ISSUE 09 – DECEMBER 2015

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CYBER-SECURITY

HOW TO CASH IN ON THE NEW ARMS RACE

PLUS...

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KEEPING IT IN THE FAMILY

DO FAMILY-OWNED FIRMS REALLY OUTPERFORM?

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Dear Reader,

In this month's issue we are turning our eyes to a subject that once was of interest only to geeks and IT professionals, but which now sits right at the heart of the world economy.

Cyber-security entered the public discussion in earnest when Julian Assange started Wikileaks, a public platform that by now has published more than 10 million sensitive documents. It was the first high-profile case of digital copies of confidential documents being stolen and published on an industrial scale. That was back in 2010.

This year saw another such high-profile case, Ashley Madison. All 37 million customers of the world's biggest adultery website had to live with their entire confidential information, including sexual preferences, becoming available to anyone who has internet access. Insufficient cyber-security at the company that operated the adultery website led to hackers being able to steal the files and publish them.

WikiLeaks and Ashely Madison are only two names in a long series of recent breaches into computer networks. There were an unprecedented number of such cases in 2015, with a total of more than one billion records – including health, financial, email and home address data – being stolen.

The UK's biggest data breach of the year happened at Carphone Warehouse, the phone retail store. As many as 2.4 million customers had their personal information taken in the breach, affecting 4% of the entire population. Investors, too, became a victim of cyber-security-related crimes. Crowdfunding service Patreon got the Ashley Madison treatment when it found its entire data published online.

Antony Jenkins, the former CEO of Barclays Bank, recently stated that the financial industry is going to face its "Uber" moment. He warned that technological advances could soon render half the number of bank branches and employees unnecessary. That, however, isn't going to happen if companies, including banks, aren't upgrading the security of their computer systems.

During the coming years, cyber-security is bound to become one of the world's fastest growing industries. It wouldn't be a surprise if one or two cyber-security entrepreneurs rose to the same level of wealth and fame as Mark Zuckerberg of Facebook or Bill Gates of Microsoft.

What are the most important trends, and which companies can investors place their bets on? Read on to find out...

Best regards,

Swen Lorenz,
Editor, Master Investor

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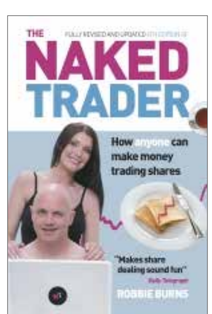

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BY JIM MELLON

MELLON ON THE MARKETS

As I write this, I am on a working Norwegian ferry, hugging the coast between Bergen half way up and Kirkenes in the far North of the country. Kirkenes was the second most densely bombed town (after Malta) in Europe in the Second World War, and is the nearest town in Norway to the Russian border and Murmansk. It is also farther East than St Petersburg and Istanbul.

It is also a point of entry for the wave of migration that is currently destabilising Europe. Readers may have seen video footage of asylum seekers crossing from Russia into Norway on children's bicycles; there is a rule that you can't walk across at this point, hence the bikes. About 5,000 people, mostly young men, have crossed in this way and now add to Kirkenes's small population.

Norway is keen that these people should settle in this Arctic region; it is underpopulated, and the 41 visits to small ports I have made on this trip so far reveal a plethora of hamlet-like towns with too few people to make them viable. As Norway's oil bonanza turns sour, indigenous young people are heading south, to the bright lights of Oslo, or even to those of London and Berlin.

At first, as applications for asylum are processed, the refugees will stay in the North; they have no choice. But as soon as they have papers, they will head south. People from Afghanistan, Syria, and Pakistan et al are unlikely to want to endure 20 hour days of darkness in winter, as well as freezing temperatures.

And they will, under the current rules in the Schengen area, which Norway is part of, be able to do just that – i.e. leave and travel freely, most likely to Germany and to Sweden.

Along with the millions arriving in Europe this year, and likely millions next year, the Kirkenes bicyclists represent the tip of a very large iceberg (pun intended).

These people are coming for a variety of reasons, but one that is not much talked about is the stalling of economic growth in the emerging markets, particularly those at relatively early stages of development. Emerging markets are growing at the lowest rate in recent recorded economic history; and in some areas, the decline in growth is downright worrying. In Africa, hailed recently as a miracle continent, overall growth in 2015 is only forecast at 3.5% in real terms, with countries such as South Africa and Nigeria suffering outright declines in GDP per capita.

The reality of the matter is that Africa's "miracle" was more likely due to a windfall from commodity price inflation in the recently broken super cycle for metals and minerals. It wasn't down to productivity growth; indeed, Africa's governance indices are lower than they were in 1999, a disastrous situation for a notoriously corrupt continent.

In Pakistan, Afghanistan, Morocco, Tunisia, Algeria and Albania, as in many other countries, the situation is the same: poor economic growth – or at least growth that doesn't produce enough jobs – and a surplus of manpower.

The rise of automation in the West and in Japan (and indeed in China) is depriving the poorest of developing countries of the lift they would hitherto have received just a few years back. This boost would have been from the movement off farms to the cities and to export manufacturing. This was the model for China, for the Philippines, for India (to an extent), and (earlier) for Singapore, Korea, Hong Kong and Taiwan.

> **"COUPLED WITH THE OBVIOUS PROBLEMS FROM UNCONTROLLED MASS MIGRATION, EUROPE IS THE PLACE TO WATCH OVER THE NEXT YEAR."**

And the model *did* work; compared to 1990, when 37% of the world's population lived in poverty (defined as less than $1.90 per day), today only 10% do so. Indeed, in Asia, thirty years ago, 60% of the population lived in poverty; now it's less than 4%.

Increasingly, manufacturing is being done at the point of consumption, using robots and other production techniques that are less labour intensive. This means that there is less work to go around for the people of the frontier developing countries, especially at a time when those beholden to commodity exports are having a tough time. The advantages conferred in the earlier era of developing markets don't seem to be the same for the latecomers. And hence the Great Migration.

This migration will certainly continue, with all the benefits (to Germany, for instance with its demographic issues) and disadvantages (some inevitable influx of radicals, poor integration and cost).

And this, along with the financial problems of the Euro Zone, as well as mounting terrorist outrages, could well mark the beginning of the end of the federalist European project. In fact, with or without a referendum in the UK, Brexit might happen simply because there is likely to be a fracturing of the current European Union set-up.

In particular, the debt trap that France and Italy find themselves in (I call them the FRITS – French and Italian Sinkholes) are ominously dangerous. France and Italy just can't grow their economies fast enough to avoid eventual default on their massive debts, which altogether are about 15x bigger than Greece's. Remember the ructions earlier this year about extending and pretending on the Greek debts, and imagine a comparable situation for France and Italy. We can't – because it is nightmarish to contemplate and nice Mr Draghi says he will do all that is necessary to avoid it. Well, he may not be able to hold these particular waves back.

Already, **Schengen** is heading to the departure lounge; there are serious disputes in the Euro Zone about the extent, if any, of further monetary stimulus, and Germany's massive current account surpluses are showing up in vastly increased Target 2 balances at the ECB. In a nutshell, this means that Germany is keeping the Spanish and Italian banking systems afloat.

"WITH OR WITHOUT A REFERENDUM IN THE UK, BREXIT MIGHT HAPPEN SIMPLY BECAUSE THERE IS LIKELY TO BE A FRACTURING OF THE CURRENT EUROPEAN UNION SET-UP."

The tricks that Mr Draghi has used so far to keep the Euro project alive, notably QE and ultra-low interest rates, will have decreasing efficacy as the negative interest rates at the ECB reach the practical limits of the zero bound. He is limited in what bonds he can buy, as the supply of suitable ones is tight, and there are concentration limits. He might end up buying loans from banks directly. But this would be highly resisted by the Bundesbank.

The magician is digging deep into an increasingly empty box of tricks.

The Euro Zone remains the biggest single risk to the world economy; not China, which has problems, but is not a disaster, and not the US, which motors along, albeit at a reduced rate. The Emerging Markets are a mixed bag, and Japan is still fighting deflation, with modest success.

Coupled with the obvious problems from uncontrolled mass migration, Europe is the place to watch over the next year.

All negative yield bonds are a sell, and some are worth shorting. The Swiss Franc is a sell against everything, the pound is a sell against the dollar, the Canadian dollar a buy against the US dollar, and gold and silver are buys. I'd stay clear of overpriced US markets; the UK and European markets are for stock pickers, and there I like **Kuka and Siemens** in Germany, and **Shell** in the UK.

I like **Turkey** as a punt (Garanti Bank and Halk Bank), and I like **China** (large company ETFs), as well as Brazil (the cheapest market in the world (ETF again) – and I really like **Vietnam.** It's probably best to buy the listed closed end funds, which normally sell at a discount. **Vietnam** could just be the last developing country to escape the curse of automation and localisation. My company of the month is **Arrowhead Research.** I just met with them and I think they do have a cure for Hepatitis B!

Happy Hunting!

Jim Mellon

WHAT JIM READ THIS MONTH...

Skreemr, the Mach 10 supersonic aircraft

Fans of the new Amazon web-series *Man in the High Castle* may have found themselves missing the 'good old days'... By that I mean super-fast air travel and not a global Nazi Empire, of course. But with plans to recommence Concorde flights by 2019, Canadian designers are looking to step it up a notch. They have designed the reassuringly name Skreemr, that would reach speeds of over Mach 10, around five times faster than Concorde.

Read more: http://www.telegraph.co.uk/luxury/travel/90250/skreemr-the-mach-10-supersonic-aircraft.html

Were the Luddites right about technology and jobs?

At the recent Trade Union Congress, Bank of England's Chief Economist Andy Haldane warned that up to 15m jobs in the UK cold be replaced by robots. Of course this is nothing new, but the article looks to the ethos behind the Luddites (the real-life historical movement not the out-of-touch 40 year olds without Facebook who still use Nokia 3310s) and what this displacement of labour means for our society.

Read more: http://www.bbc.co.uk/news/business-34813903

Robots take on more elaborate tasks amid worker shortage

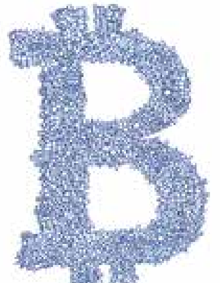
On a related note, it seems the manual global workforce is actually facing a shortage, according to the Wall Street Journal. But the robot workers waiting in the sidelines aren't quite up to the job, say the experts. For now robots can only perform basic tasks, those requiring increased dexterity and complexity still require humans. But not for long, Stanford University's Vivek Wadha predicts that by 2050 robots will be capable of every task we are.

Read more: http://www.wsj.com/articles/robots-take-on-more-elaborate-tasks-amid-worker-shortage-1448291203

Silicon 2.0 promises super-powered chips and solar cells

So apparently a whole sector, and indeed an entire valley, has been founded on a lie. Silicon, it seems, has been grossly over-estimated and is now 'holding back' advances in technology. A group of researchers are determined to find a suitable replacement. But to no doubt avoid the confusion of rebranding, they are looking to restructure silicon itself. Monocrystalline Semiconductor Valley doesn't quite have the same ring to it.

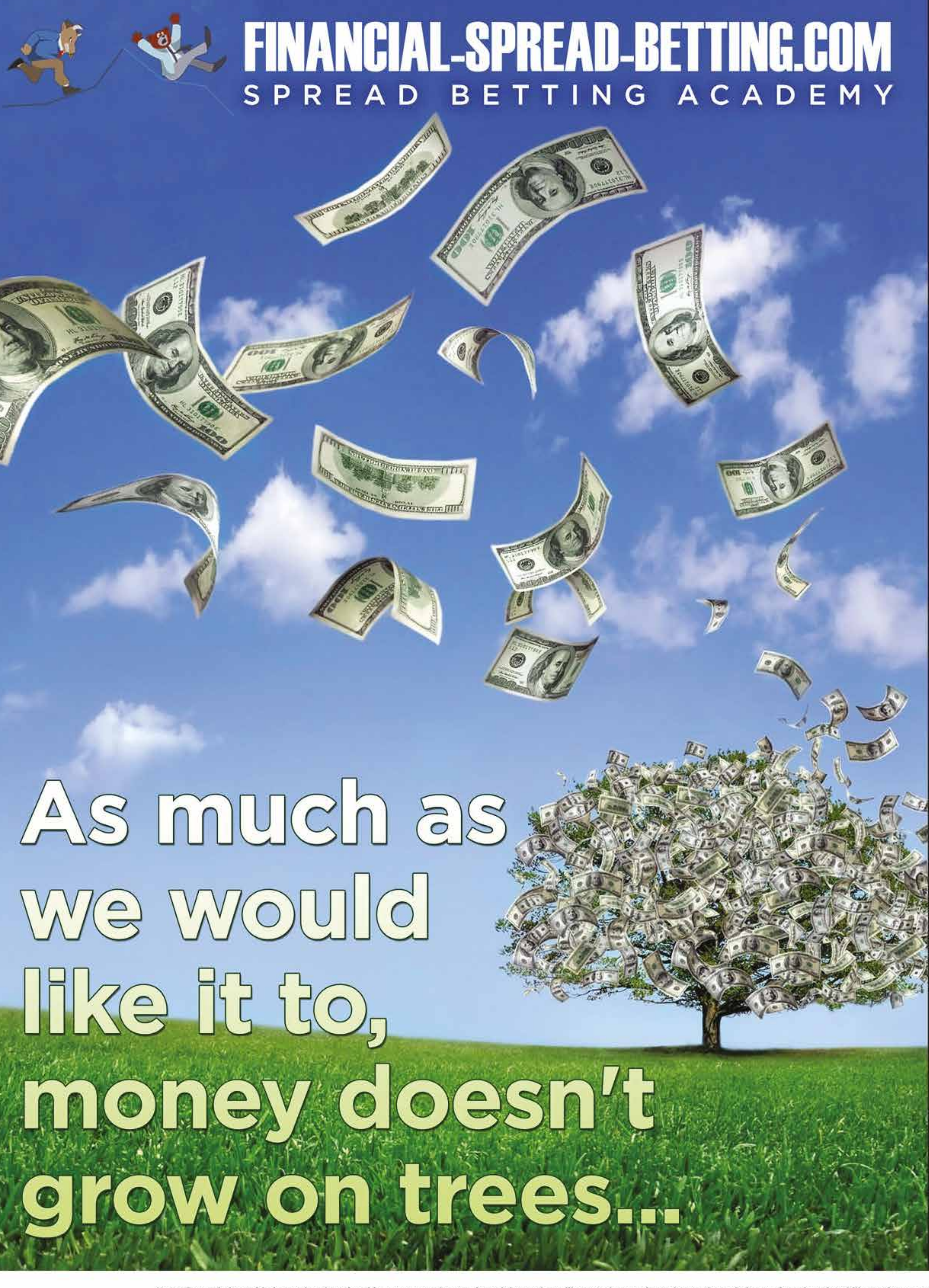
Read more: https://www.newscientist.com/article/mg22830480-500-silicon-2-0-promises-superpowered-chips-and-solar-cells



Technology: Banks seek the key to blockchain

"You should be taking this technology as seriously as you should have been taking the development of the Internet in the early 1990s. It's analogous to email for money." Declared Blythe Masters, head of Digital Asset Holdings, a blockchain start-up set to revolutionise online money transfer. The latest advance in FinTech aims to drastically cut infrastructure costs for banks by harnessing the power of bitcoin.

