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IS THERE A BUBBLE IN BIOTECH?

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WELCOME



No one who is active in the world of investment could have failed to notice the phenomenal rise of the biotech sector over the past half-decade or so. Our very own Jim Mellon was early into the breach, having even published a book, *Cracking the Code*, which outlines the momentous changes taking place in this important sector – changes which, he predicted, would make fortunes as well as transform lives.

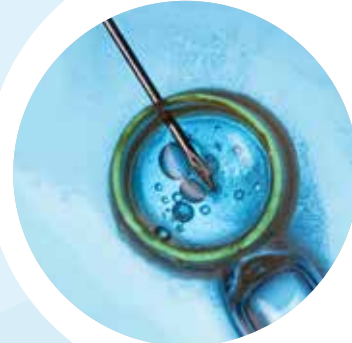
But with the NASDAQ Biotech Index up over 250% in the last five years, it is understandable that some are starting to question the sustainability of the biotech boom – especially given the recent sell-off, which was particularly harsh for biotech investors. Some have even likened the current situation to the dot.com bubble of the late 1990s. So, are we in a biotech 'bubble', or is the recent sell-off just a good opportunity to buy into what could very well prove to be the investment opportunity of the century?

In this month's edition of Master Investor Magazine, we've brought together a selection of industry experts to flood our pages with market insight in order to help readers answer that very question. You will note that in some cases our contributors have competing views. Unlike many of our fellow publications, Master Investor does not espouse a 'house view', which means that our writers have the freedom to express their unadulterated opinions. We believe passionately in this agnostic approach because, contrary to the delusions of some industry practitioners, investment is closer to an art form than a science. That is about as close to a 'house view' as you will get from us – but if any of our contributors wishes to argue against this view, they are most welcome.

Some of the worst investment decisions are made when debate is stifled. Back in the heady days of the dot.com bubble, those who questioned the logic of massively inflated valuations for technology stocks were berated as philistines who simply failed to grasp the 'new paradigm' of growth. The naysayers attracted little attention in the media, while those who predicted ever higher valuations made the financial headlines. The consequences of such a climate, where technology investors constituted an overwhelming body of opinion that almost verged on religious zealotism, were catastrophic. Perhaps this time it really can be different – but only if we have the debate.

Best regards,

James Faulkner,
Editorial Director



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BY JIM MELLON

MELLON ON THE MARKETS

Every year, in this season of mellow fruitfulness, I come to the Viva Mayr Clinic by the beautiful Worthersee Lake in Austria. The clinic is a sort of detox retreat, and I have been put on Diet no. 1, which allows for Lilliputian morsels of food on two occasions a day. Diet no. 0, on the other hand, is liquids (and by that, they mean liquids with no calories), and apparently some are eager to sign up for that brutal regime.

Not so the world's central bankers; they are all apparently anxious to sign up to Diet Number Infinite, involving lashings and lashings of newly printed money. They are, however, while expanding their balance sheets with all this money creation, almost to a man (it's mostly men in central banking) trying to *shrink* the values of their national currencies.

Since my last missive, the Fed has balked at raising interest rates, despite a rate hike being necessary, in my view, if a normal economic back-drop is ever to be achieved. Mario Draghi in the benighted Eurozone, has indicated an expansion and most certainly extension of his own version of quantitative easing, and China has cut reserve requirements and interest rates in an attempt to keep growing at the Politburo-endorsed 7 per cent real rate it demands.

Japan's central bank is said to be toying with more easing, and lots of smaller countries are doing their level best to play beggar thy neighbour policies by encouraging their domestic currencies down.

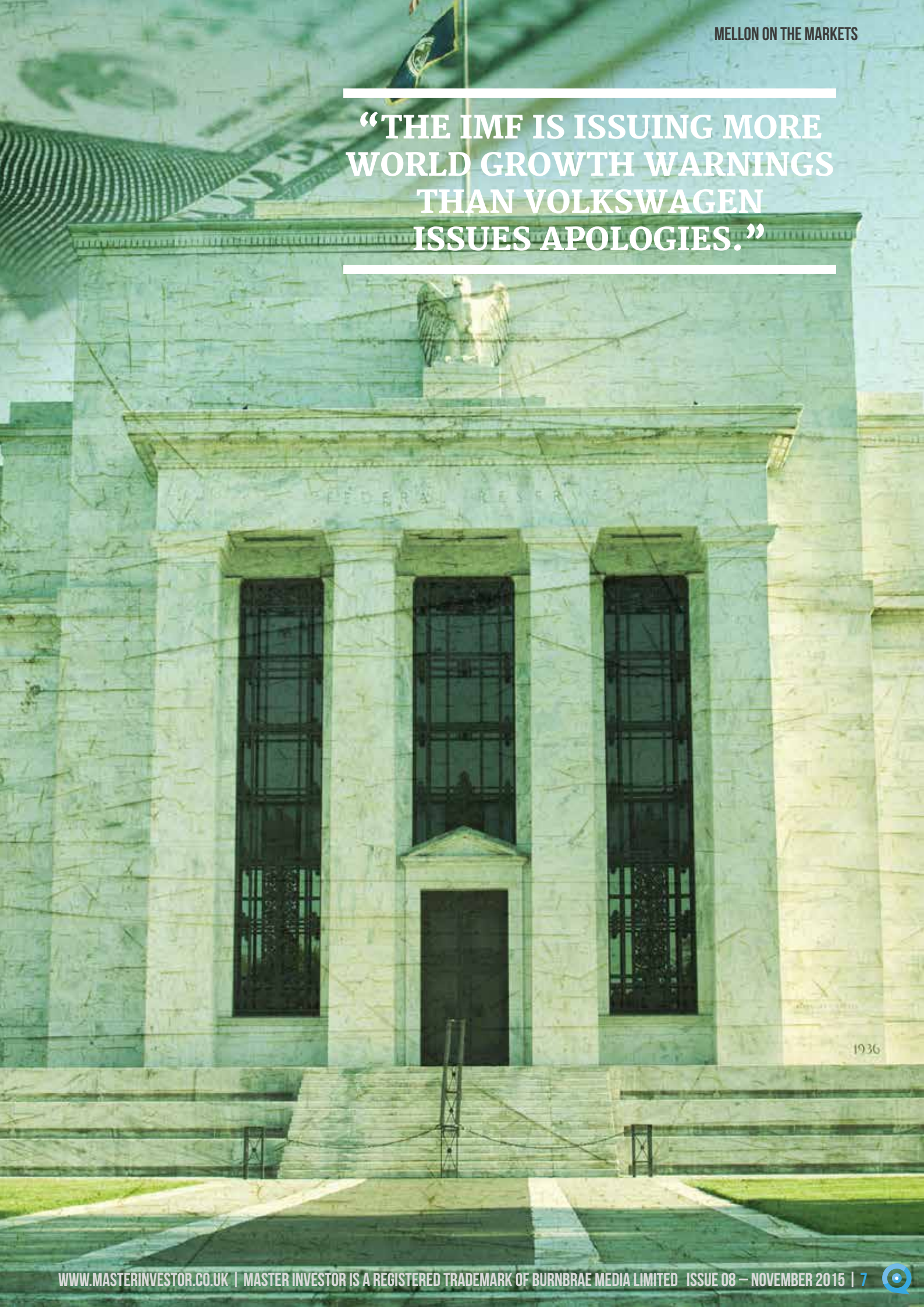
“THE CENTRAL BANKERS REALLY DON'T KNOW WHAT TO DO; SCARED OF JEOPARDISING FRAGILE RECOVERIES BY RAISING INTEREST RATES OR ADOPTING LESS EXPANSIONARY POLICIES, THEY ARE STUCK IN THE KEYNESIAN HEADLIGHTS WHICH SUCK THEM EVER CLOSER TO EVENTUAL DISASTER.”

All this is having unintended effects. I have written and spoken before about the tremendous misallocation of capital that occurs when there is an actively pursued Zero Interest Rate Policy (ZIRP). Largely due to this, world productivity has flat-lined, and the IMF is issuing more world growth

warnings than Volkswagen issues apologies. Now world GNP growth is forecast at sub 3% this year, the lowest in recorded memory.

At the same time, the asset bubbles that are the direct result of these ZIRP policies (and now even NIRP – negative interest rate policies) show ever increasing signs of being close to breaking point. Corporate debt spreads over US Treasuries and other (reasonably) certain governmental bonds are blowing out, and default rates (particularly in energy) are rising. US profit growth, despite the huge amount of debt financed buy-backs I have spoken of before, has stalled and is now in reverse. And the US dollar's strength, the result of everyone else trying to export their deflation, is hurting. The US industrial sector is undoubtedly in recession, and while the overall economy is propped up by government expenditure, housing and consumption, it is now slowing markedly. Indeed, exports are now under severe pressure because of dollar strength and weakness in key markets such as China and Euroland.

**“THE IMF IS ISSUING MORE
WORLD GROWTH WARNINGS
THAN VOLKSWAGEN
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1936



And yet, the central bankers really don't know what to do; scared of jeopardising fragile recoveries by raising interest rates or adopting less expansionary policies, they are stuck in the Keynesian headlights which suck them ever closer to eventual disaster.

Everyone is trying to gain advantage by devaluation; at least three quarters of the world's central bankers are trying to talk their currencies down. But when everyone is at the same game, none can really succeed.

Taking the Eurozone as the pre-eminent example of trash talking its own currency, the consequences are even more nuanced. The Germans don't really (despite VW) need a devaluation; indeed their economy remains far too skewed to exports, partly the result of a way-too-low exchange rate. Their impoverished neighbours really, really need this weakening euro, however, and are damn pleased about it. It's not doing them a lot of good though, since France and Italy remain pretty desperately set. France in particular has made almost no progress on the reforms that it needs to get out of its quicksand. France and Italy (the FRITS, my very own acronym for this pair of economic millstones) are caught in debt traps. No matter how hard they try, their nominal GDPs cannot grow fast enough to overcome the corrosive effects of rising debts, even at low interest rates.

And woe betide them when interest rates rise, perhaps on the back of a recognition that even Super Mario can't hold the tides of market reason back for ever. Sooner or later, this pocket Canute will be overwhelmed by the rolling waves coming right at him.

If there were no referendum in the UK, I reckon the implosion of France (probably the least anticipated thing in economics at the moment) as well as the refugee crisis would do the job of taking Britain out of the European Union by themselves. And that would be because there would be NO EU to leave!

It is inconceivable that Germany would allow the monetisation of all French and Italian debt (which would be the only solution to a full blown crisis in Euro-land). Nein, danke, as it would represent a massive transfer of wealth from

Germany to the others. More likely is a breakup of the Eurozone into hard and soft zones – something that should have been done in the first place.

But there WILL be a referendum in the UK before that, and the result will be much closer than people, especially the bien pensants, who know little of forecasting economics and who were the biggest advocates of the UK's joining the Euro, think.

So, onto money making opportunities. I have banged on about buying Japan since 8,000 on the Nikkei and it is still my favourite market. I wouldn't hedge the currency as Japan doesn't need further devaluation. It's now hovering around 19,000 and I think it could go to 25,000 before we turn elsewhere for gratification.

Elsewhere, I have sold Greece, which provided enough for a few ouzos, and I still remain long a little China on the bounce theory. The US treads water, and although from time to time it lurches violently down or upwards, it's hard to see huge traction when earnings are under pressure and value is hard to find.

In particular, the biotech sector has been hammered in the US, with the travails of Valiant, and the shining example of opportunistic overpricing provided by the little prick of a hedgeie who triggered this sell off. But, in my view, investments in selected biotech stocks will provide the best returns over the next ten years, and we are buying selectively. I still like **Synergy Pharma** in the US and I like **Summit** in the UK – if its drug for Duchenne's muscular dystrophy works, then it will be huge. Binary, though.



“I HAVE BANGED ON ABOUT BUYING JAPAN SINCE 8,000 ON THE NIKKEI AND IT IS STILL MY FAVOURITE MARKET.”

I fancy **HSBC** for its dividend and for exposure to emerging markets, which are surely due a bounce, and I am tempted by **Rio Tinto**, yielding 6.2 per cent and with the financial capacity to destroy much of the competition.

In terms of FX, we are coming to a BIG opportunity, which is when to buy the Euro. I think now is still the time to short the Swiss Franc against the Euro (and that has already been a good trade – conviction idea at Master Investor 2015) and be ready to buy Euros at about 1.09 against the dollar. This is not a forever trade, but it should yield a handsome return. Remember, get your FX right and you can make a lot more than by playing in equities!

Also, I am a buyer of Canadian dollars against the US dollar here. I look for 1.25 from current level of 1.31.

And I have a very positive feeling about gold and silver. I am loading up on those!

Happy Hunting!
Jim Mellon



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to follow
Jim's trades
on Twitter**

WHAT JIM READ THIS MONTH...



Should a Self-Driving Car Kill its Passengers in a "Greater Good" Scenario?

A car hurtles towards a crowd of people in the road, either it hits the crowd saving the driver within, or it turns to crash off the side of the road, likely injuring or killing the driver but saving the crowd. A research team from the Toulouse School of Economics are looking into the moral and ethical implications surrounding self-driving technology. They've not yet got to the scenario where one of the passengers grows up to be Hitler, but we await their findings.

Read more: <http://www.iflscience.com/technology/should-self-driving-car-be-programmed-kill-its-passengers-greater-good-scenario>



Try my extrasensory jacket on for size

"Our senses are just plug and play devices inherited through evolution". Neuroscientist David Eagleman has developed a wearable device which reacts to sounds and translates them as patterns of vibrations, essentially a vibrating jacket. The jacket is being used to open up the auditory world to the deaf by rewiring their brains.

Read more: <https://www.newscientist.com/article/mg22830420-500-my-smart-vest-will-offer-you-extra-senses>



Better data has the power to save more lives

Data is being used in the smallest ways to improve our lives every day. It is used to determine which book we might like to buy next or what box-set we might want to binge-watch. But Melinda Gates wants us think bigger; she wants governments to use data to improve the lives of citizens in the nations that really need it. Not to recommend their next download, but to improve healthcare and education, making sure it gets to the right people in the most effective way possible.

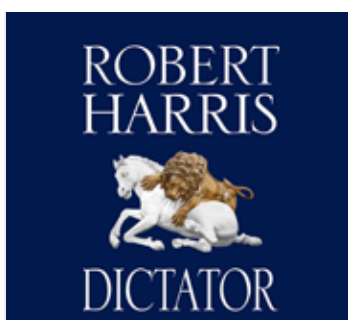
Read more: <http://www.wired.co.uk/magazine/archive/2015/11/features/wired-world-2016-melinda-gates?linkId=18331983>



Toyota's radical Kikai concept is the anti-connected car

It may look like a Chitty Chitty Bang Bang Decepticon, but Toyota's latest concept car aims to steer design away from the ultra-high tech trend of turning your car into an extension of your smart phone. Instead the Kikai returns focus to the automobile itself by displaying the raw mechanics on the outside, while placing the driver in the centre of the dashboard for fully immersive driving.

Read more: <http://www.theverge.com/2015/10/28/9625296/toyota-kikai-concept-to-kyo-motor-show>

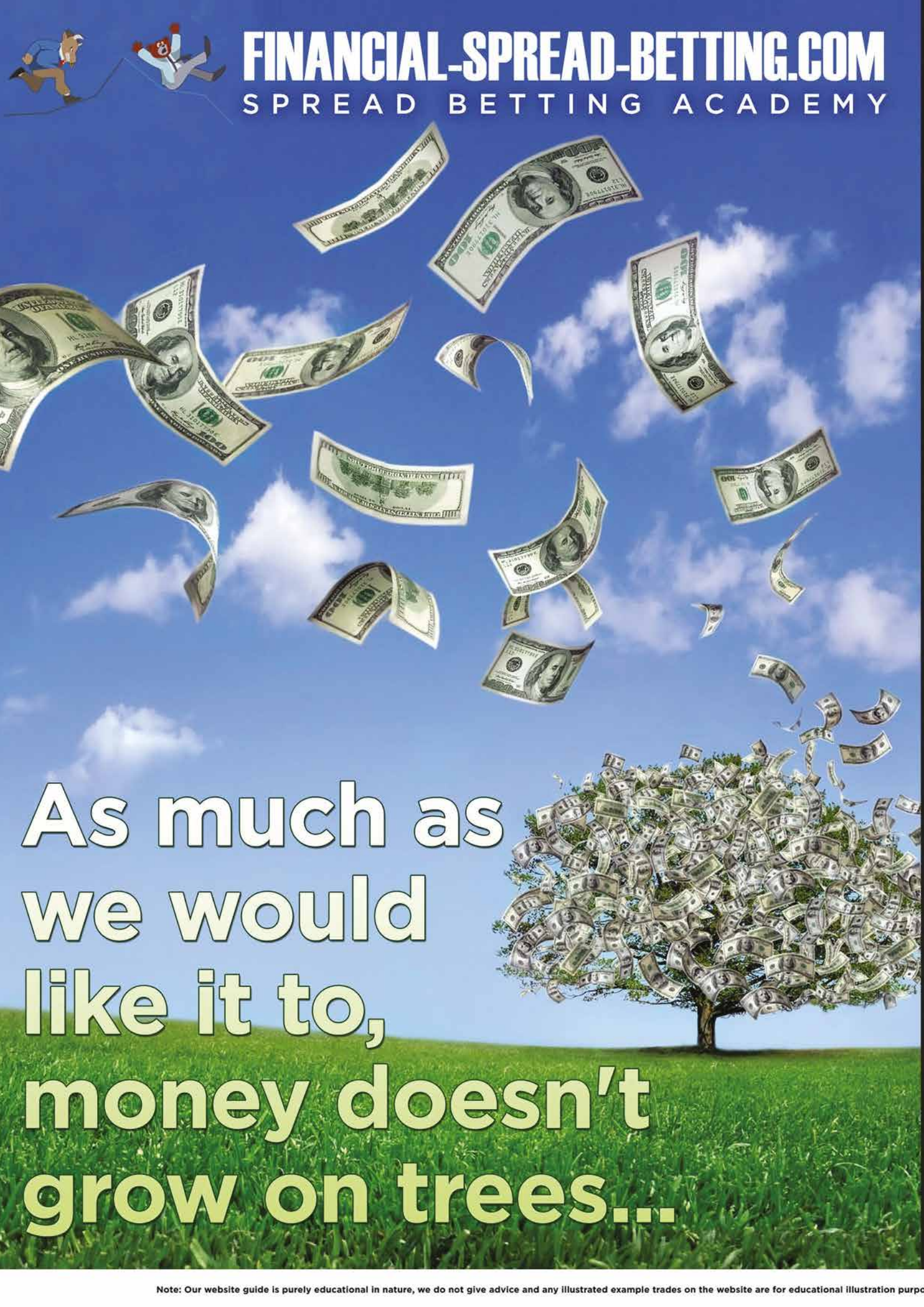


Dictator, Robert Harris

Yes a book! Dictator is the final instalment in Robert Harris' trilogy, set in Rome in the first century BC and charting the rise and fall of the orator Cicero. Nearly a decade in the making, riveting and fast paced, bringing historical context to life with curiously familiar characters who wouldn't seem out of place in modern day Westminster.

Read more: http://www.amazon.co.uk/Dictator-Robert-Harris-ebook/dp/B00T19UN-MQ/ref=tmm_kin_swatch_0?_encoding=UTF8&qid=1446124895&sr=1-1





As much as
we would
like it to,
money doesn't
grow on trees...

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

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

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

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

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

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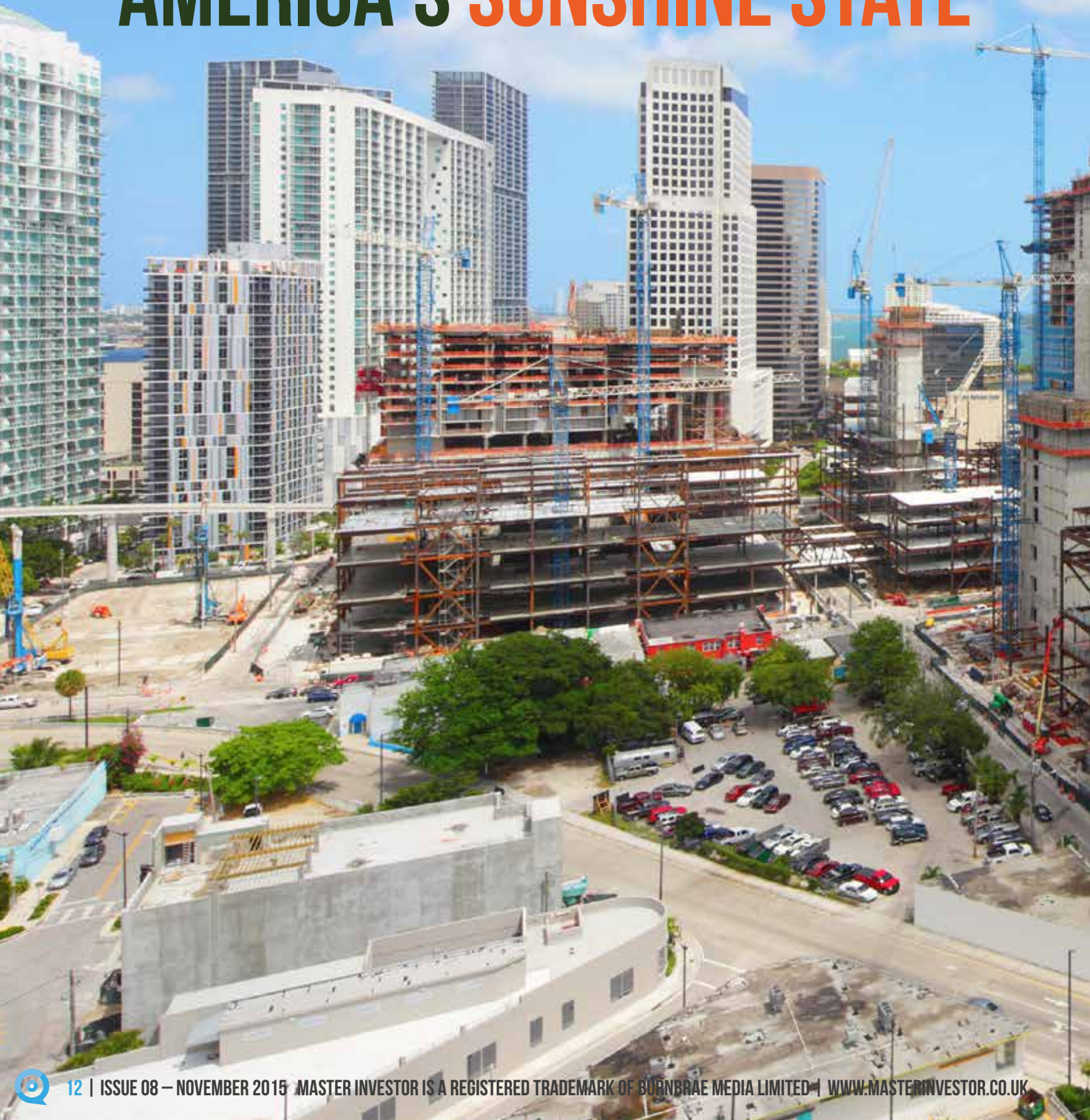
Simply visit: www.financial-spread-betting.com



BY SWEN LORENZ

AROUND THE WORLD IN A DOZEN PROPERTIES (PART 8)

HOW TO BUY CHEAP LAND IN AMERICA'S **SUNSHINE STATE**



Florida has long been known as the United States' ultimate retirement haven. Investors flock to the Sunshine State either to buy a condo for golf holidays or to purchase a water-front home for their retirement. However, not everyone is aware of the changing dynamics in the US' southernmost state.

The numbers alone are staggering. Would you have known that Florida is now the 3rd most populous state of the US? In 2014, it surpassed New York State in terms of population, and at last count nearly 20 million people lived within its boundaries. The Miami metropolitan area is now the 8th largest metropolitan area of the country. That's despite Florida only ranking as the 22nd largest state in terms of land mass. Clearly, the state famous for the Everglades, Disney World and near-eternal sunshine has grown into a veritable economic powerhouse.



Florida also has the highest percentage of retirees (as a proportion of the state's overall population) in the US. The most recent statistics show that 17% of the state's population is older than 65. However, there are also entirely new dynamics at work nowadays.

Miami has grown to be the no. 1 financial centre of Latin America, by virtue of using its location inside a safe banking jurisdiction to serve corporations and investors in a region of the world that has experienced huge economic growth but doesn't have the same kind of stability and reliability that the US can offer. Whether it's a Brazilian high net worth individual seeking private banking services or an Argentinean corporation requiring access to investment capital: for them, all roads now lead to Miami.

“THERE ARE CERTAIN PARTS OF MIAMI THAT HAVE BECOME KNOWN AS THE ‘WALL STREET OF LATIN AMERICA’.”

Not only is Miami's population already 70% Hispanic. It also benefits from Latin American investors simply seeking the safety and professionalism of the US banking and finance market, while wanting to stay as close to home as possible. With plenty of flight connections from Miami to anywhere in Latin America, and ongoing political instability in major countries like Brazil, Venezuela and Argentina in particular, there are certain parts of Miami that have become known as the "Wall Street of Latin America".

Brickell, a neighbourhood of Miami, has been transformed from being a low-key neighbourhood with stately

mansions as recently as the 1970s, to functioning as a major banking and finance hub for the Latin American economies. It houses 53 banks and an increasing number of high-rise buildings.

Anyone who is someone in Latin America tries to buy a place in either Miami or other parts of Florida. It's a must-have item, not the least because it opens up the possibility of living in the US, in case political circumstances back home take a turn for the worse. The case of Venezuela makes it clear why owning a property in Florida is not just an investment, but virtual life insurance too.

Miami is merely a highly visible symbol for the rise of Florida, and the ongoing changes stretch across the entire state. Not the least because investing in Florida is also a way of optimising taxes. Florida does not levy any state income tax, and the state's overall per-capita tax rate is the fourth lowest in the US. There is also a high degree of economic freedom, including in the development of new land. Whereas some US cities, like San Francisco, are already actively restricting further development and changes to the city's landscape, Miami is actively encouraging it. This sort of laissez-faire policy extends through most of the state, and has led to the transformation of the entire state.

All of these factors conspire to make Florida one of the US states with the most consistent long-term growth. Capital is flowing into the region, including from a growing number of tech firms who are discovering Florida as a place with lower operating costs and an increasingly good availability of young, dynamic staff.

How can private investors soak up some of those rays?

Outside of the obvious ways of purchasing condos, houses or other forms of direct ownership of property, there are some less obvious routes to gaining a foothold in the Sunshine State. One of them has its roots in the railroad companies that once provided the all-important access for conquering and settling this part of the United States.



More than a century ago, the American experience, for many, came to life when the railroads opened up a nation, linking people, products, and places. During the late 1800s, one of these railway companies, the Atlantic Coast Line Railroad, set up a separate holding company for its vast land possessions in Florida: The Atlantic Land and Improvement Company.

In the 1960s, the land-holding arm was spun off and renamed Alico, an acronym of its original name. It subsequently fell under the control of Ben Hill Griffin, a citrus grower who at one point was listed as the richest man in the US. He used his vast landholdings to develop a farming empire involving citrus, cattle, sugarcane, and timber.

With 160,000 acres, the land owned by **Alico (Nasdaq:ALCO)** is more than twice the size of Malta. The company is by far the largest land owner in the state, and one of the largest land owners in the Western Hemisphere. It ranks among the 20 largest land owners of the United States.

The company describes itself as a farming operation, first and foremost. However, its CEO, Clay Wilson, is the first to concede that "anybody in Florida who owns land is in the real estate business". Whereas the company is quite discreet about it, that's true to a bigger extent than would be apparent at first sight.



Throughout the decades, Alico has regularly spun off individual pieces of land to have it developed. Most of the time, this takes place through selling land to a property developer, often at a multiple of the farmland's previous value. The rampant growth of the state's economy has led to some of Alico's farmland coming into contact with locations that make it more interesting for development than for growing citrus fruits. It's a trend the company quietly capitalises on, while using its existing agricultural operation to generate an ongoing return.

In its agriculture business, Alico is now using its access to the capital markets to act as a consolidator of the Florida citrus industry. It recently spent \$363 million on buying three other citrus operations in Florida, making the company the largest citrus grower in the entire US. However, even in Florida its market share is only 10%. The market is highly fragmented and smaller operators are struggling to deal with investments into technology whilst overcoming temporary challenges such as the citrus greening bacteria that recently devastated harvests. It's an ideal situation for a strong player to come in and buy up smaller competitors to create a market leader with huge economies of scale.

With these purchases, Alico is getting its hands on yet more land. In essence, the company has become a fund for investing into Florida land, with the ag-

“CAPITAL IS FLOWING INTO THE REGION, INCLUDING FROM A GROWING NUMBER OF TECH FIRMS WHO ARE DISCOVERING FLORIDA AS A PLACE WITH LOWER OPERATING COSTS AND AN INCREASINGLY GOOD AVAILABILITY OF YOUNG, DYNAMIC STAFF.”

ricultural operation providing a yearly return, and longer-term capital growth due to rising land values providing an added return on top.

There are 8.2 million Alico shares outstanding. The company's current land holdings amount to 650 million square metres. In other words, each share represents about 80 square metres of land ownership. Currently, the shares are trading at \$43.

What's the intrinsic land value of the shares and are investors well-advised to jump in?

Some of Alico's land holdings are under environmental protection and are therefore essentially worthless. Other parts will be off limits for development and are likely to produce citrus fruits for eternity. It's not easy to put a definitive price-tag on the land holdings. However, it's possible to come up with an initial estimate.

Agricultural land is valued at an average of \$5,400 per acre in Florida, or \$1.30 per square metre. Even when taking the company's debt into consideration, the shares are currently not even trading at the full value of the agricultural land. The occasional one-off gain from selling off land for development purposes is currently thrown in entirely for free.

The company's dividend yield is negligible, but from an asset value perspective, the shares clearly are cheap. Before the financial crisis, the shares traded as high as \$65. Sooner or later, the share price is likely to surpass its old record level. "Alico is hunting for even more land", according to Wilson. Who'd blame him? As Mark Twain said, they are not making any more of it. And with an ever-growing population, Florida land values look set to rise further in the long run.





BY DR ANDY SMITH

IS THE BIOTECH BOOM AT AN END?



**“INVESTORS THAT INVESTED
HEAVILY INTO PUBLIC AND
PRIVATE LIFE SCIENCE
INVESTMENTS IN THE LEAD-
UP TO JULY 2015 WILL NOW BE
STARING DOWN THE BARREL
OF A SERIES OF ACUTE AND
PROLONGED WRITE-DOWNS.”**



With the closely-watched NASDAQ Biotech Index (NBI) up over 250% in the last five years, against just under 13% for the FTSE 100 over the same period, it is no wonder that I and other market commentators have been using the phrase 'bubble' to describe the biotech sector boom. With the NBI falling by over 20% in the last three months against a more sedate 6% drop in the FTSE 100 index, many have suggested that the biotech bubble has burst. However, for a bubble to be said to have burst, all of the air should have come out of the bubble and that may imply still worse to come. Our fund is a broad healthcare fund that can include very small capitalisation companies, but also profitable medical devices and diagnostics companies, big pharmaceutical companies and even big healthcare conglomerates like Johnson & Johnson. Before we speculate whether the biotech bubble will deflate further towards an eventual capitulation, let's take a look at the investor behaviour associated with bubbles and see if they apply to what we have seen in the biotech sector up until mid-July.

“OVER THE LAST YEAR THERE HAVE BEEN ONLY 16 DAYS WHERE THE S&P 500 INDEX HAS OUTPERFORMED THE NBI ON A YEAR RETURN BASIS, BUT WORRYINGLY 12 OF THOSE DAYS HAVE OCCURRED IN THE LAST THREE WEEKS.”

Stock market bubbles share a number of characteristics. One of them – momentum – is a result of a bubble rather than the cause. A more appropriate ex-

planation of the cause of momentum is extrapolative expectations without a fundamental investment rationale. This is caused by the assumption that stocks moving in one direction will continue to move in that direction. Momentum is a double edged sword once reversed, but the biotech sector certainly has at least typified unrealistic expectations from generalist investors in the last few years. The risk of those outsized expectations as illustrated by the rise of the NBI certainly implies momentum, as does its recent fall. The downside to momentum is only recently being recognised, as over the last year there have been only 16 days where the S&P 500 index has outperformed the NBI on a year return basis, but worryingly 12 of those days have occurred in the last three weeks.

Extrapolated and wildly optimistic expectations are very characteristic of any sector in a bubble period. When President Clinton and Prime Minister Blair jointly announced the sequencing of the human genome at the start of this century, expectations soared on the belief that all diseases would be cured with the aid of genomics. While that may one day be largely true, the time frame for that to be achieved is beyond most investors' return profile, let alone their lifespan. In the same way, the plethora of gene therapy and cell therapy companies, let alone the hundreds of drug and biologic discovery companies that have come to the market as new IPOs promising blockbuster products, have stoked the expectations that they can all succeed when the reality is that most will fail.

Furthermore, the strength in the biotech sector over the last few years has been attributed to the FDA approving more drugs every year (which has been true), a high level of M&A (not so true), and a more stable or profitable biotech sector (more of a yes and no answer). For the past three years, the FDA has approved more drugs each year and this had led many to suggest that biotech is a lower risk investment than had been the case, say, a decade ago. Only part of this is true since the drugs approved in recent years with the most commercial potential have been discovered and developed by either big pharma, or the big biotech companies that have already been assumed



to be at least fairly valued (see below). Many of the drugs approved by the FDA and launched by smaller biotechs have been, and will remain, loss-making commercial failures. The high level of M&A has been focused mainly in specialty pharmaceutical companies (those with sales and profits) and not loss-making biotechs where, in any case, the rise in their share prices means that no big pharma would consider acquiring them. Finally, the sector has more profitable biotech companies than it had ten years ago, but by number these are diluted out by the many hundreds of small biotech companies that will almost certainly never have profits. So the sell-side mantra that goes 'big biotech is profitable, so buy small never-to-be-profitable biotech (so we can earn juicy underwriting fees)' is a fallacy.

