants. Actually Saudi made a new law banning the adoption of any children from outside the kingdom. While we're at it we should also colonise Saudi and their neighbours and stop all this nonsense of manipulating oil prices. They don't have democracy either, and although I'm not a big fan of democracy, it's certainly better than dictatorship or ruling monarchy. They'll be easy to size up militarily, not least because we sold them the kit they'll be using to defend themselves!

The Chinese won't have any such quibbles about being master of their domain. And that's another aspect. We need to be pre-emptive because when their economic miracle ends they will be on the warpath – my prediction is for water to start with: the water in Lake Baikal (20% of the world's drinking water) is the objective. Mongolia is the theatre of war and after the battle which China inevitably wins due to sheer numbers, they will also have the East of Russia and become Sarah Palin's new neighbour. Their territorial demands won't stop there either. Peace doesn't break out, it has to be imposed. If we want a stable global environment then we have to make it happen actively. Peace by force is still peace. And there's no other way to have world peace than to enforce it. So vote for me if you want world peace!

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MARKETS IN FOCUS
SEPT 2015

FOREX

Forex	Sep %	YTD %
USD/CAD	1.3	14.6
EUR/GBP	1.1	-4.9
USD/CHF	0.9	-2.0
EUR/CHF	0.4	-9.5
GBP/AUD	-0.1	13.1
EUR/USD	-0.5	-7.7
USD/JPY	-1.0	0.2
AUD/USD	-1.4	-14.2
EUR/JPY	-1.5	-7.5
GBP/USD	-1.6	-2.9

GLOBAL INDEXES

Index	Sep %	YTD %
Dow Jones	-1.5	-8.6
NASDAQ 100	-2.2	-1.3
S&P 500	-2.6	-6.7
Russian Trading System	-2.8	0.8
FTSE 100	-3.0	-7.7
FTSE MIB	-3.2	12.0
Bovespa	-3.4	-9.9
S&P/ASX 200	-3.6	-5.5
Hang Seng	-3.8	-11.7
CAC 40	-4.2	4.3
Euronext 100	-4.7	2.3
DAX (Xetra)	-5.8	-1.5
IBEX 35	-6.8	-7.0
Nikkei 225	-8.0	1.6

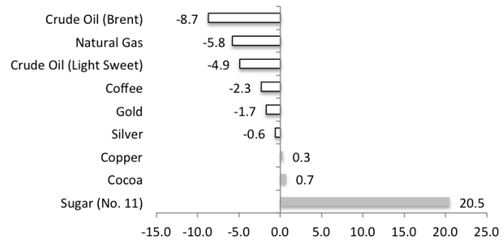
INTEREST RATES

Central Bank	Key Rate	Next Meeting
BOE	0.50%	Oct 8
ECB	0.05%	Oct 22
FED	0.25%	Oct 29
BOJ	0.10%	Oct 7
SNB	-0.75%	Dec 10
BOC	0.50%	Oct 21
RBA	2.00%	Oct 6
RBNZ	3.00%	Oct 28
BOS	-0.35%	Oct 27
BON	0.75%	Nov 5

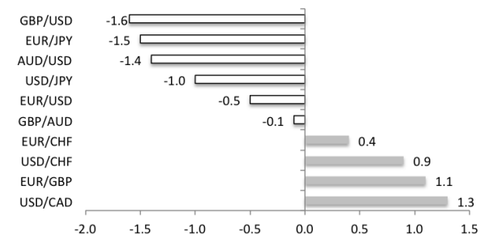
COMMODITIES

Commodity	Sep %	YTD %
Sugar (No. 11)	20.5	-11.4
Cocoa	0.7	5.0
Copper	0.3	-18.3
Silver	-0.6	-7.4
Gold	-1.7	-5.8
Coffee	-2.3	-26.2
Crude Oil (Light Sweet)	-4.9	-15.6
Natural Gas	-5.8	-13.2
Crude Oil (Brent)	-8.7	-15.8