Read more: http://www.ft.com/cms/s/2/eb1f8256-7b4b-11e5-a1fe-567b37f80b64.html#axzz3sKAKGvQR



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

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

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

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

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BY SWEN LORENZ

AROUND THE WORLD IN A DOZEN PROPERTIES (PART 9)

SHOULD YOU GIVE IN TO THE SIREN CALLS OF SWISS PROPERTY YIELDS?

No overview of property investment opportunities around the world would be complete without including the ultimate safe haven investment destination – Switzerland! Investments in bricks and mortar have always had a strong safety aspect, and Switzerland, in turn, is one of the world's most renowned places to safely stash away a nest egg. Are Swiss properties worth an investment, and might they even be an alternative to negative interest rate investments into Swiss bonds? Master Investor investigates...

Any analysis of investment opportunities in Switzerland will have to start with the game-changing abandonment of the Euro exchange rate floor and the subsequent economic shock Switzerland experienced. The consequences of this particular move will impact the country for years to come. In January, the Swiss Central Bank allowed the Swiss Franc to freely fluctuate. The subsequent appreciation relative to the Euro and the US Dollar caused tremendous issues for the export-orientated Swiss economy. Overnight, Swiss products became 30% to 40% more expensive for foreign customers. Swiss products were never exactly cheap, but have now become incredibly expensive.

> **"ANYONE TRAVELLING TO SWITZERLAND WHO HAS BOUGHT A $5.50 STARBUCKS COFFEE WILL HAVE A ROUGH IDEA WHAT SWISS INDUSTRY IS DEALING WITH."**

Anyone travelling to Switzerland who has bought a $5.50 Starbucks coffee will have a rough idea what Swiss industry is dealing with. The same coffee would cost $1.95 in New York and $3.10 in London. Thanks to its exchange rate, Switzerland is currently home to two of the world's most expensive cities, Zurich and Geneva. The Swiss Franc's relative illiquidity and status as one of the

world's most highly regarded safe haven currencies has led to its value soaring, in a way that a few years ago no one would have ever thought possible.

It's not just the prices of day-to-day goods that are hard to get your head around. Equally baffling are the country's bond yields and how they compare to the yields that are achievable through investing into property in the very same country.

Swiss bonds with a maturity of up to 10 years are yielding a negative interest rate, which basically requires savers to pay a bank to keep their money. There is now such a growing problem with savers simply taking cash out of the bank and stuffing it under the mattress, that Swiss authorities are said to be seriously considering banning cash altogether and switching to a digital currency.

Swiss property, on the other hand, yields 3.2% to 3.8% p.a. In an era of negative bond yields and high stock market valuations, investing into property currently represents one of the few ways for pension funds, insurance companies and other large and safety-conscious investors to generate an attractive and reliable yield.

However, the question is: how reliable and sustainable are such yields?

Switzerland is currently a country of contradictions. Whereas the economy shows clear signs of dipping into a recession, property companies are sticking to their plan to increase supply. They are being encouraged by cash-rich investors who want to deploy yet more money into office properties, simply for lack of having any suitable alternatives. For as long as bond yield remain negative, even a gradually declining rental yield seems like the lesser of two evils. Throw in the opportunity for leverage – money being available easily after all – and it is possible to achieve a return of 5% to 6% on what seems like a relatively safe asset class.

That's why companies like **PSP Swiss Property (ISIN CH0018294154)** continue to experience a high level of interest. Set up in 2000, the company is now managing one of the country's largest property portfolios, valued at

"SWISS AUTHORITIES ARE SAID TO BE SERIOUSLY CONSIDERING BANNING CASH ALTOGETHER AND SWITCHING TO A DIGITAL CURRENCY."

CHF 6.5bn (£4.2bn). The company's portfolio is focused on central locations in Zurich, Geneva, Basel, Berne and Lausanne. Two thirds of the company's rental income comes from office space, 15% from retail space, and 6% from parking spaces. A team of almost 90 staff members are actively managing the portfolio, and they have managed to find strong anchor tenants, such as the Swiss Postal system, Google, and the national telephone company, Swisscom.

The company at last count showed CHF 99 per share in equity, and currently trades at CHF 78 per share. If PSP Swiss Property liquidated its entire portfolio tomorrow, it would have to pay taxes on accumulated capital gains, but even after taking those into consideration it could achieve a liquidation value of CHF 83 per share. In other words, shares in PSP Swiss Property are currently trading below their liquidation value.

Its most recent dividend was CHF 3.25 per share, giving the share a dividend yield of 4.1% p.a. Despite fears that Switzerland is facing a recession, and despite the looming over-supply of properties in at least some locations, there is steady interest from yield-hungry investors.

Will the dividend payout likely remain at the current level, and what's the risk of falling property prices dragging down the company's net asset value and share price?

Even after sifting through all recent research on the Swiss property market, little is clear about the market's future trend. On the outskirts of major cities, large amounts of office space oversupply have appeared on the horizon. Yet, in central locations, quality space remains in short supply and high demand, although there are signs of over-supply of smaller, lower quality offices in inner-city locations. Swiss banks, on one hand, are facing secular changes to their business models and how banks in general operate. At the same time, high-tech companies continue to move into Switzerland, to take advantage of the highly qualified work force and the ability to utilise a stable legal environment and first class infrastructure.

Throw in the fact that most rental agreements for the properties held by PSP Swiss Property are long-term, and the company has a high degree of safety when it comes to projecting its income.

In theory, at least, PSP Swiss Property should make for a safe investment with

an attractive dividend yield. In real life, however, not all is as safe as it seems. The Swiss currency, economy and property market have entered unchartered waters. Market imbalances of the kind currently seen in Switzerland more often than not end in tears. It's hard to foresee how the current phase of seemingly attractive rental yields for Swiss properties could come to an end. However, it had been equally hard to foresee the Swiss Franc's sudden appreciation in January 2015, given how the Swiss Central Bank had reassured markets about the exchange rate floor just days before abandoning it.

"DESPITE FEARS THAT SWITZERLAND IS FACING A RECESSION, AND DESPITE THE LOOMING OVER-SUPPLY OF PROPERTIES IN AT LEAST SOME LOCATIONS, THERE IS STEADY INTEREST FROM YIELD-HUNGRY INVESTORS."

The combination of sky-high prices by global standards, rising supply in a weakening economic environment and unprecedented imbalances in capital markets should lead investors to heed caution instead of giving in to the temptation of a seemingly attractive yield. If an unexpected shock hits the system, the 4% annual yield is unlikely to make up for the subsequent drop in capital values. Also, the currency risk is, in any case, a considerable one. A currency that appreciated by 30% to 40% overnight could eventually move in the opposite direction at an equally fast pace.

For now, it would seem preferable to follow further developments from the sidelines.

BY JAMES FAULKNER AND SWEN LORENZ

CYBER-SECURITY:

THE NEW ARMS RACE – AND HOW TO PROFIT FROM IT

2015 will go down as the year when cyber-security entered not just the mainstream media, but also board rooms and executive offices. Making sure that customer information and other sensitive data stays safe has become recognised as a subject that can take down CEOs and even entire companies. Ashley Madison, the adultery website that saw its 37m datasets about clients leaked to the public, was just one recent example of many. What was once regarded as a subject that was best delegated to the IT department is now a major growth area. Investors, too, have started paying attention to the growing number of opportunities in the field.

It's quite possible that in a few years' time, the cyber-security industry will talk about the time "before Ashley Madison" and "after Ashley Madison". Whereas this is by no means the biggest case in point, it certainly was the most evocative case. With information on 37 million prospective adulterers, including their sexual preferences, with lots of celebrities and captains of industry involved, it's hard to imagine a data leak that could have made for juicier media material.

UK LARGE- AND MID-CAP STOCKS WITH EXPOSURE

Although defence giant **BAE Systems (LSE:BA.)** is better known for its ships, planes and tanks, it is now a major cyber-security player in its own right. In recent decades BAE has undergone a transformation that has seen it refocus its offering away from hardware and toward services, which now account for roughly half of group turnover. As a major element of this transformation, between 2008 and 2011 BAE acquired five cyber-security firms, including the £531 million purchase of UK market leader Detica. Renamed *BAE Systems Applied Intelligence*, this unit now heads up the firm's cyber portfolio.

With sales growth in conventional armaments muted due to the budget restraints of major customers, the move into the cyber-security sector has proved to be a useful source of growth to offset a more lacklustre performance elsewhere in the business. Overall, mid-single digit sales growth is expected in the cyber division in 2015 with strong sales growth of around 30% planned in Applied Intelligence offsetting marginally lower sales in Intelligence & Security. BAE offers exposure to the sector via a diversified portfolio of defence assets, which also comes with strong income attractions. The prospective FY16 dividend yield of 4.8% is almost twice covered by prospective earnings estimates, and the firm appears conservatively geared with net debt of just over 1x EBITDA.

Another firm to look out for is **QinetiQ (LSE:QQ.)**, whose expertise in this area permeates its offering and proliferates its image as HM Government's 'go to' tech specialist. QinetiQ's cyber intelligence business, Cyveillance, recently launched a cloud-based cyber threat centre that monitors the internet, provides alerts and delivers data on domain names, IP addresses, phishing and malware attacks. This provides direct access for customers to its monitoring and investigative tools and complements its existing consultancy-based services. We also like QinetiQ for its exposure to a raft of growth markets, such as robotics, unmanned aircraft and the space industry, not to mention its net cash pile of £195.5 million (as as 31st March 2015) and relatively modest valuation.

Meanwhile, **Ultra Electronics (LSE:ULE)** generates a quarter of its revenues from its Security & Cyber division where it notes that "budgets are increasing, particularly in nations that face terrorism, border control issues, internal threats and IT infrastructure dependencies." Ultra, which draws just over half of its revenues from the defence sector, has expertise in a number of specialist areas which are often seen as 'mission critical' and where its technology is market leading. The shares don't look particularly expensive on c.15x prospective earnings, but activity levels remain subdued, with a book to bill ratio of 0.93x for the six months to June 2015.

The scope of the entire security problem of the IT industry is staggering. Cyber attacks in 2014 have claimed high profile victims such as JP Morgan, the White House, Yahoo, AT&T, eBay, Apple, UPS, and even Google. In the UK, a recent high profile victim was Talk Talk, the telecoms and internet service provider.

At times, it feels like there is a new attack every day, and on more than the odd occasion the size of the security breaches is nothing but mind-boggling. The JP Morgan cyber attack affected 76 million households in the US. To put that immense number into perspective, recent estimates indicate that fewer than 120 million households exist in the US.

Finally, the cyber-security industry is getting the attention it deserves – and it's now officially one of the world's fastest-growing sectors of the information technology business! Between 2015 and 2020, the size of the industry is projected to grow from $77bn to $170bn. That's equivalent to a compound annual growth rate of 9.8%. The European market for cyber-security is expected to grow to $35.5bn by 2019, equivalent to a compound annual growth rate of 7.2%. Europe accounts for 27% of the entire global market for cyber-security, with further major markets in the US and Asia.

"BETWEEN 2015 AND 2020, THE SIZE OF THE INDUSTRY IS PROJECTED TO GROW FROM $77BN TO $170BN. THAT'S EQUIVALENT TO A COMPOUND ANNUAL GROWTH RATE OF 9.8%."

Within this industry are a number of sectors that are projected to grow even more quickly. Amazingly enough, so far hardly anyone has paid attention to insuring against the risks arising from insufficiently secure IT systems. Two years ago, the global market for insurance against computer security breaches amounted to just $1 billion, and most of that was focused on the US market. During the past 24 months, the market has grown 150% to $2.5 billion. Further growth is virtually a certainty, as insurance companies start offering products for this area. An entirely new set of terms is emerging, such as "cost-per-breach".