With all these minefields, it is almost forgivable that those investors who are not sector specialists, and some that supposedly are, can get caught up in the hype of a rapidly inflating biotech sector and do something that also characterises a bubble. Classic bubble behaviour is to invest in an asset that in normal times, a rational investor would never consider, like tulip bulbs or a recently launched dot.com company. Here the evidence for a biotech bubble-bursting is compelling. Take again the hundreds of biotech IPOs that have thrust themselves onto the market in recent years. The biotech IPO window,



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which currently looks to be closing on both sides of the Atlantic, is a long pipeline of very young and speculative companies. It is logical to believe that three years into an open IPO window, the highest quality and most mature companies have long since made it out and what is left resides at the bottom of an immature and murky barrel. Until very recently these prospects for value destruction, formally known as hot bi-

otech IPOs, have been able to list and investors have been buying them just because... You can substitute the 'it's a roll-over week' with 'they're a biotech' and in retrospect we may look back to see that both have similar lottery dynamics rather than being investments.

Another classic characteristic of a bubble is when low quality companies outperform high quality companies. Once

again, the evidence is compelling for a biotech bubble since the fact that the pariahs of UK life sciences – for example a cell therapy company that has remained on clinical hold by the FDA for many years; a cancer vaccine company that has recently been put on clinical hold by the FDA; a gene therapy company that barely manages to treat a patient a year in clinical trials; and an antisense company that rais-

About Andy Smith, PhD

Andy Smith is Chief Investment Officer at Mann Bioinvest, an Isle of Man based company that was established to service sophisticated clients seeking advice on the biopharma sector. Andy commenced his career as a scientist in the research and development division of ICI and then SmithKline Beecham. After completing his PhD in Molecular Biology at the University of Nottingham in collaboration with Glaxo, Andy switched to a commercially focussed role at SB Pharmaceuticals and was appointed as Global Brand Manager for Bactroban and New Products in the Anti-Infectives Global Marketing Group, a position he held for over two years.

In 2000, Andy moved into the asset management and venture capital industries at 3i and subsequently held the position of lead fund manager for three life science specific funds: – 3i Bioscience Investment Trust plc – International Biotechnology Trust plc; and – AXA Framlington Biotech Fund. Andy was awarded the tech-mark Technology Fund Manager of the year for 2007. After leaving AXA, Andy held appointments as Director of Business Development at the Oxfordshire Bioscience Network, Contributing Editor at Scrip, and Head of Corporate Finance at PharmaVentures. Andy is also a fund manager at Aetia Limited, a FSA authorised and regulated firm.

Andy has a unique combination of experience across operations and research and development at major pharmaceutical companies coupled with an astute commercial and financial perspective from his experience as lead portfolio manager at the aforementioned life science sector funds. This breadth of knowledge provides Andy and Mann Bioinvest with the ability to evaluate opportunities in the sector comprehensively.

In addition to his Ph. D., Andy holds a Bachelor of Science Degree from North East London Polytechnic and an MBA from the University of Greenwich and is a visiting lecturer at Regent's College London focusing on healthcare valuations and modelling.



Over about the last eighteen months, the Magna Biopharma Income fund, the public market fund which we are investment adviser to, has underperformed many other funds that, unlike us, have jumped on the biotech bandwagon and are now suffering it's much less kinder side. Furthermore, we have not made many recent private investments since their valuations lag the public markets by about 12-18 months. So any investors that invested heavily

on the stock market, like the terrorist atrocities of September 11, 2001, result in a flight from risk that hits the biotech sector harder than most. In addition, the all too frequent US government shut-downs that result from Congress failing to agree a budget extension, may reasonably be linked to biotech since the FDA is an agency funded by the US government. Similarly, the controversy of US drug price inflation is one that directly impacts biotech. But there have also been more recent and sporadic issues with Greece and the Euro, the growth of the Chinese economy and declining emerging markets that have a direct effect on broad stock markets and an indirect effect on biotech. In the last year, biotech-specific issues like drug pricing or the chair of the Federal Reserve's concern over valuations have only caused temporary pull-backs in biotech. However, now it is much more serious since the weight of generalist money and ETFs seems now to jump onto any excuse to exit the biotech sector specifically and equities in general, driven by the perfect storm of general market issues, concerns over biotech valuations, a spate of clinical failures, and momentum moving in the opposite direction to the three-year run-up.

Has the biotech bubble burst? Absolutely, and the air looks like it will be bleeding out for a while yet.

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BY JAMES FAULKNER

AN INTERVIEW WITH ELIOT FORSTER OF MEDCITY AND IMMUNOCORE

James Faulkner: Hi Eliot. Thanks for taking the time to speak with Master Investor. Recent years seem to have witnessed a proliferation of new developments in the life sciences sector. In your opinion, which of these have the most profound implications for patients – and indeed investors?

Eliot Forster: I think if you look back at the past decade, developments in areas such as Hep C, the coming of age of gene therapy and advances in cancer, particularly in the area of immuno-oncology, stand out. Immuno-oncology, which is the area Immunocore operates in, has generated real excitement, because of the dramatic benefits in cancer treatment, in some cases doubling response rates.

Our treatment approach, based on soluble T cell receptors, is a more versatile approach than most other immuno-oncology treatments currently in clinical trials, as it can potentially target a much broader range of tumour types, including solid tumours, and we're very optimistic about what it offers to both patients, in terms of

improved survival and quality of life prognosis, and investors.



JF: Life sciences stocks have generally had a terrific run of late. However, some are now suggesting that the biotech sector in particular is exhibiting bubble characteristics. Is that something you recognise?

EF: The market does appear to have corrected itself after several strong years – and in large part this is a reaction to the political debate in the US over drug pricing – but I don't believe we are in a bubble. There's been a quantum change over the past ten years in validation of scientific and medical advances. People have witnessed first-hand how previously blue-sky ideas such as the harnessing of the immune system to combat cancer can be turned into commercially viable products, and I believe to a large extent the acceleration of value that we've seen in the public and private markets is a reflection of that.

JF: Are there any particular areas that investors might have overlooked up until now that could spring to life in future?

EF: Gene and cell therapy are examples of areas which have been in development for some time because the promise was so compelling, but risks and logistical difficulties have made the road to commercialisation a bumpy one. In recent years we've seen the science proved in clinical trials and now

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we have seen gene and cell therapeutics cleared by regulators. In the past three years we've seen the first gene therapy, Glybera, and stem cell therapy, Holoclar, approved for sale in the Western world. Bringing drugs to market in these areas is still challenging, but there's now a proven path to market on top of a compelling scientific case and I think in the future investors will become more confident about approaching these areas.

JF: The US is head and shoulders above everyone else in the industry. Should investors looking for exposure still look primarily to the US, or are there better bargains to be had elsewhere?

EF: *There are fantastic healthcare assets all over the world. The US has historically had better developed biotechnology clusters, larger biotechnology companies and a much deeper pool of available investment capital. But Europe is also exceptionally strong in bioscience and some regions, such as the UK, France and Belgium, can now stand shoulder to shoulder with US clusters and the investment case is gathering pace to match this. I am Chair of MedCity, an initiative designed to promote investment into life sciences in Oxford, Cambridge, London and the South-East of England, and we've seen a growing appreciation of what the UK has to offer in terms of its world class science base, a supportive tax environment and growing awareness of the need to support commercialisation. You will have seen this year a number of US healthcare companies choosing to list in the UK, which is testament to the fact that Europe's biotechnology base and investor community is rapidly becoming as sophisticated as the US.*

JF: Here in the UK pharmaceuticals is one of a small list of things where we actually record a trade surplus. What is the current state of the life sciences industry in the UK? Is the government doing enough to promote this vital industry?

EF: *Successive UK governments have increasingly recognised the need to support science-based businesses in this country, and the current government is especially supportive, with initiatives such as the Patent Box and various grants and tax benefits making an enormous difference to the ability of scientists and entrepreneurs to bring science to market. It's no*

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accident that we have a dedicated Minister for Life Sciences in George Freeman, who has a real grasp of the sector and thoroughly understands its needs, so in general the bioscience industry is happy with the level of support now.

There is some concern more recently that support for life sciences may be cut as part of an upcoming spending review. We would urge the government to continue to recognise the pivotal role that life sciences plays in the wider UK economy and to continue to provide the targeted support that has benefited so many businesses operating in the UK.

JF: The UK is notoriously bad at commercialising IP incubated within its universities. What is the industry doing to ensure that it takes full advantage of the huge amount of research conducted at UK institutions?

EF: *The UK is home to some super successful IP commercialisation companies and the tech transfer offices are now very well equipped to support the universities and academics, so this has really*

changed. You have only to look at the fact that there are three companies listed on the UK stock market, Imperial Innovations, IP Group and Allied Minds, whose business model is based on commercialising IP from universities, who now have a collective market capitalisation of around £3 billion, as evidence of this.

JF: Can you tell us a bit about MedCity and how it is helping to promote early-stage investment in the UK?

EF: *MedCity was set up about 18 months ago, backed by the Mayor of London, Boris Johnson, and its goal was really to put some momentum behind this phenomenon: turning good science into good business by creating a supportive investment climate and driving our economy through life sciences.*

We believe our approach benefits everyone in the value chain – on the one hand we are flying the flag for UK science-based businesses looking for investment by helping to link them up with interested investors and supporting them in their outreach, and we also offer what we call

Eliot Forster

Dr Forster is Chairman of the MedCity project and has almost 25 years of experience in the pharmaceutical and biotechnology industry. He currently serves as Chief Executive Officer of Immunocore, one of the world's leading biotechnology companies, with a highly innovative immuno-oncology platform technology.

Dr Forster previously served as Chief Executive Officer of Creabilis since 2010 and prior to that role was Chief Executive Officer of US biotechnology company Solace Pharmaceuticals Inc. His other previous roles include Head of EU Development and Operations for the EU and Asia at Pfizer, where he was responsible for drug development activities across multiple geographies and brought several drugs to market, and Clinical Research Manager at GlaxoSmithKline.

He holds a PhD in neurophysiology from Liverpool University and an MBA from Henley Management College.

a "concierge service" to anyone who is interested in exploring investment in those businesses, helping them make the right connections.

It's long been known that UK universities have some of the best science in the world, but historically these haven't always fed smoothly into commercialisation. In part it's about making sure that all the various components in the science ecosystem, from university labs to start-ups to VCs up to global companies, are talking to one another in order to help the infrastructure of UK life sciences run in an interconnected way, and also making connections between investors and science-based businesses.



MedCity hasn't been going very long so we can't take credit for all of this but we are helping to create an environment where people recognise the benefits of doing science business in the UK. In June we assembled a group of people from the healthcare and investment industries to talk about creating a £10 billion fund to invest in UK life sciences. This is just one example of where we're trying to connect up the participants who can help channel the capital that abounds in London into its science.

JF: The 'patent cliff', downward pressure on drug prices from governments and competition from generic manufacturers have all forced big pharma to become leaner and

meaner. Does this mean the focus in terms of drug discovery and development is shifting to smaller companies where higher risk is a given?

EF: *The symbiosis between large pharma and biotech is stronger than ever and the trend towards outsourcing of R&D by Big Pharma means that biotech companies are playing an increasingly central role in shaping the future of the research and development pipeline. Data published earlier this year showed that the fees – through M&A and in-licensing deals – that biotech companies are getting from Big Pharma have reached a historical record and that's a testament to the value that these companies provide in generating pipelines for the global companies. Biotechnology is an inherently risky area, but as companies scale up and bring more drugs to market they are becoming better at managing these risks. Pharma relies on biotech for innovation and the small biotech model has been proven to work.*

“THE UK IS HOME TO SOME OF THE WORLD’S MOST SOPHISTICATED INVESTORS, AMONG THEM SEVERAL WHO HAVE A GREAT GRASP OF THE SECTOR – YOU ONLY HAVE TO LOOK AT NEIL WOODFORD AND INVESCO AS EXAMPLES OF INVESTORS WITH GREAT EXPERTISE AND A TRACK RECORD OF SUCCESSFUL LIFE SCIENCES INVESTMENT.”

JF: It is sometimes said that UK investors do not 'get' biotech. Has this had a negative impact on the indus-

try in the UK? What can be done to ensure that UK companies get access to the 'patient' capital they require?



EF: *The UK is home to some of the world's most sophisticated investors, among them several who have a great grasp of the sector – you only have to look at Neil Woodford and Invesco as examples of investors with great expertise and a track record of successful life sciences investment – and Immunocore benefited from this in its recent Series A private round. Biotech investment requires a long time horizon and investors must be ready for the high risk/reward long game. But we see more and more investors who understand the sector and are prepared to take the long game.*

JF: Looking to the future, where do you see the most important developments taking place and how can investors position their portfolios to capitalise on them?

EF: *Cancer immunology and gene and cell therapy have huge potential roles to play. Investors need to be willing to provide adequate capital to allow the premium companies to expedite their development plans in these important technology areas.*





BY DR JON REES WITH DR EDWARD INNS

RISK VS. REWARD AND THE LIFE SCIENCES INDUSTRY — NAVIGATING THE INVESTMENT LANDSCAPE

US biotech indices fell 23% in the four weeks from 19th September 2015 until 19th October 2015, but we remain enthusiastic about investing in the life sciences industry – more so than before. In this commentary, we'll share why we think the market fell, explore some of the new listings and fundraises on the public markets especially in the UK, but also find out how to access managed portfolio and unquoted opportunities with a special focus on the UK.

Numerous industry debates in the US and Europe in 2015 have focused on the question of whether the life sciences industry, and in particular the biotech industry, is suffering from some kind of overvaluation bubble or whether it is entering a longer period of sustained boom. Of note, how-

ever, is that of late the industry has not been talking about a bust. Leading US biotech industry commentator John Carroll, polled the 150,000 followers of his FierceBiotech daily newssheet, and 75% felt that a rebound is on its way.

I was lucky enough to put together one of these debates early in 2015, which concluded that a bubble had formed on the crest of a sustained life sciences boom which is seeing biotech as an industry become net profitable, and take the place of the pharmaceutical industry as the source of new medicines. Technology convergence and changing behaviours are creating new markets

for increasingly complex healthcare solutions which can no longer be developed by companies in isolation. Hot areas like precision medicine, big data, gene and cell therapy, immuno-oncology, regenerative medicine, synthetic biology including gene editing, as well as digital health and m-health are among areas of focus attracting the most attention.

With as much as \$5 billion having been invested in the life sciences industry in the UK since the start of 2014, things are very different to the dog days of 2008-2009, when the industry was suffering from cash exhausted venture funds which struggled to refill, a public market in London which was effectively closed to IPOs for 5 years, patchy support from Angel networks, and little in the way of relief from government. But

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the reluctance or inability of most venture funds, government and others to address "the equity gap", the difficulty faced by companies endeavouring to translate research through proof-of-concept, creates an opportunity for those excited by science-based R&D.

Specialist debates aside, when mainstream journalists start to question the incredible performance of leading Exchange Traded Funds in your sector, you start to smell the coffee.

Having returned 25%, 65% and 47% in each of the last three calendar years, the **AXA Framlington Biotech Fund Z Acc** managed by Linden Thomson even got a write up in the Telegraph in March 2015 reporting a 279% return since 2010. Crucially the journalist concerned, Kyle Caldwell, asked whether it was too late for investors to profit from the booming sector. Indeed it was, with about half the froth coming off during the late August stock market correction, but it took a US Presidential nominee's tweet to take the rest of the gas out of the biotech sector's fizz, and the fund is trading about 25% lower than its all-time peak just three months ago. This specialist was particularly hard hit because of its mainly US holdings in medium and large biotechs, a market where the level of irrational exuberance exceeded the sector enthusiasm witnessed in Europe.

Like many sectors, the level of volatility in the biotech sector is high, and when greed outdoes fear it gets overvalued the same as every other sector. Understanding the triggers for bubble deflation, exotic though they may be, is key to how you manage your investment risk. Let's look at the story behind that trigger in more detail.

By now, many of you will have heard of Martin Shkreli at Turing Pharmaceuticals, who increased the price of toxoplasmosis treatment Daraprim 50-fold from \$13.50 to \$750 per pill on 17 September, 2015. Shkreli isn't unique, but he was particularly careless to get into a fight on Twitter with John Carroll, Senior Editor of the world's most popular daily biotech trade mag, FierceBiotech. Carroll's twenty-two thousand followers on Twitter reamplified his "fierce" displeasure when on 20 September he was labelled a "moron" for asking Shkreli to explain price increase

of an old drug like Daraprim. An almost viral social media avalanche followed, vilifying Shkreli. This was the trigger for Clinton's intervention; and by close of play that same Monday 21 September the NASDAQ Biotech Index had lost nearly 5% – and it kept falling.

Senator Bernie Sanders and Congressman Elijah Cummings introduced a bill on 10 September 2015. The paradigm shift which would have been introduced by The Prescription Drug Affordability Act of 2015 would have been to authorise the US Secretary of Health and Human Services (HHS) to negotiate drug prices with pharmaceutical companies to reduce the costs of Medicare. Effectively, it would have moved the US's Medicare more into line with the UK's NHS. It has been claimed that this tweet attacking drug companies lost investors \$132 billion. Other commentators have pointed out that there is no chance of either Sanders' or Clinton's drug bills coming into force with a Republican controlled House of Representatives and Senate. Shkreli and Clinton were both part of a trigger which allowed building negative sentiment on valuations to deflate over-valued assets.

Commercialisation of IP Funds

With their focus on later-stage pharmaceutical and biotech companies already at market, ETFs aren't the way to get exposure to investments in life sciences R&D companies as they emerge and grow – the higher risk end of the market, but one that is exciting. There is a slew of UK-based "Commercialisation of Intellectual Property" (CIP) funds invested in the space here in the UK, most of which are listed. These tend to be hands-on investors, getting involved in founding enterprises, recruiting some key staff, assisting their portfolio firms in fundraising, as well as



incubating and developing them.

IP Group plc (LSE:IPO) is a 14-year-old London-listed investor with a £1.3 billion market cap, with around two-thirds of its 90-company portfolio active in medtech, diagnostics and biotech (the remainder are cleantech and tech firms). IP Group was the pathfinder which pioneered the partnership model with UK universities, now counting 15 among its partners across the UK. Around 15% of the companies in its portfolio are quoted. IP Group's shares were quite resilient during the Summer correction, and better resisted the biotech bubble deflation of late September, trading higher than they were in August 2015 and 8-fold higher than 2010 during the Great Recession. Key holdings include Oxford Nanopore (as yet unlisted), **hVIVO (LSE:HVO)** as well as Oxford Sciences Innovation and Cambridge Innovation Capital.

Imperial Innovations plc (LON:IVO) is a London-listed organisation, a £700 million market cap hands-on investor in technology from the "Golden Triang-



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Price gouging like this in the specialty drug market is outrageous. Tomorrow I'll lay out a plan to take it on. -H
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gle" especially the UK's four leading universities, Oxford, Cambridge, UCL and Imperial College, with significant investments in biotech and medtech firms like **Circassia (LSE:CIR)**, PsiOxus Therapeutics, Cell Medica and Veyan Holdings with some coverage of ICT and engineering. Since listing a decade ago they have invested nearly £250m in their portfolio firms, giving exposure to a mixture of unquoted and quoted companies. Innovations fell sharply during the summer correction, but rose following Hillary's tweet, and may be heading toward a five-year high.

Net Scientific plc (LSE:NSCI) is a specialist and smaller listed CIP fund manager focused on UK and US-based digital health and diagnostics companies, with some biotech coverage, which has recently become more ambitious under the new CEO, François Martelet MD, currently raising £20 million from investors including star fund manager Neil Woodford. Though it's early years following its IPO and initial £30 million fundraising in September 2013 weren't always auspicious, the appointment of the new CEO and investment from Woodford constitutes something of a rehabilitation.

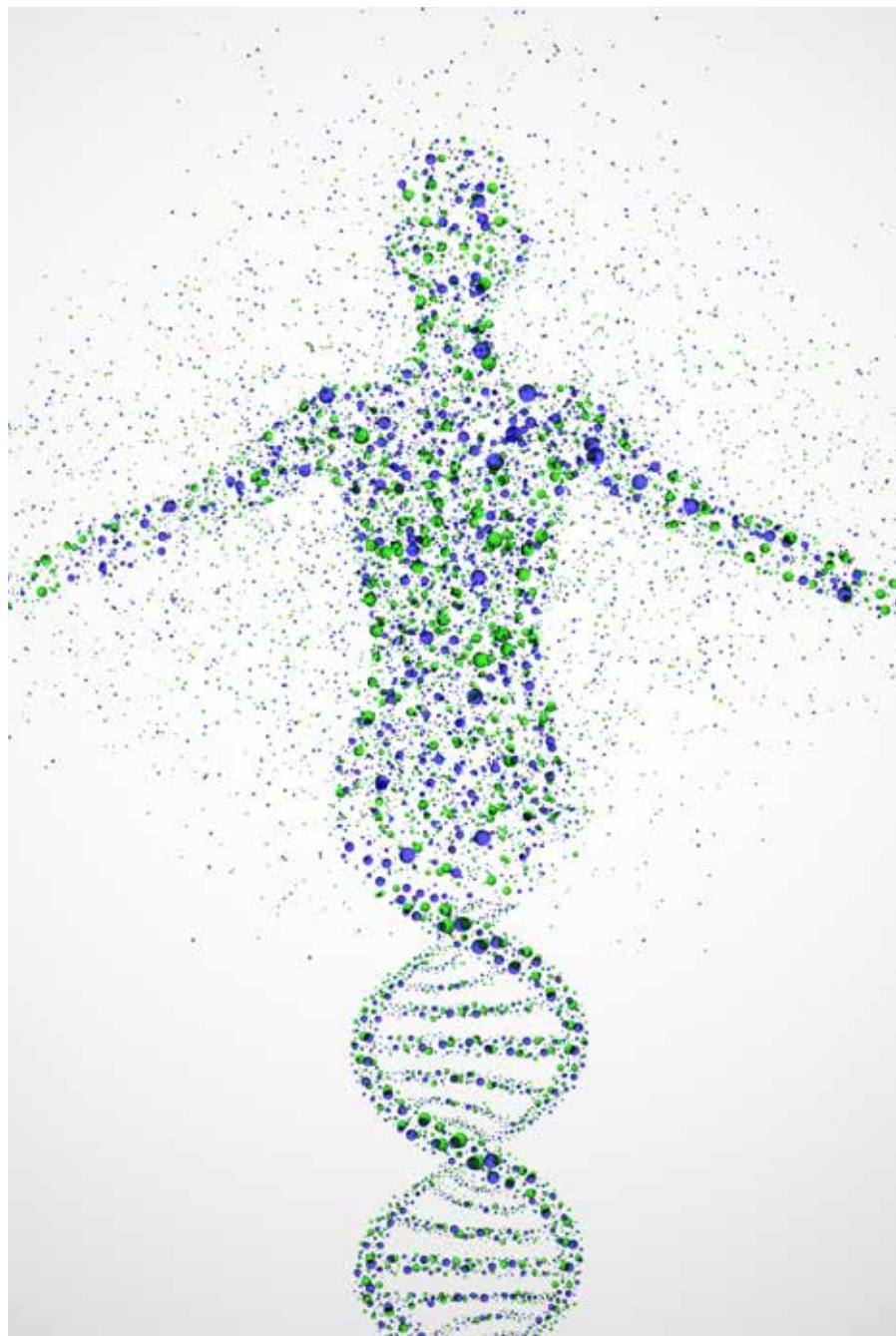
Mercia Technology plc (LSE:MERC) is another investor in technology-based companies, but this time from universities in the Midlands and North of the UK. Mercia listed at the end of 2014, raising £70 million, and offers some limited exposure to life sciences, with a much greater focus upon other sec-

tors.

However, the game-changer in 2015 was the establishment of the **Woodford Patient Capital Trust plc (LSE:WPCT)**, which listed in April 2015, peaking in August almost 20% up on its offer price. It has since fallen back, but it is management's stated intention to target 10% per annum returns. This is the closest thing the UK has to a biotech megafund, but appears more arms length than the CIP funds; instead it often backs their expert bets with depth of capital. When a star fund manager who backs biotech sets out to raise £200 million – albeit with an upper limit of £500 million – and goes on to raise £800m, exuberance is in play. Like other funds, this suffered in the general deflation of the market

during the summer, and in the life sciences sector-related bubble deflation following Clinton's populist tweet. Patient Capital's strengths are that by virtue of Woodford's support for both the CIP funds and co-investments in their portfolios, it has sector-specialist advice from boutiques, and the depth of capital to follow their investments through failure to success. Finally, with Chair Susan Searle – the well respected executive who led Imperial Innovations for over a decade – they've crucial experience to tap at board level.

Patient Capital has invested in a mixture of unquoted and quoted firms, and is highly weighted towards life sciences, diversified across company stages of development, and 75% fo-



cused on early-stage and early-growth companies. This darling of the sector has also received cautious criticism for the rapidity of deployment of the funds, and the depth of internal expertise in early-stage investment. However, their depth of capital has earned them significant positions in a number of the UK's most promising companies. The trust currently includes investments in six CIP funds that in turn give further exposure to the sector, including some of those mentioned earlier, as well as the significant **Malin plc fund (ISE:MLC)**, which listed in March, raising €330 million, and the grand-master Dave Norwood-chaired Oxford Sciences Innovation plc vehicle which raised a record-setting £320 million in its initial fundraising this summer.

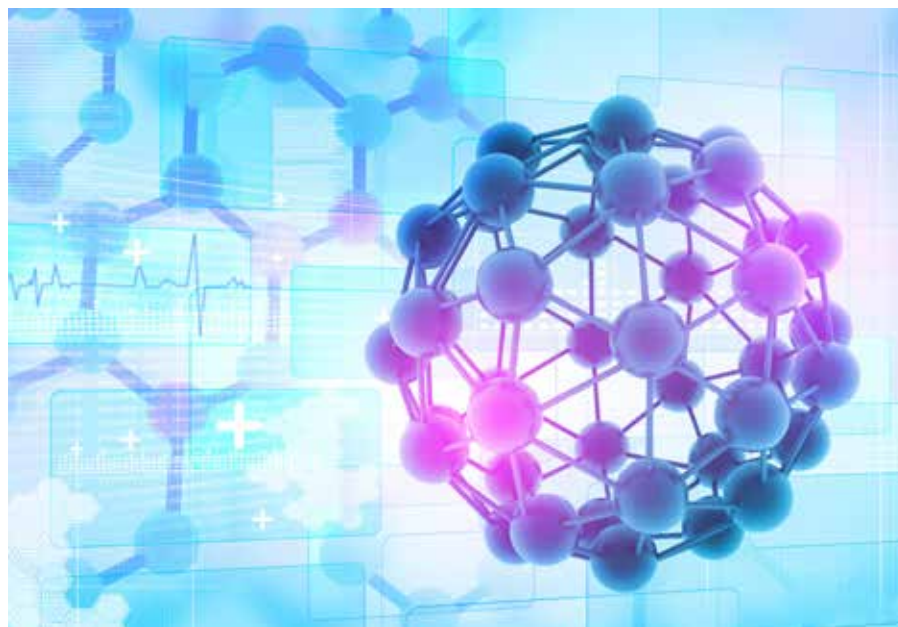
Other CIP firms to investigate are **Allied Minds plc (LSE:ALM)** and **Pure-Tech Health plc (LSE:PRTC)** which raised £125 million and £108 million respectively. Also worth keeping an eye on are the two as yet unlisted funds commercializing Oxbridge university research Cambridge Innovation Capital plc and Oxford Sciences Innovation plc if they should decide to go public.

So collectively, this class of vehicles I'm calling CIP (Commercialisation of IP) funds has accumulated significant amounts of capital to invest in diversified science-based businesses, and the Woodford-effect has increased the potential depth of capital.

Next we'll take a look at a sample of interesting life sciences equities.

Selected UK life sciences IPOs and placings in 2015

In our view, the most exciting UK biotech company to list this year was **Adaptimmune (NASDAQ:ADAP)**, which is also the UK's most newsworthy immuno-oncology company this year. Adaptimmune's hot TCR technology has a long history, with the precursor company, Avidex, having been founded in 1999, acquired by MediGene in 2006, and spun-out in 2008 alongside the larger Immunocore – another one of the most promising UK biotech companies with a prodigious deal-making record (and also featured elsewhere in this issue). Having raised \$191 million in its NASDAQ IPO in March 2015, on top of a huge \$104 million Series A six



“THERE HAS BEEN A GLUT OF LONDON PLACINGS THUS FAR IN 2015, BUT WE’RE GIVING SPECIAL MENTION TO SIX COMPANIES: SUMMIT, ALLERGY, CIRCASSIA, PREMAITHA, SAREUM AND PHYSIOMICS.”

months earlier, Adaptimmune is trading slightly above the offer price. Marking out its confidence, Adaptimmune recently announced significant investments in a manufacturing facility in the US and a new research and development centre in the UK. A few months earlier, US immuno-oncology biotech **Juno Therapeutics (NASDAQ:JUNO)** raised \$265 million in its IPO, signing a \$1 billion deal with **Celgene Corporation (NASDAQ:CELG)** in June. These were two of many private and public fundraising rounds in 2015 for immuno-oncology, including **Adura's (NASDAQ:ADRO)** \$119 million IPO and Immunocore's \$320 million financing – the largest private life sciences fundraising in Europe – and many others of mixed quality which in hindsight appears to have been a stampede.

London IPOs in 2015 included **Redx Pharma (LSE:REDX)**, which raised £15 million to further its "hit-to-lead" specialism which focuses on discovering candidate drugs for licensing to pharma in the oncology, anti-infective and immunology spaces. **Motif Bio (LSE:MTFB)**, which raised £2.8 million at IPO, and a further £22 million to conduct its late-stage trial of iclaprim

as a treatment for MRSA and other multi-drug resistant bugs, is backed by Invesco as well as **Amphion Innovations plc (LSE:AMP)**, yet another CIP fund! Finally, US biotech **Verseon Corporation (LSE:VSN)**, which bucked the trend by listing in London raising £66 million in May, plans to use its in-house computationally-driven discovery platform to discover new drugs, including its lead compounds for anticoagulation therapy in preclinical development.

There has been a glut of London placings thus far in 2015, but we're giving special mention to six companies: Summit, Allergy, Circassia, Premaitha, Sareum and Physiomics.

Summit Therapeutics plc (LSE:-SUMM) raised a further £21.2 million in a placing in Q1 2015, to further develop SMT19969, their new and highly selective antibiotic to treat *C.difficile* while potentially leaving the healthy gut microbiome unharmed; as well as SMT C1100, which is a treatment for Duchenne muscular dystrophy. **Allergy Therapeutics (LSE: AGY)**, which raised £20 million in April to acquire Alerpharma SA in June, already has a number of products on the mar-

ket, and posted better than expected results in October to see its shares rise 88% higher than a year ago. **Circassia Pharmaceuticals plc (LSE:CIR)**, the allergy and asthma speciality pharma which, having completed the largest UK biotech IPO in March 2014, raising £200 million, raised a further £275 million in June 2015 in a bold move to acquire Aerocrine AB and Prosonix. Collectively, these acquisitions give Circassia the tools to potentially diagnose, manage and treat asthma, broadening its portfolio of asthma and other respiratory diseases, and adding two marketed products with the potential for eight product launches by 2021.

Premaitha Health (LSE:NIPT), the innovative molecular diagnostics company, raised £8 million in a placing in July, and in October opened a new clinical lab to meet demand for its IONA® test, the first CE-marked non-invasive prenatal screening test which estimates the risk of a foetus having Down's syndrome and a number of other serious genetic diseases.

Twelve-year-old **Sareum Holdings plc (LSE:SAR)**, the cancer drug discovery and development business, may have come of age with the award of patents for Aurora FLT3 and the readying of CCT245737 for phase I clinical trials. Their placing in May raised £1.4 million and the firm has collaboration agreements with the Institute of Cancer Research, London, Cancer Research Technology, and the CRT Pioneer Fund.

Physiomics plc (LSE:PYC), which was the world's first listed systems biology company (2004), just signed its fourth

big pharma customer to its virtual tumour service, which can be used by drug development teams to work out if they've chosen the right target to drug. Despite a slew of good news, including a large pharma customer presenting at a conference on its deployment of Physiomics technology, the price of the shares remains just 0.05 pence, down two-thirds on a year ago following a discounted share placing in Q1 which raised £270,000.

But the deflation of the bubble has more recently had a temporary stalling effect, with the postponement of a number of IPOs this autumn, including speciality Acacia Pharma Group plc, as well as Shield Therapeutics plc. Regardless, it seems inevitable that the market for healthcare will grow and the sustained boom will resume, because the industry in Europe has reached net profitability following years of investment in R&D.

So what about the unquoted opportunity?

While big pharma and medtech corporate players still dominate the life-sciences industry, they are being displaced by medium and large biotechs like Gilead, Celgene, Vertex, Biogen and Regeneron, and a tsunami of disruption by innovative newcomers looms large on the horizon. Following the pattern that emerged in the consumer-tech industry over the last decade, it is becoming easier and cheaper to commercialise ideas from the lab that would have once seemed outlandish. Take, for example, the myriad applications of whole genome mapping which 15 years ago cost \$3 billion for an individual and today costs less than \$1000 dollars. Combine this with the increasing trend for big pharma to look to acquisitions to bolster their shrinking pipelines as they fall over 'patent cliffs', and you have an environment



About Dr Jon Rees

Jon is an entrepreneurial, innovation and investment-focused life sciences PhD & tenacious senior executive with deep strategic insight. He can draw on a vast personal network within the investment and life sciences industries. Drawing upon his knowledge, experience and network he is now consulting for R&D companies, financial services and other organisations. He led and built OBN for a decade, growing it from a University project into a leading UK trade association, building the largest life sciences investment conference in Europe, BioTrinity, and establishing OBN as a powerful voice for emerging R&D companies. Jon did his post-doc at the University of Oxford and holds a doctorate from the University of London.

About Dr Edward Inns

Edward Inns is an Investment Analyst at Oxford Technology Management. After studying Materials Science at Oxford, Edward moved into the field of tissue engineering and obtained a PhD from Cambridge for research on artificial bone marrow. He now works for Oxford Technology Management where he sources and manages investments in a broad range of life sciences start-ups.