COMMODITIES 1M%



FOREX 1M%



FTSE 350 BOTTOM

Sector	Sep %	YTD %
KAZ Minerals PLC	-51.5	-67.2
Glencore PLC	-38.3	-69.4
Premier Oil PLC	-36.7	-60.1
Petra Diamonds Ltd	-32.6	-56.6
Allied Minds PLC	-27.6	-4.1

FTSE 350 SECTORS BOTTOM

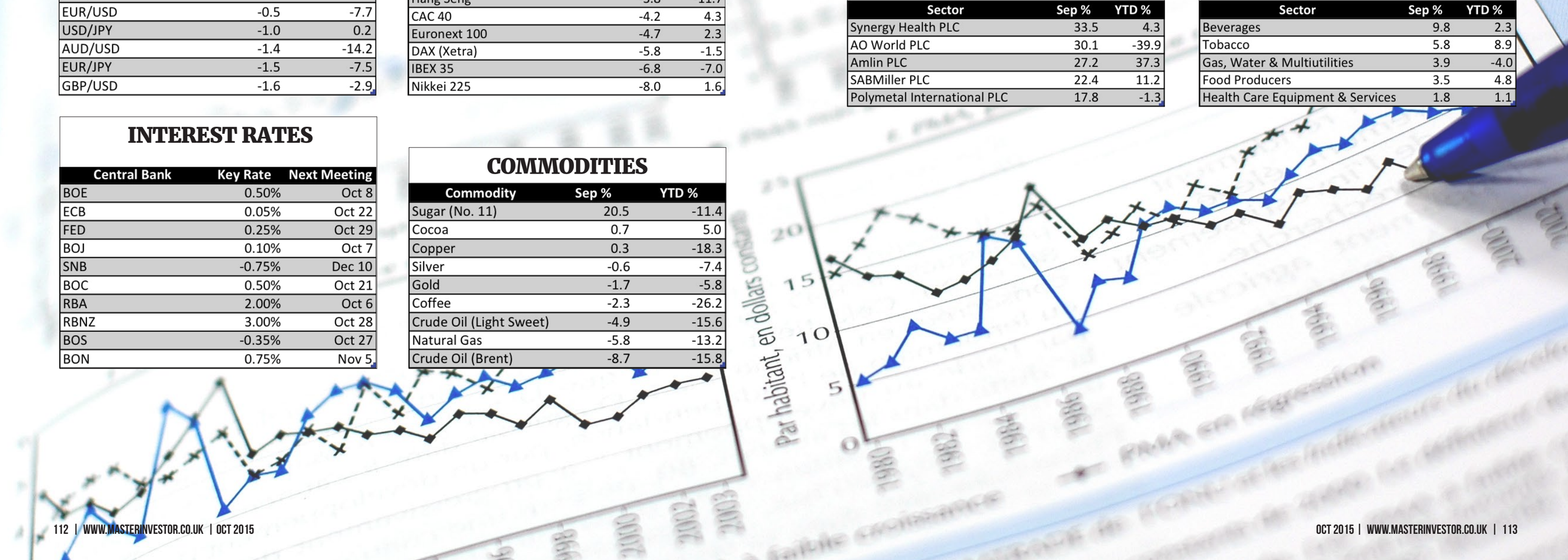
Sector	Sep %	YTD %
Mining	-16.1	-39.7
Industrial Engineering	-11.5	-20.4
Oil Equipment, Services & Dist	-10.8	-5.9
Construction & Materials	-8.9	13.4
Automobiles & Parts	-8.1	-22.1

FTSE 350 TOP

Sector	Sep %	YTD %
Synergy Health PLC	33.5	4.3
AO World PLC	30.1	-39.9
Amlin PLC	27.2	37.3
SABMiller PLC	22.4	11.2
Polymetal International PLC	17.8	-1.3

FTSE 350 SECTORS TOP

Sector	Sep %	YTD %
Beverages	9.8	2.3
Tobacco	5.8	8.9
Gas, Water & Multiutilities	3.9	-4.0
Food Producers	3.5	4.8
Health Care Equipment & Services	1.8	1.1



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