The sheer scale of the problem is only now emerging. One of the peculiarities of cyber-security issues is that few companies actually report a breach when one has occurred. Companies are embarrassed and afraid of claims from customers whose data they lose to unauthorised third parties. Reported security breaches alone are estimated to cost private enterprise between

$400 billion and $500 billion per year. The unreported cases could add 2-3 times as much to the bill. Cyber-criminals stole up to $1 billion from approximately 100 financial institutions in the US, Germany, Russia, Ukraine, and China over a two-year period, according to researchers from security firm Kaspersky Lab.

Hacking into computer systems is now a global industry, with computer experts hiring themselves out to corporations, governments and other clients to illegally break into computer systems of competitors and other nations. The US government alone has spent $100 billion on computer security since 2000 and is currently running a yearly budget of $15 billion dedicated to cyber-security. Between 2000 and 2015, the yearly budget the US federal government spends on cyber-security increased 14-fold. Pretty much everywhere else in the world, government budgets for cyber-security are rising at comparable speeds.

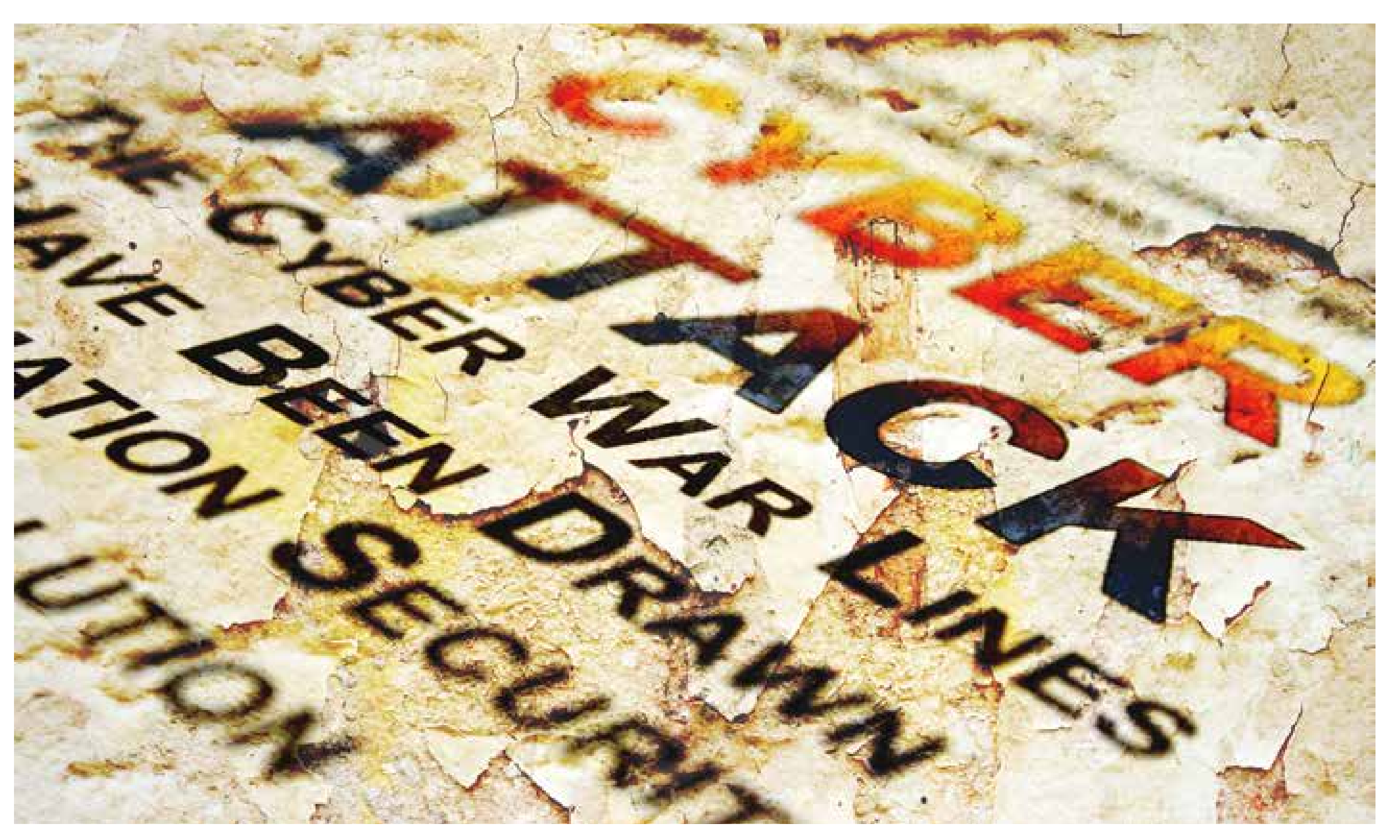
The ever-increasing number of computer devices on the planet is adding another level of complication to the subject. Cars are now so dependent on computer chips that they, too, have become the target of hacker attacks. Add to this the billions of mobile devices such as phones and tablets, as well as

CYBER INSURANCE

A less obvious way to gain exposure to the growth in the cyber-security market is via the insurance companies that insure against losses incurred through cyber crime. Surprisingly, only a limited number of companies outside the US are buying cyber insurance; but the trend is nevertheless clear and inexorable. In particular, the US and UK governments are keen to insure that companies do more to safeguard themselves and their customers in this regard, and legislation is slowly making its way through in both jurisdictions, not to mention the EU, which should help steer things in the right direction. Cyber cover is set to be a major growth area of the insurance industry according to an Insurance Institute poll, which saw 80% of respondents concur with that statement.

According to broker Westhouse, **Beazley (LSE:BEZ)** is currently the clear UK market leader and enjoys early mover advantage in this area via its Beazley Breach Response product. The other two companies to look out for are fellow Lloyds insurers **Novae (LSE:NVA)** and **Hiscox (LSE:HSX)**. Global cyber premiums are estimated to have reached $2.4 billion (£1.6 billion) in 2014, up from US$1.3 billion (£850 million) in 2013 (source: ITProPortal, February 2015). To put this into context, total non-life premiums in the advanced economies were $1.65 trillion in 2013. Given that cyber increasingly permeates most aspects of our daily lives, it is only rational to assume that cyber insurance premiums will continue to grow strongly in both absolute and relative terms for the foreseeable future.

> “BETWEEN 2000 AND 2015, THE YEARLY BUDGET THE US FEDERAL GOVERNMENT SPENDS ON CYBER-SECURITY INCREASED 14-FOLD.”



UK PURE-PLAY CYBER STOCKS

With a market cap of almost £1.2 billion, **Sophos (LSE:SOPH)** is the UK's largest listed pure-play cyber-security company. The Oxfordshire based company made its stock market debut in July and is still majority owned by private equity group Apax Partners, who offered 35% of Sophos stock in the IPO in order to reduce debt. The firm sells its software, which protects against hackers and cyber attacks, to mid-sized corporate, which account for around three quarters of the IT security market and are generally seen to be less prepared than larger companies to cope with the cyber threat. Revenues have been growing rapidly and the firm managed to turn a $22.2 million operating profit in the year to March. The upfront subscription-based business model makes Sophos highly cash generative, with cash generation well above the equivalent EBITDA figure for the year to March.

Meanwhile, **NCC (LSE:NCC)** (which stands for National Computing Centre) pinpoints and eradicates security flaws in applications using penetration testing, reverse engineering and code reviews, while providing assurance over security and vulnerabilities for all information held, software and applications used, as well as the web environments. It also works to plan for and manage the impact of a potential hack and a rapid response forensic team. With its talents in high demand among many high profile organisations, NCC Group is fast becoming a truly international business, with operations in four continents and associated benefits of scale. In particular, its Total Assurance offering, which provides organisations with peace of mind that their most important assets are protected and operating as they should be at all times, is considered to be unrivalled within the industry.

Of particular note for the future is the firm's investment in *.trust*, a generic top level domain (gTLD) which aims to create a universal environment for end users to operate and navigate the internet with complete safety and security. The group established a new wholly owned subsidiary, Artemis Internet Inc. in San Francisco, to develop the critical infrastructure and know-how to deliver this project. While Domain Services is expected to generate revenues in the current financial year (to 31 May 2016), the division is still expected to report a modest loss this year as the Group continues to rollout and invest in its new capabilities. However, it is expected that the division will make a positive contribution in the financial year to May 2017 as all the service lines start to contribute fully. The ultimate goal is to offer a unique and secure gated community for companies to offer improved security enabling their end users and customers to interact with them safely and securely over the Internet.

Growth in both revenue and profitability has been fairly consistent over the years, and the most recent trading update flagged organic revenue growth of 17%, an improvement on the 14% seen in the previous half. Management are confident that they remain on course "to sustain our double digit organic growth and strong cash generation" and expect to meet expectations for the current financial year. And with over 50% of the Group's revenues now outside the UK – with the majority in North America – the firm's ascent will not have gone unnoticed in the industry. We believe NCC will become a takeover target before long (if it isn't already), although the strong performance in recent years now means the shares are trading on c.23x current year's earnings forecasts.

Finally, **GB Group (LSE:GBG)** specialises in identity management, primarily generating revenues from software that helps consumer-facing businesses identify their customers. The firm is particularly exposed to the growth of online commerce via its ID verification business as the reliable identification of remote users becomes ever more important to business. In the UK there are significant opportunities for growth as automated processes replace manual checks. Meanwhile, although a relatively small amount of revenues are derived from overseas at present, international expansion is seen as a major avenue for growth in the coming years. The group has access to multiple data sets, many of which are exclusive to GB and are major competitive barriers to entry. The shares have clear strategic value, but currently trade on a P/E ratio in the mid-30s reflecting the firm's strong and consistent growth record.

N.B. You can read more about GB Group in our executive interview on page 30.

the increasing number of devices used to operate homes and households, and you get a feel for how many potential gateways there are for unsavoury characters breaking into computer systems and stealing or manipulating data.

The industry is already struggling with a shortage of labour. In the US alone, more than 200,000 positions related to cyber-security are unfilled because there are simply not enough qualified professionals available. It is estimated that at the current rate there'll be a shortage of 1.5 million cyber-security professionals around the planet by 2020. Obviously, an increase in salaries could lead to a run on universities and other institutions that offer training for this area. A recent Rand Corporation study estimated there are around 1,000 top-level cyber-security experts globally vs. a need for 10,000 to 30,000.

Experts in the field point out that the market is now simply catching up with standards that should have been adopted many years ago but were simply ignored. The industry is now in catch-up mode, driven by the desire of decision-makers in companies and government authorities to secure their personal career against any Ashley Madison-style occurrences. Ashley Madison's CEO, after all, lost his job following the data breach. His spectacular downfall, involving the cancellation of a planned $200 million IPO, will remain on other managers' minds for many years to come.

The growth of the Internet and the every-day use of electronic devices have created a huge opportunity for companies that offer cyber-security solutions and related services and products. In retrospect, it's baffling that it should take so long to see increased awareness that the benefits the information technology industry has brought to everyday life aren't entirely risk free. A recent poll in the US stated that Americans now worry about falling victim to cyber crime more than any other type of crime. Clearly, the public has now caught on. With those risks finally firmly on the radar screen, it's a near-certainty that new multi-billion dollar companies will emerge – some of which could make early investors rich in the process. For investors looking to gain a slice of the action, the companies covered in this article are a good place to start your research.

US STOCKS

Readers may well be familiar with **Symantec Corp. (NASDAQ:SYMC)** through its Norton Antivirus product. At first glance, Symantec might not seem the most exciting cyber-security play, as recent sales and profit growth figures have been lacklustre. This is partly down to the fact that the large corporate that constitute Symantec's main client base have built up their own in-house security departments which has led to reduced demand for Symantec's products and services. That said, the firm is a strong cash generator and pays a decent dividend. The real interest for us, though, comes in the form of an imminent spin-off of the firm's data management business Veritas, which is expected to complete in January 2016. This will enable the group to focus on its core security offering and could eventually spark a re-rating, making the shares a potentially interesting recovery play.

For a more straightforward growth play investors might want to take a look at Israeli firm **Check Point Software Technologies Ltd. (NASDAQ:CHKP)**. The $14 billion market cap specialises in firewalls and has an estimated 15% share of the network security market. The firm's sought after capabilities are underlined by its operating margins of almost 60% and a forward P/E of around 19x. There is also plenty of cash available on the balance sheet for potential acquisitions and buybacks.

Meanwhile, those with an eye to a more speculative investment could check out **FireEye Inc. (NASDAQ:FEYE)**, which has carved out a niche for itself in a market it helped to create. Unlike more traditional antivirus solutions, FireEye's software tracks potentially malicious software on its network of virtual machines in real time. This allows it to identify what are referred to as "zero-day exploits" – exploits that IT staff have literally 'zero' days to identify and address. Revenue growth has been rapid, but the shares seem to have gotten ahead of themselves and have more than halved in recent years as investors have taken fright at the lack of profitability and the fact that the company is still burning through cash.

"A RECENT POLL IN THE US STATED THAT AMERICANS NOW WORRY ABOUT FALLING VICTIM TO CYBER CRIME MORE THAN ANY OTHER TYPE OF CRIME. CLEARLY, THE PUBLIC HAS NOW CAUGHT ON."

BY JAMES FAULKNER

AN INTERVIEW WITH KOBUS PAULSEN

CHAIRMAN OF COGNOSEC

James Faulkner: Thanks for taking the time to speak with Master Investor. To begin with, please introduce yourself, and the company you represent, to our readers.