“IF OSBORNE WANTED TO STIMULATE A REVOLUTION IN FUNDING FOR LIFE SCIENCES START-UPS THEN HE HASN'T GONE FAR WRONG.”

that is highly favourable for start-ups. With the resulting blockbuster IPO valuations for biotech and medtech start-ups, does it make sense to wait for the companies to list before investing? Traditionally the answer has been yes. Even start-ups that get to phase I clinical trials only see 5% of drug molecules make it to market. Those that make it through to phase 3 clinical trials see a healthier 55% chance of progressing to market but often companies will IPO before they reach that stage.

Despite the potential rewards, the risks are enough to make many retail investors think twice. However, due to a recent push by George Osborne to build the life sciences sector in the UK, the balance of risk to reward has been flipped on its head. This is mainly thanks to the Enterprise Investment Scheme (EIS) and its three-year old sibling, the even more generous Seed Enterprise Investment Scheme (SEIS). These tax reliefs provide an instant income tax rebate on investing and further loss relief if the company folds. This means that, for a 45% taxpayer investing under SEIS, if the company is successful they receive half of the invested amount back and pay no tax on the capital gains. If the company folds, then their maximum loss would be only 27.5% of the invested amount (reduced even further to 13.5% for those with sufficient capital gains). To further complement this state-backed generosity, there has been a surge in non-diluting grants for biotech, pharma and medtech start-ups which are also eligible for SEIS and EIS.

If Osborne wanted to stimulate a revolution in funding for life sciences start-ups then he hasn't gone far wrong. Lightpoint Medical was an early beneficiary of SEIS funding when it was launched in 2013 to take an imaging technique, which allows surgeons to see cancer tissue, from the lab and into the clinic. Since launch, Lightpoint has won £7m of non-dilutive grants and has raised an EIS eligible £2 million Series A round which gave an effective 15x multiple for the SEIS seed



investors in under two years. Now, as more and more studies prove the efficacy of their system, they are raising a £10 million Series B round which looks set to increase early investors' multiples even further. When the maximum downside is limited to 27.5% (13.5% for some), the potential to make such tax-free returns starts to look very favourable when compared to listed biotechs with their unlimited downside.

The argument for investing under SEIS and EIS is highly convincing, but the first challenge that many people face is finding the deals to invest in. The three main ways to access these deals are angel networks, crowdfunding sites like Syndicate Room, as well as Venture Capital funds. There are many angel networks in the UK that provide opportunities to meet potential investee companies, though life sciences start-ups make up a very small portion of their deal flow. Networks such as London Business Angels, who operate **Angels in MedCity**, or **Investors** provide access to a some investment opportunities in early-stage life sciences companies. Crowdfunding has recently seen a number of high profile biotechs raise large sums such as **Cell Therapy Ltd**, led by Nobel Prize winning heart disease researcher Sir Martin Evans, who raised £690k. Despite some notable exceptions, crowdfunding platforms have the same problem as angel networks with a small number of life sciences companies struggling to stand out amongst the overwhelming sea of easy-to-understand consumer tech. Among the platforms, **Syndicate**

Room has emerged as the leading European platform for equity financing of science-based companies, with CEO Gonçalo de Vasconcelos attracting a number of key deep-pocketed and reference investors into his crowd.

There are, however, Venture Capital Funds dedicated to making SEIS and EIS investments in the life sciences sector. A new player in this field is **Deepbridge Capital**, who offer a life sciences specific SEIS product. The range of VC firms offering exposure to life science start-ups through sector agnostic technology funds is much wider, with SEIS and EIS opportunities available from **Mercia Fund** and **Symvan Capital**.

The second challenge is then picking winners without the deep data that can be found for quoted companies. This requires access to strong networks in the scientific community and the ability to understand the potential of often somewhat bewildering science. While that profile does fit some sophisticated individuals, it is possible to use the experience of long established funds such as **Oxford Technology**, who have invested in high-tech start-ups for over 30 years and now offer a combined SEIS and EIS technology fund. Investors in the fund have gained exposure to life science success stories, such as LightPoint Medical, and emerging companies, including **Combat Medical** which is revolutionising the treatment of bladder cancer.

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BY NICK SUDBURY

FUNDS CORNER

SETBACK FOR THE BIOTECH SECTOR

Biotech companies and the specialist funds that invest in them were one of the best performing areas of the stock market until mid-July when the sector experienced a sharp reversal. Many of the fund managers that invest in this area believe that the sell-off represents a long-term buying opportunity, although others are more cautious.

From the low in March 2009 to the peak in July 2015 the NASDAQ Biotechnology index rose by a staggering 580%. In the last few weeks it has fallen back around 23% and is now trading at a similar level to where it started the year.

One of the main catalysts was the slow-down in China, although the worst of the sell-off was triggered by comments from Hillary Clinton, who said that she would reform the way drugs are priced if elected president next year. Janet Yellen, the chair of the Federal Reserve, had earlier warned of stretched valuations in the biotech sector.

Investment trusts

There are four investment trusts operating in the Biotechnology and Healthcare sector, with ten-year returns ranging from 272% to 494%. The manager of the smallest of them, the Inter-

national Biotechnology Trust, is Carl Jansonm, who believes that the sell-off has been overdone.

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Jansonm has said that the reversal was triggered by fears of slowing global growth and that this has affected all growth stocks because of their reliance on economic expansion. He thinks that biotech stocks shouldn't have been as heavily written down as the others as their earnings are more predictable due to patent protection.

To support his argument he says that the top six US biotech companies' earnings per share are estimated to grow on average by 16.9% per annum over the period from 2015 to 2018. This is due to the massive earnings power of successful new treatments once they come on stream.

The **International Biotechnology Trust (IBT)** invests in high-growth, development stage biotech companies. It has a concentrated portfolio with the top ten holdings making up 52.6% of the fund with almost all of the shares listed in the US. Over the last ten years the investment trust has returned 352%.

Jansonm believes that the best strategy is to invest in companies that will release late stage clinical trial results on drugs with significant earnings potential over the next year. A positive outcome could lead to a massive re-rating of the shares and a possible takeover bid from a larger rival.

The good, the bad and the ugly

The best performer in the sector has been the **Biotech Growth Trust (BIOG)** with a ten-year gain of 494%. It is managed by OrbiMed Capital, which also runs the more diversified **Worldwide Healthcare Trust (WHT)**.



“JANSONM BELIEVES THAT THE BEST STRATEGY IS TO INVEST IN COMPANIES THAT WILL RELEASE LATE STAGE CLINICAL TRIAL RESULTS ON DRUGS WITH SIGNIFICANT EARNINGS POTENTIAL OVER THE NEXT YEAR.”



“ONE OF THE HIGHEST PROFILE CASUALTIES OF THE SELL-OFF WAS NEIL WOODFORD, WITH HIS UK EQUITY INCOME FUND AND PATIENT CAPITAL INVESTMENT TRUST BOTH ADVERSELY AFFECTED.”

BIOG has a portfolio of just 37 holdings with the top ten making up 66% of the fund. The shares are trading on a discount to NAV of 6.1%, which is much tighter than the 9.2% discount on IBT.

One of the highest profile casualties of the sell-off was Neil Woodford, with his UK Equity income fund and Patient Capital investment trust both adversely affected. Neither are specialist biotech funds, but both have exposure to the sector.

The **Woodford Patient Capital Trust (WPCT)** aims to provide long-term capital growth by investing in a portfolio of early-stage quoted and unquoted UK equities. Its largest holdings include a number of biotech companies such as Prothena and Northwest Biotherapeutics, some of which also appear in his larger open-ended fund.

WPCT lost 7.8% of its value during September mainly because of the biotech sell-off, but Woodford remains confident about the prospects and has been adding to his holdings in the sector. He has said that the valuation of Prothena is nowhere near the bubble level seen by some of its peers.

Despite the recent setback the closed-ended funds may be the safest way to gain exposure to these sorts of stocks as the managers can never be forced to sell into a falling market to meet client redemptions. This could be

a real problem for their open-ended counterparts if the reversal turns into a rout.

Open-ended funds

The open-ended funds are all included in the Investment Association's specialist sector along with everything else that doesn't fit into any of their other main classifications. Over the last five years the most successful have been AXA Framlington Biotech and Pictet Biotech with returns of 245.6% and 157.8% respectively.

According to the data from FE Trustnet, **AXA Framlington Biotech** is the best performing open-ended fund over the last five years of all the 3,156 that are listed on its website with Pictet Biotech not far behind at number 7. This fantastic performance has helped to attract massive investor inflows into the sector.

Five years ago the AXA fund had just £40m in assets under management, but the combination of high returns and new money has boosted the figure to just under £750m. Linden Thomson, the manager, has invested the cash in 67 stocks with the largest holdings including Celgene, Gilead Sciences, Biogen and Amgen.

In her latest monthly commentary she says that the sell-off was triggered by fears about slowing Chinese economic

growth and the fact that valuations had become overstretched due to the increase in merger and acquisition activity. She argues that the long-term sector fundamentals remain positive with plenty of new treatments in development.

“DESPITE THE RECENT SETBACK THE CLOSED-ENDED FUNDS MAY BE THE SAFEST WAY TO GAIN EXPOSURE TO THESE SORTS OF STOCKS AS THE MANAGERS CAN NEVER BE FORCED TO SELL INTO A FALLING MARKET TO MEET CLIENT REDEMPTIONS.”

A slightly more defensive option could be **Polar Capital Biotechnology**. The fund was launched in November 2013 and aims to 'preserve capital and achieve long-term capital appreciation' by investing in the 'biotechnology ecosystem'. It has a concentrated portfolio of 38 holdings with 15% of the fund allocated to the Pharmaceutical sector and 12% in cash at the end of August. Assets under management are just \$68.5m.

The manager, David Pinniger, has said that the cash was built up in expectation of continued volatility and that he expects to invest it in the near term as the opportunities present themselves. He believes that the biotech sector offers growth at a reasonable price compared to what is available elsewhere in the global economy and thinks that the fund's small size and concentrated holdings will generate strong out-performance.

“MANY OF THE MANAGERS THAT OPERATE OUTSIDE OF THE SECTOR ARE MORE CAUTIOUS THAN THEIR SPECIALIST BIOTECH COUNTERPARTS.”

Despite his optimism there has to be a risk that the huge capital inflows into the sector have pushed the valuations well beyond what the fundamentals can justify. To guard against this it would be sensible to only allocate a small proportion of your capital to this specialist area.

Specialist ETFs

There are 42 ETFs in the Pharma, Health and Biotech sector with four of the top six performers over the last five years having specialist biotech mandates. They are ProShares Ultra NASDAQ Biotechnology, SSGA SPDR S&P Biotech, iShares NASDAQ Biotechnology index and First Trust NYSE Arca Biotechnology index.

The **ProShares Ultra NASDAQ Biotechnology ETF** aims to generate twice the daily return of the NASDAQ Biotechnology index and has just over \$900m in assets under management. It provides exposure to 145 underlying companies and over the last five years has returned an incredible 930%, although the three-month loss of 34.9% demonstrates the high level of risk associated with these sorts of products.

A safer ungeared alternative is the **iShares NASDAQ Biotechnology index ETF**. This is up 269.5% over five years, which is still a very healthy return albeit much more modest than the ProShares product. During the last three months it has only fallen back by 20%.

Many of the managers that operate outside of the sector are more cautious than their specialist biotech counterparts. A good example is Gervais Williams, a small cap specialist who runs the Miton Multi-Cap Income fund.

Williams says that he has no investments in small biotech stocks and points out that the NASDAQ biotech in-

dex is up 3.7 fold in recent years, which is more than the Chinese mainland stock market rose before its recent collapse. He admits to having looked at these companies and acknowledges that they are doing some interesting things, but says that the risk/reward ratio is not in investors' favour at the current valuations.

Only time will tell if the sector is going to bounce back, but if you want to invest it would be prudent to keep your exposure to less than 5% or 10% of your portfolio. It would also be sensible to drip feed your money in over the next few months to minimise the risk of being caught out by another sell-off.





BY ADRIAN KEMPTON-CUMBER

TECHNICAL ANALYSIS CORNER

BIOTECH: THE NEXT PONZI SCHEME?

I remember listening to a recording of Napoleon Hill reading his book *Think and Grow Rich*. Quite interesting stuff, much of it is still relevant today, particularly in terms of basic principles. For a brief while in the noughties there were books coming out all over the place where people, mainly internet marketers as far as I could see, had 'updated' the text of Hill's book. I'm not a big fan of that.

It's a bit like getting Mona Lisa and painting a mobile phone in; or amending Debussy's *'La Mer'* to include the sound of the cross channel ferries. It's fine as it is, thank you very much. Actually, there is an example of this being done for ideological reasons. I heard the result many years ago on Radio 3, and needless to say, now you can find it on YouTube. The Soviet Union had Tchaikovsky's 1812 Overture rewritten to exclude the Romanov anthem, God save the Tsar (Боже, Царя храни). Without that it just makes it sound like Napoleon won, the Marseillaise being the only familiar melody.

One of the things the Napoleon of the Hill variety picks out as a good way to get rich is to invest in modern technology. Of course what was new-fangled in 1937 America is something we'd now regard as traditional, but there are plenty of new fields to invest in these days. 3D-printing is an obvious one – we've

already seen companies come and go in that field, giving lots of trading opportunities along the way.

**“THE WAY TO MAKE
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**THE SMART MONEY
WON IN EVERY BUBBLE
FROM THE SOUTH SEA
TO SUB-PRIME.”**

The way to make money in trading is to locate bubbles and exploit them. The smart money won in every bubble from the South Sea to Sub-Prime. Bubbles show that there simply isn't enough of everything to go around. The gold market is a good example

of that. Real gold costs a lot more than paper gold. Sovereigns are not as cheap as the spot price, in spite of attracting no VAT because they are currency. A bit of profiteering there methinks. Also, the fact that the US seems reluctant to give Germany back its gold which leads one to consider the fact that they may simply not have it – there isn't enough to go around.

So you could argue that the model here is a Ponzi scheme. It's true of any population, even we humans. Malthus was wrong so far but it would seem certain that there will be a limit to the number of mouths that can be fed on this planet sooner or later, and when we hit that brick wall it will be just like any other over-population. The Ponzi part comes from the fact that people are buying into having babies geometrically on the basis there will be food to feed them which thus far has been geometric in growth too.



We can apply the same logic to a stock rally: ultimately there isn't enough to go round so the price rockets.

Can we expect biotech to create the sort of tech bubble we saw 15 years ago? Well, these days legions of people are educated just enough to think they know everything, and can extrapolate in fields of which they have no knowledge. There's a pervasive notion that all opinions are equal. They're not. Received opinion is valueless and opinions that, for instance, counter scientific fact, are not opinions at all, and clearly carry no weight whatsoever. They deserve to be openly ridiculed. The hang-over of centuries of oppression by agenda-ridden religions has resulted in a feeling that morals, in the same way as opinions, somehow have equal weight, and that's not true either. Morals – and for that matter ethics – change from person to person, from day to day and from place to place. The problem is that the more common moral 'values' are the ones that have been dogmatised for centuries. As a result lots of biotech is wasting time and money because people are having pointless and irrelevant debates about things like whether it's moral to use stem cells in research, when in reality they don't really know what stem cells are or where they are being sourced

from; they don't even care about the greater good they are being used for, and have no reasonable reason for being involved in such a debate in the first place. It's the same thing with GM and most of the biotech field really.

It is against this landscape of uninformed co-ordinated interference that the Biotech industry sits. What we're always looking for with a play like this, into a sector that is new, is the same kind of thing we would look for in a Ponzi scheme: one that isn't yet over-subscribed. Perhaps a look at the Tech Boom might be in order. It's a similar thing as we're looking at a highly speculative play on patents, and other more intangible assets, that can be valued almost anywhere between around zero and infinity! What we're going to have to do is to anticipate the behaviour of market participants and, more importantly, the potential market participants – most of all the public. It's the public we ultimately make money out of in these situations: they provide the liquidity for the professionals and the well informed to get out at a profit, leaving the amateurs holding the dead cat some people will be talking about when it hits the ground. We won't give a monkey's whether the dead cat bounces or even dances. We'll be long gone.



The question is how do we do that? Well it's pretty basic stuff. In trading it's very easy to overlook the obvious, and over-complicate things. In late '99 we see the NASDAQ [IXIC] break above many months of resistance around the 2,900 level. We then move into a congestion area which lasts through the spring of 2000. Breaking above that it's reasonable to expect a measured move, and that it does so bouncing off the top of the Ichimoku cloud is just



a nice little confirmation. A measured move is exactly what we get: roughly 800 points into the congestion area and roughly 800 points out. So assuming you're in this market that should mean you manage your trade tightly at 5,000. There is another factor here. When the public get involved in the last leg of a rally it usually goes up more quickly and you see an almost vertical move up to the target level. It doesn't disappoint. The rate of increase roughly doubles in the measured move compared to the move into the congestion area. That's a great sign the public is getting in. The smart move there was to run a tight stop at 5,000 and look at playing a continuation if one presented itself, which it didn't. Profits need protecting and in what was obviously a seriously over-bought situation common sense has to prevail.

Back to biotech today. The NASDAQ Biotechnology Index [NBI] is not looking very good. Could it be that a lot of public investors think it's an unethical sector? Particularly in the US where there is polarisation in such matters. It's looking very weak. We've seen a Head and Shoulders, and they appear on all the biotech sector and ETF charts I studied, and it's playing out. I certainly wouldn't be buying into the sector right now. There's a double H+S



on the chart. Quite hard to see on the candlestick chart. For H+S patterns you can't beat the Point + Figure chart. I've marked the two sets of shoulders and it's so easy to see. Basically anything that looks like the Empire State Building is a H+S.

So, sadly I don't think we're going to see a biotech bubble quite yet, which is a shame as it has a certain ring to it. On another note, perhaps I should have called this article Pyramiding into Ponzis.

**“I CERTAINLY
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BUYING INTO THE
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DOUBLE H+S ON THE
CHART.”**





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



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



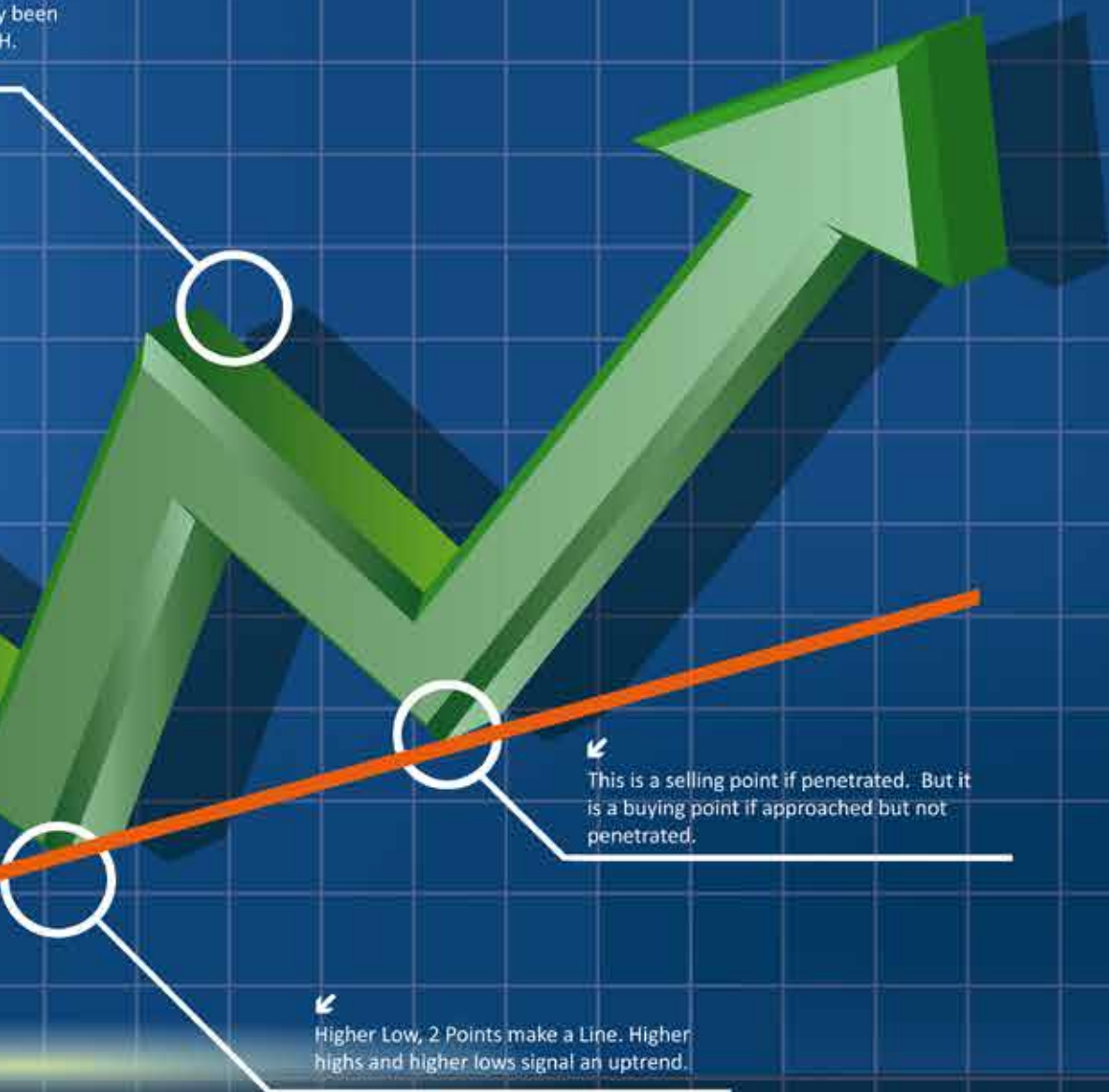
Clear and Strong Uptrend. An up trendline is a straight line which slopes upwards and is drawn to touch successive low points in an uptrend.

Trendline Support in 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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BY FELIPE R. COSTA

ECONOMICS CORNER

HOW MUCH IS BIOTECHNOLOGY WORTH?

Biotechnology is one of the most interesting and promising market sub-sectors, which offers investors a peculiar pattern of returns. Unlike almost all other market segments, where returns are positive on average, returns on biotech stocks are negative on average. But investors are nevertheless willing to accept such an average because they know that sometimes, when they get it right, their investment can be factored 5x, 10x, or even 20x in a matter of days.

Biotech companies are educated guesses on a blind future, where hundreds of millions of dollars are spent researching something no one really knows will serve any purpose at all, let alone any potential commercial exploitations. It is not a surprise that 90% or more of the projects end with unsatisfactory results, with investors losing their money and their patience. But it is exactly because of the remaining 10% that investors are willing to pledge their money and wait for the long shot opportunity. It is a bet on an unlikely outcome. But as long as some pattern of cash flows can be identified and a probability distribution can be assigned to them, there is an investment opportunity. The main prob-

lem lies in valuing such an opportunity, as not even the highly skilled research teams inside biotech companies truly understand their odds. Biotech is a game of skill and luck.

The opaque nature of the business provides a window of speculative opportunities, with investors anxiously waiting for any piece of information to vigorously buy and sell these stocks. Further contributing to the speculation is the lack of earnings history, dividend payment, and analyst coverage these companies usually come with. Investor sentiment plays a key role in price formation in the sector, which often leads to a wide disconnect between price and fundamental value. Biotech is prone

to bubbles and is heavily exposed to a boom-and-bust cycle.

A peculiar sector

Biotech is all about burning capital in research and development over the years; joining cutting-edge technology with highly skilled scientists in the hope that they will discover the cure to some plague, disease, or medical condition; and hoping that such potential discovery can be exploited commercially. But biotech is a very peculiar business, different from almost all others.

Just think about a restaurant, a hotel, or a furniture business, for example. As long as there is demand for the



“BIOTECH COMPANIES ARE EDUCATED GUESSES ON A BLIND FUTURE, WHERE HUNDREDS OF MILLIONS OF DOLLARS ARE SPENT RESEARCHING SOMETHING NO ONE REALLY KNOWS WILL SERVE ANY PURPOSE AT ALL, LET ALONE ANY POTENTIAL COMMERCIAL EXPLOITATIONS.”

products and services provided by them, they can easily take care of the rest, which is not a deal more than supplying the market with the products they produce and services they provide. The risk for these businesses is in demand. On the contrary, when the biotech firm is born, a huge demand is already there waiting to be filled. But the company doesn't know for sure if it will ever be able to supply anything. The risk for biotech is in supply. It is relatively easy for a restaurant to hire a good chef and fill a kitchen with the necessary appliances for him to cook succulent meals to delight clients. A hotel can also buy the necessary furniture and hire talented staff to attend clients. In the biotech case, one doesn't know if the research team will be able to ever develop anything, no matter how much cutting-edge machinery we add. Even at advanced stages of prod-

uct research and development, when a company has found a drug that works, it still must get the approval of the most stringent regulators, and after that, convince governments, patients, and insurers that the drug is worth paying for. The panorama for biotech is therefore relatively unfavourable and discouraging.

Biotech focuses on novel drug development and clinical research aimed at treating diseases and medical conditions. It is not difficult to realise how large the market for these companies is. But it is also not difficult to realise how thin the path to success is; with companies taking years to develop some usable drug and then still depending on exogenous factors to market it, before investors ever see a penny in return. This is a business with a strong speculative nature that will be

heavily impacted by subjective measures of value.

The Fed, sentiment, and price bubbles

The Federal Reserve (in the hands of Ben Bernanke) engaged in the most expansionary monetary policy ever seen, by first cutting interest rates to near zero, and thereafter, by spending trillions of dollars purchasing debt securities. Bernanke was always a strong supporter of quantitative easing and bold policy action. As soon as rates were cut to 0%-0.25%, he didn't hesitate to flood the system with liquidity, in a desperate attempt to rebuild economic growth, by pushing investment (through lower interest rates) and consumption (through higher asset prices). Such low rates mixed with

“AT THE END OF 1995, THE AVERAGE BIOTECH COMPANY HAD A MARKET VALUE OF \$330 MILLION. THAT AVERAGE IS NOW \$2.4 BILLION. THE SECTOR IS BECOMING BIGGER AND FATTER.”



enhanced credit conditions should, in theory, help real investment and consumption, and thus generate growth and inflation. But, years after, we know that may not be the case. Growth increased but investment and consumption are still lagging far behind. The central bank was not able to drive inflation back to its target value, and because it allowed an emergency policy to last for too many years, it may have created some collateral damage – a massive asset bubble.

The central bank has been more effective in generating asset inflation than consumer inflation. Through buying trillions of dollars of assets, the Fed increased demand for these assets in a significant way, pushing prices higher. At first, it alleviated the pressure on household finances via lowering mortgage payments, and helped increase wealth through portfolio effects. But, at the same time, as the yields on safer assets were approaching zero, investors and savers had to look for riskier assets to preserve their wealth over time. As a consequence, equity prices could only rise. Money started flowing to risky investments, in particular to the equity market, even though the economy was not recovering at the same pace, creating a disconnect. Basel accords further contributed to the reallocation of funds from the real economy to the financial economy, which pressed equity prices even more.

Under such conditions, we should be wary of the current uptrend in equities because it seems more the result of an artificial boost in prices than the reflex of a healthy economy.

Implications for biotech

Why does all the above matter for biotechnology? It matters because the sector is heavily exposed to speculation and investor sentiment. When yields are decimated by the central bank, households and professional investors are pushed into the equity market. As a whole the market rises. But the money doesn't flow evenly. Research conducted by Baker & Wurgler (2006, 2007) shows that sentiment has a varying impact in equities, depending on a few conditions. For example, speculation in the utilities sector is usually limited. The main reason lies in the fact the sector is made up of well-established

“IT IS IN SECTORS WHERE THERE ARE SMALLER, YOUNGER, HIGHLY VOLATILE, HIGH-GROWTH, DISTRESSED, NON-DIVIDEND-PAYING, AND UNPROFITABLE STOCKS THAT THE EXCESS MONEY ACCUMULATES. THE WHOLE BIOTECHNOLOGY SECTOR IS A PERFECT MATCH.”



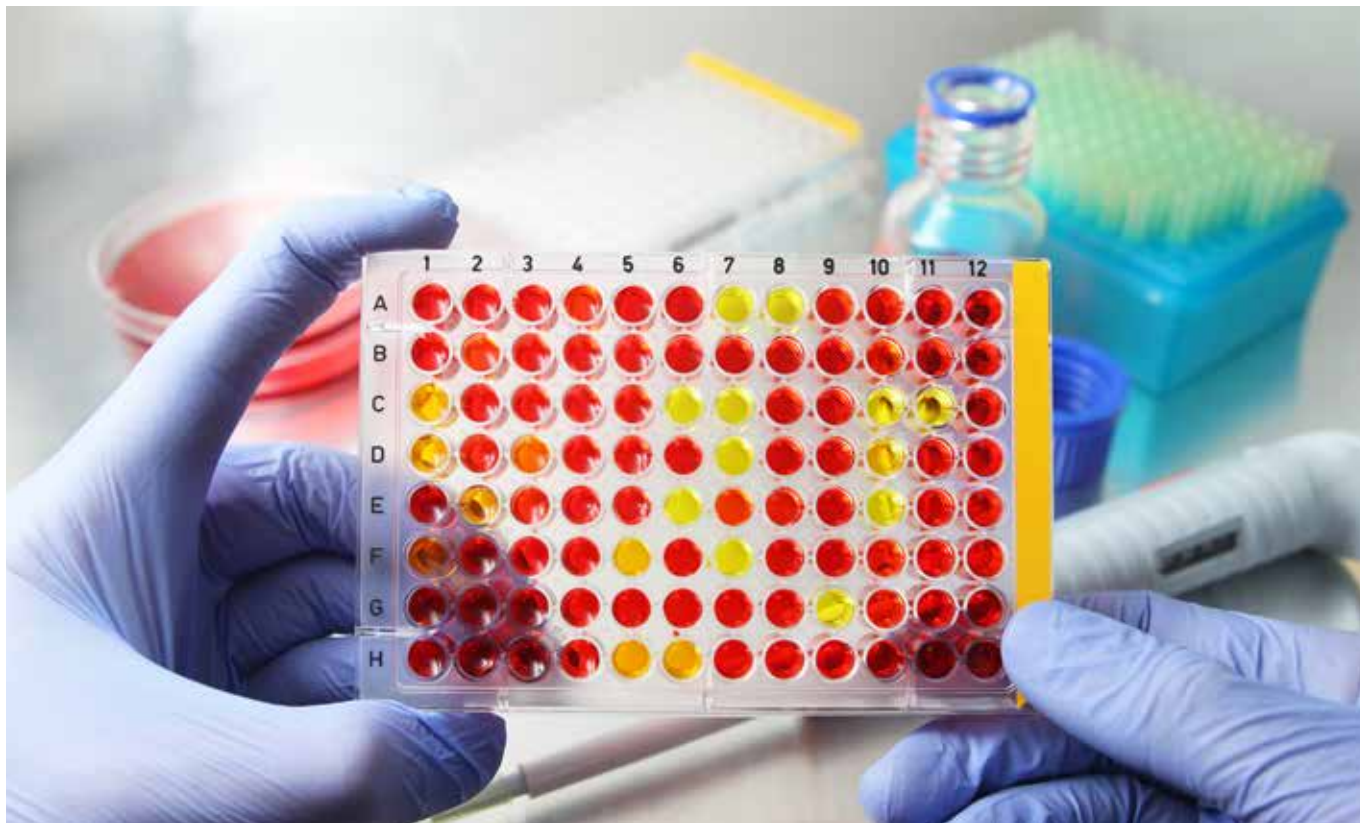
companies, with a long track record of earnings and dividend payments, which are followed by a large number of analysts, and for which future cash flows are estimated with a high degree of certainty.

When sentiment is high (many times boosted by massive central bank intervention), people take downside risks lightly and then seek out the best upside potential they can get. Those difficult-to-value stocks offer the best opportunities. Their price starts to rise, attracting new buyers who help drive the price even higher. These companies offer huge profit potential but often don't have any record of positive earnings. During the tech bubble, investors ignored all traditional valuation metrics because they overestimated the profit potential of nascent companies, just to later discover they were wrong about it. Every time sentiment rises

too much, money flows to the equity market and tends to create bubbles in particular sectors. It is in sectors where there are smaller, younger, highly volatile, high-growth, distressed, non-dividend-paying, and unprofitable stocks that the excess money accumulates. The whole biotechnology sector is a perfect match.

During the last three years, the Nasdaq Composite rose 63.2% while the Nasdaq Biotechnology index rose 127.5%. In the list I'm currently looking at (not represented here), which is filled with 375 US biotech shares, there are 59 (15.7%) showing a rise of over 100% over the last three years. The cut-off in performance for the top 10 list is 500%. Biotech companies benefited from low interest rates and a liquidity glut, with much money flowing into the sector disproportionately. Since the end of 1995, the total market value reflected





in the S&P 500 has risen more than four-fold from \$4.3 to \$17.9 trillion. The market value of the biotechnology sector rose from \$17.5 billion to \$803.9 billion, or 45.9x. That is an alarming growth rate.

At the end of 1995, the average biotech company had a market value of \$330 million. That average is now \$2.4 billion. The sector is becoming bigger and fatter.

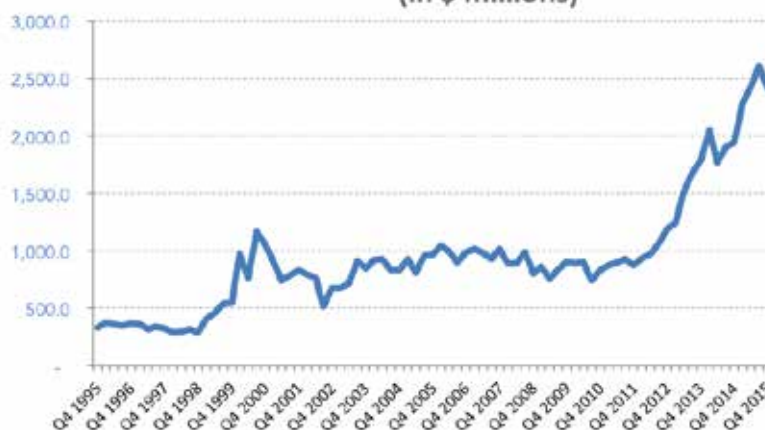
The rise observed in biotech is too great for it to be sustainable. While there are certainly a few good opportunities, we know that 90% of the projects are doomed to fail. The recent uptrend in prices cannot reflect reality, because there is no reason to believe that scientists have suddenly become more skilled, which could have contributed to increase the likelihood of success. The explanation for the recent uptrend seems to rely more in the excess liquidity and difficult-to-value thesis than on anything else. Recent years have been characterised by an inflow of money from emerging markets and very low interest rates, which favour the increase in asset prices, in particular of those more exposed to speculation. But with the risks to the global economy mounting quite quickly, sentiment may soon revert and the biotech sector will by then be left exposed.