Kobus Paulsen: *My name is Kobus Paulsen, and I am founder and chairman of Cognosec. Since 1999 have I have acquired and divested multiple internet-based businesses, specialising in internet payments and cyber-security.*

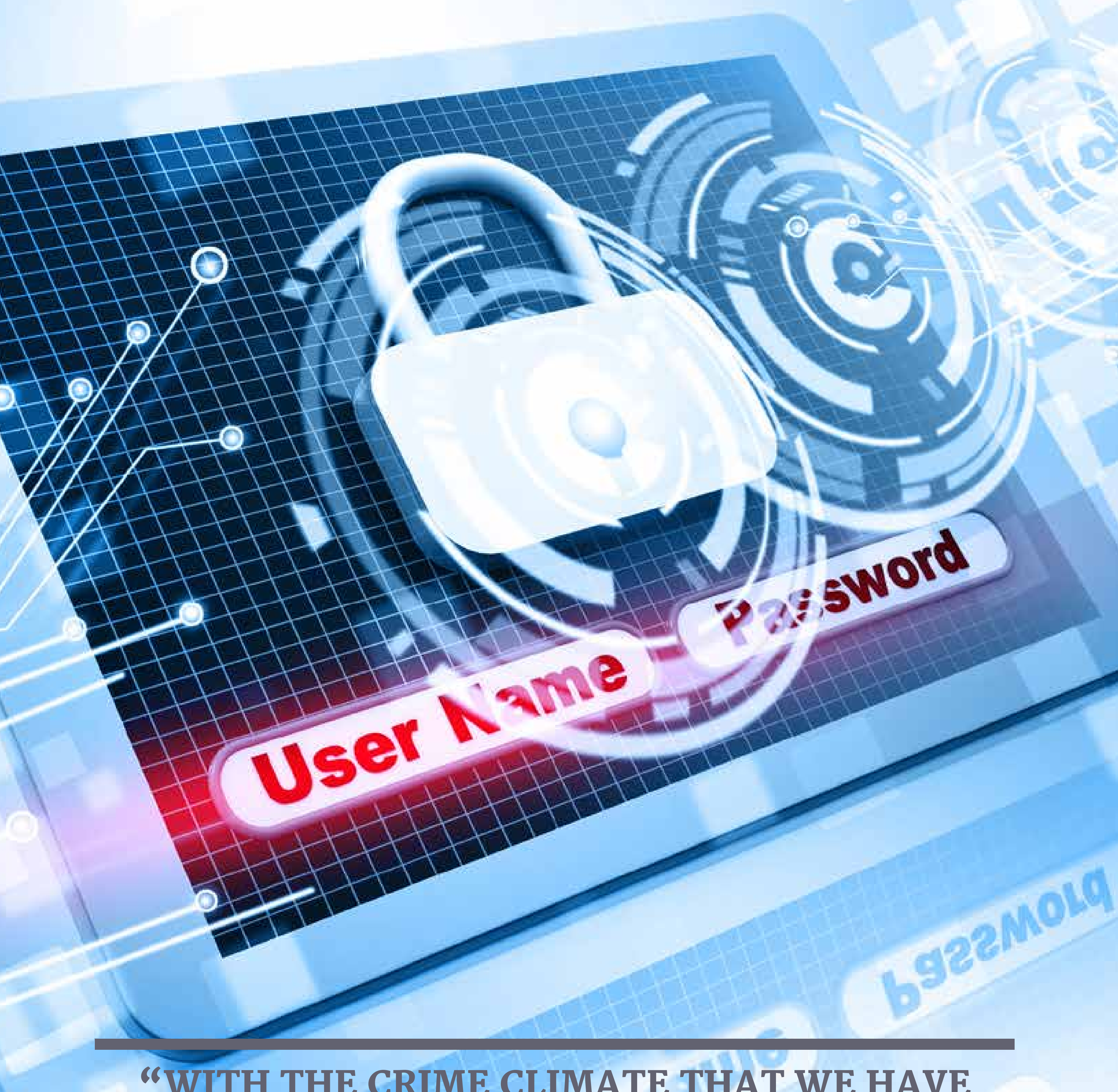
Founded in 2012, Cognosec is a group of specialist cyber-security companies headquartered in Sweden, and operating internationally through subsidiaries in Europe, South Africa, Kenya, and the United Arab Emirates. The group delivers security, governance, risk and compliance services to help businesses in a variety of industries – including banking and finance, government, healthcare, manufacturing and retail – to protect themselves against the growing threat of cyber crime.

JF: Cyber crime made it onto the front pages recently with the hacking of TalkTalk, a major UK telecoms provider. High profile hackings like this one seem to be becoming more common of late. Are companies, both in the UK an internationally, doing enough to protect themselves from this growing threat?

KB: *Unfortunately no – many companies are still not doing enough to protect themselves from cyber crime. We still have the same issue that we have always had – that many businesses will only do enough to meet regulatory requirements and avoid fines. With the crime climate that we have today, where teenagers have the ability to hold large corporations to ransom, regulatory requirements are really the bare minimum of protection. Organisations need to do much more to keep their data safe. When they inevitably reach that conclusion, Cognosec has the ability to show them this can be done.*

What we also see in the market is that with technology developing so quickly, businesses are losing control of their data faster than they are protecting it. Data can now be processed, collected and transferred far easier than ever before. As a result, organisations have increasingly little idea of what data they collect, where it is stored, and who has access to it – which works in favour of cyber criminals. It has therefore never been more important for businesses to get their security in place.

JF: Robert Hannigan, the Director of GCHQ, recently warned that "The global cyber-security industry is not developing as it needs to: demand is patchy and it is not



"WITH THE CRIME CLIMATE THAT WE HAVE TODAY, WHERE TEENAGERS HAVE THE ABILITY TO HOLD LARGE CORPORATIONS TO RANSOM, REGULATORY REQUIREMENTS ARE REALLY THE BARE MINIMUM OF PROTECTION."

"WE STRONGLY BELIEVE THAT THE GREATEST TREND IN THE SECURITY INDUSTRY RIGHT NOW IS SECURITY COMPANIES OFFERING A HOLISTIC APPROACH TO CYBER-SECURITY."

yet generating supply." What, in your opinion, are the current shortcomings of the industry, and how might it develop in future to address those shortcomings?

KB: *In our opinion, the shortcomings of cyber-security don't lie with the industry itself. The solutions necessary to protect organisations are out there, and there is a multitude of innovative products and services, but too often organisations do not understand the risk enough to invest in these solutions. Security vendors can continue to stress the risk of cyber crime, but ultimately the decision to invest has to come from within the organisation itself.*

JF: Should governments be doing more to regulate the sector and force companies to implement certain standards of cyber-security to protect themselves and their customers?

KB: *We have worked with a number of government organisations, and have witnessed first-hand that there is certainly a role for government in enforcing a standard of cyber-security, by ensuring companies have a basic level of protection or by driving awareness of breaches. However, there is a limit to how effective regulation can be. The government can't force companies to protect themselves; the impetus to improve security standards will have to come from the private sector.*

JF: According to Forbes, the worldwide cyber-security market is defined by market sizing estimates that range from $77 billion in 2015 to $170 billion by 2020. Given that cyber threats are only going to get worse in the coming years, is this currently the best secular growth market out there right now?

KB: *The simple fact is that every organisation, from the largest enterprise, to the smallest online business, needs some degree of cyber-security. Moreover, as cyber criminals continue to create new methods of attack, demand is constantly being generated for innovate methods of defence. Cognosec is itself a product of this massive demand – as companies look for organisations to help them face the ever increasing risk of a breach. It will come as no surprise then, that we certainly expect the cyber-security market to continue to grow at a rapid rate, as many companies have, and continue to create, insecure infrastructures.*

JF: The risks for companies not deploying sufficiently robust cyber-security solutions are clear. However, with many a listed cyber-security firm now commanding a very high stock market rating, I think readers might want to know about the sector-specific risks facing cyber-security companies. What are the key risks for these companies?

KB: *There are special risks for cyber-security companies, because they are naturally an attractive target for cyber criminals looking for a challenge. If a security company can be hacked, it makes their entire user base vulnerable. Security companies therefore have a great responsibility to make sure they are protecting their own infrastructure as well as that of their customers – it is all a matter of practising what you preach.*

JF: What are the key trends developing within the industry right now? What should investors be looking for when they assess a cyber-security firm?

KB: *We strongly believe that the greatest trend in the security industry right now is security companies offering a holistic approach to cyber-security. As the security landscape gets more and more complicated, organisations cannot just buy siloed technical solutions and hope that it will solve all their problems – it won't. Security companies need to act in a consultancy capacity, to help organisations see where they are at risk and choose the right solutions for their problems. As breaches continue to hit the news, there is a huge opportunity for investors to spot the companies that are really helping organisations – by identifying their vulnerabilities and walking them through protection step by step – because these are the companies that are ultimately going to be indispensable as the last line of defence.*

JF: The Internet of Things (IoT) is set to be a major feature of the tech landscape in the coming years. Surely this greatly exacerbates the potential disruption that a successful cyber attack might have on people's lives?

KB: *The Internet of Things will certainly increase the potential effect of a securi-*

ty breach, as it massively increases the scope for cyber attacks. Everything connected to the internet is vulnerable to attack – and soon hundreds of thousands of new devices from toasters to door locks, to critical infrastructure systems, will be connected to the internet. While having a light bulb hacked doesn't sound disastrous, each one of these devices is a potential door into a network. Unfortunately, these devices are being built with convenience, rather than security in mind. As for sectors such as the energy sector and transport, the risk of a serious incident is becoming extremely high and the results are potentially disastrous if access to back door opportunities are not protected by companies like Cognosec.

JF: Besides companies, research reveals that cyber crime can seriously affect the daily life of individual people. What kind of cyber crime may people face on a regular basis? What can people do to protect themselves?

KB: *The most prevalent personal threats are identity theft, which we are all aware of, and ransomware, which is becoming increasingly prevalent. Ransomware is malicious software which locks users out of their computes and holds them ransom, with cyber criminals demanding a payout to release the victim's system – it is one of fastest growing threats. All we can do is to continue to impress the same message that we have for the last fifteen years: don't open emails from unknown users, be careful what you download and make sure that you have malware protection on your personal devices.*

JF: What does Cognosec bring to the table in the fight against cyber crime?

KB: *Cognosec is a global leader in cybersecurity, with a vast amount of expertise to help companies internationally protect themselves against cyber crime. We operate across multiple public and private sector organisations – with experience in handling security in almost every sector – including, but not limited to, government, healthcare, manufacturing and financial services.*

Most importantly, Cognosec offers a truly holistic approach to cyber-security. It isn't just a software provider, and it isn't just a consultancy service. Cognosec has ownership of the complete value chain: advisory and assurance services, solutions, implementation and managed services. This, coupled with our extensive partnership network with security solution providers, makes us a single stop for any customer looking to deploy full protection for their organisation.

JF: In an important milestone for the company, Cognosec AB will be soon listed on Nasdaq First North in Stockholm. Would you please explain the reasons behind the listing on the Stockholm exchange and your plans for growth?

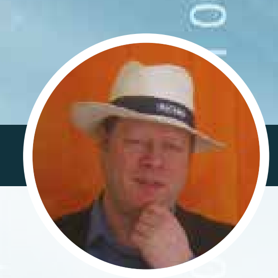
> **"JAMIE DIMON, JPMORGAN CHASE'S PRESIDENT AND CEO, IS OPENLY QUOTED AS HAVING DOUBLED THE COMPANY'S CYBER-SECURITY BUDGET TO $500M IN THE CURRENT FINANCIAL YEAR."**

KB: *Cognosec AB is recognised as a beacon in the provision of Global Cyber Defence Solutions. In order to further our organic and acquisitive growth potential, and due to the huge market for our IP, Assurance, Products and Advisory services, we felt it essential that we increase our visibility in this highly competitive but deeply fragmented space. NASDAQ First North offers us the potential to step up our offerings and to accelerate our plans on an international scale, from both visibility and liquidity standpoints, and underpins our commitment to providing best of breed solutions to organisations' cyber-security needs and their ongoing requirements for prevention, protection, surveillance and remedy.*

The sector's potential is enormous. Taking one example alone, Jamie Dimon, JPMorgan Chase's President and CEO, is openly quoted as having doubled the company's cyber-security budget to $500m in the current financial year and Markets & Markets reference CAGRs in excess of 9.8% per annum over the next five years to provide a total global cyber-security market of in excess of $170bn by 2020. Cyber security is now recognised as the most important consideration facing boardrooms around the globe, due to the effects that it has on both business continuity and reputational risk. Prevention is always better than cure. NASDAQ First North provides us with a solid backbone to execute our global reach in this critical area.

JF: The media refers to the fight against cyber crime as an 'arms race' between the good guys and the bad guys. Are the bad guys winning?

KB: *Crime, cyber or otherwise, has always been a battle between the "good guys" and "bad guys". The only difference with cyber crime is how fast the methods of crime evolve. There will never be a winner in this fight – crime is always going to take place. But there will also always be ways that organisations can protect themselves – the virtual equivalent of locks and intruder alarms. That is what we are helping companies do.*



BY ADRIAN KEMPTON-CUMBER

TECHNICAL ANALYSIS CORNER

THIEVES IN THE MACHINE

A few years ago I had a contract with T-Mobile and I'd found a much better deal they couldn't compete with so I gave notice on my contract. The funny thing was a couple of days before I'd phoned to tell them my voicemail wasn't working properly. They asked me for some password, which apparently I would have thought up in the shop when I got the phone a couple of years before. They refused to help me sort out the problem unless I could remember it, and I couldn't. I asked them who they thought, other than me, would try to fix a problem on my phone, but to no avail. Bizarrely, I was able to cancel the contract without any password at all, nor any mention of it.

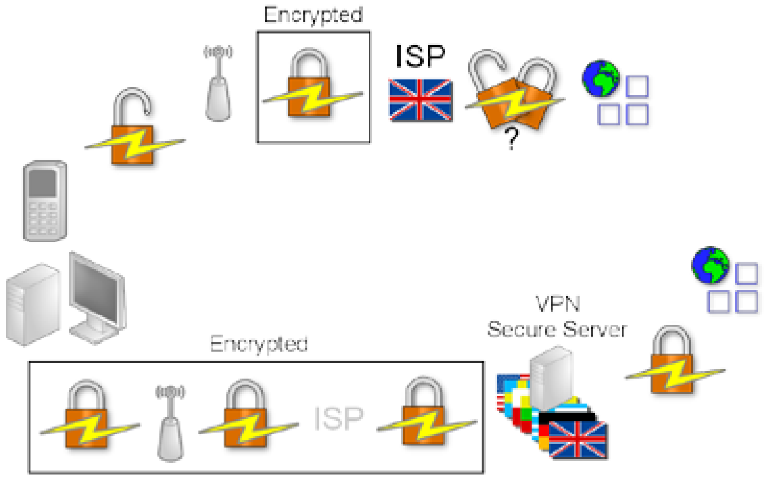
A couple of days later I got a call from T-Mobile, apparently sorry I was leaving. I asked how I could know it was T-Mobile calling me. They couldn't give me a satisfactory answer (because there isn't one), so I told them I'd have to take them through security and asked what my postcode was. They couldn't answer and I told them to Gordon Ramsey off. I wouldn't have spoken to them anyway. "Write to me" is my default position on incoming calls from any business.

The point is you can absolutely no longer take phone calls from anyone you don't know. It's too risky. Their numbers are almost always withheld, but even if they weren't it's still not enough to be certain they are who they say they are. One Call Centre Chimp got quite shirty when I said "any of your customers who would take this call are idiots and you should get rid of them as they put your employer's business at risk".

> **"IT'S NOT THAT HARD TO INTERCEPT YOUR CONNECTION FROM A NEARBY HOUSE, CAR OR GARDEN SHED."**

A far bigger risk is that people are intercepting your internet traffic. Particularly if you use wi-fi. Even if you're using it at home. It's not that hard to intercept your connection from a nearby house, car or garden shed. In a public space, like an airport or railway station, you are even more at risk. Lots of people trade on tablets and mobiles too and you are doing something quite risky there. There is a solution and it's simple.

A VPN (Virtual Private Network) is a secure way of using Wi-Fi – and wired connections too – which many companies use, but despite being available these days to the individual, is not yet mainstream. A VPN works by encrypting all the data coming out of your PC (or tablet, mobile etc.) and sending it to a remote secure server where it is decrypted and the connection made to the website or service you have requested. It's fast too. I use a high speed connection and experience good speeds, even streaming HD video.



In the diagram I've shown a connection without a VPN (top) and with a VPN (bottom). Basically in a standard setup the internet traffic is vulnerable up to your router/hub. It then goes to your ISP who in turn knows all the sites you visit, and they then connect you to them. Government snooping is an issue of liberty. We would go loopy if our mail was opened but we've been lulled into allowing our emails to be scanned by all and sundry. The old "if you've got nothing to hide..." argument is irrelevant. It's an unreasonable invasion of privacy. Your ISP may be required at some point to pass your internet activity to a government department. You wouldn't accept someone looking over your shoulder and making notes as you read newspapers, visited the library, chatted to friends and did your shopping. This is no different.

"GOVERNMENT SNOOPING IS AN ISSUE OF LIBERTY. WE WOULD GO LOOPY IF OUR MAIL WAS OPENED BUT WE'VE BEEN LULLED INTO ALLOWING OUR EMAILS TO BE SCANNED BY ALL AND SUNDRY."

A VPN connection encrypts your internet traffic before it leaves your device (PC/mobile/tablet), so it can't be intercepted locally; your ISP connects you only to the VPN which is a remote secure server. It doesn't have to even be in the same country as you, and that provides an interesting conundrum for services like television broadcasters. The remote server then connects with the sites you wish to visit. Everyone should be using a VPN at all times for their own security. This is especially pertinent when carrying out financial transactions, like trading online.

Another development which is interesting in the cyber sphere of influence is the protocol behind Bitcoin: the block chain. It's a distributed electronic asset register that is public inasmuch as you can see all the transactions, but only as much about the parties to the transaction as the system allows. The list of transactions is distributed in full, and because it's impossible to alter transactions after they are made, it is a very good way to record asset ownership. It provides a complete audit trail. NASDAQ has launched such an asset register, called Linq, in autumn 2015. It records share ownership. We can expect more ventures like this. The block chain could be used for all manner of things from recording copyright information and insurance contracts, to controlling electronic referenda and elections. Given its apparently indestructible properties it's the obvious place to record this kind of data. It uses mathematically complex unique keys to allow transactions to be made. It will come in handy with anything where proof is required, as it is unalterable.

I imagine all the world's bourses will in time, voluntarily or otherwise, use block chain solutions for transaction records. They're secure and easy to audit. But that doesn't necessarily mean we'll get full transparency as public market participants. The LSE doesn't publish the record of every single trade in real time. Rules 3030-3033 [of the London Stock Exchange] allow for certain transactions to be delayed from publication, which of course means we may well not know for some time that a very large trade has been made, nor at what price. This is important as it interrupts your data flow and affects your indicators, especially since these 'delayed' trades tend to be large, and the traded price an improvement. Integrity of data is crucial to the technical trader.

Finally, some more practical measures you can take today to help keep yourself safe in the cyber world. Obviously, run an anti-virus suite, especially on Windows PCs. Avoid opening emails that look dodgy or where you are uncertain of the origin. That very much includes emails from close friends that look odd. Give them a buzz and check. Don't open emails with 'Fwd' in the subject heading.

Although you can use a VPN on them, I'd be inclined not to trade on a mobile device. It's quite easy, and often free, to get price alerts on the go via SMS or email, and even live charts. Then phone your broker to make the trade. I also have an email specifically for use on my mobile, which I never reply from, and have important emails forwarded to so I receive them on the go. I then contact the sender by phone if it's urgent.

Take cyber-security seriously. Go a bit overboard on it rather than under. Don't make the mistake of thinking that you'll be covered in every situation of cyber crime. If you let them in it'll be your fault and your problem.

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BY JAMES FAULKNER

AN INTERVIEW WITH DAVID WILSON

CFO OF GB GROUP

James Faulkner: Thank you for taking the time to speak with Master Investor. Please give our readers a brief overview of GB Group, for the benefit of the uninitiated.

David Wilson: *GB Group, trading as GBG, is a global specialist in Identity Data Intelligence. This means we help organisations make decisions about the customers they serve and the people they employ. Through our fundamental belief that the digital economy relies on everyone having access to data they can trust, GBG enables companies and governments to fight fraud and cyber crime, to improve customer experience and to keep children and vulnerable adults safe. We have a strong financial track record with a revenue compound annual growth rate of 19%, increasing operating margins after investing for growth, high revenue visibility and high profit to cash conversion.*

We are headquartered in Chester, UK and have 18 offices across the world from where we provide solutions to many of the world's biggest organisations as well as disruptive newcomers.

JF: Cyber-security is now right up there with terrorism as one of the gravest threats facing society. How significant is the specific threat from identity fraud in terms of the wider cyber-security picture?

DW: *Identity fraud is a constant threat organisations must address in order to ensure they comply with regulation and build trust with consumers. The recent number of high profile data breaches will add to the already growing concerns amongst business leaders and the public around cyber-security. These attacks emphasise how much pressure organisations face in trying to stay one step ahead of the fraudster. It is our continuous demand for better customer experience and instant access to products and services that is fuelling the growth of data exchange between organisations and consumers. We all want what the Internet offers and are prepared to share our data to make the experience as quick and easy as it can possibly be but this leaves the organisations we interact with in possession of a hugely valuable commodity – the data that identifies us. They must be properly equipped to cope with this.*

JF: What unique capabilities does GBG possess that enable it to compete in such a complex and sensitive marketplace?

DW: *GBG has a range of services, from registering data about new customers and verifying them to KYC and AML standards, to using data from ongoing interactions to help build customer relationships, monitoring for risk and fraud, and employing and locating people. We have access to over 280 datasets that cover 190 countries and can verify the identity of over four billion individuals – more than half the world's population.*

Our differentiation is our global capability. GBG's software platforms provide customer onboarding and risk and fraud solutions globally. We currently have clients in 60 countries, and on premise installations in over 40 countries.

Our clients value our approach to innovation and our focus on delivering solutions that they can depend upon. Our product development teams apply the Unique Value Proposition process to every product in order to clearly differentiate us from the competition – we call this UVP3. We work collaboratively with our clients

"WE HAVE ACCESS TO OVER 280 DATASETS THAT COVER 190 COUNTRIES AND CAN VERIFY THE IDENTITY OF OVER FOUR BILLION INDIVIDUALS – MORE THAN HALF THE WORLD'S POPULATION."

to draw the greatest intelligence from the datasets to which our products connect.

JF: GBG boasts a number of high profile customers including the Serious Fraud Office, Barclays, Microsoft and John Lewis. Have private companies and public institutions been too slow to react to the threat posed by identity fraud?

DW: *We work with our customers to help them combat identity fraud and I have sympathy with the management teams of such large organisations – keeping on top of what is happening with every customer account, all the time, is an immense challenge. But it is one that, in the identity data intelligence sector, we have to join forces to overcome. The best chance we have of doing that is to ensure that we don't cut off the supply of data that helps us understand the bigger picture. For instance, data sharing among organisations helps to identify potential new trends in fraud or cyber crime before they hit; and electronic ID verification systems reference data from outside the organisation to check if what the customer is saying is really true.*

JF: Recent high-profile hackings must have been a wake-up call to many companies. Have you seen any increase in activity levels on the back of such news events?

> **"DATA IS ONE OF THE MOST VALUABLE ASSETS AN ORGANISATION NOW OWNS – THE CRIMINALS ARE PROVING THAT."**

DW: *In a recent survey by PwC, it was revealed that nearly 9 out of 10 large organisations have suffered some form of data security breach in the last 12 months. Whilst the mainstream media is now devoting greater attention to this topic, particularly where household brands are concerned, we have seen consistently growing interest in the solutions we provide over many years. Data is one of the most valuable assets an organisation now owns – the criminals are proving that. But it's our belief at GBG that the transparent and responsible use of our personal data is also the most powerful tool we have to take them on.*

JF: Acquisitions have been a key component of growth of late. How have they strengthened GBG's offering? And given that the entire sector is now rather highly rated, do you still see M&A activity remaining a feature of growth going forward?

DW: *Our recent performance has been one of continued success. The teams at DecTech Solutions and CDMS (Transactis) have successfully integrated into the wider GBG family. With the addition of California-based Loqate in April 2015, we have further strengthened our group capability and global presence. We are in an excellent position to not only develop into expanding markets ourselves, but enable our clients to move into new global markets by utilising the Identity Data Intelligence we provide.*

M&A activity will remain a potential avenue for us to grow the breadth of solutions we offer our clients and we have a team dedicated to identifying and examining opportunities that fit our business model.

JF: You recently rolled out GBG ID3global, a software tool that can verify the identities of over four billion people worldwide using publicly available data. That sounds pretty impressive! Is this a world first? What plans do you have for this part of the business?

DW: *We are the first to provide access to verify this number of identities in one single platform with the powerful ability to define the exact requirements you are screening for. With increased global movement of people and opening of new markets, organisations need to know individuals are who they say they are and GBG ID3global is a formidable tool that enables them to do this. The solution can be easily integrated into a customer's own infrastructure and we are increasingly working with clients who choose us to help facilitate the positive disruption of business models.*

Whilst this solution can provide Identity Data Intelligence on over half the world's population and is now compliant to KYC standard across 38 countries, we are constantly working to increase our coverage. Part of our service is to advise especially new or growing companies on best practice and what they need to do, including supporting them with anti-money laundering (AML) requirements they have to meet. The solution can provide robust ID checks as part of an AML process for nearly 40 of the world's largest economies.

JF: You're on record as saying you've only "scratched the surface" in terms of the potential of the identity intelligence market, and headcount is set to grow three-fold by 2020. What are the long-term challenges and opportunities facing the business as it looks to dig deeper into this market?

DW: *We can already provide identity data intelligence on more than half the world's population, and as the spending power and connectivity of developing markets increases, we have an enormous opportunity to help organisations innovate and grow whilst fulfilling their responsibilities to regulators and customers.*

There are challenges around legislation and the way data is stored and managed, but we see this as an opportunity to ensure identity data is of the highest quality and handled securely, to build increased trust amongst consumers. One of the biggest challenges for this market is keeping ahead of the myriad fraud and criminal processes.

"ANY ORGANISATION THAT HAS MULTI-JURISDICTIONS OR CARRIES OUT CROSS BORDER TRADE IS A POTENTIAL CLIENT OF OURS; HENCE WE ARE JUST SCRATCHING THE SURFACE."

Whilst GBG will face the challenge of developing and attracting new talent as we expand globally, we believe we are targeting a nascent market, with a number of global clients. Any organisation that has multi-jurisdictions or carries out cross border trade is a potential client of ours; hence we are just scratching the surface.