Total Market Value of Listed Companies (in \$ millions)



Source: Datastream, Master Investor

Average Market Value of Listed Biotech Companies (in \$ millions)



Source: Datastream, Master Investor



OIL PRICE Portfolio Optimisation
FISCAL RISK Production Profile
Commercial Risk Expected Monetary Value CAPEX
Economics
POLITICAL RISK
CONTRACTUAL DUE DILIGENCE DATA FLOW & VALUE
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BY JAMES FAULKNER

AN INTERVIEW WITH

MICHAEL JOHNSON

CEO OF RHINOMED

James Faulkner: Thanks for taking the time to speak with Master Investor. To begin with, please give our readers a brief overview of Rhinomed and what it's all about.

Michael Johnson: Rhinomed is a Melbourne, Australia based medical technology company. We are listed on the Australian stock exchange (ASX:RNO). The company has developed a nasal respiratory technology that helps you to radically improve the way you breathe, sleep, take medication and maintain your health. We're focused on a couple of major global market opportunities and significant unmet needs in sleep (snoring and Sleep apnoea), sport, wellness (congestion, anxiety, Appetite management) and drug delivery.

We have just launched two products into the global consumer health markets – Mute™ which reduces snoring and improves sleep quality and Turbine™, a sports breathing technology that helps people to breathe better and improve their performance in aerobic activities.

Rhinomed emerged out of the ashes of a listed medtech company that had failed to deliver. My involvement came at the start of 2013 when I was invited to help turn around the company. In the two and a half years since, we have not only managed to develop and launch two exciting

technologies onto the global market; we are also now carrying out a clinical trial for our breakthrough sleep apnoea technology that will address mild/moderate sleep apnoea and are scoping a nasal drug delivery programme. Our technology platform is now protected by over 60 patents, 13 of which are granted. We're a fast moving company with global ambitions!



JF: Turbine was the first product to go on sale. What was the inspiration for the product and how was it developed?

MJ: We understand that placing something inside your nose seems like a novel idea at first. So we needed to find a market with an early adopter group who act

as a reference group for a much bigger mass market. As a result, the first application from our technology platform was the Turbine and its design for aerobic exercise and sport. The Turbine is a sports breathing technology that sits in the nose and is designed to make breathing easier. When breathing through the nose, you warm, humidify and filter the air, and in aerobic activity this is important as it allows the air to be readily brought into the lungs and used efficiently.

The Turbine technology was designed and developed by our industrial design team with the input from triathletes, runners and cyclists and also some leading sports medicos. We've been through a lengthy development programme that has included numerous prototypes, so the Turbine you can buy on the market today is in fact version 3.0. The Turbine has been awarded a CE mark from the European authority, is registered with the US FDA and the Australian TGA.

So, it's our first product to market, but it won't be the final version you see – we are already working on some improvements to the Turbine which will further assist athletes.

JF: Can you tell us a little bit about how Turbine has been received in the sporting community and how sales are progressing?

“THE TURBINE IS A SPORTS BREATHING TECHNOLOGY THAT SITS IN THE NOSE AND IS DESIGNED TO MAKE BREATHING EASIER.”





MJ: The Turbine is designed for anyone doing aerobic activity, from percussive activities such as running all the way through to more passive activities such as yoga. Our initial target market are the millions of people participating in cycling and triathlon. These folks love technology that can provide a 'marginal gain' and breathing better can be that difference – especially at the elite level.

“PLEASINGLY, THE TURBINE IS QUICKLY BECOMING AN ESSENTIAL PART OF THE STANDARD KIT FOR ATHLETES.”

Pleasingly, the Turbine is quickly becoming an essential part of the standard kit for athletes. They have their fuel, their hydration and we now help them to get the

air they need to succeed. And that's what it's all about. It's been great that since releasing the new version of the Turbine at the start of 2014, we have helped Chris Froome win this year's Tour de France, Shannon Rowbury set a new American record for the 1500m (breaking Mary Deckers 31-year-old record in the process), the Canadian Aerovelo team set a new world record for human powered speed (136km/hr) and Kiwi Linda Vilmussen become the UCI Woman's 2015 Time Trial World Champion. It's exciting to see such great results.

The Turbine is now available in over 19 countries, including the UK. Our focus has been on targeting the niche cycling and triathlon stores, establishing a presence in this early adopter market, before we go broader into the large sports retailers. So while it's still early days, we are seeing sales increasing in line with the growing awareness of the product. As distribution increases, we expect to see the product move into the mainstream.

JF: The second product, Mute, went on sale earlier this year. I always considered snoring more of an annoyance than a medical issue. What are the wider implications of snoring and how serious are they?

MJ: Snoring impacts 45% of the UK population and it is now well recognised that it can severely impact people's relationships, health and ability to function effectively, both at work and in general life. Snoring is annoying. No question. And even more so when you consider that in 1950 Brits were getting an average of 9 hours sleep and now you're getting an average of 6.5 hours.

Everyone values a good night's sleep. So snoring quickly moves beyond annoying when you are being kept awake by a snorer. It's worth noting that one of the loudest snorers ever recorded was an English woman who hit 110 decibels – that's louder than a low flying jet. That's more than just annoying! It's also why so many people are now being forced to sleep in separate rooms. We conducted a recent survey (September 2015) that identified some 32% of Britons are sleeping in separate rooms because of snoring.

We believe we have a pretty compelling solution. Our Mute technology has been shown in a user trial (n=118 couples, 5-day in home user trial) to reduce snoring in 75% of respondents. We think that's pretty good. And certainly the feedback we are getting from customers reinforces that the Mute works. By stenting the

“SNORING IMPACTS 45% OF THE UK POPULATION AND IT IS NOW WELL RECOGNISED THAT IT CAN SEVERELY IMPACT PEOPLE'S RELATIONSHIPS, HEALTH AND ABILITY TO FUNCTION EFFECTIVELY, BOTH AT WORK AND IN GENERAL LIFE.”

nose and allowing you to breathe better, we know we can make a big difference in the lives of many people. At only £16.99 for a packet of 3 which will last you up to a month, Mute is an easy way to tackle snoring.

The clinical aspect of snoring is a little more serious. It is increasingly recognised that snoring can be a precursor to Sleep Apnoea. Sleep Apnoea is a common disorder where you may have one or more pauses in breathing or shallow breaths while you sleep, these can last from a few seconds to minutes and in severe cases may occur 30 times or more an hour. There is a lot of emerging medical research that points to Sleep Apnoea being linked to heart disease, depression, dementia and even Alzheimer's. So there is no question that it's an area that people need to be aware of.

JF: Do you have any estimates for the potential market size for these products?

MJ: Rhinomed, as a platform technology company, has the opportunity to be involved across multiple major global markets. The global sleep aid market is currently estimated at over US\$54bn and rapidly growing. One of our closest comparators is the Breathe Right strip – this was the major part of a company called CNS that was bought out by GSK in 2007 for US\$566m. So that certainly gives you an idea as to the potential values placed on companies like Rhinomed. We note that even through the final patent on the strips expired in 2013, sales are still around the £80m mark from some reports.

The sleep apnoea market is obviously growing globally. Companies such as Resmed and Phillips are the larger players but are increasingly under pressure from the large clinical gas companies like Air Liquide and BOC. We see a very real opportunity to be a significant player in the Sleep Apnoea market which currently has revenues of approximately US\$13bn. Our Mute technology is the entry point as



we identify snorers early in the diagnostic process. However, we have also developed a clinical technology that is targeting the 70% of patients who suffer from Mild to Moderate Sleep Apnoea. In June of this year we commenced a clinical trial at Monash Health in Melbourne, Australia that seeks to show that our new Intra Nasal Positive Expiratory Air Pressure (INPEAP) technology is effective and well tolerated. A positive trial result would be a real landmark milestone for Rhinomed, so we look forward to seeing the results of the trial over the next six months. In essence, if the INPEAP technology is both effective and well tolerated we have a potential breakthrough, front line solution for patients who are not only Mild or Moderate Obstructive Sleep Apnoea patients but also the 60% of patients who are currently not compliant with existing therapies.

JF: Are there any other similar products in the market? What is Rhinomed's USP and how does it protect its intellectual property from the competition?

MJ: There are numerous snoring aid and sleep apnoea devices on the market that have varying levels of success. We know the key to success is not only a clinically proven technology, but one with clear, unambiguous branding. We are strong believers in branded technology. All our

technology is clearly positioned as the premium leader in its category. Our USP is melding clear clinical evidence based technology to breakthrough brands. We recognise that compelling clinical trials is the price of entry. Ultimately however, asking people to try the product for themselves and make up their own minds is the key to the success.

We have invested significantly in creating and maintaining a strong intellectual property portfolio, with a family of 56 patents in the nasal and respiratory area. We have also secured a further 60 Design Applications and Trademarks protecting our valuable brands. The complexity of manufacturing materials and process, combined with strong global branding and IP portfolio helps protect our market position from competitors.

JF: Mute went on sale in the UK exclusively in Boots at the end of October. How significant is this deal for Rhinomed?

MJ: This is a landmark deal for Rhinomed. Boots UK is not only an iconic consumer health retailer and pharmacy; they are also a strong strategic fit for Rhinomed. As part of the Walgreens Boots Alliance company they are firmly part of our global distribution strategy. To get your product on the shelves of Boots is a big achievement for any small med tech





company and we are thrilled to be able to help British snorers. We recently completed an internal launch at the Boots UK headquarters in Nottingham and will be rolling out a consumer campaign in November in London.

The deal is significant across a number of fronts. We recognise that the ability to engage with people at the pharmacy level early in their journey with sleeping issues enables Rhinomed and the pharmacist to have a unique, and indeed powerful, conversation with consumers before they may have decided to seek assistance from a GP or specialist. As a company that aims to provide solutions right across the entire sleep category (from snoring and decongestion, to sleep apnoea) – this is a critical success factor as it allows us to identify and begin communicating with potential patients years before they see a Doctor. The relationship with Boots is a pivotal part of delivering on this strategy and we have been thrilled that the WBA and Boots UK team not only appreciate the value of this strategy but are actively supporting it. It's been great to work with a company like WBA that understands innovation and the need to deliver value to customers.

JF: Rhinomed is currently listed on the ASX Down Under. Are there any plans to give us Pommies a slice of the action via a UK listing?

MJ: Rhinomed has a strong link with the UK. One of our former directors was Lord Simon Reading, while some of our strongest shareholders are based in the UK, including Master Investor's Jim Mellon and our global brand ambassador and shareholder Olympic legend and 5 times gold medallist, Sir Steve Redgrave CBE. The ASX and Australia has been a good launching pad for Rhinomed, but our aspirations are truly global, so this could ultimately move us towards additional offshore locations and opportunities in due course.

JF: With Turbine and Mute now on the market, are there any other products in the development pipeline that readers should be aware of?

MJ: Absolutely! As mentioned, the sleep apnoea technology INPEAP, (Intranasal Positive Expiratory Airway Pressure) is undergoing a Phase I pilot study and we are looking forward to seeing the results

of this study. There is no question that this is a major milestone for the company.

In addition, we have further offerings under our 'delivery' programme. In its simple form, this could be in the form of adding a decongestant – menthol, Eucalypt and Rosemary – to the Mute and Turbine. This would allow us to access a massive global market and provide some real and exciting innovation to both our existing sleep/snoring and sport franchises. In its more complex form it involves using the platform for drug delivery. If patients are wearing the device for up to 8 hours, it opens up a range of opportunities for the delivery of medication – we have commenced some preclinical work looking at sumatriptan for acute migraine. This market alone is projected to grow to \$5.6bn by 2021. We will look at assessing a range of drug targets that could benefit from improved nasal delivery over the next 36 months.

“OUR USP IS MELDING CLEAR CLINICAL EVIDENCE BASED TECHNOLOGY TO BREAKTHROUGH BRANDS.”

While Rhinomed is still an early stage company, our progress is pleasing. We have a platform and pipeline that is truly exciting and which can change lives for the better. What differentiates us is that our strategy is focused on validating the value of the technology platform as we go by showing that it not only works, but is valued by customers, retailers, patients and clinicians.

Michael Johnson

Michael Johnson is an experienced leader and innovator who has specialised in the successful commercialisation of emerging technologies and brands for over 20 years. Michael has worked in and for a wide spectrum of companies from ASX300 through to start-ups in Life Sciences, Cleantech, Financial Services, Energy and Utilities, and Manufacturing. He has been a Principal at 2 leading global consulting firms where he advised on innovation. He has also held senior roles in top marketing and communication firms, launching high profile products and brands.

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BY ROBBIE BURNS

ROBBIE BURNS' TRADING DIARY

After a quiet summer there's a sudden deluge of IPOs coming to market. That's "Initial Public Offerings" to you and me. These are companies that have decided they want to float on the market. But how do you decide which ones to go for? It's quite difficult. Some float and do brilliantly. Others crash and burn. And some, well, don't do an awful lot one way or the other.

The first thing I look at is whether they are going on the lightly regulated AIM market or opting for a full listing. Those heading for AIM I treat with immediate suspicion. That's because with light regulation in this market some companies have launched and basically made themselves look much better than they were in reality. Camkids and Naibu, anyone? They looked great until they unravelled fast, both ending up at zero.

“THE FIRST THING I LOOK AT IS WHETHER THEY ARE GOING ON THE LIGHTLY REGULATED AIM MARKET OR OPTING FOR A FULL LISTING. THOSE HEADING FOR AIM I TREAT WITH IMMEDIATE SUSPICION.”

That rarely happens with companies floating on the main market where heavier regulation usually stops dodgy

companies from listing there. The other plus point about a main market listing is that, depending on the valuation, shares quickly get included in the FTSE 100, FTSE250 or small cap indices so fund managers and index linked funds tend to buy in.

So let's take a look at some of the shares about to be listed (some of these might indeed be listed by the time you read this). I've had a good read through the bumph the companies put out about themselves and my favourite after reading them all – drum roll – is brick maker **lbstock (IBST)**.

lbstock says it is experiencing big growth in its key UK brick market, driven by a shortage of homes and supportive government policies. Even better, it says it is struggling to keep up with demand and there are high barriers to entry to the industry. What I really like about it are the figures – profits and revenues have risen strongly over the last three years. There is no sign of this stopping. And because it's a main listing my guess is the valuation will be enough to get it into the FTSE 250 index. So in December it should gain some more publicity and funds will be forced to buy in.

The annoying things about new issues are plentiful. I want to buy lbstock for my ISA, but bizarrely you can't buy a main market issue for the first week in an ISA as it trades "conditionally". What the heck?! But even more inexplicable is the fact that you can buy them as a spreadbet on day one – which is exactly what happened when I wanted to buy one of the biggest new issues of the year, **Worldpay (WPG)**.

Worldpay is one of the biggest payments companies and so a longer-term stake in it seemed to make sense. However, on day one to get some tax free it had to be a spreadbet, so thanks to IG Index! A week later I topped up on Worldpay in the ISA. This is one of those new issues that looks good: a giant of a company and likely to be valued highly enough to get into the FTSE 100 shortly. And that should bring about further rises. For me, a core holding now for at least a couple of years – barring a general market meltdown of course.

Another new issue I am interested in is along similar lines to lbstock: retirement housebuilder **McCarthy and Stone** – which probably has to buy a brick or three from lbstock. The company has produced some fantastic fig-

ures showing revenue grew by 25% in a year. And with lots of building likely in its sector, the firm looks a reasonably safe bet.

Another that looks quite good is **Equiniti** which was due to float on Oct 30th (so should be listed by the time you read this). Again, some pretty impressive figures here and this is one of the rare ones that you could buy at the same price as institutions as most brokers were prepared to allow dealings in them before launch so I've asked for £5,000 worth. This company supplies tech, payment and admin services to a lot of big companies. The dividend here should be good too. The annoying bit is no fixed idea on pricing of the issue, so a bit of a gamble there. I am hoping it launches nearer the bottom of its indicated range.

**“WORLDPAY
IS ONE OF THE
BIGGEST PAYMENTS
COMPANIES AND SO
A LONGER-TERM
STAKE IN IT SEEMED
TO MAKE SENSE.”**

I expect to hold Worldpay, Equiniti, Ibstock and McCarthy and Stone for some time in spreadbet accounts and ISAs. I think all four should deliver the

goods over the years, with some decent dividends thrown in too.

Moving to a risky AIM one – **Evgen Pharma (EVG)** has just floated at 37p. As it's on AIM it makes a risky stock even more so, as it is a clinical stage drug development company focused on cancer. That means it's impossible

to value and would be a pure punt for fun money. Running my own SIPP, I find it entertaining to use 10% of it for fun punts like Evgen. Expect to lose but be delighted if one turns out to be a big winner. But always be wary of AIM listings!

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.





BY IAN GURNEY

AN INTRODUCTION TO PEER-TO-PEER LENDING

The United Kingdom has been at the forefront of innovation in the financial services sector and the explosion of peer-to-peer lending has proved this to still be the case.

So what exactly is peer-to-peer lending? Traditionally individuals (and businesses) would save their money in a bank, building society, or other financial institution, and that company would then lend this money to other individuals or businesses who needed to borrow. Peer-to-peer lending simply removes the bank, building society or other financial institution from the process. The process is as its name suggests – lending between peers. These loans are arranged through a peer-to-peer company or peer-to-peer provider, with the participants in the process being referred to as "lenders" and "borrowers". In a lot of cases lender and borrower may not know the identity of each other.

There are typically many lenders involved in a single borrower's transaction, and each lender typically would have many borrowers, so this

is a concept that can only be delivered in a digital world.

The lender's funds are spread between multiple borrowers, so that if any one borrower cannot repay – and it can almost be guaranteed that some loans will not be repaid – then a lender will not be adversely affected. The interest rate paid to the lender should be set to cover any expected bad debts (loans that are not repaid).

Classic financial institutions making loans will charge borrowers more than they pay savers – this is how they make money. This interest margin – which is considerable – pays for the staffing and all other commercial and regulatory costs, along with covering the expected bad debts of such loans. With peer-to-peer lending all of the interest, less the peer-to-peer platform's cut (which can also be sig-

nificant), is paid to the lender, but the lender is also assuming all of the risk associated with the loan.

It is therefore very important to point out that peer-to-peer lending is not saving. Saving is perceived to be risk free, as it is backed up with the Financial Services Compensation Scheme. Peer-to-peer lending sites do rightly publicise the warnings "capital is at risk". However peer-to-peer lending is not investing in the classical sense as there is no upside beyond the interest the borrower has agreed to pay. Therefore this new asset class is referred to as peer-to-peer *lending*.

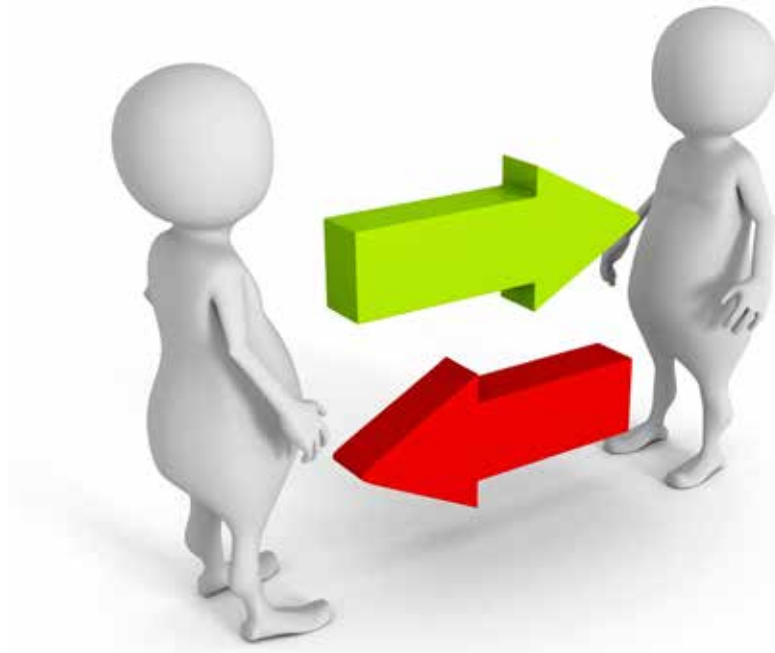
Peer-to-peer lending is funding by the crowd, but the term *crowdfunding* is usually associated with equity funding which is something quite different. Equity crowdfunding is investing, unlike peer-to-peer lending.

“WITH PEER-TO-PEER LENDING ALL OF THE INTEREST, LESS THE PEER-TO-PEER PLATFORM’S CUT (WHICH CAN ALSO BE SIGNIFICANT), IS PAID TO THE LENDER, BUT THE LENDER IS ALSO ASSUMING ALL OF THE RISK ASSOCIATED WITH THE LOAN.”



This can be confusing, which is why the industry refers to itself as peer-to-peer lending. In the United States peer-to-peer lending is referred to as market-place lending.

As the number of companies operating in this space have increased, there are now a variety of types of peer-to-peer lending. Some companies operate an auction model, where each lender bids on a loan, with the lowest rates winning. Other companies operate a market model where lenders set their interest rates and their funds are placed in a digital queue. Some companies also offer a "provision fund" or insurance so that if a borrower does not repay, the fund will repay the loan, and this fund is typically paid for with a lower interest rate, so one way or another it affects the overall return received by lenders.



“TO DATE ZOPA HAS FACILITATED OVER £1BILLION IN PEER-TO-PEER LOANS TO INDIVIDUALS WHO WANT TO BORROW UP TO £25,000 OVER A PERIOD OF BETWEEN 2 AND 5 YEARS.”

Zopa was the first peer-to-peer company in the world and launched in 2005. Zopa stands for Zone Of Possible Agreement, which describes the process. There is a rate at which the borrower is prepared to pay and there is a rate at which the lender is prepared to receive, and where there is agreement, a loan can be made. To date Zopa has facilitated over £1billion in peer-to-peer loans to individuals who want to borrow up to £25,000 over a period of between 2 and 5 years. Zopa has operated a variety of lending models, but the current safeguard model allows lenders to receive a return of between 3% AER and 4% AER for basic rate taxpayers, and between 2.2% AER

and 3% AER for higher rate tax payers, for loans between 3 and 5 years with protection of a provision fund.

Funding Circle launched in 2010 and offers loans of up to £500,000 to businesses. Funding Circle has just transitioned to a fixed rate model where lenders would receive between 3.3% AER and 7.0% AER for basic rate tax payers, and between 2.2% AER and 5.0% AER for higher rate tax payers, assuming bad debts are what Funding Circle predict, for loans between 1 and 5 years.

RateSetter also launched in 2010 and, like Zopa, offers loans to individuals. No lender on RateSetter has ever lost any money due to RateSetter's provision fund. The current typical returns on RateSetter are between 2.5% AER and 5.1% AER for basic rate tax payers, and between 1.9% AER and 3.8% AER for higher rate tax payers, for loans between 1 month and 5 years with the protection of a provision fund.

There are cashback offers for all of the big three peer-to-peer companies, and many of the smaller ones on the [P2P Money Cashback](#) site. Peer-to-peer lending does come with risks, but some of these risks can be mitigated. Here are our top tips for successful peer-to-peer lending.

Research a peer-to-peer company before lending

There are over 50 peer-to-peer companies now operating in the United Kingdom, but prospective lenders should do some research before committing funds. Useful resources include:

- <http://p2pindependentforum.com/>
- <http://www.p2pmoney.co.uk/companies.htm>
- <http://www.fsa.gov.uk/register/firmSearchForm.do>
- http://fca-consumer-credit-interim.force.com/CS_RegisterSearch-PageNew
- <http://p2pfa.info/>

New lenders should initially start out with the established companies, such as those that are members of the P2P Finance Association.

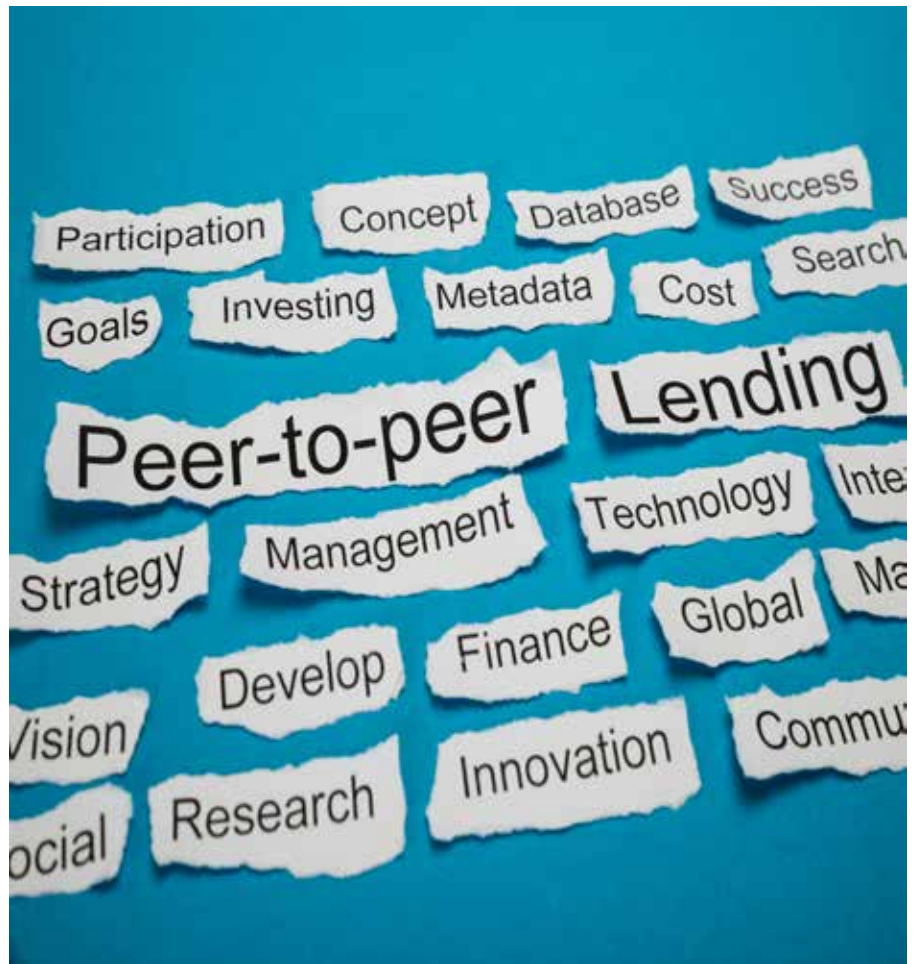
Spread funds across multiple loans

Each loan will have some risk that the borrower will not repay for whatever reason. In order to ensure that a single bad debt won't adversely affect a lender's return they need to spread their money as thinly as possible. Some platforms do this automatically, but for others it is a manual process. Ide-

ally each borrower should not be more than 0.5% of a peer-to-peer lender's entire funds.

Spread funds across multiple platforms

Although the peer-to-peer sector is now regulated by the Financial Conduct Authority, lenders are not protected by the Financial Services Compensation Scheme. As well as the risk that a borrower does not repay there is therefore a risk that the peer-to-peer platform ceases to trade. There have unfortunately been a number of platform failures to date. While the peer-to-peer company is typically not a party to the loan agreement, as they are the facilitators of the process, it may not be possible to cost effectively enforce a loan agreement without them. There are now provisions within the FCA regulations to ensure that capital is ring-fenced so that a loan book can be run down when a company ceases to trade. This additional protection has not been tested in a real platform failure yet, and lenders may find themselves with unexpected additional costs in order to wind up a loan book.



“THERE ARE OVER 50 PEER-TO-PEER COMPANIES NOW OPERATING IN THE UNITED KINGDOM, BUT PROSPECTIVE LENDERS SHOULD DO SOME RESEARCH BEFORE COMMITTING FUNDS.”

Only this month a Swedish peer-to-peer company filed for bankruptcy after reporting "suspected misconduct within the company", and with around 10% of lenders' funds unaccounted for it is unclear how they would or could recover these funds.

In summary the peer-to-peer lending sector is new and highly innovative and regulators and some laws are playing catch-up, but this should not detract from a vibrant and thriving model that has helped many tens of thousands of lenders and borrowers alike.

p2pmoney.co.uk

About Ian

Ian Gurney is a director of innovate software development company based in the South West. Ian has over 20 years commercial experience within IT. In 2011 he launched the P2P money website which covers all aspects of peer-to-peer lending and this has attracted national media coverage and is hugely influential within the sector.

About P2P money

The P2P money website was the first to provide independent news, reviews, information and comparisons of the latest loan and lending rates from each peer-to-peer and peer-to-business provider in the United Kingdom. This will allow users to make an informed choice on the best company for them. p2pmoney.co.uk is the leading cashback comparison site on peer-to-peer lending within the UK, with information, news and statistics.



<http://www.p2pmoney.co.uk/press>

Ian Gurney, founder of the P2P money website, has lent money on some of the peer-to-peer platforms in the UK. Please also refer to the [disclaimer](#).





BY VICTOR HILL

OPPORTUNITIES IN FOCUS

INDIA FACES THE FUTURE WITH CONFIDENCE

India remains a bright spot. China is slowing down as it rebalances away from export-led growth. Countries such as Russia and Brazil are facing serious economic difficulties. Growth in Latin America continues to slow sharply... We are also seeing a weakening of activity in low-income countries... At the global level, there is still a drag on the economy because financial stability is still not assured¹.

**Christine Lagarde, Managing Director, International Monetary Fund,
Washington, 01 October 2015**

Alone amongst developing economies, India is surging ahead. Indian Finance Minister Arun Jaitley recently announced that all India's macro-economic parameters, including the fiscal deficit and the rate of inflation are encouraging. Industrial production was up 6.4% in August. He predicted that India's GDP growth rate for 2015 will exceed the 7.3% achieved last year. Even as global growth slackens, India's is picking up. Having overtaken China in the

growth league, India's confidence is palpable.

This month I want to take a closer look at India, from where I have just returned, and to explain why, alone amongst the pack, there are special grounds for optimism there. The New Normal is a world in which China re-balances its economy away from property and manufacturing in order to boost living standards. But it could also be a world in which India

steps in from the cold and emerges as a major manufacturing power in its own right.

A world in which China grows at 6% and India at 8% would entail a new dynamic.

The fundamentals are sound. Interest rates are heading down. In fact, the Reserve Bank of India (RBI) has lowered its benchmark repo rate by a cumulative 125 basis points over



**“HAVING OVERTAKEN
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the last twelve months, given falling inflation and fiscal rectitude.

The 30-stock Mumbai BSE Sensex index reached its record high of just over 29,000 on 29 January this year and thereafter disappointed investors. Since mid-July, the trend has been back up. In the last week of October the Mumbai market is at around 27,500. In contrast, the Shanghai market has had a dismal year – and is still not out of the woods.

India has huge untapped economic potential which is now being unleashed by the economic policies of the government of Narendra Modi's BJP (Bharatiya Janata Party – Indian People's Party), which came to power in May 2014.

But while Indians may talk about having overtaken China in growth terms, there is still a massive difference between the two countries in terms of GDP. In 2013 China had a nominal GDP of around US\$9.181 trillion, making it the second largest economy in the world, while India weighed in at US\$1.938 trillion. That made it the world's tenth largest economy. So China is a whopping 4.7 times bigger than India in nominal GDP terms, with a similar sized population. (China has over 1.3 billion people and India 1.2 billion).

“MODI PLANS TO PRIVATISE (OR AT LEAST PART-PRIVATISE) STATE ENTERPRISES, TO LIBERALISE RIGID LABOUR LAWS AND TO DE-REGULATE.”

So what has given India a spring to its step?

Prime Minister Narendra Modi's government quickly signalled a break with the past. After independence from Britain in 1947, India paid lip service to Gandhian economics (a kind of spiritual emphasis on self-sufficiency and personal integrity) while, in prac-



tice, steering the course of state socialism. Mr Modi would never detract from Gandhi's standing – the *Mahatma* remains the revered *Father of the Nation* – but there has been a marked shift away from Gandhian ideals. Spinning wheels no longer encapsulate India's aspirations.

Modi's economic policy is to support big business (and India's bigger businesses are very big indeed), to promote Indian manufacturing, to reduce (politically motivated) state subsidies, to privatise much of India's public sector and to reduce corporation taxes. He is also determined to drag India's inadequate infrastructure into the 21st century.

Narendra Modi is the first Prime Minister to command a majority of seats in India's lower house of Parliament, the *Lok Sabha*, since 1984. His decisive victory over the socialist-leaning Congress Party, which dominated India's politics for decades, was historic. Hitherto, most of the economy was controlled by the state and economic policy was dominated by state-planning.

Significant it is then that Mr Modi has dismantled the State Planning Commission established back in 1950. No more five year plans. In future, the market will decide the pattern of investment in India.

Then Modi plans to privatise (or at least part-privatise) state enterprises, to liberalise rigid labour laws and to de-regulate. He has also unveiled an ambitious infrastructure programme, including bullet train lines (Japanese technology) to link the great commercial cities of Delhi, Mumbai, Kolkata and Chennai.

India's strategy under Modi is to become a manufacturing powerhouse: a major producer of both consumer goods and machine tools. At present, [as I mentioned in a recent MI blog article on Tata Motors](#), India manufactures around 3.8 million cars per year. Mr Modi's medium-term aim is to manufacture 10 million cars per year. *Make in India* is the new political mantra.

Back in the early 1950s India actually produced more steel than China. Now China produces about ten times as much steel as India (one reason for the global glut). Modi and company believe it is time to close the gap. There is a lot of catching up to do.