JF: R&D must play a crucial role in making sure GBG stays ahead of both the competition and the fraudsters. How does the company approach product development and how is that funded?

DW: *New proposition development and continued innovation is vital in our industry. We approach this internally within our own technology team; approximately 30% of our staff work in product or technology development – fundamentally our R&D resource. But we also develop partnerships in key areas of expertise, particularly relating to use of data in specific application areas like Politically Exposed or Sanctioned Persons (PEPs) and understanding what is happening on the 'dark web' with regards to client data so we can understand what we need to develop to help protect us all.*

JF: GBG aims to "internationalise" its products and services. Where does the group operate currently and where do you see the best opportunities for expansion?

DW: *GBG has customers in over 60 countries and operates from 18 offices across 10 countries in Europe, North America and Asia Pacific. We see opportunities in three main areas. Firstly: to continue building the breadth of our offering in the UK where the foundations of our group lie and to look at how we can apply this leading knowledge and expertise to further markets. Secondly: to expand our expertise in combating fraud and risk internationally in both the public and private sectors. Thirdly: to enable our existing clients, large and small across all sectors to grow their own international business through the opportunity to verify identities and understand customer needs in new territories. For example, online purchases by APAC consumers are set to be nearly three times higher than European ones by 2020 – that presents a tremendous opportunity for retailers, but they need to be properly equipped for success.*

BY NICK SUDBURY

FUNDS CORNER

INVESTING FOR A COMFORTABLE RETIREMENT

The pension freedoms that came into force in April have resulted in a massive change to the way that people finance their retirement. Data from the Association of British Insurers shows that in the first six months under the new rules a total of £2.85bn was invested in income drawdown products. This was comfortably ahead of the £2.17bn that was used to buy annuities.

Retirees who opt for income drawdown can leave their pension fund invested and take out whatever income they want as and when they need it. They keep full control of their capital, which is a big advantage compared to an annuity, but it can be difficult to know how much it is safe to spend, especially given the ongoing market risk.

Most people who find themselves in this position will want an investment that offers a competitive and reliable source of income with a relatively low level of risk to their capital. The obvious solution is a high yielding multi-asset fund where the diversification reduces the volatility below that of the equity market.

Multi-asset funds reduce the risk by spreading the money across shares, bonds and property. This allows the managers to increase the diversification of their portfolios while also looking to achieve a decent yield.

> **“RETIREES WHO OPT FOR INCOME DRAWDOWN CAN LEAVE THEIR PENSION FUND INVESTED AND TAKE OUT WHATEVER INCOME THEY WANT AS AND WHEN THEY NEED IT.”**

New options

Investment management groups have been quick to spot the opportunity and have created around 60 new multi-asset funds in the six months to the end of September. A recent example is **Jupiter Enhanced Distribution,** which has an estimated yield of 4% with monthly income and the prospect of long-term capital growth.

The fund operates in the Investment Association's Mixed Investment 20% to 60% Shares sector and currently has 40% in equities with the rest in bonds. It launched in September and is still really small with just £10m in assets under management.

Another recent addition is the **Rathbone Strategic Income Portfolio,** which operates in the unclassified sector where the managers have more freedom to alter the asset allocation. It was created on 1st October and aims to generate a long-term total return of CPI inflation plus 3% to 5% per annum as measured over a minimum period

of five years, subject to a targeted minimum annual yield of 3%. The volatility is intended to be two-thirds or less of the MSCI World Index over a rolling three-year period.

The **Aviva Investors Multi-Strategy Target Income** fund was launched in December 2014 and has one of the most complex mandates available to retail investors. It aims to generate a target annual income yield of 4% above the Bank of England base rate in all market conditions with monthly distributions. The four-man management team also seeks to preserve capital while keeping the volatility to less than half of that of global equities over rolling three-year periods.

In order to achieve this threefold objective, the managers make extensive use of a range of derivatives with one of the strategies being to write out-of-the-money options in return for the upfront premiums. The fund has had a fairly quiet start with a 10-month return of 4.31%, of which 2.86% was distributed by way of income.

Tried and tested

Some of the more established funds can also fulfil a similar role in an income drawdown portfolio. A good example is **Henderson Cautious Managed,** which was launched in February 2003 and operates in the Mixed Investment 20% to 60% Shares sector. It doesn't target a specific yield, but simply aims to provide income and long-term capital growth.

"ONE OF THE MAIN LIMITATIONS WITH OPEN-ENDED FUNDS IS THAT THEY HAVE TO DISTRIBUTE ALL OF THEIR INCOME DURING THEIR FINANCIAL YEAR."

The fund has just over £2bn in assets under management and is fairly defensively positioned with 52.7% in equities, 34.5% in bonds and 12.8% in cash. It has returned 31.3% over the last five years, which puts it 19th out of the 143 funds in the sector and has a historic yield of 3%.

Ethical investors may prefer the **Eden Tree Higher Income** fund, which can take on more risk as it is in the Mixed Investment 40-85% Shares sector. The fund aims to provide an above average and growing income with long-term capital growth.

EdenTree uses an ethical screen and will only invest in companies with sustainable environmental, social and governance policies. Their Higher Income fund was launched in November 1994 and over the last five years has returned 31.2%. This puts it towards the lower end of the sector, but its main emphasis is the income and at 4.5% it has a higher yield than any of its peer group.

The **Premier Multi-Asset Distribution** fund aims to pay an attractive rising quarterly income with long-term capital growth. It invests between 20% and 60% in equities with at least 30% in fixed income, with the money going into externally managed funds rather than individual shares and bonds.

Someone who invested £10,000 in 2010/11 would have received income of £478 during the first year, with successive annual distributions of £501, £466, £517 and £518. This is a pretty good return and reasonably consist-

"THE NEW PENSION FREEDOMS HAVE MADE IT POSSIBLE FOR PEOPLE WITH RELATIVELY MODEST SAVINGS TO LEAVE THEIR MONEY INVESTED RATHER THAN USING IT TO BUY AN ANNUITY."

ent, which is important if you are relying on it to pay your monthly cost of living. The Premier Multi-Asset Distribution fund was the second best performer in the sector over the last five years with a total return of 48.2%.

Premier also runs the **Premier Multi-Asset Monthly Income** fund, which has returned 47.6% over five years. This pays out every month with the annual income from a £10,000 investment starting in 2010/11 being £392, £534, £508, £582 and £540. Multi-asset funds are interesting products, but have higher than normal ongoing charges in excess of 2% due to the fact that they invest in other funds.

Investment trusts

One of the main limitations with open-ended funds is that they have to distribute all of their income during their financial year. This means that the annual income will tend to fluctuate and could be higher one year than the next, as was the case with the two Premier Multi-Asset funds. Retirees who rely on the distributions could find this quite a challenge.

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

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

A good example is the **Merchants Trust (MRCH),** which has paid higher dividends to its shareholders each year for the last 33 years. Over the last ten years the total annual distribution has increased from 18.9 pence per share to 23.8 pence. It has also produced an impressive capital gain with the shares up 83%.

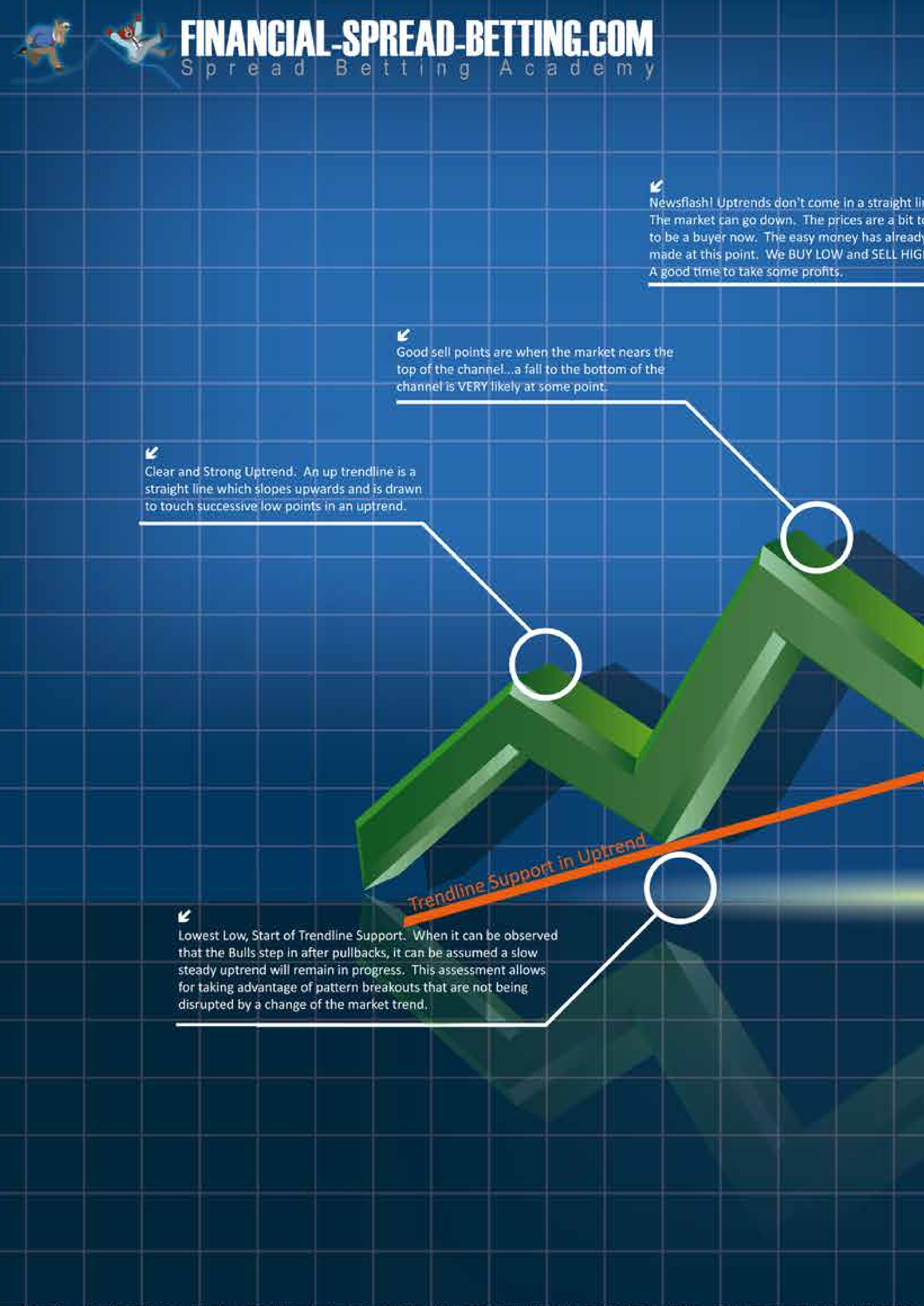
One fund that has been designed specifically with the income drawdown market in mind is **BlackRock Income Strategies Trust (BIST).** It was previously known as the British Assets Trust, but the mandate was changed at the end of February with the management switching from Foreign & Colonial to BlackRock.

The fund's new objective is to target a total return of CPI inflation plus 4% gross per annum over a market cycle of five to seven years. The intention is to grow the dividend at least in line with inflation over the medium term and there is also a clear focus on capital preservation.

BlackRock Income Strategies has 64.9% invested in equities, with 18.1% in fixed income and the remaining 17% in cash alternatives. The shares are currently yielding 5.01% with quarterly distributions and they are up about 6% since the change.

Income drawdown sounds like an attractive option, but retirees who spend too much out of their pension fund could run out of money early. They also have to protect their capital against the impact of inflation, which normally means having some exposure to share prices and leaves them open to the risk of a capital loss.

The new pension freedoms have made it possible for people with relatively modest savings to leave their money invested rather than using it to buy an annuity. Many retirees have taken advantage of the new rules, but these are early days for income drawdown and it remains to be seen whether the funds are up to the challenge.



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BY FELIPE R. COSTA

ECONOMICS CORNER

THE SWEDISH RESIDENTIAL PROPERTY TIME BOMB

Property prices have been on the uptack during recent years and have accelerated over the last few in particular. An apartment in the most expensive area of London averages an astounding £11,600 per square metre while the average for the whole London region is still a respectable £4,425. But London is not an isolated case.

In the centre of Stockholm an apartment costs on average around £6,250 per square metre, which is at par with prices in Wandsworth, London. The Swedish property market has been on a bull run since the mid 1990s. Fuelled by low interest rates, loose credit conditions, and several supply limitations, the Swedish property market has reached bubble dimensions, and is now waiting to capitulate and drive the rest of the economy towards recession. As buyers and sellers are happy to see their equity rising overnight, policymakers prefer to indulge an unsustainable situation rather than doing something that could disrupt sentiment. But inaction comes at the cost of bigger problems in the future, as everything that goes higher on credit must eventually come back to earth with a crash.

While Swedish property prices seem unshakable, prices have collapsed in many other countries, in particular in the US where a recession was ignited from this market. The 2007-2009 financial crisis, which is still not completely behind us, is a huge piece of evidence that house prices cannot rise forever. Fuelled by cheap credit, demand for houses was stunningly higher than supply for years, leveraging the economy and exposing it to increased downside risks. But a time comes when the market capitulates. A key question that arises

is: what contributed to this excess demand? The answer can also help explain what is happening in Sweden.

Central banks miss the big picture

Milton Friedman was always a strong advocate of keeping a tight control of the money supply because he believed that any increase in the rate of growth of the stock of money above the increase in productivity would just lead to an acceleration in inflation. But central banks dismiss this reasoning because they have been able to increase the stock of money, at a time when productivity gains are sluggish, without generating any inflation. They don't perceive any harm stemming from this policy stance, which aims at creating excess liquidity for years. But they're wrong about it. According to the Quantity Theory of Credit, developed by Richard Werner, there are two possible outcomes resulting from an expansion of the money supply: (1) consumption credit grows and, with it, demand for goods and services, which creates consumer inflation; (2) financial credit grows, and then the same pool of financial assets is bid up by a greater amount of money, which creates asset inflation that is not captured by CPI measures. In this latter case, there is unproductive credit creation and an asset bubble forms because demand rises while total wealth remains constant.

With the help of the Quantity Theory of Credit, we can better understand why central banks avoided inflation and why central banks created banking crises and property bubbles. During the 1990s, low interest rates helped banks expand broad credit in excess of nominal GDP. Most credit was used to finance the purchase of financial assets and property, leading to a massive and continuous rise in asset prices. Because central banks were targeting CPI indices, they missed this collateral effect. But, unfortunately, such a collateral effect is at the root of the last financial crisis that hit the global economy and will again be present over the next. With central banks reacting to the latest crisis by increasing the pace of money creation, it seems they still fail to understand they are planting the seeds of another financial crisis.

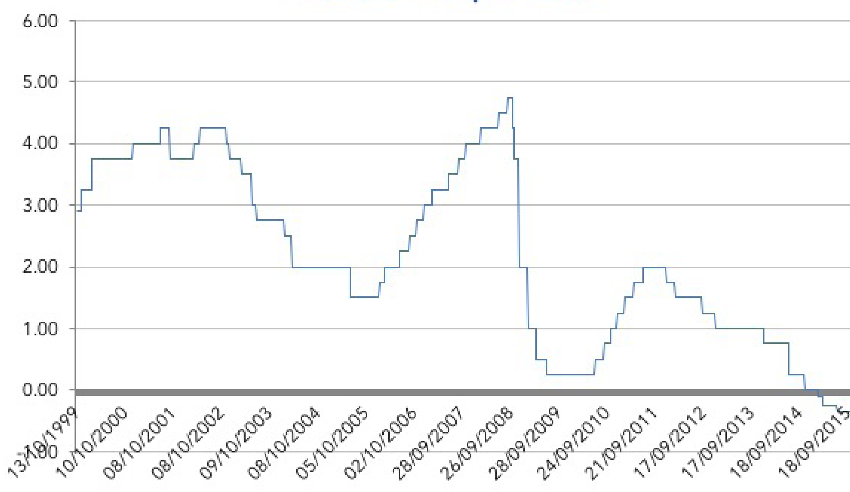
The Swedish case

A particularly concerning case is the residential property market in Sweden. Unlike what happened in Denmark and in Spain where the property market crashed during the European sovereign debt crisis, in Sweden nothing seems to disrupt the interminable ascent of house prices. But what happened in the US, Denmark and Spain just reminds us that the market cannot grow forever. The faster the market grows in excess of GDP, the ever more leverage is attached to it, and the worse the collapse will be. The housing market cannot grow faster than overall wealth forever.

The Riksbank is currently following the ECB's excessive easing policies, as otherwise the krona would start appreciating against the euro, undermining Swedish external trade. In 2010, and after cutting its key rate to 0.25pc, the Riksbank started hiking it towards the 2.00pc level; but at the end of 2011 it had to revert policy. Currently the Riksbank keeps its repo rate at the -0.35pc level and its deposit rate at -0.75pc. While a central bank would always argue that the interest rate is a general tool that should not be used to prick bubbles (if a central bank ever recognises one), the truth is that it has been creating a few as a collateral effect of its policy.

When house prices rise too much and for too long, new home buyers are attracted, as they fail to foresee the risks of a collapse in their equity. Banks, by their turn, are also usually enthusiastic about the extra income they can

generate by lending more. When interest rates remain at very low levels for a long time, the central bank gives out the wrong signal to the economy and decisions are taken based on the prospects of that rate remaining at such low levels for an indefinite period. Such policy has been helping to drive real house prices higher and, in turn, generate an unsurmountable expansion of household debt. In Sweden, household debt-to-income grew from around 90% in 1995 to 175% in 2015. House prices grew almost 175% in the same period. While the price rise certainly contributes to household wealth, the overall debt assumed to purchase houses is growing faster than income. Household leverage is growing too fast, exposing the economy to a downturn in economic conditions. If a re-



cession occurs (which it will, sooner or later), bad loans will pile up and banks may need to be bailed out. Household wealth, which is ever more dependent on those skyrocketing house prices, would by then crash.

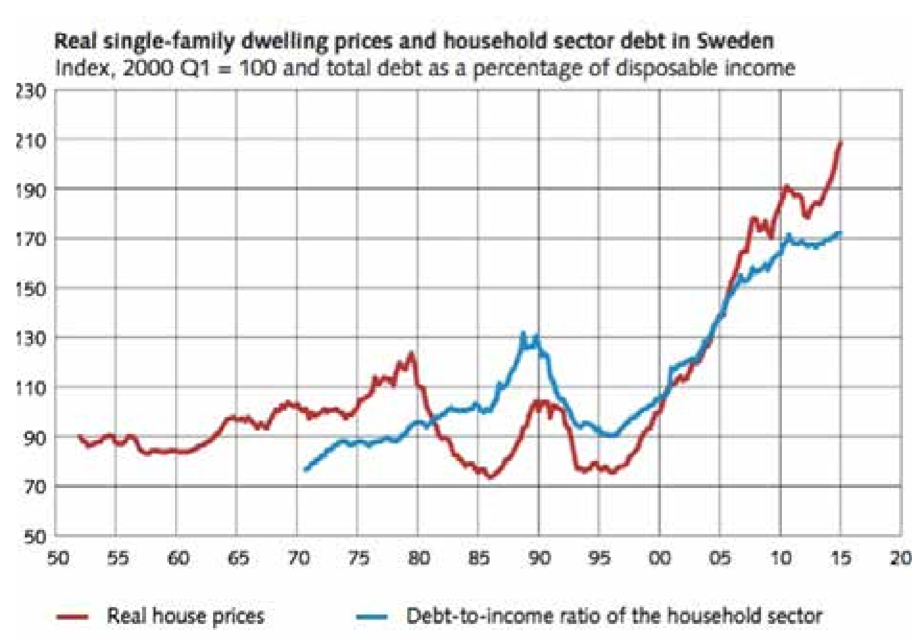
Demand gets a boost...

Over the last few years, Sweden and other Nordic countries have been attracting large inflows of money. While none of these countries are genuine safe havens, they were seen as much safer than other European destinies when the sovereign crisis emerged. By then Swedish government bonds were seen as a safe investment, which helped keep interest rates lower than they should have been, and for longer. With the European economy severely wounded in general, the excess liquidity in Sweden contributed to a rise in demand for financial assets and property.

But the Swedish housing bubble is not just being driven by central banks. Rather, there are several other features also contributing to it. While credit has been widely and cheaply available, banks have magnified this effect with the use of interest-only loans. This kind of loan is a great emergency tool to absorb the negative effects stemming from a recession, as it can help households retain their assets during adverse situations (and this way also help to avoid a banking crisis). But banks have been assigning these kinds of loans when the economy is under extremely favourable conditions, thus extending leverage to the limit and then reducing the degrees of freedom in the system. In an economy where households have the opportunity to purchase a house when its price is the highest and when mortgage costs are the lowest, and through paying interest alone, I wonder what could happen if just one of these features deteriorates a little. The Economist reports that 40% of loans are currently not being repaid at all, as households are just paying interest. These data are alarming.

If asked about this, the Riksbank (as well as many other central banks) would claim that any potential bubble should not be dealt with by the use of interest rates. They would refer to macroprudential regulation as the adequate way of dealing with collateral effects. But the Swedish government has so far failed in approving regulation capable of curbing any rise in demand. As long as sentiment is high and there are solvent buyers, banks continue to lend money, no matter what the government does. Tight capital requirements on mortgages, caps on borrowing by individuals, and other restrictions aimed at limiting the purchase of property have been imposed without any significant success. Banks and borrowers always find a way, even if that means getting part of their loans at higher rates than before. After all, banks borrow money at negative rates from the central bank so they have a clear incentive to be creative in finding ways to bend regulations, and households have a track record of ever increasing house prices so they have a clear incentive to purchase. Of course, new laws could be approved to block demand, but any less moderate measures reducing credit in a significant way would also lead to a sudden crash in house prices – a result no one is willing to contemplate, because of the potential consequences for the overall economy.

"IN SWEDEN, HOUSEHOLD DEBT-TO-INCOME GREW FROM AROUND 90% IN 1995 TO 175% IN 2015. HOUSE PRICES GREW ALMOST 175% IN THE SAME PERIOD."

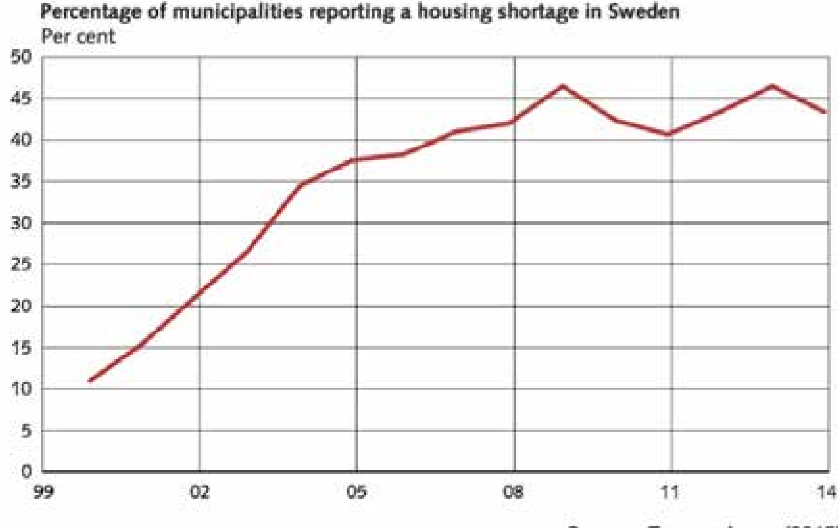


Source: Emanuelsson (2015)

...and supply is limited

A mix of low interest rates and favourable conditions is boosting demand for residential property in Sweden, which is pressing prices to appreciate uninterruptedly and at a very fast pace. But this is only half of the story. There is a whole set of issues on the supply side also contributing to the observed path of price increases. Prices wouldn't have risen as fast if supply were not as tight as it has been. A study by Robert Emanuelsson from the Financial Stability Department of the Riksbank evaluates the Swedish residential housing market in detail and shortlists the factors contributing to a shortage of residential housing as follows: (1) high land prices and construction costs; (2) demanding processes for land and planning; (3) municipalities' planning monopoly; (4) lack of competition in the civil engineering and construction industries; (5) regulation of the rental market; and (6) strict legislation on quality of housing.

The Swedish residential market suffers from quite a few market failures (which bestow pricing power to land owners and construction companies), and has been negatively impacted by approved legislation. This mix imparts rigidity on the supply side and helps explain why in a 20-year interval supply has not expanded to absorb the excess demand. There is an overall sense of shortage but supply doesn't move accordingly.



Source: Emanuelsson (2015)

Municipalities with highest Tobin's Q in Sweden, 2006 and 2010

MUNICIPALITY	TOBIN'S Q (2006)	MUNICIPALITY	TOBIN'S Q (2010)
Sundbyberg	2.79	Danderyd	2.75
Solna	2.74	Sotenäs	2.53
Danderyd	2.50	Lidingö	2.43
Lidingö	2.45	Solna	2.36
Sotenäs	2.21	Vaxholm	2.29
Stockholm	2.14	Båstad	2.27
Nacka	2.12	Nacka	2.21
Båstad	1.92	Tanum	2.10
Tanum	1.88	Sundbyberg	2.04
Vellinge	1.81	Stockholm	2.02
Öckerö	1.81	Höganäs	2.02
Malmö	1.80	Lysekil	1.90

Source: Emanuelsson (2015)

To evaluate how profitable it is for a supplier to build a house, the Tobin's Q ratio developed by Tobin (1969) is of good use. While first developed for use in capital markets, the ratio is flexible enough to be applied in many sectors and industries. The idea is very simple: if the cost to build a house is lower than its market price, then it is profitable to build. In a free market, houses would be provided until the market price is equal to the cost of producing them. The Tobin's ratio is then expressed as the ratio of market price of an existing home to the total production cost of a new, similar home. In a competitive market this ratio should tend to gravitate towards one. Emanuelsson shows that this ratio is near two in many municipalities in Sweden, which means that home builders are able to double their investments. In Stockholm the ratio was 2.14 in 2006 and still 2.02 in 2010. In a competitive market such a situation could not last because other suppliers would enter the market and provide additional housing, causing a decline in house prices. Equilibrium would be reached only when the ratio decreased to near one.

When the Tobin's Q ratio persists at such high levels, it is clear that some monopoly power and limitations exist within the sector. In fact, as pointed out in the report, there are two sources for this. First of all, municipalities have control over land and retain their pricing power by keeping the supply of land for construction tight. With a growing population, particularly in big cities, house prices can only rise. There are even reports of people buying houses without ever visiting the house. Second, there are several barriers to entry in the construction market and the existing companies act within an oligopoly framework, retaining pricing power by providing fewer houses than the market would be willing to absorb.