India and China set about development in radically different ways. While China set out in the 1970s to become a manufacturing powerhouse and then branched into services, the Indian economic miracle has been driven, so far, largely by service industries: call centres, software, even insurance, in which India excels. The next phase is to realise India's manufacturing potential. That will entail technology transfer from the US, Japan, Europe and elsewhere.

India, like China, has been a huge beneficiary from the global collapse in oil prices over the last year or more, which will benefit the economy by an estimated US\$50 billion this year – a good moment, then, to phase out fuel subsidies.

Let's recall also that India has a vibrant agricultural sector and is a net exporter of foodstuffs. As a wine-lover, I am excited to see so many Indian wines now available, especially from Maharashtra; but let us just say that while

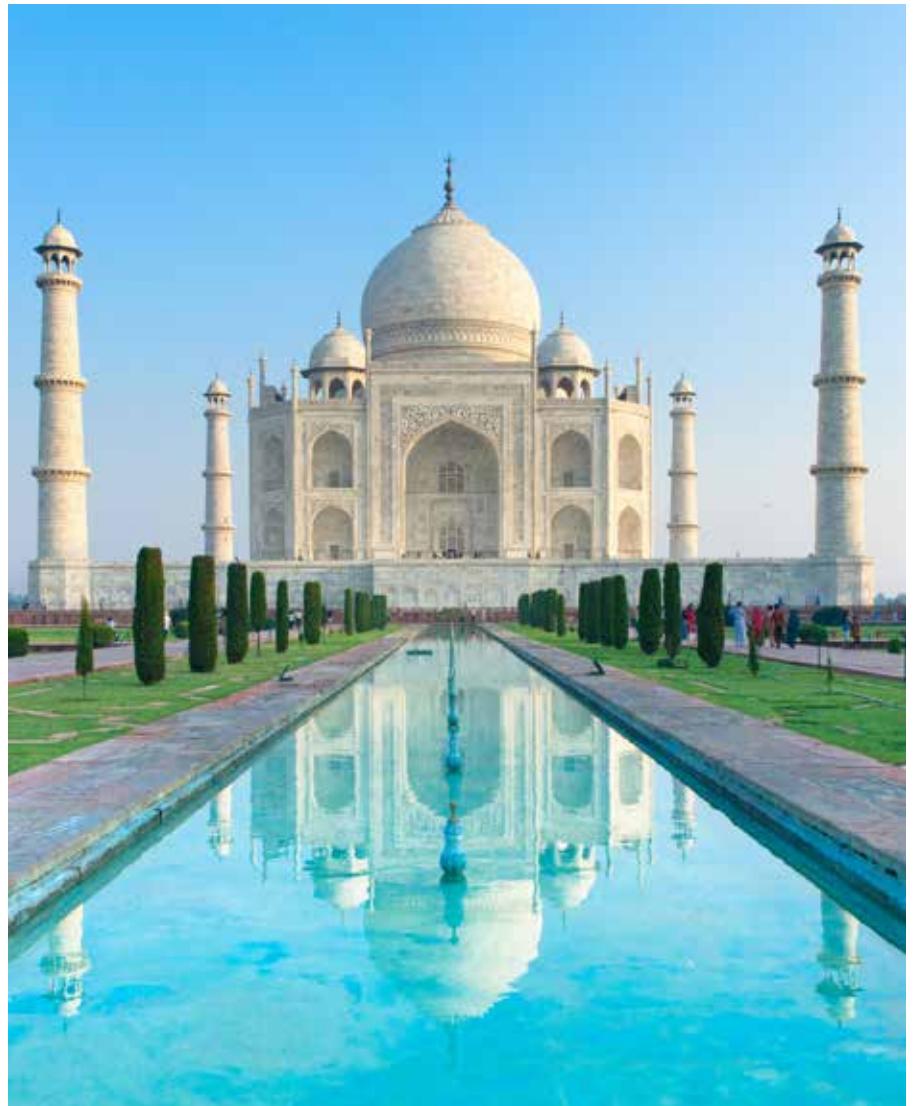
the Indian wine industry has still not reached its destination, the direction of travel is impressive.

India is a democracy with an electorate of nearly one billion people: all citizens over the age of 18 have the right to vote in elections. Governments that disappoint are booted out. Also, it functions, generally, according to the rule of law. Although, as in China, there is a tendency towards hierarchy, unlike in China, there is a high degree of transparency, and a vibrant media to hold politicians and businessmen to account.

“ALTHOUGH, AS IN CHINA, THERE IS A TENDENCY TOWARDS HIERARCHY, UNLIKE IN CHINA, THERE IS A HIGH DEGREE OF TRANSPARENCY, AND A VIBRANT MEDIA TO HOLD POLITICIANS AND BUSINESSMEN TO ACCOUNT.”

Demographics are a vital factor in India's prospects. The population, currently at 1.248 billion, is still increasing, and, with a higher birth rate than China, India is set to become the world's most populous country by 2022, just seven years from now.

Many foreign investors will tell you that investing in India is fraught with problems. One is the inconsistency of the implementation of tax regulations. Another is the stifling and ineffectual bureaucracy. Despite this, the latest World Economic Forum Global Competitiveness rankings are encouraging. India has gained 16 places this year



and is now ranked in 55th place. Brazil, in contrast, has fallen to 75th position.

With Obama's visit to India as chief guest at the Republic Day Parade on 26 January this year, there was much talk in India about a *New Alliance for the 21st Century* between the world's two largest democracies, evidenced by a *Treaty of Friendship*. Beyond the hype, a strong US-India axis is already a significant feature of the geopolitical landscape.

The major tangible outcome of Obama's visit was the agreement on nuclear technology, concluded after more than six years of talks since the initial bilateral agreement of 2008. The Indian press made much of the fact that this was an agreement to transfer US *dual use* nuclear technology to India. This covers both civil nuclear technology (electricity generation) and the provision of materials and equipment used to enrich uranium and reprocess uranium (potentially for military pur-

poses). This will give energy-deficient India the wherewithal to make current persistent power outages a thing of the past. And, medium-term, the potential to upgrade its nuclear arsenal.

The United States does not go around giving out nuclear technology to all and sundry. It already supplies military hardware to India – some of which was unveiled during the military parade on Republic Day, Obama looking on. In all but name, India and America are now military allies, the main focus of their alliance being, ultimately of course, the containment of China and the isolation, if needed, of Pakistan. If the West is the military-commercial network headed by America, then historians might conclude that 2015 was the year when India became part of *the West*.

And the US-India Investment Treaty was designed to stimulate long-term investment in infrastructure and manufacturing. The current level of US-India trade of US\$100 billion per year is



targeted to rise to US\$500 billion soon. Moreover, India and the US pledged to work together on such joint concerns as intellectual property, cyber-security, climate change (both Obama and Modi are persuaded that this is top-priority), and, of course, Islamist terrorism. Mr Modi was back in Washington in late September, his second visit – though he was partially eclipsed by the simultaneous presence there of President Xi and the Pope.

India already has a firm soft-power footprint within the US. Some of the leading US corporations are run by India-born CEOs, not least Microsoft, headed by cricket-loving Satya Nadella, who was born in Hyderabad in 1967. There are 2.8 million US citizens of Indian heritage. This cross-fertilisation, based on a shared language and a shared passion for technology, is proving significant.

India is a technology hub. Its space programme has sent a probe to Mars. Mumbai, boasting more skyscrapers under construction than any other city in Asia, is a major regional financial centre. India is building its own Indian Neutrino Observatory (INO) in a deep cave in Tamil Nadu. In September, it sent a space observatory satellite into orbit.



With possible competition from China, India now has the largest middle class in the world which is fluent in English. I have only recently understood that the

“IF THE WEST IS THE MILITARY-COMMERCIAL NETWORK HEADED BY AMERICA, THEN HISTORIANS MIGHT CONCLUDE THAT 2015 WAS THE YEAR WHEN INDIA BECAME PART OF THE WEST.”

real test of being "middle class" in India is not about income: it is the ability to speak and write good English. Indians who are fluent in English look down on those who aren't. This middle class is book-reading, internet-savvy, outward-looking and ambitious. They increasingly travel abroad: Indian newspapers are replete with travel ideas.

How best to get exposure to India's exciting equity market? There are, of course, many pooled investment vehicles as most of the major investment stables offer an Indian-themed product. Two such funds that I have been following for a while include **The India Fund (NYSE:IFN)** and the **Aberdeen Emerging Markets Infrastructure Fund (LUX:AINF2A)**, the latter being not specifically India-themed but which has maintained a large proportion of its exposure to Indian projects. These have both held up roughly in line with the Indian equity market. The India Fund did nicely last year, though not so brilliantly this year.

I'm bullish on returns on Indian infrastructure. It's endearing that, when you cross a bridge or enter a new toll highway in India, the digital information panel informs you, not just of driving conditions and the temperature, but the bridge or highway's *Internal Rate of Return (IRR)*. Most Europeans and North Americans would have trouble



getting to grips with such information; but clearly our Indian friends imbibe this solemnly.

What about naked equities of which there are about 5,750 listed on the Mumbai markets? Recently I argued the case for **Tata Motors (NYSE:TAT)**, the largest automotive company in India. Just consider the vision required for Tata to buy Jaguar Land Rover (JLR) from Ford back in 2008 – an investment which has handsomely paid off.

Going forward, I am excited by the outlook for Indian banks. **ICICI Bank (NYSE:IBN)**, has also been an Indian pioneer, flying the Indian tricolour overseas with mixed results. It is a big universal bank with branches across India and beyond. It is fair to say that its share price has been volatile over time reflecting erratic earnings data – yet when it comes right it does so big time.

But where I see most potential for gains in the Indian equity markets over the next 24 months is in India's burgeoning e-commerce sector. I'll just offer a few ideas here, though I have many more in the pipeline.

Last month, the prominent textiles-to-telecoms conglomerate **Aditya Birla Group (NSE:ABIRLANUVO)** launched an online fashion portal



“IT’S ENDEARING THAT, WHEN YOU CROSS A BRIDGE OR ENTER A NEW TOLL HIGHWAY IN INDIA, THE DIGITAL INFORMATION PANEL INFORMS YOU, NOT JUST OF DRIVING CONDITIONS AND THE TEMPERATURE, BUT THE BRIDGE OR HIGHWAY’S INTERNAL RATE OF RETURN (IRR).”

in the last funding round in May round was Tiger Global. **Flipkart's** two founders, Sachin Bansal and Binny Bansal (not brothers), both former Amazon executives, are worth over \$1 billion each. They have equal stakes of 7.5% in the company they launched as an online book retailer in 2007. The Bansal boys are India's first e-commerce entrepreneurs to make billionaire status.

And let us not ignore the food sector, even in a traditional country with a unique culinary heritage, given the rapid development of the middle class taste for daily products. I like **Nestlé India**, which, while majority owned by the Swiss food giant, is separately listed on both Indian exchanges (**BOM:500790** and **NSE:NESTLEIND**). The company's portfolio of dairy products includes all the major brands of its parent, mostly locally produced. Its beverages include the Nescafé range of instant coffees. Despite wonderful tea, Indians are acquiring a coffee habit.

Amongst its prepared dishes and ingredients, Nestlé India offers the ubiquitous MAGGI range of noodle brands with sales of some INR 25 billion last year. India-watchers will know that MAGGI noodles hit the national headlines recently when five Indian states banned the product following the alleged detection of contaminated samples. There appears to have been a uniquely Indian political element involved in all this. That said, the production bans were effectively lifted on 16 October and Nestlé India's share price rose 7%. The product range is about to be re-launched with a massive national ad campaign. An opportunity, perhaps?

Prospective investors in India should be aware that India Inc. has hit a pocket of political turbulence of late. Mr Modi's attempt to arrogate to the executive greater powers to appoint judges has been conclusively rebuffed by India's Supreme Court. And if there are mutterings that Mr Modi's BJP Government is showing more authoritarian tendencies, the liberal-inclined elite which dominates the (English-speaking) media has also begun to criticize

called **abof.com** which currently sells 55 or so brands, including those owned by the parent. Browse this site and be amazed by the stylish and exotic apparel craved by India's middle classes. This portal, according to management, is oriented more towards the "discovery-driven consumer rather than the intent-driven consumer"ⁱⁱⁱ. By which I understand it is intended to stimulate demand from impulse buyers.

There is some debate amongst Indian analysts as to whether the website's no-discount strategy is a missed opportunity, but initial fanfare appears to have generated good traffic. AB group has created a team of 200 people, mostly based in Bangalore, (reportedly partially poached from other Indian online players such as *Snapdeal*, *Myntra* and *Zomato*).

Flipkart, India's largest e-commerce company is India's answer to Amazon.com. In a society where relatively few citizens possess credit cards, and where logistics are (shall we say) problematic, an online shopping portal requires infrastructure. **Flipkart** has positioned customer kiosks across India where people can pay for their purchases (in cash) and collect the goods that they have bought online.

Flipkart is valued by Forbes at \$15.5 billionⁱⁱⁱ. The most prominent investor

Investors in **Flipkart** include Russian billionaire Yuri Milner's DST Global, South Africa's Naspers and the Qatar Investment Authority. The e-commerce platform ships eight million packages a month and has 45 million registered users. **Flipkart** delivers to over 1,000 cities and towns in India and currently has 33,000 employees.

Flipkart needs funds to stay ahead – acquiring start-ups, expanding its logistics network, upgrading its technology and recruiting more Silicon Valley-types. Its long-anticipated flotation could happen in 2016. Don't miss it – this could be sensational. Another *Alibaba*.

Back to basic industries: **Reliance Industries (RIL) (NSE:RELIANCE and BOM:500325)** owns and operates the world's biggest oil refinery at Jamnagar in Gujarat state. Its petrochemicals business extends from offshore gas recovery to US shale gas fields. Reliance Retail, a subsidiary, is one of India's leading downstream networks. On 16 October **RIL** reported like-for-like sales growth of 16% *over the previous quarter*, although year-on-year sales have declined with the crude oil price. Net profits rose by 14.3%^{iv}. Gross refining margins (GRM) for the quarter reached \$10.60 per barrel against \$8.30 in the same quarter last year.





Mr Modi for creating a climate in which religious intolerance, and even extremism, are flourishing.

During October, nearly forty eminent poets and writers returned their awards from India's most prestigious academy, the *Sahitya Akademi*, in a co-ordinated protest against the Government's supposed failure to protect freedom of expression. The catalyst was the assassination of MM Kalburgi, a prominent Hindu theologian, academic and winner of a Sahitya Akademi award, on 30 August. Mr Kalburgi, famous for controversial religious ideas, was presumably shot dead by Hindu fundamentalists. Such people have also been involved in a number of high-profile incidences of lynching perpetrated on victims who have allegedly been involved in the consumption of beef – still a strict taboo in orthodox Hinduism.

The Government has responded ungraciously to the writers' protest. Finance Minister Arun Jaitley called it "manufactured" and stated that the true reason for writers' displeasure was the "shrinking fortunes" of the Congress Party, which he claims they all still support. Sonia Ghandi, Congress's President, says that India has departed from its democratic traditions.

Mr Modi's refusal to condemn these events is puzzling. Remember that Mr Modi is an outsider, a non-dynast in a country where political dynasties have hitherto held sway (most notably the Nehru-Ghandi dynasty). Unlike his predecessors, he owes no ideological allegiance to either Gandhian economics or state socialism, and has set himself

against what BJP supporters see as the liberal establishment.

Elections currently underway in the populous Eastern state of Bihar seem to be going against Mr Modi, in favour of Nitish Kumar's Janata Dal. Indian politics is never dull.

“PROSPECTIVE INVESTORS IN INDIA SHOULD BE AWARE THAT INDIA INC. HAS HIT A POCKET OF POLITICAL TURBULENCE OF LATE.”

Yet, despite India's edgy religious politics, one has to give credit where it is due. Both India and Pakistan (including what is now Bangladesh) gained independence from Britain at midnight on 15 August 1947. Yet, while India has remained a constitutional democracy ever since (if flawed) and has conducted its affairs according to the rule

of law, Pakistan has lurched from one military government to another. India has celebrated pluralism throughout.

Overall, and despite the gross inequality and sporadic injustices of Indian society, Indian political institutions work. Britain's legacy, while still controversial, was evidently not entirely negative.

Sometimes India, for all its exoticism, conjures up a lost England. India has more English-speakers than the United States. I agree that *Hinglish* can sometimes be difficult to understand; but then, as an Indian writer said (Arundhati Roy?), *nobody owns the English language*. Commuters on the Delhi metro read historical novels by Indian authors like Amish Tripathi – in English.

It is a land where smartly dressed men watch cricket while drinking tea; where pedigree horses and dogs are prized; where *manners maketh man*.

One of India's greatest gifts to the British has been its cuisine, which we adore – because it is the best in the world. India is an active member of the Commonwealth (our royal family is surprisingly popular) and a major investor in the UK. Tetley Tea is owned by the Consumer Products division of the Tata Group. How British is that?

There are 1.45 million British citizens of Indian heritage here, according to the UK 2011 census, as against about 247,000 British citizens of Chinese heritage. Strange then, that Messrs Cameron and Osborne have chosen to become Best Friends with the People's Republic of China. The Chinese might have more cash to spare (for now) but we shall never share the natural cultural affinity with China that we already enjoy with our Indian friends.

And, extrapolating forwards, India will be as rich as China is now in just 20 years.

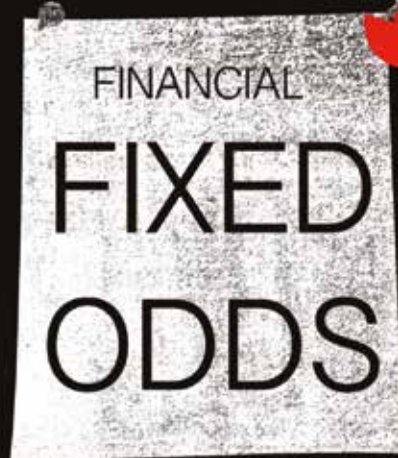
- i Reported in *The Statesman*, India, 02/10/2015
- ii *The Economic Times*, Mumbai, Saturday, 17/10/2015, page 4
- iii <http://www.forbes.com/sites/saritharai/2015/05/18/indiaslargest-e-commerce-firm-flipkart-valued-at-15-5b-its-sachin-binny-bansal-billionaires>
- iv *The Economic Times*, Mumbai, Saturday 17/10/2015, C4

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BY SAMUEL RAE

CURRENCY CORNER

A ROCKY FEW QUARTERS LOOK SET TO CARRY US INTO 2016

So we recently learnt that the People's Bank of China (PBOC) was cutting its base rate to 4.35% and its reserve requirement ration (RRR) to 17.5%, from 4.6% and 18% respectively. The cuts come against a backdrop of widespread speculation that the Chinese economy is slowing, and likely to be the catalyst behind a global economic downturn. The impact of the cuts remains unclear, but one thing is for sure: it looks to have confirmed the overarching sentiment that there are some volatile times ahead.

If China slows down, and cuts back on foreign direct investment, it will have wide ranging implications for both the US and Europe – two economies that are themselves struggling to maintain any level of expansion, and in which the respective central banks have very few tools available to counter any contraction. So, with that in mind, what are the implications for the forex markets, and how can we adapt our approach to incorporate the inevitable volatility?

Those familiar with my strategy will be aware of my approach, but as a quick recap, I look to enter according to classical candlestick formations, in the direction of a predefined fundamental bias. I trade only major pairs, as this allows me to focus my fundamental

bias accordingly. That out of the way, how am I going to play the China situation? Well, the currency most tightly associated with China is the Australian Dollar, at least as far as correlation is concerned. China has high levels of FDI in Australia (the Australian commercial and rental property boom seen over the last decade or so was largely driven by Chinese capital) and much of Australia's mining industry is financed by Chinese capital (iron ore, copper, gold). When China slows or contracts, therefore, the Australian economy takes a hit.

“IF CHINA SLOWS DOWN, AND CUTS BACK ON FOREIGN DIRECT INVESTMENT, IT WILL HAVE WIDE RANGING IMPLICATIONS FOR BOTH THE US AND EUROPE.”

So a weakening Australian economy gives me a bearish AUD bias. Why? Because in the face of a slowing economy, the RBA will generally cut the AUD base rate in an attempt to stimulate borrowing and, in turn, spending. Interest rates are the primary near term determinant of a currency's value – if an interest rate is higher then an investor earns more for holding the currency in question overnight, and so a higher rate will lead to buying activity. Ergo sum, anything that implies an interest rate hike translates to a bullish fundamental bias and, conversely, anything that implies a cut translates to a bearish bias.

I suspect the RBA will cut rates before the end of the year (there are many proponents of the opposite argument, so make up your own mind on this one!) and if they do, we will see some immediate Aussie weakness. My bias in the AUD/USD, therefore, is to the downside.

A look at the chart shows a recent swing high just shy of 0.74, and I expect this level to hold firm as resistance over the coming weeks. If we get a nice candlestick formation – I'll be looking in particular for a bearish pin bar rejected from resistance – it will put me short towards a downside target of September lows around 0.69.



Looking elsewhere, I'm also bearish on the EUR/USD. The US Fed has put itself into a situation whereby it has very little control over the US economy, but the dollar will likely remain strong over the coming quarters purely from a safe haven perspective. Talk of an expansion of the QE programme in Europe, compounded by the latest data misses

“THE US FED HAS PUT ITSELF INTO A SITUATION WHEREBY IT HAS VERY LITTLE CONTROL OVER THE US ECONOMY, BUT THE DOLLAR WILL LIKELY REMAIN STRONG OVER THE COMING QUARTERS PURELY FROM A SAFE HAVEN PERSPECTIVE.”



out of Germany, suggests we are far from seeing any sort of interest rate hike from the ECB in the near term.

Just as with the US Fed, the ECB has run out of policy tools to counter an economic downturn, and it looks like Germany, traditionally the economy that has helped the Eurozone stay afloat, is no longer in a position to do so. This is also a byproduct of the situation in China – Germany exports a huge amount of vehicles, engineering components and technical services to China. Its rate of dependence on exports to China has increased exponentially over the past decade, and while this has helped Germany to maintain expansion throughout that period, it has also served to increase the nation's exposure to what

now looks like an inevitable downturn in China.

Looking at things from a technical perspective, the Euro has tanked of late versus its US counterpart, and it is looking more and more like we are going to hit parity. If further data misses come out of Germany, and ECB President Mario Draghi maintains what looks to be an increasingly bearish stance on policy, then this likelihood increases exponentially.

To summarise, Euro down, Aussie down, US dollar up – purely through association and its (increasingly fragile) status as a safe haven asset. It's going to be a rocky few quarters!





BY RICHARD GILL

SMALL-CAP CORNER

THE TOP DOGS IN ANIMAL HEALTHCARE

As discussed elsewhere in this issue, developments in human healthcare are set to transform the way we live. Alongside this, advancements in technology have also boosted the health prospects of a number of other species – especially those that we share our homes with and those which we eat! And where there is growth there are investment opportunities.

The world population is getting larger, older and acquiring a taste for meat.

According to the United Nations' mid-case forecasts, the world will have 9 billion people by 2040. That's a lot of additional mouths to feed. In addition, we will need to be fed for longer – the UN expects a life expectancy at birth of around 73 years by 2040, up from the current figure of 68. Combined with the effect of places such as China and Brazil adopting more "Westernised" diets, more and more meat is going to have to be produced. But this isn't simply a case of making more cows, chickens and pigs – yields and quality are going to have to improve too. Herein lie ex-

cellent opportunities for animal genetics, medicines and feed additive businesses.

On the other side of the animal health market is companion care. While the pessimists wouldn't believe it, we are all getting richer and global growth is continuing to be seen. A rising economy is beneficial for pet ownership – as incomes rise pets become more affordable, and Rover might be more likely to be treated to something from the dazzling range of pet accessories which are available. The demographic trends mentioned above are also a driver of companion care – as we get older and live for longer a pet makes a good substitute for human

companionship. So on this side of the market veterinary surgeries and medical suppliers look set to benefit.

London "leads" the way

The London market hosts a number of quality companies which operate in animal healthcare, many of which have delivered excellent returns for shareholders over the years. But at present pretty much all of them trade on relatively high earnings multiples and only offer small dividend yields.

Industry stalwart and private investor favourite **Genus (GNS)** looks to have its best times behind it. Shares in the animal genetics and bull se-

**“A RISING ECONOMY
IS BENEFICIAL FOR PET
OWNERSHIP – AS INCOMES
RISE PETS BECOME MORE
AFFORDABLE.”**



men business have risen by around 700% in its 15 years on the market. But now a mature, FTSE 250 listed business with profit warnings behind it, the shares look expensive on a multiple of 25 times earnings and offer a yield of only 1.4%.

The general market consensus is similar for mid-cap peer **Dechra Pharmaceuticals (DPH)**. The specialist veterinary pharmaceuticals business has also seen share price growth of around 700% over 15 years. But trading on an earnings multiple of 22 times and yielding just 1.9% the shares look fully valued.

With a vets business and selling a range of animal health products, **Pets at Home (PETS)** is another FTSE 250 business with exposure to the sector. But having announced a disappointing trading update at the end of October and still having a high rating despite balance sheet concerns, the shares look best avoided for now.

To the small caps and highly acquisitive vets business **CVS Group (CVSG)** and pharmaceutical products company **Eco Animal Health (EAH)** are performing well but look to have slightly stretched valuations. My two favourite picks with the small cap animal health sector are as follows:

ANIMALCARE

The Business

Originally listed on the OFEX markets as a supplier of cattle ear tags, **Animalcare (ANCR)** has grown over the years into a specialist supplier of generic veterinary medicines and animal identification products. Based in York, the company targets a UK pet medicines market which, according to the National Office of Animal Health, is worth £332 million a year. While the UK is the company's main area of focus it also earns around 8% of its annual revenues from the EU.

Animalcare operates across three divisions:

Licensed Veterinary Medicines – provides a range of branded and mainly generic, licensed pharmaceuticals to veterinary professionals in the UK and

in Northern Europe. The range contains four categories: antibacterials, anaesthetics & analgesics, Aquapharm intravenous fluids and vitamins & speciality pharmaceuticals.

“THE COMPANY TARGETS A UK PET MEDICINES MARKET WHICH, ACCORDING TO THE NATIONAL OFFICE OF ANIMAL HEALTH, IS WORTH £332 MILLION A YEAR.”

Companion Animal Identification – provides identification technology for UK pets under the Identichip microchip identification system and operates the Anibase database, which manages the data of 5 million microchipped pets and their owners. This makes the company the market leader in electronic identification for pets in the UK.

Animal Welfare Products – a range of support products used by veterinary



professionals in the diagnosis and care of their patients, for example intravenous infusion accessories, ophthalmic instruments, hygiene equipment, bandages and dressings.

Financials

Results for the year to June showed another good set of numbers, with revenues up by 5.1% to £13.5 million. Pre-tax profits grew by a more pronounced 12.6% to £3.01 million as margins improved. The real stand out part of the financials, however, was the cash flow performance. Helped by an improved working capital position (mainly reduced stock levels), cash generated from operations was very strong at £4.52 million – representing cash conversion of 150%. Animalcare ended the period with net cash of £5.8 million, had no debt and hiked the total

dividend for the year by 10.9% to 6.1p per share.



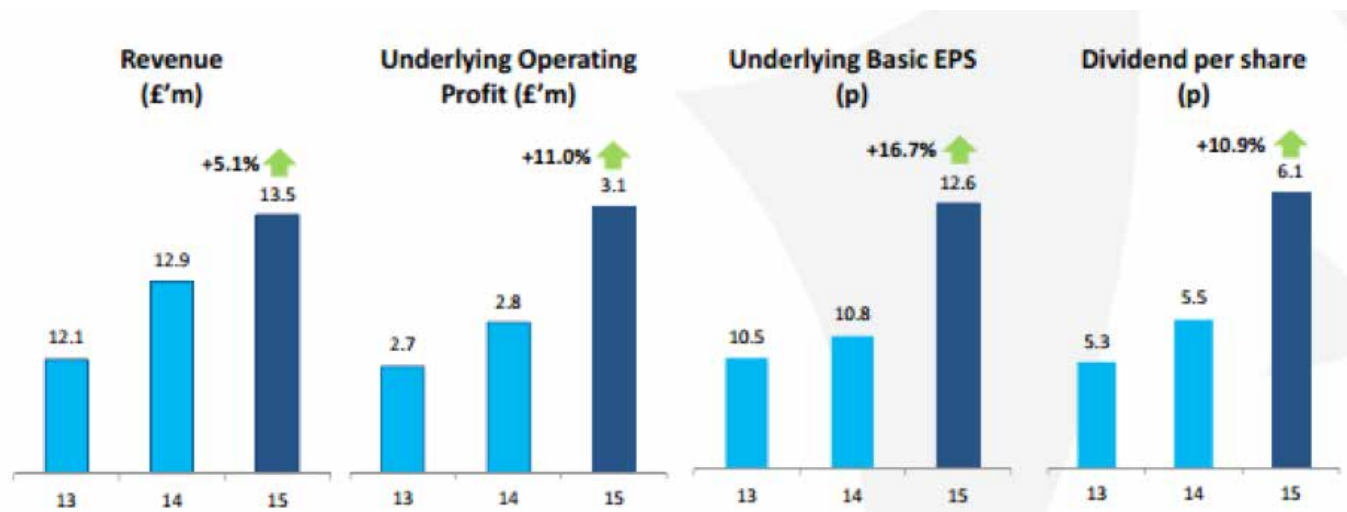
Animalcare business model: Source – company website

The best performance came from the core Licensed Veterinary Medicines division where revenues grew by 8.8% to £8.6 million. Animalcare benefited from a competitor to its Buprenex pain relief product being absent from the market for several months, boosting non-recurring sales by an estimated £0.2 million. There were also a number of new product launches, including Pet Remedy, a drug used to calm pets of all species, and four new products were launched in the second half focused on the companion animal market, sales of which are said to be progressing well.

Not doing quite so well but putting in a steady performance nonetheless was Companion Animal Identification. While sales volumes of the identichip microchips grew by 1.7%, overall divisional revenues fell by 4.5% to £2.3 million after a large equine export order in the previous period skewed the numbers. Finally, revenues in Animal Welfare Products grew by 2.6% to £2.65 million, driven by the infusion accessories range.

Opportunities & Risks

A few pieces of data in Animalcare's recent results caused some concern. For example, according to the Pet



Source: Animalcare PLC

Food Manufacturers' Association, UK dog numbers fell by 4.7% to 8.5 million and cat numbers by 6.8% to 7.4 million. This was put down to charity campaigns focused on responsible pet ownership. Nevertheless, Animalcare doesn't seem to have been negatively affected, citing the clinical nature of its products and demographic of its end customers as a defensive quality. In addition, the National Office of Animal Health estimated that companion animal medicines revenues only grew by 1.1% in the year to March 2015. Again Animalcare outperformed, with its own pharmaceutical products growing ahead of the UK market.



Key to the growth of any business is the launch of new products, and Animalcare has been notably active in this area recently. From 2013 to 2015 product development spending increased from £0.1 million to £0.8 million and the company believes that there is significant revenue potential from its pipeline projects. During the last financial year four new and four existing product development projects reached the "Regulatory" pipeline stage, with three being submitted to the authorities for assessment. One has already

been approved and will be launched in the UK in the second half of this year. The other two are said to be progressing successfully through regulatory assessment.

Regarding the overseas market, the company is looking to expand and to that end recently appointed a Head of Export Development.

**“SINCE 2008
THE FIRM HAS
RETURNED £5.5
MILLION OR 26.6P
PER SHARE IN
DIVIDENDS TO
SHAREHOLDERS.”**

Valuation

Shares in Animalcare have performed very well since the company listed on AIM in January 2008, rising from a listing price of 55p to the current 240p. They rose by 18% in October this year alone. That's a superb compound annual growth rate of around 21%.

The house broker's current target price is 245p, which implies only 2% upside from the current price of 240p. On forecasts for 11.7p of earnings in the current financial year the shares trade on a multiple of 20.5 times. The expected yield of 2.54% is reasonable and amongst the highest in the sector.

I believe that the company's rating is deserved given the decent growth being posted, debt free balance sheet, strong cash flow and solid net cash position. Also, since 2008 the firm has returned £5.5 million or 26.6p per share in dividends to shareholders.

Overall, Animalcare is a quality company with strong cash resources to take advantage of growth opportunities, and thus looks like a good long-term buy and hold.

ANPARIO

Similar in many respects to Animalcare, but with a stronger overseas focus, is Anpario. Again like Animalcare, the company has its origins in an OFEX markets listed entity (Kiotech) but has advanced significantly over the years via both acquisitions and organic growth.

As it stands today Anpario is an international producer and distributor of natural feed additives in the areas of animal health, hygiene and nutrition. Key brands include Kiotechagil – high performance natural feed additives for the aquaculture and agriculture markets, Meriden – which supplies the flagship Orego-Stim additive, and Optivite – feed additives that enable the greater absorption of nutrients to optimise animal performance. Organic animal feed business Vitriton was sold in March this year for a net £0.75 million so the firm could focus on the specialty feed additive portfolio.

Put simply, Anpario's feed additives help farmers to improve the health



“ANPARIO IS AN INTERNATIONAL PRODUCER AND DISTRIBUTOR OF NATURAL FEED ADDITIVES IN THE AREAS OF ANIMAL HEALTH, HYGIENE AND NUTRITION.”



of their animals and thus to achieve higher yields. To give a case study, the Orego-Stim additive has been shown in trials to increase average egg production in chickens from 68% to 80% over a one-month period.



Anpario's product range is developed and manufactured at its facility in Worksop, Nottinghamshire, and then shipped to customers both in the UK and internationally. International markets made up 83% of revenues in the first half of the current financial year. While the firm mainly uses local distributors overseas, it has subsidiaries in China, Brazil and the US, three markets which account for approximately half of the global market for its products.

Financials

Anpario has a strong track record of growth, with earnings having grown by 114% during 2010-2014 and the dividend being increased by 125%. Results for the six months to June were a little more subdued, however, showing revenues down by 4% as the firm sold its organic animal feed business to focus on selling its specialist additives. The strategy seemed to work, however, with gross margins increasing strongly from 39.1% to 44.7%. A 10% rise in admin expenses, offset by a lower tax charge, saw net profits from continuing operations rise by 13% to £1.46 million.

The cash performance wasn't quite so strong, however, as a £1.62 million fall in trade payables (the firm paying its bills faster) affected the numbers. The net operating inflow was £1.07 million,

down by 20%, but helping the large cash pile to continue to grow. Net cash at the period end was £7.9 million and the company remained debt free.

Operationally, the International business saw revenues fall by 7% to £9.8 million but operating profits only fell by 5% to £1.51 million. Strong growth of 11% and 17% was seen in Asia Pacific and Latin America respectively and China continued to stand out with 31% growth. However, political issues held back progress in the Middle East, Africa and Russia. In the UK and Eire revenues grew by 17% to £1.85 million and the focus on higher margin products saw operating profits rise threefold to £0.4 million. On the outlook the firm said that the second half had started well and it was confident of maintaining momentum seen in the first half.



Orego-Stim

Bacon bonanza

Perhaps the main driver of growth for Anpario's products is the increasing demand for meat and fish in developing

countries. As countries get richer they tend to adopt more "Westernised" diets, which contain a lot of meats such as beef, pork and chicken. For example, having around 50% of the market, China is the world's largest producer of pork. But this is not enough to feed demand, with Chinese pork imports estimated by the USDA Foreign Agricultural Service to have risen by an average of 150% *per year* between 2007-2014. Overall, consumption has risen fivefold since 1980. An outbreak of blue ear pig disease caused production to fall by around 8% in 2006/07, demonstrating the importance of having healthy and disease free animals.

Valuation

While Anpario shares had a bad few years after the company joined AIM in June 2005, since the start of 2009 they have increased 13-fold. The current price of 332.5p is just off the all time high of 362.5p. That puts the shares on a multiple of 21 times forecasts for the current year and 18 times 2016 forecasts. The yield on offer for 2015 is 1.65%.

Again, these figures rate the company highly, and deservedly so. But long-term upside potential remains. Market drivers are strong and the company's cash position places it well to make an earnings enhancing acquisition – something which it has a good track record of doing. I would also argue that with the share price where it is the company might be brave enough to be looking at a larger deal, part financed by its paper.

On balance, at the current share price Anpario looks like one for a long-term buy and hold portfolio.

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BY JOHN CORNFORD

HOW TO VALUE JUNIOR MINING STOCKS (PART 3)

COAL MINERS GROPPING FOR THE LIGHT SWITCH

“IN TANZANIA BOTH THE CHINESE (SINOSEC) AND THE UNITED STATES (USAID) ARE VYING TO FINANCE ITS DESPERATE NEED FOR POWER WHILE THE CHINESE ARE OFFERING TO BUILD ALL FOUR STATIONS.”



Coal miners today are not particularly attractive to investors. Falling prices and the long-term threat to coal use from global warming policies mean that only very niche opportunities will be of interest.

One such, which is beginning to attract attention now, and which also involves a difficult exercise in valuation, is an ideal example to continue John Cornford's series. With limited space here, extra features will be posted on our website.



If you've come across a coal deposit in a vast developing country, miles from any rail line to where customers might buy your coal, and when international coal prices have collapsed, what better way to capitalise on your find than a mine-mouth power station to feed what is usually a drastic country power shortage? Selling your product via transmission lines will be far less costly than using or building a rail line.

In such a position, after a long period of development spending and now hopefully closing in on funding, are four UK companies: **Ncondezi Energy (NCCL)** (formerly Ncondezi Coal), which is negotiating since 2013 to build a 300MW station at Tete in Mozambique, and seemingly stumbling; **Oracle Coal-fields (ORCP)**, which seems close to securing Chinese funding for its 600MW station on its vast coal field in Pakistan; and two companies, **Edenville Energy (EDL)** and **Kibo Mining (KIBO)**, negotiating to build their respective 120MW and 300MW stations at the north and south ends of the Rukwa coal field in the west of Tanzania, 300 miles north of NCCL's Mozambique project. In Tanzania both the Chinese (Sinosec) and the United States (USAID) are vying to finance its desperate need for power while the Chinese are offering to build all four stations.

But they can need up to \$1.5bn, and our companies are market minnows in the £10-£20m range. Their projects' NPVs (\$100m-\$300m) are much greater than their market caps because the extent to which funding will affect value flowing through to present day shareholders is very difficult to estimate. What economics have been published lack the detail needed for

outsiders to perform the calculations accurately and broker notes are necessarily vague.

“JUDGING BY THE BULLETIN BOARDS, SOME EVEN EXPECT THAT ALL THE VALUE WILL FLOW THROUGH TO THEM, FORGETTING THE BIG CHUNK THAT FINANCE PROVIDERS WILL WANT TO CAPTURE. EVEN THE HOUSE BROKER FOR ONE HAS BEEN PEDDLING THAT FALLACY.”

However, although commissioning and income for all four is at least three years away (even if financed tomorrow), as more detail is released investors are likely to develop more interest – in fact they already are. But the problem is that muscular funding partners are required who will expect a big chunk of any value from the electricity sold. With the possible exception of Oracle Coal, all started life as small explorers or mere coal miners, and seem not to have shareholders informed enough to work out the financing implications of complex projects. Judging by the bulletin boards, some even expect that all the value will flow through

to them, forgetting the big chunk that finance providers will want to capture. Even the house broker for one has been peddling that fallacy.

One BB poster, however, has likened such projects to a dinghy with a line secured to a drifting supertanker for which it is claiming millions in salvage money. It might be so. But it might also be that wind, waves, and serendipity could capsize the mighty tanker and crush the tiny dinghy.

To work out what large or small share of the 'salvage money' shareholders might expect is what we bend our mind to. It should be an ideal exercise in the interplay between NPVs, IRRs, capex, and market cap. But we do not have an inside track to the funding terms that might be under negotiation for any of the four (especially as the Chinese are involved, and because banks keep such deals under wraps). Rather, we assess what a moderately informed investor should consider before investing.

As should now be clear, the 'intrinsic value' of such projects is not primarily what counts for their present shareholders. Instead of trumpet a project's economics (its NPV and IRR) and its sensitivities to discount rates, costs and commodity prices etc., what a company should really do is highlight the sensitivities of its shareholders' interests to the necessary funding – i.e. the effect on value per share of different equity dilution and debt splits and loan or streaming terms. But none do, and only some analysts do.

So, whether a project has a tremendous NPV, or a dizzying IRR, is of concern mainly to the fund providers. The equity shareholders will take the rump of any value, for which a useful illustration is to think of the long-term value generation (the NPV plus the capex) 'at the project level' once it has been financed, as having to be sliced and diced among the loan providers and new shareholders. It is this fact – that a project's economics is not the same as the economics from the point of view of the investor – that can baffle the investor and has apparently baffled one of our four companies' brokers, who touts a 'target price' for its shares 'made up' (the right term) of the 'project NPV' divided by the present number of shares in issue – as if

the company's present market cap will meet project capex that is nearly twenty times larger. Such thinking conflates the two different concepts.

Complicating the calculations is that while all four projects comprise a coal mine and a power station, NCCL and ORCP have indicated that mine and station will be lumped together in one integrated project, while EDL and KIBO do not yet seem to have decided.

That is important because, while power stations tend to be off-the-shelf designs, and government electricity authorities tend to limit their profitability to an IRR of around 20%, the coal mines are likely to vary in profitability. Obviously for an 'integrated' power project, it makes no sense to assess the profitability of the coal mine alone, but Kibo has just published a definitive feasibility study for its Mbeya (formerly Rukwa) coal mine showing an exceptional 54% IRR. Unfortunately it is not clear whether its assumed coal price (\$32/tonne) would be acceptable to the power station (for which sufficient economic data won't be available before end 2015).

Given that Kibo says "an integrated project would be financed as one", and that it has other mining projects, we don't therefore know whether it will present investors with an integrated coal-to-power project (costing some £450m) or whether it will come up with just the more profitable and considerably less expensive (only £25m) coal mine.

We try to assess the potential value to present shareholders of each option later in this piece, and the implications for the other projects later. For all, the medium-term value will be the price at which the projects can be sold to the new equity investors who are going to have to put up the usual 25-30% of the respective capex. (Although other financing options like securitisation of the delivered electricity are possible, they shouldn't greatly affect the principles here.)

We do this via spreadsheet models which test the number of shares necessary at whatever price to raise the equity component (added to shares already in existence) and the resulting earnings or cash flow per share (allow-

"THE SITUATION DOES NOT LOOK ALLURING FOR THOSE SMALL EXPLORERS WITHOUT MUCH IN THE WAY OF CASH AND LIMITED DIVERSIFICATION OF ASSETS. THEY NOW SEEM TO BE HISTORY, AS THEY SAY."



ing for loan repayments and interest). Then we assess the acceptability to the new major investors of the resulting return on their investment (which the sparse literature indicates should be in the 20-25% IRROE range for projects in developing countries). It is what the financial engineers at the banks will be doing, although they will have far more accurate 'inputs' than we have. Unfortunately, such is the sensitivity of the models to small variations in those 'inputs', our answers can only be very rough estimations, although we believe we are in the right ball-park.

Unknown factors that affect the result include, for example, the lending terms for such projects. Kibo assumes 10-15 years at LIBOR + 5%, which looks low compared with the literature. And of course all are subject to many risks including deliverability and politics.

The longest running and largest is Oracle Coalfield's Thar project in Pakistan, which has just announced a shareholder agreement with China's Shanghai Electric Power Company (SEPCO), the world's major builder and operator of coal power stations (over 700 in the last 50 years), who is also collaborating with Kibo, EDL, and Ncondezi. After nine years development, it expects to reach financial close in the very near

future (which is why the shares are strong) at which point all agreements and funding will have to be in place, with first power expected in 2019.

The agreement is for SEPCO to own an initial 10% and ORCP an initial 90% (before the other funders come in) of the special purpose vehicle set up to raise the \$1.6bn needed and whose terms for both debt and equity (or other forms of funding or securitisation which the Chinese have indicated they will provide) will be our only guide to terms on the other projects.

House broker Brandon Hill hopes ORCP's £300m required equity can be raised at 10p per share (vs a current 2.4p) which it says will deliver an NPV (adjusted to our standard 8% discount rate) per the resulting 4bn shares in issue of over 40p. But as will be explained, this simple calculation is before deducting the cost of finance – often more than 50% of a project's value. Similarly, that 40p is before checking whether the resulting earnings return for the investors putting up the bulk of the cash at 10p meets the 20-25% Return on Equity Invested that appears to be the norm – and which will have to take into account the near four-year 'dead' period before the first returns materialise. As will be seen, that 40p



per share theoretical NPV is not therefore any guide to the share price that can be expected in the run up to production, which usually turns out to be less than a third of that level.

Even so, these figures indicate a substantial profit on their shares for current holders in the run up to a financing and it is interesting that Oracle's figures result from the 20% IRR 'at the project level' that is all that the Pakistan government will allow. As seen, Kibo expects a 54% IRR for its mine alone (although this might have little bearing for an integrated project, where the economics will be determined by the eventual electricity tariff).

The project that had been expected to arrive next is Ncondezi Energy's Tete 300MW station in Mozambique, where it has a coal resource (intended to supply India until coal prices fell drastically) much bigger than Kibo's or EDL's.

The project, which on paper looks as good as the others, is however already a year late despite apparently having many of the required agreements in place, including with the Mozambique government and with customer Electricidade de Mozambique – and despite NCCL as the project owner having in December 2014 secured African Finance Corporation as a key investor.

“SO IT SEEMS MOST LIKELY THAT KIBO WILL CONCENTRATE ON WHATEVER SHARE OF MCPP IT (AND ITS SHAREHOLDERS) CAN AFFORD TO HANG ON TO.”

Since then, NCCL has announced that it is seeking a strategic partner to help fund and manage the project, so it seems that its other partners and potential customers may be concerned that it will run out of cash before finalising the deal. There is a dearth of news to explain the delays, so the shares

have sunk to a very low 1.6p where the company is valued at only £4m, against a reported NPV (no discount rate given) of over \$200m (in line with the other similar projects.). Reflecting the failure of its original Indian coal supply strategy, the firm's current value is only 1% of its flotation value in 2010.

That only goes to show the disconnect between a yet to be constructed 'project', and its 'owner' who can easily go bust at a value only a fraction of its alleged value. The corollary is that if Ncondezi's owner can secure the funds or partner it needs, its shares could be one of the more attractive recovery plays.

Next and the smallest, but a project that looks to be one of the more attractive (because it is of a more easily handled size) is Edenville Energy's coal mine and proposed 160MW station at the northern end of the same Rukwa Tanzanian coal field as Kibo's 300MW station. Key to both Kibo's and EDL's timetables is obviously Tanzania's plan for the desperately needed expansion of its electricity infrastructure, and so far there is little information as to which of EDL's or Kibo's two different sized projects could fit in first with any new power grid.

Evaluating Kibo

Kibo is the more difficult investment story because in addition to its Mbeya Coal to Power project (MCP) it also has mining exploration projects – all much too early stage to have any value now, although a 720K oz gold (mostly inferred) resource near other large players in the Lake Victoria goldfields might be saleable. If, as one possibility, Kibo elects to sell an interest in the MCP to finance its exploration, investors would be aware that such spending attracts little recognition currently, and so it seems most likely that Kibo will concentrate on whatever share of MCP it (and its shareholders) can afford to hang on to.

We have run two models for Kibo, one for only its mine based on the recently updated Definitive Feasibility Study, and the other on the much less detailed Preliminary Economic Analysis for integrated coal-to-power, where a full update is promised for later this year.



Adding the two together doesn't work for a share valuation, because either Kibo subsumes its mine into the larger integrated project where the power tariff will determine the economics (and to reflect its spending to develop the mine it will be credited with an initial \$20m share of the SPV to raise the c.£450m needed); or it stays with the mine alone, relying on the power station as a customer and whatever price it will pay for the coal. It can't opt for both, although it might opt for partial shares of each.

For Kibo's mine alone, we have taken its figures (the necessary details to make them add up are confidential and there are gaps in those announced) to construct a very approximate financial model. Then we have tested a range of prices at which the required £10m equity (adding some for plc costs) might be raised and the resulting earnings and (assumed) dividend per share.

It may be surprising that these show a feasible issue price of no more than 10p, even though the 'project' NPV per share (at the 8% discount rate to which we have converted all the figures) is around 34p for the same resulting shares in issue (and despite that the PER once up and running would be only around 4 times). That is because the institutions, to support such a raise, and for protection against operational problems, expect a very high return – the literature suggests well over 20% IRR – on their equity investment. On our assumptions and figures, at a 10p raise their IRR would be less than 20%. The same factor, including the four year 'dead' period before they see any return at all, is why the forward PER has to be so low.



“WHETHER THE MCPP WOULD BE A BETTER DEAL FOR KIBO’S CURRENT SHAREHOLDERS THAN THE SMALLER, MORE PROFITABLE MINE ALONE IS NOT IMMEDIATELY OBVIOUS, BUT WILL DEPEND ON THE BALANCE OF THE FINANCING TERMS.”

We stress that these figures are sensitive to details not yet disclosed (and early stage feasibility studies are only 25-30% accurate in any case), so merely give an indication and don't mean that Kibo's share won't rise further once a mine-only project is fully up and running. But that is more than four years into the future, while we estimate that 10p is the maximum institutions would pay in a near-term capital raise. On the other hand, given that the equity component of capex for the mine alone is quite small, it is conceivable that private investors with lower expectations would come in with a full capital raise, which would enable a higher share price – a scenario we have not examined.

So much for the mine alone. For the integrated MCPP project, available in-

formation, especially the timings assumed, is even less complete.

But Kibo has reported a project IRR of over 23% on capex of around £450m – slightly higher than the other three projects, possibly reflecting the higher return in the smaller mine component. However, as explained, because Kibo will have to subsume its mine into the larger integrated project, that must mean that the power component itself is of much lower profitability, although its NPV might be larger.

Net annual cash flow for the integrated MCPP for instance is 5.6 times that for the mine alone, but the required capex is about 19 times larger. So whether the MCPP would be a better deal for Kibo's current shareholders than the smaller, more profitable mine alone is not immediately obvious, but will depend on the balance of the financing terms.

Adjusting Kibo's estimated mid-NPV₁₅ of \$255m to our standard 8% discount rate in sterling gives £837m, and, once the capex has been made (but before considering the financing effects) the 'Gross' PV (the future cash flow to be apportioned between the equity and loan providers) at an 8% discount rate becomes £1,287m.

Running our tests shows that in order for an institutional equity shareholder to achieve his 20% EIORR threshold on his investment from the dividends he will expect over the 27 year lifetime, he cannot pay more than 9p per share. Once again, despite the resulting 1.82bn total Kibo shares in issue delivering a low-looking forward PER (once up and running in, say, 2021 of 4 times) and the running yield on an assumed 70% pay-out eventually rising to 20%, that does not mean an institution will pay more than 9p now.

Given the lower profitability of the larger project, it is not surprising that this capital raise price would be lower than for the coal mine alone.

So, that broker's 'target' price of over 30p/share based on the NPV is shown to be the nonsense that it always was, and some investors might want to know why a share price can never get near to a theoretical NPV or Gross PV per share. Put simply, it is because:

- 1) The NPV is stated before being shared out among the providers of the necessary capital. The new equity providers will take their proportion of profits after loan providers have taken their interest.
- 2) Once a project loan is raised, the remaining equity shareholders (expanded to provide the equity contribution) as well as having to share their interest in the profits, will bear the further deduction of loan payments, interest, tax and depreciation.
- 3) In Kibo's case the stated PV is for inflows up to 27 years. A bank might look that far ahead, but no sensible equity investor would. Looking at cash flows over 13 years ahead instead of 27 reduces the PV by 40% and for 7 years ahead (at an 8% discount) reduces it by 2/3rds (assuming even flows over the period, whereas in reality this can be variable). So a sensible investor would confirm what the PV will be on whatever the variable cash flows are over a sensibly short period ahead.

It seems to us that Kibo will finance its mine separately – which, provided the coal price and a timetable is confirmed, might be possible via private investors at a higher price than 10p (but not above 15p) – and sell off whatever share of the power station it is deemed to have built up (which won't include the c\$20m share it now has in the integrated SPV) or take on a major partner.

For a complex problem, space constraints mean we have not been able to discuss all the possibilities for Kibo, but only to give an outline, with approximate figures, of the principles involved in estimating a funding deal. We will discuss Oracle, Edenville and Ncondezi later, probably on the website, and will revisit Kibo when its promised DFS for the integrated project becomes available in the next few months.

In a later note we will also be describing a rough and ready method – less complex than constructing and testing financial models, but based just on NPVs – that enables comparisons between the present attractiveness (or not) of companies with projects that will need institutional backing. While enabling comparisons, however, it won't necessarily deliver absolute valuations.





BY ROBERT SUTHERLAND-SMITH

THE LIMPOPO DISPATCHES

THE WORLD IS TOO MUCH WITH US

This month's edition of the Limpopo dispatches includes a look at the views of BP's chief of economics; another look at the riddle of China's economics; and a general assessment of the UK equity market. It also includes a description of George Osborne arriving by submarine and, naturally, a poetic observation of William Wordsworth.

Amongst my many books that I brought with me, the day I left South Kensington for the last time for a new life on the remote Limpopo, is an anthology of the works of the poet Wordsworth, which I keep with my other books in a large Victorian, superior persons travelling trunk marked 'Wanted on Voyage'. It belonged to the late Lord Curzon, once the coolest thing in the late British Empire and resident of coolest Carlton Terrace residential address, where he lived because it was handy for the House of Lords (real hunting, shooting and fishing Lords in those days of course) and Buckingham Palace down the road and the Atheneum Club on the corner in the evenings.

The Wordsworth line that I have chosen as my text today is his poetic observation that "The world is too much with us". When things get too

complicated and hard to cope with and I want to stop the world and get off (an experience we all have from time to time) I just quote, with a sigh, those words of dear old William Wordsworth: "The world is too much with us."

**"THE GREAT
BEARISH FEAR IS
THAT CHINA'S
GROWTH WILL STALL
TO AN EXTENT THAT
IT WILL BRING DOWN
MARKETS."**

That is why I eventually opted for the quiet life here on the mighty Limpopo. But news of the world outside

somehow keeps filtering through – I know not how. It seems that the world just cannot leave quiet places alone! Naturally, I do not torment myself by having a PC, a tablet or a smart phone. Somehow the news just blows in on the trade winds.

We get visitors of course; that cannot be avoided. We had George Osborne here last week. What I could not understand was why he arrived in a Chinese navy nuclear submarine at midnight. The local witch doctor, the local Church of Scotland missionary and the ancient old actuary known mysteriously as 'Number 5' and I were having a jam session under the moon, when this thumping great submarine emerged from the mighty waters of the Limpopo. The name I discerned on the conning tower was 'PRCS – People's Republic of China Ship – Eastern Power House'.

**“THE NORTH EAST
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It was a bit of shock; we were half way through a rendition of 'Midnight in Moscow' in the style of Acker Bilk, when the hatch opened and out popped George in a bright red builder's hard hat and reflective, yellow protective clothing – obviously and wrongly supposing our little colony to be some kind of photo opportunity. He strode towards us smiling, hand outstretched in greetings accompanied by someone with a cap pulled well over his eyes, who I immediately recognised as that blighter Mandelson. Osborne spoke, seizing me by the hand and saying:

"Greetings from the People's Republic of the UK and its new workers party (known also as the party for workers – no socialists allowed) government of Chairman Cameron and me!"

The blighter Mandelson chipped in with: "Have you considered the utility value of Chinese-made nuclear power?" in the manner of banking salesman selling sub-prime mortgage finance. I wondered why he was promoting Chinese nuclear power – and came to an obvious conclusion. I stood speechless and dumbstruck. Dr. Tomboya, M.A. (Cantab), the local witch doctor, gazed, his face drained of all intelligible emotion. Angus Mc Quirkie the local Church of Scotland missionary called out to me:

"Say something man."

So I replied, "The World is too much with us!" George looked utterly bemused by this off-message message. A thousand flashes of photography illuminated the night for a second or two and I thought I could hear William Wordsworth saying on the chilly breeze that had suddenly sprung up:

"You're damn right about that!"

Suddenly there seemed to be a host of golden daffodils!

Behold the perplexed UK equity investor

1. The future of oil and gas shares

The most sweeping investment news last month were the reports of the speech by Dr. Spencer Dale, the chief economist at BP, arguably the most



“THE SITUATION DOES NOT LOOK ALLURING FOR THOSE SMALL EXPLORERS WITHOUT MUCH IN THE WAY OF CASH AND LIMITED DIVERSIFICATION OF ASSETS. THEY NOW SEEM TO BE HISTORY, AS THEY SAY.”

experienced and pioneering oil exploration company in our hydro carbon world.

Assuming that not everybody will have read his profound, groundbreaking yet logical conclusion, I thought it worth summarising because it seems to put the case for an end to oil exploration, an industry which looks as though it may be going the same way as coal-fired, steam-driven train locomotion.

Very simply, the overwhelming work of climate scientists around the world supports the scientific belief that the world's climate is indeed warming and that warming is driven in significant part by the massive use of carbon fuels. There are of course climate change deniers of this scientific work and conclusion, whose lobbyists argue their case like lawyers (which some of them seem to be by qualification). To the man on the Clapham omnibus, it seems sensible to base individual judgements on the researched views of leading climate scientists and not trained lawyers and others, many of whom, appear to have no education in science – particularly when the scientists in question seem to constitute about ninety per cent plus of world scientific opinion. It seems that most governments are also coming round to that opinion. This fact is the game changer which investors need to take into account when trying to appraise investment opportunities.

Dr. Dale's analysis

Very simply, Dr. Dale of BP points out that if all known reserves of carbon energy were used and burnt up, including oil, coal and gas, this would amount to an estimated 2.8 trillion tonnes of carbon emissions. The problem is that the increasingly influential body of global scientists who point a finger at hydrocarbons as a significant culprit believe that no more than 1 trillion tonnes of carbon fuels should be used, if, as I understand it, an extra crucial and devastating two degrees rise in world temperatures is to be avoided. Time is running out for the avoidance of such a grim fate for the world and our common humanity.

This thinking, as reflected by Dr. Dale, makes sense of oil companies using current cash and capital resources to change their assets to those with the lowest production costs. It is only that kind of production which will prosper in a world where oil is hopefully and likely to be replaced increasingly by carbon neutral resources. Only this month, research concluded that the long term price of land based wind power, is now cheaper than oil, gas and coal.

This does not necessarily mean that traditional oil companies will eventually go out of business, particularly the large ones. They will, one reasonably supposes, do what companies have always done: adapt and change,

a process which looks as though it has already begun. They will not, presumably, be spending cash flow on more costly oil and gas exploration leading to ever more costly production. It is now important for equity investors to take that into account when appraising the strategy of oil companies. But the situation does not look alluring for those small explorers without much in the way of cash and limited diversification of assets. They now seem to be history, as they say.

My instinct is to invest in big oil companies but to pay rapt attention to what they have to say about the future, which will be different from their history for more than the last one hundred years. It seems that technology has advanced rapidly enough to make it much cheaper to turn production on and off.

“MY INSTINCT IS TO INVEST IN BIG OIL COMPANIES BUT TO PAY RAP T ATTENTION TO WHAT THEY HAVE TO SAY ABOUT THE FUTURE, WHICH WILL BE DIFFERENT FROM THEIR HISTORY FOR MORE THAN THE LAST ONE HUNDRED YEARS.”

This month, OPEC made it clear that it is continuing to pump oil and gas because, no doubt, it is losing its status as a monopoly supplier and thus has less control over the price. If less oil is to be used in future, then those with low costs of production, like Saudi Arabia, will keep pumping to the maximum production level while the going is good. It looks as if deep water, high cost engineering businesses like those born out of North Sea oil in Aberdeen have a more questionable future than many of us thought a short time ago. The world of hydro carbon



fuels is now changing so rapidly that few of us a mere ten years ago could have foreseen the USA's rise to oil self sufficiency by the end of the current decade. No wonder Her Majesty's Government wants a state owned Chinese company to finance, design and build nuclear power generators in the UK. The world, as Wordsworth used to say, is too much with us!

2. China: does it exist and to what extent?

Another world wearying problem for simple UK investors like me, is to judge the true state of the Chinese economy and what it means – assuming you can work that out – for us all. Ideas and observations continue to pour across the thresholds of our lives in torrents, like water over the Niagara Falls. Judging by some of the commentary, China and its economy may simply not exist! Or is it simply the figment of a million experts' *a priori* collective opinions; no more than a conjuring trick, in which the hands of an army of China statistical agency statisticians deceive the eye in presenting a hologram of cunning eastern deception in the manner of the late Dr. Fu Man Chu? As my former principal office at the British Colonial Office used to say through clenched teeth gripping a briar pipe: "Damn clever, these Chinese."

In the fog of economic growth, like the fog of war, we are all easily lost. The truth is that when it comes to the economy of China few of us actually know the whole truth. The great bearish fear

is that China's growth will stall to an extent that it will bring down markets. Is that a reasonable basis on which to desist from UK equity investment? Almost certainly not!

First, until George Osborne's hitching us to the chariot of the Chinese Communist Party's political economy has been an attachment of some years, it is unlikely that China's sneezing will cause us here to directly get pneumonia as a result. That will only happen directly, once we become a sufficiently large and successful exporter of goods and services to the Chinese economy. More by luck than judgement, we at present seem to have too little that the consumerising Chinese masses wish to buy. HM Government understandably wishes to put us in such a position of future vulnerability, because it will meantime produce employment and tax revenue.

Given the world and China's current circumstances, we should perhaps thank our lucky stars that we no longer export coal, minerals and metals. (For example, it was as long ago as the nineteenth century that Cornwall had the largest copper mine in the world!) But obviously we have hopes of selling more to the mass consumer markets that we are relying upon the Communist Party of China to deliver to the world in due course.

And there are signs in the Q3 Chinese GDP figures that such an ambition is gradually being realised. It is staggering for a non-expert China watcher



“WE HAVE THE CONDITIONS FOR A PRE-CHRISTMAS RALLY BUT THEREAFTER IT IS LIKELY TO BE MORE OF A TRADING MARKET.”

like me, and no doubt to the tunnel vision disbelievers, that services are now the biggest component of China's GDP growth. It is equally significant that consumer spending in China (according to a reputable British economic forecasting company) has recently become an estimated 60% of GDP growth. China seems to be going consumer before our very eyes! In short, there is new and emerging evidence that China's dictatorial government may actually be succeeding in its long term economic plan (they have a real one) to build the economic infrastructure on which to further build growing services and consumer spending. The north east of China, its manufacturing heart, may be in recessionary mode but the service and consumer sectors of its coastal economies appear to be growing. You should not forget how large China is just as you should never forget how large America is.

Finally, can we believe that the recently published GDP growth figures put by China's statistical agency? Not a fair question for UK investors who just want to know if it's reasonable to buy Marks & Spencer shares or the equity of BP or British Land. But it is a question we are obliged to address in a market of clashing vested interests. First, no one knows! The range of guesses is too wide for the comfort of certainty. Second, I see that 150 world economists, all of whom are paid good salaries to try to get these things right, have recently in consensus estimated China's GDP to be growing at 6.8%. The fact the latest data show growth at 6.9% is either too convenient for words or comfortingly close enough to be convincing. I stick with the "close enough to be convincing" school of thought, particularly since the Chinese economy is clearly changing to everybody's advantage. Do I believe that China's slowdown is a good enough reason not to invest in equities? No!

3. Finally, the UK equity market: where goes it?

In the hubbub of theory and counter theory about China, I have decided to



avoid the predictions of super bears because some of them will, inevitably, be bears by nature; people compelled by genetic inheritance to seek the gloom of despair. Other than that, as indicated above, I think that there are objective reasons for thinking that China's economy will continue to be a positive influence on world economic activity over the next few months. Inflation is low and there seems to be room for the authorities to inject some economic stimulus by reducing bank reserve requirements. It could, so some commentators believe, even put the foot down on the infrastructure spending pedal. I am happy therefore, in a market that seems to have more than discounted a lot of bad news (or expectations of it) about China, to see scarcity value in the optimistic point of view.

The world's still largest economy seems to be ticking away pretty well, though that too seems to be experiencing too little rather than too much inflation. The Federal Reserve staffers with Mrs. Yellan at their head hesitate nervously to cross the Rubicon with the commencement of the long awaited rise in the US Fed funds rate. When it eventually comes, as it should for the peace of mind of all of us, I guess it will prove a discounted, anti-climax relief. The estimates for a 2.5% increase in US GDP this year are not exciting but are still positive, thus providing room for the hope of more economic growth rather than fears of overheated economic downtrend. Despite tapering, it does not particularly look like the fag end of an economic cycle, which is the natural and conventional expectation

as interest rates begin to go up. The US markets are currently down 3% on the levels they were at last December. The US market ingredients include the traditional consumer-led Christmas run-up and not much fear of profit taking in general.

At home, notwithstanding the steel industry's woes, confidence of both business and consumer looks resilient as we approach the annual consumer society Christmas spending round. Spending power seems to be improving, partly as a result of low inflation and some improvement in wages – a crucial thing for a consumer economy. A look at the FTSE 100 chart shows that it is close to a breakout from the downtrend in share prices that began last spring. If it does break out, where could it get to?

The FTSE 100 Index is currently valued at around 17 times with a dividend yield of 3.9%. The share price chart indicates resistance about 10% above the current level. On that basis, there does not seem to be a lot to go at, so stock selection seems key to finding shares with a prospect of above average returns. That particularly means trying to find the most reliable dividend payers. There is a growing expectation that dividends may be cut here and there, possibly making the average dividend yield of 3.9% not as inviting as it at first glance seems. There is no getting round it: finding the right shares with sustainable dividend yields is going to be important. We have the conditions for a pre-Christmas rally but thereafter it is likely to be more of a trading market.



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BY FILIPE R. COSTA

THE GREATEST INVESTORS & TRADES

DAVID DREMAN

A FEATURE ON OUTSTANDING INVESTORS

This new column will feature investors, traders and scholars that excelled in the world of finance and investment by either making money for themselves or by creating new standards that significantly contributed to advances in knowledge for the investment arena.

Some of these personalities are very refined in terms of the theoretical background they possess and were thus able to unite two worlds that often sit apart: the theoretical research-driven world of academia and the practical effort-driven 'real' world. Some built investment strategies from a strong theoretical background, exploiting the 'soft' rationality that drives investors' behaviour to achieve consistent profits over time, while also pushing the envelope in the field. Others are highly skilled, self-made individuals, who survived the boom-and-bust cycle of the past and are ready to profit from those who still believe that "this time will be different".

No matter how theoretical or intuitive each group may appear, nor how different their own approaches may be, they both show consistent profits over time, giving evidence that it is possible to beat the market in a consistent manner. In doing so, they challenge the traditional Efficient Market Hypothesis

(EMH), which claims that investors are unemotional individuals who are able to process large quantities of information and take the best rational decisions in a way that drives the market towards equilibrium and efficiency. In such a perfect and efficient world, prices would reflect fundamental value at all times and the best an investor could do would be to allocate his funds between the market portfolio and a risk-free asset.

But in the real investment world, psychology merges with mathematical abstractions to deliver consistent deviations from what the EMH advocates. Market participants, be they individual investors or professionals, are guided by emotion; they constantly overreact to information, ignoring hundreds of years in financial records to focus their attention on a few salient characteristics, always following the crowd. Under such conditions, those who are able to disentangle the fundamental shell from prices are able to unlock a window of profitable investment opportunities.

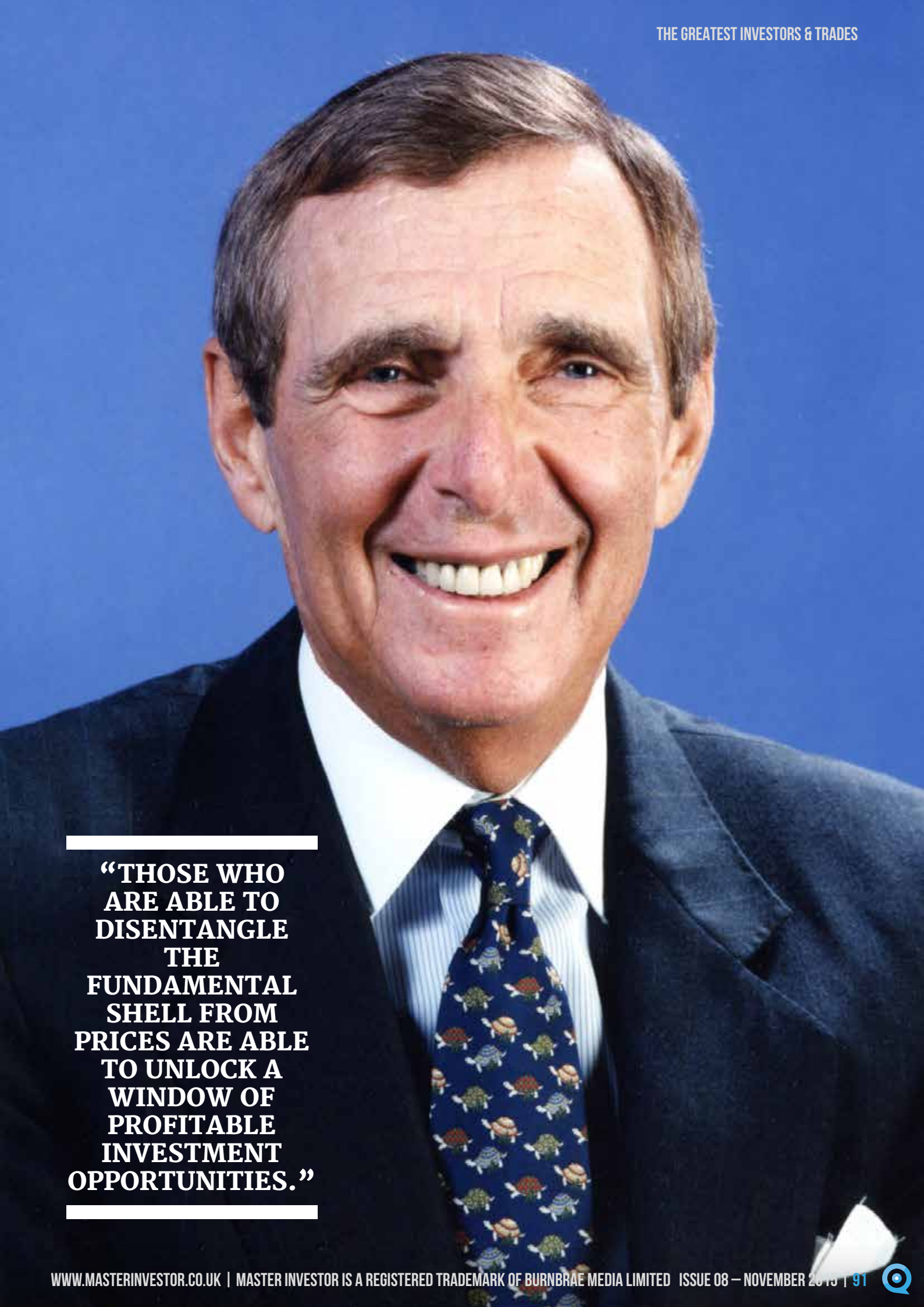
Replacing the EMH with an overreaction hypothesis goes a long way towards unlocking that profit potential. This month, we feature David Dreman, a man that blended theory and practice into one of the finest investment strategies ever developed. Dreman will

always look for those shares others hate, and be sufficiently patient to hold them until everybody realises how underpriced they were. A value investor by trial-and-error, Dreman learned his craft in the real world and shared his insights in five excellent books and many scientific articles.

Life has its lessons

David Dreman is known as a contrarian, value investor; but such a label was only acquired after some unpleasant experiences.

Dreman was born in Winnipeg, Canada in 1936. Son of a prominent commodities trader on the Winnipeg Commodity exchange, and seduced by his father's success in investing in Canadian equities, Dreman went to the US in the 1960s to work in a few research and investment roles. At that time, many of his colleagues were delighted by the impressive rally equities were experiencing. US equities offered massive potential and everybody was deeply invested. Not even Dreman escaped this heady period. But, as has been the case many times before, the hype didn't last and equities fell apart. Most of his colleagues lost everything and he was left with just one quarter of what he started with. A lesson was quickly learned and a new value investor was about to be born.



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OPPORTUNITIES.”**



Winnipeg, Dreman's birth place

The go-go bubble of the 1960s was the base camp from which Dreman started building a sound investment strategy. He landed a job at Value Line as senior editor and started writing about market psychology. His articles were centred on how to outperform the market. Learning from Benjamin Graham and David Dodd, who laid down the theoretical framework on which value investing is based, Dreman refined his knowledge and started developing his own strategy. He worked on many scientific papers published on value investing, in particular those related to the P/E ratio, hitting out at many of the methodological issues that were posed by the EMH advocates.

Investors and analysts are sentimental

While many investors and analysts conduct extensive and thorough research on a company to assess its future prospects and determine fundamental value, they fail to acknowledge that their analysis is severely flawed by the many assumptions and judgements on which it is based. An analyst does not have the ability to forecast more than a year of earnings. Scientific research shows that a large part of medium- to longer-term forecasts are just linear extensions of the one year forecasts. If the analysts were right in their projections, then companies with above- and below-average earnings would exhibit the same pace of growth over time, which research suggests is not the case. Most above- and below-average earnings growth rates tend to revert to the average, meaning there is a high likelihood of the "best" companies showing negative earnings surprises and the "worst" showing positive surprises. At the same time, there is also a

myriad of economic events and institutional interventions that affect investor sentiment over time. Analysts cannot predict those events.

With so much price dysfunction and so many unexplained anomalies, the EMH better serves the analytical scientist willing to summarise behaviours in a single number than the pragmatic investor wishing to understand how the market works in reality. Dreman believes that investor sentiment is better explained by the Investor Overreaction Hypothesis (IOH), which has three central predictions: (1) investors will consistently overvalue favoured shares and undervalue out-of-favour shares; (2) investors are over-optimistic with regard to their forecasts for the "best" shares and too pessimistic with regard to the "worst" ones, such that earnings surprises tend to favour the "worst" shares as a group; and (3) over time both groups will revert to the mean, resulting in the underperformance of the "best" shares and outperformance of the "worst" ones. This third prediction is well explained by changes in sentiment. Buoyant sentiment leads to the disconnection of prices from reality. Later, when sentiment reverts, prices come down to earth.

A simple strategy that everyone can implement

Dreman has spent his life exploring behavioural biases that open up investment opportunities. In 1977, he founded Dreman Value Management, a fund management business that is still alive and in good health. Unlike many hedge funds out there, which tend to concentrate their bets in just a few securities, Dreman believes risk can ruin a portfolio, and that one doesn't need a com-

plex algorithm to invest successfully. Instead of relying on complex mathematics without theoretical support, Dreman's investments are made of simple rules, based on a strong theoretical background supported by decades of scientific research.

In his first book, "Psychology and the Stock Market: Investment Strategy Beyond Random Walk", written in 1977, he provided investors with a detailed description of how they could invest profitably. His investment strategy is based on value, which he believes is well summarised in P/E ratios. He then advises investors to: (1) choose from a universe of medium- to large-sized companies; (2) buy low P/E ratio shares (i.e. ones that are among the bottom 40% of shares ranked by P/E ratio); and (3) hold equal amounts of 15 to 20 shares that are in 10 to 12 different industries for diversification. Such a technique looks for value in well-established companies, because these companies have greater chances of recovering from periods of underperformance. Smaller companies have a higher probability of underperforming due to financial unsoundness.

While Dreman does not oppose fundamental analysis, he still prefers to keep such analysis confined to the salient data. This is because financial theory claims that analysts aren't able to predict future performance with accuracy. To predict prices accurately one needs an estimate for future earnings, which are not observable and thus require much subjective judgement. While looking for financial soundness in financial statements can enhance the portfolio selection, one should eliminate forecasting error. An investor is better off selecting shares based on measures that don't require much judgement, if any at all.

The data collected by Dreman clearly shows the superiority of this strategy over the alternative of picking the market. More established companies with low P/E's often appreciate more than the market while also paying higher dividends. The opposite occurs with high P/E companies.

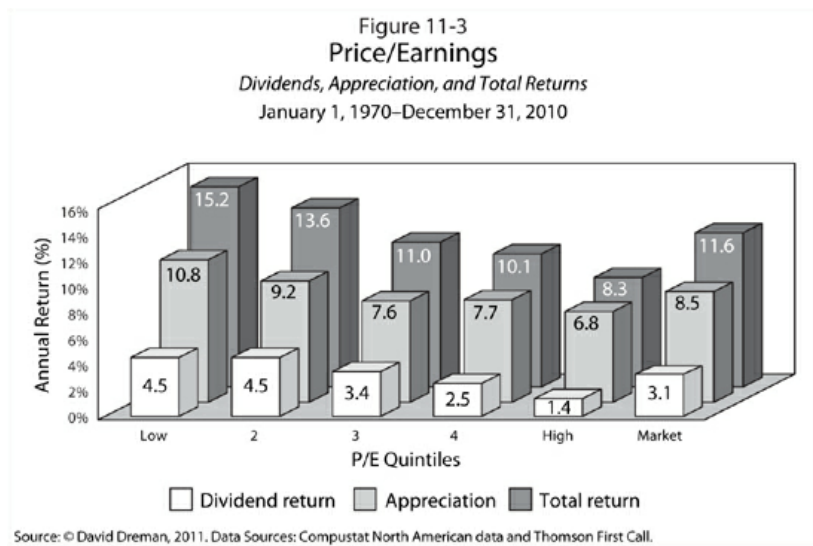
While the overall market returned 11.6% per year between January 1970 and December 2010, a strategy pick-

ing low P/E companies would have returned 15.2%. Picking the high P/E ratio companies (quite a common strategy of picking fashionable equities) would have returned 8.3%. Translating this scenario into a dollar amount, an investor with \$100,000 in 1970 would at the end of 2010 have \$2.6 million, \$9.0 million, or \$33.1 million, depending on his choice of high P/E shares, the market, or low P/E shares respectively. The difference seems small at one-year intervals, but the effects of compounding make the low P/E strategy 3.7x more profitable than the passive strategy of holding the market.

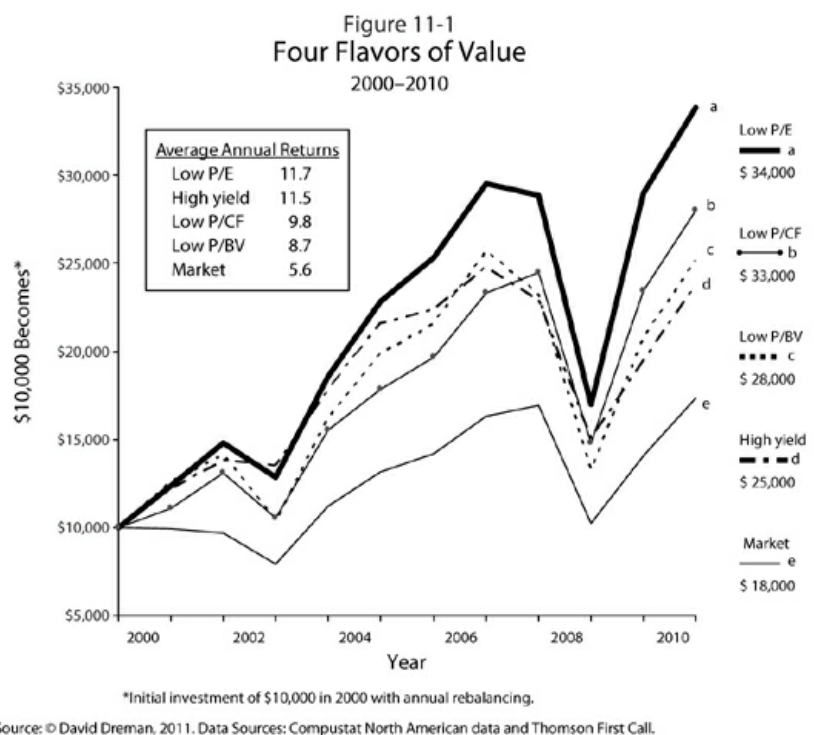
Dreman's strategy is not for the short term. He recognises that, in the short term, momentum strategies may work much better. He very well remembers the technology bubble of the 1990s, when his fund management company had difficulties in convincing investors of the soundness of his strategy. During the 1990s, sentiment was very high and distorted towards new technologies. Investors rediscovered value as something that could not be measured by traditional indicators like P/E or P/B ratios. The nascent technology sector had unlimited growth opportunities, and P/E ratios above 1,000 were not that rare. But then, suddenly, everything reverted to the "old normal" and the skyrocketing sentiment that pushed valuations to the sky evaporated and share prices experienced a vertical decline. In just nine months, Dreman was up 50% while the market was retreating 10%, thus reversing his losses accumulated during the "irrational exuberance" period.

Over the years no one was able to disprove Dreman's theories, and he continued working to refine them. In his latest book, "Contrarian Investment Strategies: The Psychological Edge", written in 2012, he extends the contrarian strategy into five different types: (1) Low P/E; (2) Low P/B; (3) Low P/CF, High-Yield, and Low P/Industry.

All the above strategies outperform the market over periods of 10-15 years. He claims that an investor should: (1) buy only contrarian shares because of their superior characteristics in terms of financial soundness and ability to turn around a difficult situation (based on one of the above five strategies); (2) in-



“DREMAN HAS SPENT HIS LIFE EXPLORING BEHAVIOURAL BIASES THAT OPEN UP INVESTMENT OPPORTUNITIES.”



vest equal amounts in 30 to 40 shares, diversified among 15 industries; and (3) buy medium- or large-sized shares.

A few final words

Emotion does matter! Investors are exposed to emotions that lead them to act with less rationality than is supposed by the EMH. Even professional investors are exposed to emotion or, at the very least, don't want to oppose the market for long periods due to cap-

ital restrictions, further contributing to price distortions. In the end, all an investor should do is seek out value, which means buying shares in unloved companies while staying clear of fashionable shares. No complicated analysis is required; investors must simply be conscious that, as human beings, they are affected by sentiment. Oh, and keep away from leverage, Dreman argues, because leverage is enemy number one of a value investor.





BY MARIA PSARRA

SCHOOL CORNER

LEARNING TO LIVE WITH UNCERTAINTY

Accepting uncertainty and learning to live with it in your trading and investing: this is today's topic, the eleventh in my series of educational articles for Master Investor Magazine. Moving forward, this series will be more focused on the best habits of winning traders, and less on the mistakes traders and investors make – even though, to be fair, these two are just like two sides of a coin...

So what do I mean by "*learning to live with uncertainty*"? In this particular context, I mean that when it comes to trading and investing, you have to accept that you will never know the final outcome of any of your actions from the outset, and that if you wish to remain sane, sound and liquid, this is something you do have to accept and embrace.

I believe this is a timely discussion given the levels of volatility we have been experiencing in the world's financial markets these last few months, and which in my view are going to persist for the near future. So what does this increased volatility and, as follows, uncertainty mean for you as an individual trader or investor?

Does it mean that you should do nothing? Stay on the side lines? Not invest or trade? Well, if that is what makes you happy, then you actually should.

But if it is not what you really want, then may I suggest that you learn to live and cope with your fear of uncertainty? Easier said than done, I hear you say – and I agree! Uncertainty is not an easy thing to live with, for anyone, including myself.

In fact, if my work colleagues could speak now, they would probably tell you that I have what appears in their eyes to be an unnecessary fear of crossing the street at the wrong time, for fear of being killed by a car. Somehow, this is not an uncertainty I want to take on, so I prefer to wait until the green light hopefully makes it safe for pedestrians to cross.

“UNCERTAINTY IS NOT AN EASY THING TO LIVE WITH, FOR ANYONE, INCLUDING MYSELF.”

However, I am more than happy to trade and advise clients to trade using highly leveraged products when I feel

the opportunity is suitable. I am also more than happy to fall in love, trust certain people, start a new business, all of which can hardly be described as being risk-averse. So I cannot possibly pretend that I despise risk; I guess I do embrace it. And still, I want you to know that there is always a level of stress that goes with each one of my trades, or decisions, however small this may have become over the years. My goal for this article is not to make you take more or less risk than is right for you; rather it is to help you understand what the right amount of risk for you may be. In the end, it is all about understanding yourself, and pursuing what makes you happy. So let us see if I can be of some assistance.

The way I look at it, both the long- and short-term have a place in our lives, and this applies to all of our investments, financial or otherwise. The point is though, we have got to understand the difference between the two, so that we enter and exit our investments of any form at the right time. When it comes to the financial markets, we also have to understand the current environment, stay flexible, and "go with the flow". We shall discuss staying flexible in one of my next articles, but for now, it is enough to say, that part of successfully living with uncertainty involves "changing sides" in order to make more money, or to avoid losing it.





Trading and investing are NOT about always being right; they are just about making money... period. As follows, in an environment of increased volatility, you have to stay flexible.

Let me give you a real life example. One of my most successful trades for 2015 was short Glencore shares. It worked wonderfully well: we made money, our clients were happy, but we also exited at the point where we saw too much buying coming in which pushed the market higher. Staying in after that point, whatever my view of the company, would have imposed on us a level of uncertainty that I am not willing to bear. So we exited. Did I know that Glencore shares would be subjected to so much selling, then buying when we first entered the trade months ago? Of course not. I did however believe that based on our fundamental assessment the shares would move lower before we first went short, and that the market no longer saw enough reason to sell (rather to increasingly buy in) when we exited our shorts.

“TRADING AND INVESTING ARE NOT ABOUT ALWAYS BEING RIGHT; THEY ARE JUST ABOUT MAKING MONEY... PERIOD.”

Do I know that every single trade I make is going to be right? No, I don't. What I do know is that I have done my research, I am following my system, and based on these factors, I am willing to take the risk of entering the position. I also know that I am always most happy to remain flexible enough to reassess, exit, or even reverse any given position at the point where the market tells me I am better off doing so. And above all this, I know, partially because I have seen it over the years, that I can pick enough successful trades to make it worth my while, and I have found a way to remind myself of this even at the worst of times. Don't get me wrong, I still get stressed some days, especially

during early UK market hours, but even when I complain, I am most happy to live with the uncertainty and I still prefer this to any other career or life choice.

To conclude, I am in no way suggesting that you should become me. I am only suggesting that if you do wish to be involved in the financial markets, you should train yourself to learn to accept the uncertainty inherent in them, and react accordingly, leaving your fears aside, and only focusing on making money.

Until next month,

Happy trading everyone!

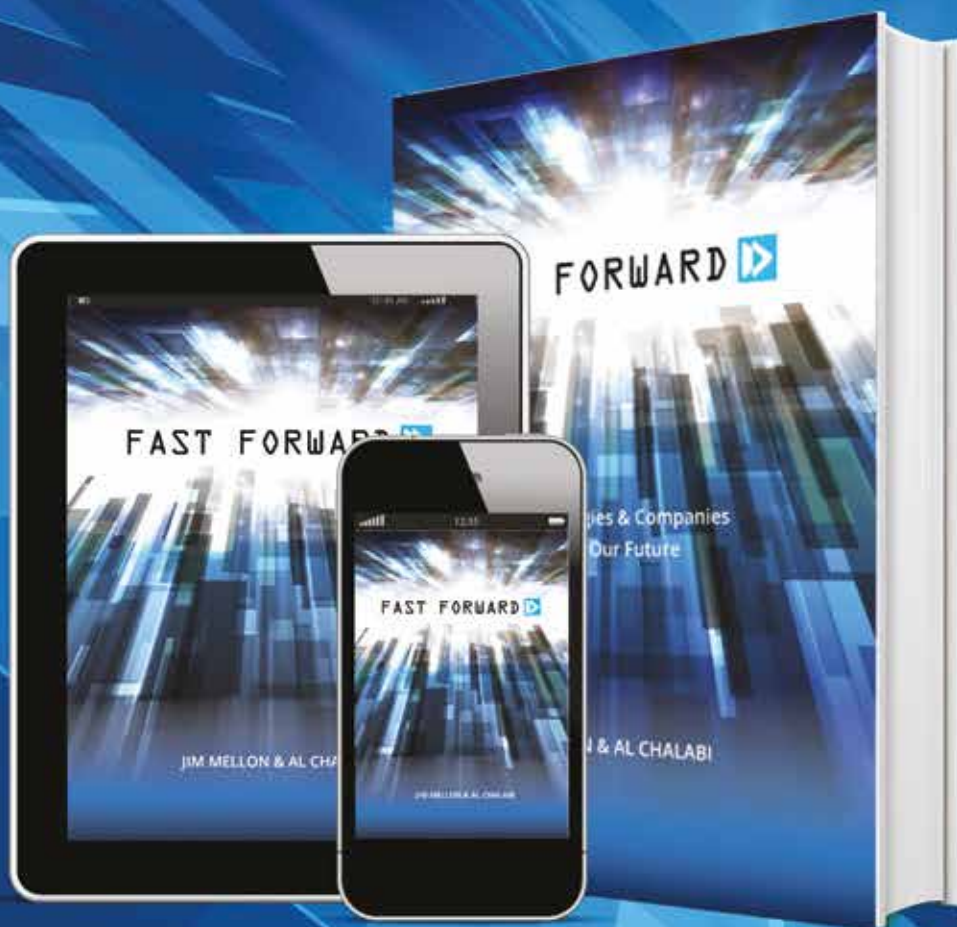
Maria is Head of Trading at ZAI Capital Markets. In her role at ZAI, Maria determines the company's trading strategy, supervises a team of experienced brokers, and advises high-net-worth individuals on suitable investment strategies. Maria employs different investment styles in order to construct personalised 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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BY CAROLINE DREWETT

ARE INTERNSHIPS DESTROYING BRITAIN'S EMPLOYMENT PROSPECTS OR ENHANCING THEM?

Paid Internships provide 35,000–60,000 positions to the UK economy each year, so why are we still so against them?

Internships have long had a bad reputation; they exploit young people who give up their summers to photocopy and make tea for large corporations, and in return, give them nothing back. There's a perception that banks and the 'Big 4' (PWC, EY, Deloitte and KPMG) utilise undergraduates as free labour and swiftly hang them out to dry once they've finished. Not only that, but the numerous interns available for unpaid work prevent graduates from finding employment; why pay someone a long-term wage when you can get a free ride?


Internships provide some 60,000 people with paid experience annually in Britain alone; with wages that, if retained by international companies, would likely just be adding to their profit margins in whichever tax haven they reside. The big 4 alone pay almost £3.5m to interns every summer. Internships seem to have reached every far flung corner of the planet; my company offers internships in the Galapagos Islands – the Mecca of eco-tourism which very few people have the luxury of visiting, let alone for a prolonged period of time with the opportunity of work-

ing amongst locals. It's both idyllic and useful for both parties, so why are we Brits still so shocked at the thought of engaging in internships, and instead writing them all off as slave labour?

**“BANK OF AMERICA
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WORKFORCE.”**

I had a new look into the current world of British internships when last year, my brother-in-law phoned up to inform me he had been accepted as a PWC intern in London. With him living in Newcastle, we were only too happy to have him stay in our flat for the summer; we were excited for him, but also empathetic that he would be earning nothing as the office skivvy for the summer, even though he was soon to add a PhD to his CV. But on day one he turned up at the office, was given his own desk, significant responsibilities and a decent wage for his troubles. He was positive that good things would follow, and not a cup of tea to make in sight! I immediately realised that the concept of interning is misunderstood in the UK, which has been somewhat behind the rest of the world in terms of its internship investment.

For years, France have had a compulsory 'stage', at it is known, whereby every student must complete a minimum of eight weeks as an intern before graduating. With good intentions, the scheme initially helped students with no work experience by ensuring that everyone had dipped



**“INTERNSHIPS
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their feet into the working world before graduating. Yet the reality is that it has arguably increased youth unemployment rates because interns are *not allowed* to be paid more than living allowances. With 1.2 million interns in the country and competition for employment high, France has finally passed a law this month guaranteeing all interns the grand total of... €523 per month. No wonder companies are shying away from employing graduates when they can get away with such brazen behaviour. Maybe it's no surprise that France is now in such financial hot water, when it's virtually impossible for their youth to find employment and morale is so low. Many graduates end up turning to the state for benefits and 25% are now officially unemployed.

However not all internships are detrimental to a country's economic stability; Singapore has found them to be both positive and necessary for their future workforce. Their national SkillsFuture internship programme aims to provide opportunities to develop each individual's potential, regardless of their starting point in life. Its purpose is to develop the country's youth towards an 'advanced economy and an inclusive society', and so puts no limits on living allowances. Bank of America Merrill Lynch reportedly pays Singaporean interns up to S\$10,000 (£4,650) per six week internship. With this attitude, it is no surprise that the Singaporean economy is consistently amongst the top five, regularly drawing young talent from overseas to its workforce.

“IT’S NO LONGER ONLY THOSE WITH BANK OF MUM AND DAD WHO CAN TAKE ADVANTAGE OF THESE OPPORTUNITIES, BUT MAYBE IT IS JUST THE PROACTIVE.”

Other countries like South Korea, America and Germany are all following suit. The age structure of internships in the UK is changing too, in part thanks to tech start-ups who refuse to bring skilled and enthusiastic interns under their wing just for cheap labour to be discarded after a short time. Companies now treat summer internships as an extended job interview, rather than a few extra hands to mingle around the water cooler. The process gives interns the opportunity to decide if they like this potential career path. Closing your eyes and randomly choosing an industry is a risky game, especially given the two year graduate programmes. In all successful cases, internships are viewed as a two-way operation and experience; not only are *you* being tested, but you should be testing the company to decide which area or industry is right for you.

Great interning opportunities are out there, but you have to seize the initiative. Speaking to a globally minded Australian-born Cass Business School stu-

dent who this summer interned with EY in London, Christopher Kainz had nothing but praise for his experience. Although he found the four stage interview process rigorous (almost identical to the graduate scheme process), once accepted, he declared the training to be 'exceptional' and it helped him learn a wide variety of skills.

Personally, I've always been a fan of tough interview processes; don't be afraid of a challenge. The harder the interview, the better the opportunity to shine, and having been grilled at the EY stages with questions that clearly require prior research and knowledge, such as "Discuss three aspects of the financial services industry that are currently changing", the outcome for Christopher was worth the effort. At just 21 years old, he was one of the successful 2-3% of applicants who were given the opportunity to work as a permanent member of staff for the summer, *alongside* graduate associates rather than underneath them.

“WHAT SETS THE SUCCESSFUL APART FROM THE UNSUCCESSFUL IS THE ABILITY TO PUT YOURSELF OUT THERE, BEFORE YOU FINISH UNIVERSITY.”

But the placement didn't just fall in his lap, and, once in, Christopher took every opportunity to further himself. Friday lunch times were not spent texting mates arranging the weekend itinerary, but dedicated to networking with other interns and employees, or visiting differing departments to affirm that management consultancy was right for him. Perhaps contrary to popular perception, Christopher notes the equality of the programme as a big draw for him as an employee; interns come from all over the UK and there was certainly a level playing field. It's no longer only those with bank of Mum and Dad who can take advantage of these opportunities, but maybe it *is* just the proactive.

So how likely is it that an internship will lead to a paid job, rather than negate the need for a company to offer one? According to Forbes, American college graduates working at paid internships have a 60% chance of it turning into full time employment. And even if it doesn't turn into employment, it's not unreasonable to experience a few companies, or even industries before you find your feet at the right place for you. People must be open to trying different options. Christopher completed three internships prior to the 'big one' at EY; he showed he wasn't afraid of hard work and trying multiple companies, nor was he under any illusion of the challenges of getting onto a programme. His willingness to sacrifice some of the less savoury but popular moments of university are clear; spending evenings working on consultancy strategies rather than go-

ing out have led to success, and can be replicated easily, if you have the drive and maturity.

What sets the successful apart from the unsuccessful is the ability to put yourself out there, before you finish university. Christopher runs his university's dynamic Cass Consultancy Society, putting on 17 events a year which draw in professional speakers; this week's event hit 100 attendees, an achievement for anyone in their third year of university. This attitude is exceptional, but it is achievable; it takes foresight and determination. Christopher started thinking like a graduate before he graduated, surveying the job market and, perhaps in his opinion most importantly, becoming a proactive LinkedIn user. Before even completing the interview process, he had messaged current EY employees who had previously studied at Cass, and asked them out for coffee to learn about their experiences and expertise. Networking is considerably easier now than it was a decade ago. With almost 370 million users on LinkedIn, you no longer need

to own half of Westminster to gain connections in the city; and with 39 million accounts attributed to students and recent graduates, it's now the fastest growing sector.

Everyone remembers starting at the bottom. Employees will be more willing to help than you might think if you are confident enough to ask for advice. Ridding ourselves of the idea that all internships are just slave labour, undergraduates should realise they're just as useful for the intern as they are for the employer. Employers want to attract top talent; it is in their interest to provide a useful placement else they've gone through the process for nothing. Before we write off internships, we need to realise what they can bring to the economy, to graduates, and to the workplace. After all, back to my brother-in-law, if a successful PWC intern views his time, sweat and money spent there as far more valuable than an entire PhD semester at a top Russell Group university, surely we need to pay heed to the internship as the new vehicle of career success.





BY 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.masterinvestor.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 October.

8th October

My longstanding colleague, Lucian Miers, notes that **APR's (APR)** 17% shareholder GE (General Electric Co) is *not* named as party to a prospective bid for APR, whose assets are mostly what was GE's power rental business and which APR acquired in 2013 for \$314 m of which \$250m was in APR paper valued at £10 per share. If anyone knows the true value of APR it is GE and they haven't to date shown any interest buying it. To them APR is just another customer to whom to sell their stuff. Put another way, APR should be shorted. I am not sure as to what level it

should be so treated. But, at 140p, I still think it is a good bet.

Elsewhere, although I have previously mentioned the very sensible doubts that should be attached by **Plus500 (PLUS)** shareholders to holding out for the **Playtech (PTEC)** 400p bid, there is a further factor: this is that holders who, eventually, cash in their chips will have to cope with the Israeli Inland Revenue since there is a withholding tax of 25% of the proceeds – in this case 100p – which only comes back after the accepting non-resident in Israel shareholder has dealt with that esteemed organisation. This kink in events arises since both Playtech and Plus500 are Israeli companies. It hardly stimulates buying for the arb.

My reckoning is that at the end of the day the FCA will kibosh this deal since PLUS will be regulated out of existence and that therefore a short at 340p is still in order.

12th October

When **AstraZeneca (AZN)**, then £40, turned down a bid from Pfizer at around £55, the objections, based on employment in the UK and the benefit of long term research laboratories based in the UK, were spurious. Given the current price of c. £40, the result has been that shareholders have been denied about £10bn. Not very wise.

The fear might therefore be that the similarly-sized bid for **SAB Miller (SAB)** could be similarly skewered. But, here, employment is not a matter falling to be considered and nobody cares about the long term handling/development of brands of beer. Further, the major shareholders are based overseas with no material cultural loyalties/duties owed to anybody bar themselves. It is all about price. SAB stands at around £37 and the comments from its board indicate that SAB will be sold to AB Inbev at a new improved offer of £44 cash. As previously remarked, this will take time.

**“THE FACT
IS THAT
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THROUGH A P2P
OPERATOR.”**



16th October

It took its time but it has happened. After all, it is surprising that there has been such a delay in troubles being identified. However, the Stockholm-listed TrustBuddy a P2P lender has emerged as having advanced £238m where £29m of this has not been lent to "legitimate borrowers". Until it is shown otherwise this £29m should be regarded as not merely irresponsibly lent but quite possibly lent to interests of the managers.

The next question is whether P2P operators in this country (none are quoted) have been developing the same practices. Needless to add, I do not know. That said, traditional bankers must be smiling inwardly since they have been criticised by investors for offering such low returns. The reason that what is offered is so low is that the traditional bankers can get away with it. But the fact is that investors are now sharply reminded of the risks faced when going through a P2P operator.

**“LAST
WEEK’S
DISCLOSURES
ARE NOT
THE FIRST
REVELATION
THAT TALK
IS PRETTY
CASUAL.”**

23rd October

I held 40,000 shares in **Victoria Carpet (VCP)** for many years and then, out of boredom, sold them about five years ago at about 250p. I thought no more about it.

That noted, I was staggered by the huge rises that have since occurred –

indeed shareholders seem to have had a cash dividend of £3 a share on the way. Given that the shares now stand at £13, this is pretty astonishing.

However, the other day, it was put to me that this rise is not explicable by trading success. Certainly, there is no stock to borrow and the major shareholders have got a vice-like grip to keep it that way.

The trouble (for them) is that, one day, they will want to sell some stock. I reckon that when the 30th September interims come out towards, say, the end of November these figures will be shown to be pretty indifferent: to whom then will the controlling shareholders sell?

26th October

TalkTalking of law: Some have canvassed the idea that **TalkTalk (TALK)** faces financial ruin through litigation brought by its customers. Perhaps. But I doubt it.

Say TALK has in effect handed a customer's bank account number and sort code to a fraudster he is not thereby enabled to make payments since he does not hold the signature or a chequebook or the online password. And so on. If indeed money is stripped from TALK's customer's bank account it is because the TALK customer has given the extra information required by the fraudster. That is not TALK's fault.

Where there seems to be a bit of both – is that TALK has told some TALK customers that they cannot cancel their annual contract with TALK without paying a break fee of the order of £200. That seems nonsense to me: why should the trusting consumer be tied to an organisation that is palpably unreliable when handling its customers' data? Last week's disclosures are not the first revelation that TALK is pretty casual.

However, it is hard to see that TALK's business will prove to have been anything other than hit hard amidsthips. And at 250p it is capitalised at £2.5bn with tnav of the order of minus £300m. Profits have historically come to perhaps £100m. This is not cheap. On the other hand, talk about TALK is.



Incidentally, just how does a blackmail approach work? After all, having paid off the so and so and given that one has no idea who he is, just why does one suppose the blackmailer will not have another go?

27th October

Beximco Pharma (BXP) this morning offers its third quarter's figure – i.e. nine months ended 30th September 2015. They are very respectable. The profit is 3.70 taka. This translates to 3.1p which supports the expectation of 4.2p for the full year. Given the current share price of 21p, this represents a PE ratio of 5 and falling. This is hardly demanding. Even after stripping out intangibles the Dhaka price is largely covered by tangible net assets. The price this morning in Dhaka is around 59p. The yield on the London GDRs remains of the order of 5% p.a. What is not to like? And then of course there is the buying in of the London end's capital by Dhaka...

28th October

It could reasonably be remarked that I am not dispassionate about the FCA. But I wrote early last week to "The Manager" to mark the FCA's card as regards the forthcoming revelations at **Globo (GBO)**. Yesterday I got a call from that august organisation, the FCA not GBO. The caller advised that GNI



“IT COULD REASONABLY BE REMARKED THAT I AM NOT DISPASSIONATE ABOUT THE FCA. BUT I WROTE EARLY LAST WEEK TO ‘THE MANAGER’ TO MARK THE FCA’S CARD AS REGARDS THE FORTHCOMING REVELATIONS AT GLOBO (GBO).”

Touch seems not to be regulated (I frequently use the reverse of old statements when sending letters). I think it was clear from my letter that I was writing about Globo on the other side – what with the date and my signature and my successfully used telephone number.

The caller then advised that Globo is not regulated. Which of course it is not in terms of investment business. But, as my letter made clear, that was not the business in hand.

Of course it occurs to me that the FCA put this character up to comment by way of a joke. But I doubt it. Carry on Bungling. It only costs somebody else's money.

29th October

No pay: **Optimal Payments (OPAY)**, which is the old NeTeller, a very satisfactory short of yore, seeks full listing. However, today it is revealed that it is finding it difficult to hold on to its customers' data. This is the current equivalent of paedophilia and denies full listing access. I sold at 300p. Anyway, I smell other troubles.

30th October

This morning's DTel advises that S and P consider that a Brexit would be bad for the UK's credit rating. This is of course pure balls since HMG can always print its way out of liabilities. So how does this S and P opinion emerge? It's quite simple: the DTel got an email from S and P offering this info. So why did S and P develop this idea? It's quite simple: the cabal of self-promoting sods in Brussels, knowing that they have finally been rumbled as to their style, has decided to go into back entry mode – what better avenue than S and P?





OCTOBER 2015

BEST OF THE BLOG

Migrant chic – the new black

When it comes to fashion I know little to nothing about it from a personal perspective. Clothes wear me, not the other way round, so without a little help from my friends I would look like I still live at home.

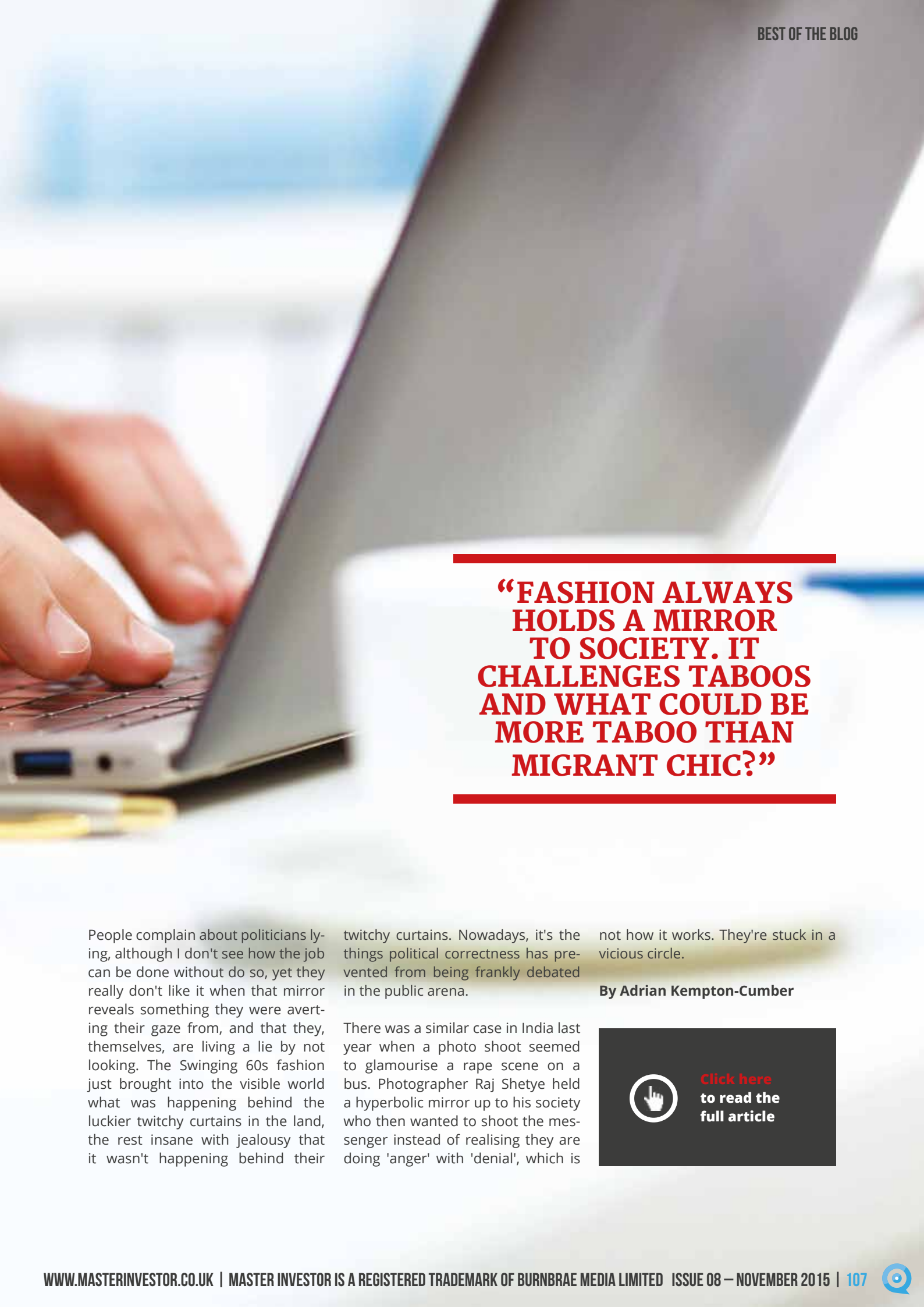
Fashion always holds a mirror to society. It challenges taboos and what could be more taboo than Migrant

Chic? We had Terrorist Chic a few years back but it's barely 50 years since fashion was holding up blurred gender roles and the permissive society in the face of an ordered 60s establishment.

A Hungarian photo shoot called 'Der Migrant' by Norbert Baksa turns the mirror on Hungarian society and delivers Migrant Chic. Photos of scantily clad models with half a breast visible, leaning on barbed wire (the

barbed wire is that stuff in the background generally slightly less thin than the models). What an image! Fashion holds up a mirror and people don't like what they see. Good.

These events are not isolated in fashion. We had heroin chic for a while. But then music came to the rescue with the Dandy Warhols' excellent Not If You Were The Last Junkie On Earth ("I never thought you'd be a junkie because heroin is so passé").



“FASHION ALWAYS HOLDS A MIRROR TO SOCIETY. IT CHALLENGES TABOOS AND WHAT COULD BE MORE TABOO THAN MIGRANT CHIC?”

People complain about politicians lying, although I don't see how the job can be done without do so, yet they really don't like it when that mirror reveals something they were averting their gaze from, and that they, themselves, are living a lie by not looking. The Swinging 60s fashion just brought into the visible world what was happening behind the luckier twitchy curtains in the land, the rest insane with jealousy that it wasn't happening behind their

twitchy curtains. Nowadays, it's the things political correctness has prevented from being frankly debated in the public arena.

There was a similar case in India last year when a photo shoot seemed to glamourise a rape scene on a bus. Photographer Raj Shetye held a hyperbolic mirror up to his society who then wanted to shoot the messenger instead of realising they are doing 'anger' with 'denial', which is

not how it works. They're stuck in a vicious circle.

By Adrian Kempton-Cumber



**Click here
to read the
full article**



The warning bells are ringing

If you believe the last summer was tough to invest in the equities market, then just wait for the rest of the year and you'll see how bad things can get!

I don't want to be the "Dr Gloom" of Master Investor, but I'm increasingly worried about the proportions the current distortions are taking, as central banks fail to realise the impact of their actions. Seven years ago central banks aggressively cut their interest rates to reduce the impact a liquidity squeeze would have in the real economy; then they proceeded to adopt a few unconventional measures to overcome the zero lower bound problem; and now they are willing to perpetuate the "emergency" policy that was adopted during severe conditions at a time when the economy is approaching full employment levels. **Investors are becoming very anxious about the future, not because they expect interest rates to rise soon, but because they fear that may not happen.** The extended delays in hiking rates and the wobbling speeches made by the Fed chair are giving conflicting signals to investors and then contributing to a substantial increase in volatility that may end very badly. The warning bells are ringing and the US equity market is going out of favour.



It was on 9th March 2009, when the financial crisis was reaching its crescendo, that the S&P 500 hit a bottom. In the advent of the Lehman collapse and the huge liquidity problems it created, the market could only be severely damaged. From an all-time high of 1,565.2 recorded in September 2007, the index

went downhill towards the 676.5 level, hit in March 2009. In 18 months the S&P 500 had lost 57% of its value. But with the help of rate cuts and a few billions of asset purchases, the FED was able to push the market back to record levels, this time to 2130.8, which was hit in May of the current year.

A financial markets crisis? What crisis?

Those who perfectly timed the market by entering at the peak of the crisis could have accumulated a stunning 216% return in May. But those whose timing was poor and who entered at the prior market top in September 2007 would still have accumulated a respectable 36% return. Every trader/investor is a winner under such conditions.

By Filipe R. Costa



**Click here
to read the
full article**

Overcoming the overwhelming: getting your first job

What they don't tell you in freshers, but what every graduate needs to know about getting a job in the real world.

Summer is over, Autumn is here and Winter is coming. With it comes the cold harsh reality of finally finishing university. It's time to pack the tatty old suitcase, leave the throngs of university life behind and dip your feet into the icy waters of the real world. The sadness of saying farewell to cheap pints and cheaper accommodation is offset by the prospect of finding that perfect job you've spent the past 20 years of education preparing for. There's nothing quite like the freedom of finally earning your own living, standing on your own two feet and being your own person, away from the ties of parental funding. You expect brand new horizons; choosing food based on its taste and quality, rather than on the only value items you can afford. Farewell three years of Lidl, hello a lifetime of Waitrose! You might even be mad enough to find yourself looking for-



ward to paying tax, as it signals the reality of finally moving towards being in the black. But with 2015 graduates being the first to have completed university under the new £9000 a year tuition fees, competition for employment is at a record high. According to a High Fliers Research survey earlier this year, the bun fight for jobs is starting earlier than ever before; a staggering **48% of first year students are already searching for theirs.**

This might come as a shock; freshers year is usually thought of as a total doddle whereby if you can muster up the intellectual ability to write your own name, you're half way to passing the year. UCL freshers were this year treated to a free t-shirt with "**F**k me, it's Freshers**" emblazoned on the front; one presumes they are amongst the 52% not searching for jobs and are undoubtedly making the most of what some call "their extended gap year". But last year the NUS Services studied working habits at university; over half of all students take part time jobs and 13% take on full time work. The reason? Over 53% of those working hope it'll boost their post-studies employment prospects. And how right they are. Aside from the transferable skills learnt in the work place, working brings maturity. We all remember arriving fresh faced on our first day at work, naive to just how tough it was going to be. But that doesn't mean working at university is a negative experience; far



“ACCORDING TO A HIGH FLIERS RESEARCH SURVEY EARLIER THIS YEAR, THE BUN FIGHT FOR JOBS IS STARTING EARLIER THAN EVER BEFORE; A STAGGERING 48% OF FIRST YEAR STUDENTS ARE ALREADY SEARCHING FOR THEIRS.”

from it. Getting fired from a Saturday morning coffee shop for being continuously late is far less life-ruining than it happening on a grad scheme when you have £30,000 worth of debt looming over you and monthly rent to pay. Not to mention having to explain at future interviews why you only lasted a month at your first real employment opportunity.

By Caroline Drewett



**Click here
to read the
full article**

In the eye of the storm: the Blackrock World Mining Trust

The slowdown in China has had a huge impact on the prices of raw materials with iron ore losing more than two-thirds of its value and copper falling 50% from the highs back in 2010/11. This has contributed to the recent stock market volatility with the mining sector bearing the brunt of the sell-off.

One of the best known funds operating in this area is the BlackRock World Mining Trust, which is listed on the London Stock Exchange under the ticker BRWM. Over the last 5 years the share price has fallen by 60% and it now trades on a discount to NAV of around 8%.

BRWM invests in mining and metal assets worldwide, but its two largest holdings, BHP Billiton and Rio Tinto have both lost considerable value. Each of these stocks accounts for more than 10% of the portfolio and will have had a detrimental impact on the returns.

Another significant investment has fared even worse. A year ago Glencore's shares were changing hands at

more than £3, but the mining company has plunged in value and you can now pick them up for less than a pound.

There was more bad news in relation to their holding in the London Mining Marampa Royalty contract. This gave the fund the right to receive the Sierra Leone mine's revenue in return for an upfront capital investment, but the money had to be written off last year after the outbreak of Ebola and the collapse in the price of iron ore.

It all sounds pretty desperate, yet the lead manager, Evy Hambro, believes that the sector has fallen to such an extent that it is now beginning to attract investor interest. He is encouraged by the fact that mining companies have cut back drastically on their costs and scaled down their production, which should help to restore the balance between supply and demand.

By Nick Sudbury



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to read the
full article**





BY RICHARD GILL

READ TO SUCCEED

EQUITY CROWDFUNDING FOR INVESTORS

BY DAVID FREEDMAN AND MATTHEW NUTTING

A BOOK REVIEW

Driven by a lack of finance available for small enterprises, along with significant advancements in the growth of the internet, the crowdfunding industry has boomed in the past few years. But it is not a new concept.

As far back as 1606 the Dutch East India Company used the power of the crowd in order to fund the lucrative venture of conducting trade between Europe and Asia. In the 1880s hundreds of small donations from everyday Americans helped to pay for the plinth upon which the Statue of Liberty stands. And in 1997, just before the industry really started to take off, rock band Marillion famously raised \$60,000 via its own fan base to fund a US tour.

Although the current market for equity investment based crowdfunding is small it is growing quickly. According to innovation charity Nesta an estimated £84 million was raised via equity crowdfunding in the UK in 2014, up by 200% from £28 million in 2013 and just £3.9 million in 2012.

So why are investors getting involved?

The power of the Internet has opened up a market which just a few years ago was only accessible by wealthy investors. Crowdfunding platforms

now enable even the average punter to get involved in angel investing. But of course the main attraction of equity crowdfunding is the opportunity to make huge returns on investment. Few other financial instruments offer the potential to increase wealth as much as equity in an early stage or start-up business does.

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Investors could lose all their money investing in a start-up but the right company, if successful, could multiply an initial investment many times over.

For example, in 2013 electric car sharing venture E-Car Club raised £100,000 via a seed capital equity crowdfunding round, and two years later was sold to car hire business Europcar. While the exact purchase price was confidential, investors who got in at the seed round are believed to have made a return of around 3 times their initial investment. So investors attracted by the potential to find the next Facebook or Google should be very interested in *Equity Crowdfunding for Investors* by David Freedman and Matthew Nutting. This is a valuable primer and authoritative guide to an industry which is still misunderstood by many. To start with, the origins and history of the sector are covered, including an explanation of how the internet really helped crowdfunding to take off. Importantly, early on in the book the key distinction is made between donation/reward based crowdfunding (the likes of Kickstarter) and equity crowdfunding (where investors are hoping to make a return on their money).

One section of the book which is especially valuable covers an area which is often ignored or put to one side when considering investing in early stage businesses – risk.

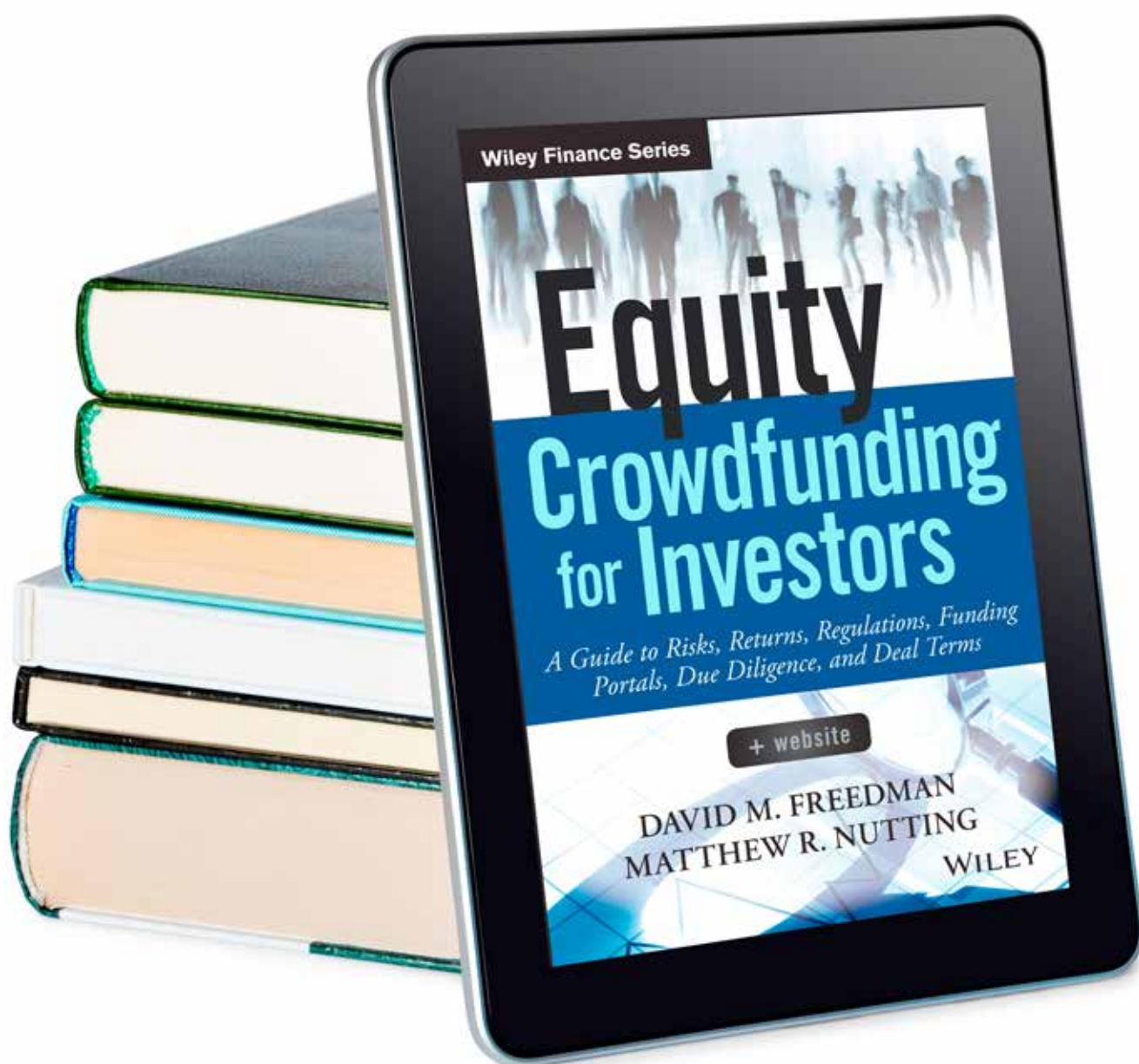
The lure of huge potential returns, along with hype and excitement surrounding start-up companies, can of-

ten cloud judgement. Investors should remember that, just like with any investment, they should do their own research and be aware of all the risks involved – not just the benefits. This is arguably even more important in equity crowdfunding given the early stage nature of the businesses involved and that failure rates for start-ups are high – one crowdfunding company even tells investors in its risk warnings that it is more likely than not that they will lose money! Thankfully the authors recognise this and dedicate four chapters of the book on advising how to invest in equity crowdfunding, includ-

ing how to develop a portfolio strategy, find suitable offerings and do your own due diligence.

While the book is slightly US centric (especially when discussing regulations) this is not a distraction. The vast majority of the text can be applied to UK based investors and it is also interesting to understand how the larger US industry is developing. Overall, I have not come across a better book on the market which covers the fast growing and potentially lucrative crowdfunding arena.

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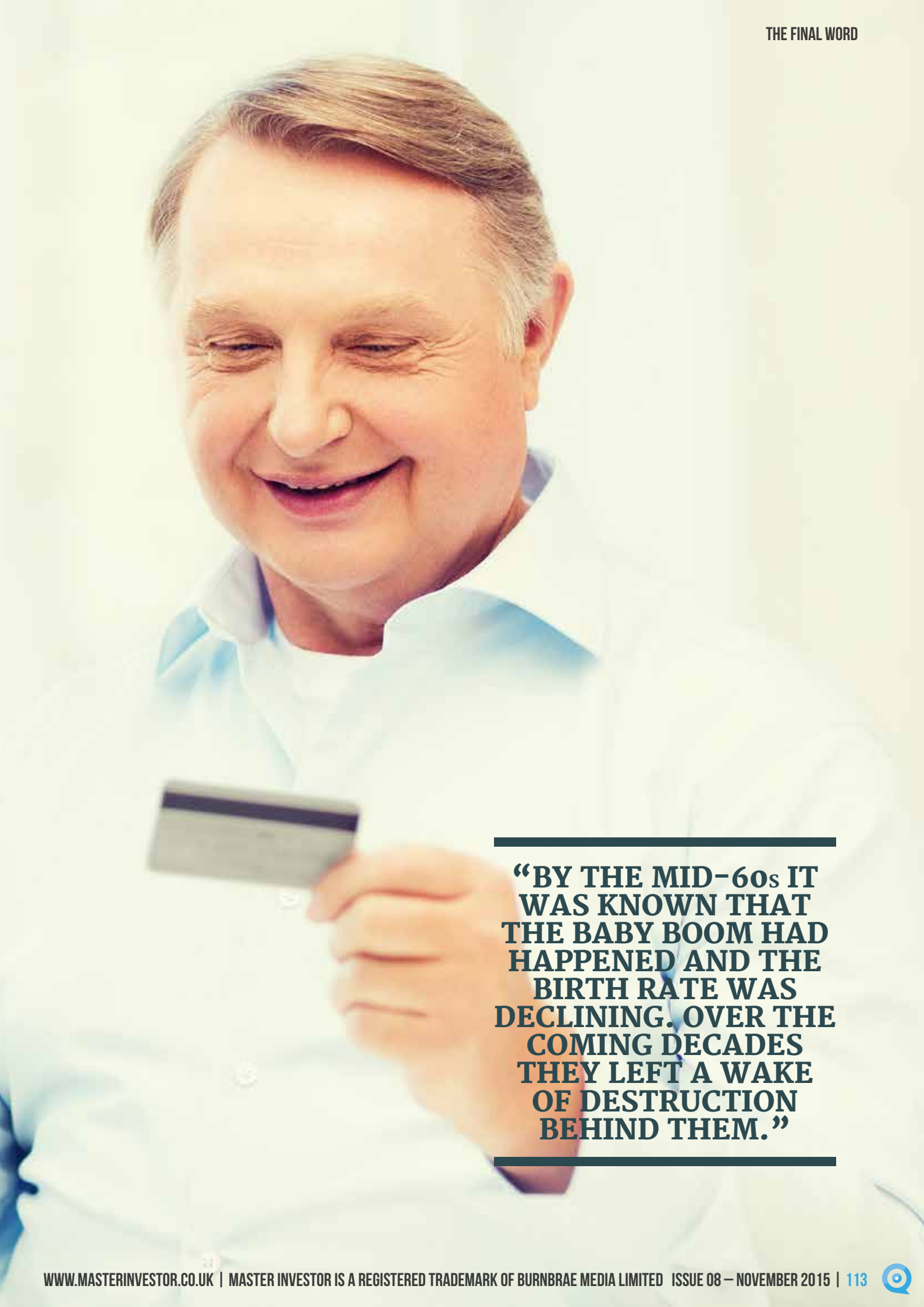


BY ADRIAN KEMPTON-CUMBER

THE FINAL WORD

THE BABY BOOMERS STOLE MY PENSION

When I was growing up the older generation were, well, older. They looked old and they had one or two stories about the War which you'd hear again, and again, and again, until you almost wished the ARP hadn't heard their muffled calls for help. In today's society that older generation is the Baby Boomers.

A close-up photograph of a middle-aged man with light brown hair, smiling warmly. He is wearing a light blue button-down shirt. He is holding a silver credit card in his right hand, which is positioned in the lower-left quadrant of the frame. The background is a soft, out-of-focus light beige.

**“BY THE MID-60s IT
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They're much cooler than the previous generation. Their stories are about hanging out with Jimi Hendrix at a party, or shagging Janis Joplin while off their tits on smack. Happy days! Apparently, with a few exceptions, they seem to have no intention to shuffle off their mortal coil, run down the curtain, and join the bleedin' choir invisible, which is quite rich from the generation that proudly sang along with Pete Townshend's anthemic words: "hope I die before I get old".

And therein hangs the problem. By the mid-60s it was known that the Baby Boom had happened and the birth rate was declining. Over the coming decades they left a wake of destruction behind them. Throughout my childhood I went to places that had been scaled down, heard tales of ones that had closed. Echoes of "you've never had it so good" were underscored by the desolate economic landscape of the '70s and early '80s. Germany and Japan were doing very well, and the phrase "we won the war and they won the peace" was born. We could hardly forget the war when every other street still had an undeveloped bomb site on it.

“MY GENERATION SHOULD BE SCARED OF CORBYN. IT'S NEXT TO IMPOSSIBLE TO MAKE A PENSION PROVISION THESE DAYS UNLESS YOU'RE PREPARED TO MANAGE YOUR OWN PORTFOLIO.”

Life in their wake was like getting hand-me-downs for everything. They were the secret of their own success: a growing population with improving living standards in a period of economic growth. This is also a recipe for flourishing pop culture. They did do some amazing things. They destroyed a lot of the old taboos. Long hair, miniskirts,



free sex, sticking two fingers up to the establishment (the Pythons exemplify this perhaps best of all): they tried to destroy class and at least succeeded in watering it down. The BBs knew their place and they didn't want to stay in it. They challenged Mary Whitehouse and so-called decency. About the only thing they didn't get their teeth into was swearing. And their clarion call about swearing – it's not big and it's not clever – only encouraged us, and it's still big and clever to this day.

They stood up for their rights, and demonstrated in the streets. They make the new generation look so pathetic. I suppose it's fair to say that they also got some things wrong. They embraced feminism, which led to unintended consequences; CND, which wanted an unclear deterrent; and let's not forget they were responsible for the awful Eurovision winners Brotherhood of Man.

They also presided over an age of wondrous scientific advances, but many led to unexpected disasters – mainly pollution of one kind or another. Overall though, it was an age of progress, and one that wasn't ashamed of itself.

Timeline:

The BBs were born into a changing world; one where technology, and ever easier credit, would create a burgeoning consumer society. It was also a world of rations and hardship, and quite a violent one. Casual violence was rife, much more so than it is today.

1960s: Being ten years behind the US, as we normally have been, we didn't

invent teenagers properly until the 1960s. But when we did our youth culture ruled the world without any shadow of a doubt.

This is the new Empire, they must have thought. They had the right demographics: there were plenty of young people to support youth culture, and also to do the menial jobs that were the foundation of the economy they would rape in the 80s. At any age the BBs would be part of the largest demographic, which would yield results now they were of voting age.

1970s: The Saudis manipulated oil prices causing global problems as per usual. Rampant inflation, which reached well over 20% at one point, gave rise to the desire for a store of wealth: property. The governments of the day ignored the demographic (pensions) time bomb that would now have been obvious. Although if life expectancy didn't increase significantly (and why would they have expected it to?), then perhaps they thought it could be dealt with as and when.

1980s: Thatcher saw exactly what was going on. With this yearning to buy property, all she had to do was make the funds available into the pay round, and the multiplier effect that Roosevelt had exploited in his New Deal fifty years earlier would do all the work. It created a nation of property owner-occupiers, and the thing about owner-occupiers is they tend to vote Tory. This was nothing more than a very clever ploy to redistribute wealth to newly minted

Tory voters – the biggest homes-for-votes scheme since Moses, you might say. And with global markets opening up, and British companies selling their expertise around the globe, Britain had bounced back from the problems of the '70s. That was probably the last time the government here actually controlled the economy in a direct way. The Thatcher government did nothing to fix the pensions time bomb, but she may have thought she had by opening up the private pensions market.

1990s: A brief respite allowing the next generation to get in on the action as the recession bites in 1991-3. Successful boomers start retiring. Governments do literally nothing about the pensions time bomb, except to penalise the coming generations for their lack of action.

2000s: As the Boomers really start retiring the grey pound becomes stronger than ever. A fit and broadly healthy generation of retirees start enjoying life on their final salary pensions, and smile with glee as the credit crunch makes governments support a near zero interest economy, meaning their income isn't being eroded, meanwhile the property bubble grows ever larger allowing BBs to cash out at the max.

2010s: My generation should be scared of Corbyn. It's next to impossible to make a pension provision these days

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unless you're prepared to manage your own portfolio. Final salary schemes are all but dead. Our pensions are inevitably going to be our houses. So we all have an interest in the property bubble continuing to grow. The BBs definitely stole my pension and I'll be damned if I'm going to let Corbyn take my assets.

And that, boys and girls, is the story of how 80% of Britain's net personal wealth came to be in the hands of the over 50s, and will remain so for the foreseeable future. There is a fantastic legacy handed down from the BBs, but also some problems; they elected governments to protect their own interests, and they are still the dominant voting demographic. Am I bitter? Yes, somewhat. My generation that followed the BBs never had the same blank canvas of opportunity they had at any stage of the proceedings. That said we have had better health care and quality of life with practically no

worries from childhood until now, so swings and roundabouts perhaps.

Sadly, one of the BBs who didn't make it was my maths teacher. Whilst filming his daughter's wedding he backed out of the church to capture the happy couple emerging. Ahead of the wedding party he was getting the best shots. The path from the church to the street was fairly short so, caught up in the moment, he walked further than he'd thought, backwards into the street where he was immediately run over and killed by a passing car. I suppose the real question here is if the car was travelling at 50 kph and the maths teacher was walking backwards at 4 kph then solve the equation for the change in momentum $Ft = m(v-u)$ for a) the maths teacher and b) the car. The car has a mass of 1,200kg (unladen). Both the driver and the maths teacher have a mass of 80kg. Please show your working. I think he'd appreciate that.



MARKETS IN FOCUS

OCT 2015

GLOBAL EQUITIES

Index	Last Month %	YTD %	Proximity to 52w High*
DAX (Xetra)	12.3	10.7	
NASDAQ 100	11.2	9.7	
CAC 40	9.9	14.6	
Euronext 100	9.7	12.2	
Nikkei 225	9.7	7.1	
Hang Seng	8.6	-5.2	
Dow Jones	8.5	-0.9	
IBEX 35	8.4	0.8	
S&P 500	8.3	1.0	
Russian Trading System	6.9	7.8	
FTSE 100	4.9	-3.1	
S&P/ASX 200	4.3	-4.5	
Bovespa	1.8	-8.3	

COMMODITIES

Commodity	Last Month %	YTD %	Proximity to 52w High*
Sugar (No. 11)	13.0	0.1	
Platinum	8.7	-18.4	
Silver	7.1	-1.0	
Cocoa	4.2	9.4	
Palladium	3.7	-15.2	
Gold	2.4	-3.5	
Crude oil (Light Sweet)	2.3	-13.6	
Crude oil (Brent)	2.1	-14.3	
Soybean	-0.9	-13.5	
Coffee	-1.2	-27.0	
Copper	-1.3	-19.3	
Iron Ore	-8.8	-33.3	
Natural Gas	-8.9	-20.9	

FOREX

Pair/Cross	Last Month %	YTD %	Proximity to 52w High*
GBP/USD	2.0	-1.0	
AUD/USD	1.8	-12.6	
USD/CHF	1.4	-0.6	
USD/JPY	0.6	0.8	
GBP/AUD	0.1	13.2	
EUR/CHF	0.0	-9.6	
EUR/JPY	-0.9	-8.3	
EUR/USD	-1.4	-9.0	
USD/CAD	-1.8	12.6	
EUR/GBP	-3.4	-8.2	

CENTRAL BANKS - RATES & MEETINGS

Central Bank	Key Rate	Next	After
BOE	0.50%	Nov 05	Dec 10
ECB	0.05%	Dec 03	Jan 21
FED	0.25%	Dec 16	Jan 27
BOJ	0.10%	Nov 19	Dec 18
SNB	-0.75%	Dec 10	Mar 17
BOC	0.50%	Dec 02	Jan 20
RBA	2.00%	Nov 03	Dec 01
RBNZ	2.75%	Dec 10	Jan 28
BOS	-0.35%	Dec 14	Feb 10
BON	0.75%	Nov 05	Dec 17

FTSE 350 TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Al Noor Hospitals	41.0	18.8	
KAZ Minerals PLC	37.2	-55.0	
Allied Minds PLC	33.9	28.5	
Cable & Wireless Comm	32.9	48.3	
Fresnillo PLC	23.4	-4.7	

FTSE 350 BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Meggitt PLC	-25.7	-31.9	
Pearson PLC	-23.6	-27.6	
SIG PLC	-23.1	-23.4	
Acacia Mining PLC	-22.2	-24.4	
TalkTalk Telecom Group I	-19.6	-16.8	

FTSE 350 SECTORS TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Industrial Metals	16.3	-45.2	
Oil & Gas Producers	10.8	-13.5	
Fixed Line Telecom.	10.1	15.3	
Life Insurance	9.2	3.7	
Forestry & Paper	8.7	43.2	

FTSE 350 SECTORS BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Aerospace & Defense	-2.8	-14.2	
Health Care Equip.	-0.9	0.2	
General Industrials	-0.4	6.4	
Industrial Transport.	-0.2	-7.1	
Banks	0.3	-12.6	



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