A few final words

When considering the country as a whole, there is no shortage of residential housing in Sweden, but the process of urbanisation has created severe imbalances across municipalities. While people migrated to the big cities on a large scale, the existing market failures prevented supply from adjusting, creating a large shortage of housing in the big cities. Instead of helping to reduce the pressure created in the market, policymakers just made it worse, by boosting demand through ultra loose monetary policy and ill-designed fiscal incentives. The resulting outcome has been a massive price rise, economic inefficiency, and extreme vulnerability to deteriorating economic conditions. In a country where 40% of home loans are not being paid down, any sudden change in economic conditions can only lead to a crash and a severe crisis.

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PLUS...

EVIL KNIEVIL ON PROXAMA:

POTENTIALLY "A REVOLUTION IN MARKETING"

ARE PRIVATISATIONS A NO-BRAINER?

ADRIAN KEMPTON-CUMBER INVESTIGATES

BORING IS BEAUTIFUL

ACCORDING TO "NAKED TRADER" ROBBIE BURNS

THE MIND OF THE MASTER

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BY ROBBIE BURNS

ROBBIE BURNS' TRADING DIARY

It can't be can it? Is it really nearly Christmas again? Frankly I feel Scrooge-like about it. Bah humbug! I hate the cold, the dark and all that. And those annoying TV ads. And... look you don't want me spoiling it for you; I'm off to Dubai for some lazing around in the sun. Now that's more like it.

But Christmas is handy, as market-wise there is usually money to be made. Yes it is the "Santa Rally". Loved by all of us traders (and journalists who can fill space by repeating what they wrote about the Santa Rally last year – done in a minute, off to the pub). So I am off to the pub in about 60 seconds.

Yes, for some unknown reason it's well known that December is one of the best months for share performance.

Most years, while it's cold outside, December is hot! The statistics support my argument: historically the strongest week of the year for the market is the 51st week. And the second strongest? The 52nd!

The probability of positive returns in December is a high 69%. The market's only had one significant fall in December since 1981. Both mid- and large-cap stocks perform equally well. Since 1984, when the FTSE was created, the index has increased on average by 2.3% in December. The market has only fallen five times in all those years.

Why are the markets so good at the most wonderful time of the year? I suspect it is down to something as simple as human psychology.

We all feel good with the approach of Christmas, then there are New Year's hopes and dreams. And probably funds want to end the year on a good note. But by the end of January we tend to be left with a bit of a hangover and that's why February isn't so good. There is also some anecdotal evidence that certain persons push up markets to make their performances look better. That's what someone down the pub told me anyhow.

Also, as markets often fall somewhat in October and November, investors begin to come in now and buy what they perceive as bargains.

The period between Christmas and New Year often sees stocks squeezing higher on thin volumes. Many stocks race higher during the holidays; there is frequently no one selling and institutions are shut. This often has a good effect on stocks at the smaller end of the market.

Of course, I am making it all sound too easy... it's never going to work out every year. But the use of tight stop losses should ensure that when you meet a year without a Santa bump, your losses will be minimal.

The best way of playing it is a FTSE or Dow long spreadbet – just a rolling one, as we're only looking short-term.

> **"HISTORICALLY THE STRONGEST WEEK OF THE YEAR FOR THE MARKET IS THE 51ST WEEK. AND THE SECOND STRONGEST? THE 52ND!"**

A trailing stop loss of say 100 points (to ensure no sudden spike out) might work out.

First (and I do this most years): I buy the FTSE 100 index in early/mid-December and I sell in early January to take advantage of the fact that the FTSE usually rises in this period.

I usually just make a simple 'long' FTSE 100 spread bet, with the stop loss in place just in case it's the occasional year when the festive uplift doesn't happen. Might even be worth having a guaranteed stop in case something bad happens when you least expect it. Remember the FTSE trades 24 hours Mon-Fri up to 9pm(ish) Fri and then from 11pm Sundays. IG even does a Sunday index spread too.

"ONE THING TO WATCH OUT FOR IS COMPANIES SNEAKING OUT BAD NEWS BETWEEN CHRISTMAS AND NEW YEAR."

There are also ETFs like LUK2 which go up if the FTSE goes up and you can use those in an ISA tax free, though unlike spreadbets it is only open market hours.

Let's have a look at the last couple of years. In 2013 when I bought just before Christmas at 6,445 and the market had a lovely festive rally and in January went to near 6,800 for a tremendous profit!

Last year (2014) the best time to buy was around mid December and then bank gains near the end of the year. So say you'd bought the FTSE around December 14th and sold just after the Xmas bash around the 28th-30th you could have banked more than 400 points as the FTSE rose from under 6,200 to over 6,800.

But do remember: the market can never be totally predicted so beware, maybe this is the year it won't happen.

I find December is also a good time to have a look at some of the smaller stocks in the market and sometimes have a bit of a gamble on a few stocking-filler shares. But only a little gamble, mind. Let's not be idiots.

Looking at specific days, would you believe it the short half day on Christmas Eve is the strongest market day of the year, with the 23rd being the strongest day.

But watch out, the first week in January is the weakest market week. (You can imagine this is when people look at their credit card spending in December and it reality hits.) At the beginning of this year the market indeed fell the first few days, though it did OK after that.

On the downside, one thing to watch out for is companies sneaking out bad news between Christmas and New Year. It's the same as political parties burying bad news on a day when a big story emerges elsewhere.

With so many people away, the companies hope the stinker will go unnoticed. So it's worth keeping an eye on news that's related to your stocks.

I get out quick if any kind of bad company news is released on one of my shares at this time.

So, to sum up... long the FTSE usually works from mid-December but by the time we hit January a switch to a short might pay.

If you're going to play the Christmas game, good luck, but remember markets sometimes don't do what is expected, so beware! Anyway if you lose I'll be hard to find... look for a very luxurious hotel somewhere in Dubai!

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.

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BY JAMES TUCKETT, CO-FOUNDER AND CEO AT INVESTUP

AN INTRODUCTION TO CROWDFUNDING FOR INVESTORS

You've probably heard a lot about crowdfunding. And how could you not? It's been all over the news and social media after being used to fund everything from breast implants, to making cult films.

The practice isn't a new one. Entrepreneurs have been raising money from their family and friends for years. And virtually everyone's done a sponsored something-or-other for charity. It was only in the early 2000s that the term started being used. Since then, crowdfunding has gained traction and become a serious alternative form of finance, with figures raised on course this year to surpass VC and Angel funding levels (Forbes). In the UK alone, the market is expected to raise £4.4bn in 2015 (nesta.org), with globally more than 1,250 crowdfunding sites in existence (Massolution).

The given (and glamorised) side of crowdfunding is the 'crowd' bit: collective judgements, coming together to support (or not) great (or not so great) ideas. This is largely emotional, creates excellent stories and in most cases, is forgotten as soon as it's over.

> **"IN THE UK ALONE, THE MARKET IS EXPECTED TO RAISE £4.4BN IN 2015 (NESTA.ORG), WITH GLOBALLY MORE THAN 1,250 CROWDFUNDING SITES IN EXISTENCE (MASSOLUTION)."**

But behind the apple pie legends and hype, there are some of the most exciting developments in finance. These are the stories that don't support the buzzword. If you ignore the headline-grabbing reward (Kickstarter) or donation (JustGiving) based crowdfunding, then you're left with an altogether different proposition: crowdfunding for a return.

This a different kind of crowdfunding, which doesn't take the crowd bit first. At its core are the principles of investing and earning returns. It's smart, researched, has long-term and very real benefits to the investor and, most importantly, has revolutionary impact on the economy. It's a serious investment vehicle.

And the next hope for the industry is that ordinary people, like you and me, with the help of crowdfunding can make more from their savings than at a bank.

By now you're probably wondering how you can get in on the crowdfunding action. Well, we're here to get you started.

CROWDFUNDING
CRO

How it works

Broadly speaking, crowdfunding for a return splits into crowdlending and crowdinvesting.

Crowdlending is about lending money to already established businesses or people. Here you can expect to see interest rates ranging from 3% to 17%. This can be done on platforms like Funding Circle, Ratesetter, Assetz Capital and ThinCats. Some people consider crowdlending to be the sensible option. It's the warm coat your Mum tells you to take when you go outside of crowdfunding.

If lending is the warm coat of finance, then investing is the gorgeous pair of stiletto heels you risk breaking your ankle in. With crowdinvesting you either win big or lose big. Using platforms like Crowdcube, CrowdBnk and Seedrs you can buy shares in a company. Yes the risks are high, but that's part of the fun. If you pick the right idea, the return can be huge.

To confuse matters, there are crowdinvesting sites that (in terms of risk) behave a lot like crowdlending sites. For example, Equity Property Crowdfunding sites like Property Partners allow investors to take stakes in companies that own and manage residential property – and as you can imagine, investing in bricks and mortar comes with less risk than investing in a relatively unproven start-up. So although it's got equity in the name, this type of crowdinvesting is more raincoat than stilettos.

> **"IF LENDING IS THE WARM COAT OF FINANCE, THEN INVESTING IS THE GORGEOUS PAIR OF STILETTO HEELS YOU RISK BREAKING YOUR ANKLE IN."**

Where to start

The first crowdfunding platform launched over 10 years ago. Since then there has been an explosion in investment-based crowdfunding, with more than 200 dedicated websites launching in the UK. And the numbers are growing – fast.

The types of investment crowdfunding are diverse: equity, lending to consumers, lending to businesses, invoice-trading, property – the list goes on. They all work in different ways and the hard part is picking the right one. There's simply too much choice and not enough information. Here *is* a good place to start though. Here's a rundown of the different types of crowdfunding you could try.

Equity Crowdfunding
Buying shares in early stage companies.
This is the most risky of the lot. Here you're putting your faith in a young company to go on and succeed and eventually return some of your investment. It's worth noting that many of these businesses do not succeed.
Try Crowdcube

Equity Property Crowdfunding
Buying shares in a company that owns and manages property on your behalf. It allows you to invest in bricks and mortar and get on the property ladder without the pain of spending huge amounts upfront and managing it. You won't just own part of the property at the end; you'll also get rental income during the journey.
Try Property Partner

Lending to Individuals
Lending money to an ordinary person. They may want to go on holiday, buy a car or pay university tuition fees. You're unlikely to have any security (things you can sell of theirs if they don't pay) so the risk is very closely tied to how creditworthy they are (how likely they are to pay you back). Despite this, these loans have seen some of the lowest default rates in the market.
Try RateSetter

Lending to Businesses
Lending money to businesses you like. Often these businesses have been around for a while and should be making enough money to service the loan (pay the loan instalments that come due). These loans *may* have security that can be sold if the business doesn't pay you back, but this is by no means always the case.
Try Funding Circle

Invoice Financing
Helping businesses with their cash flow.
Sometimes businesses are owed money but need the money immediately. In this instance, they can decide to sell their invoices on to other investors, in this case you. You give them the money now, and they pay you the original amount you lent back plus a premium. Happy days.
Try MarketInvoice

How to do it right

The key to successful crowdfunding is to make informed and responsible discoveries. **Simply, do your research**. Find out what people are saying about a business you are interested in and what others think of their business model. Ask your own questions. Be proactive – it's your money.

Know your figures. Find out exactly when you might see a return and what else you might get from it. Will it be an equity share, dividends or interest payments? On top of this, find out how (or if!) your money is protected if the whole thing goes to pot. The business, project, or even the whole crowd-

funding platform could collapse. Make sure if platforms have contingencies in place, or are actively looking at putting one in place. This is known as a living will – something investUP is working hard on to put in place.

Stick with what you are familiar with. While it's good to branch out into projects and businesses you have an interest in, it's always best to start with what you know. Your expertise will help you make great investments and decisions.

If there's a type of crowdfunding that you particularly like, **try using different platforms**. There are loads of different websites all offering different things. Funding across multiple platforms gives you a diverse portfolio and greater experience.

Use different types of crowdfunding. Don't just stick to one type if others suit your needs too. There is no reason why you can't try both lending and investing, they both have different risks and benefits and can complement one another.

The Future

To us, the future lies in changing the way we use crowdfunding sites. That's why we are launching the crowdISA – an ISA that works across more than twelve crowdlending sites. Think of it as a Cash ISA for the modern world.

At the moment, around 23 million people in the UK use the ISA tax wrapper to save – that's 46% of adults. In 2015 alone £79 billion was put into UK ISA accounts (Gov.uk). But the Cash ISA has been due for an upgrade for a while now. Low interest rates have meant fewer people are using them and are looking for other ways to save and grow their money.

So the government has created the Innovative Finance ISA. The IFISA (rolls off the tongue, doesn't it?) means people can crowdlend, ISA-style. Savers will now be able to lend money through an ISA, won't pay any tax on their earnings and get all the plusses of an ISA (regular interest payments, actual ability to save) with a greater decent potential to earn (compared to the rather miserable and sad looking Cash ISAs in the market).

There's a problem though: the Innovative Finance ISA only allows savers to use one crowdfunding site and still enjoy the tax benefit. Not good for choice and competition. It seemed to us that the Innovative Finance ISA already needs innovating – and that's where our crowdISA comes in.

Through the investUP crowdISA, savers can use more than twelve crowdlending sites instead of the IFISA's one. Like the IFISA, savers won't pay any tax on earnings but the rates crowdlending can give are much better. Investors can lend money to businesses they care about, be part of innovation and earn money. Really, everybody wins.

As a parting thought, if you're thinking that sounds like a lot of work then look out for our Robo-lending tools (automated lending tools) which will help you automate the lending process and take much of the legwork out of lending across twelve crowdlending sites.

About James

James Tuckett is a full-time crowdfunding evangelical and founded investUP in 2012. From an aerospace engineering and accountancy background, James has seen the power of the alternative finance sector at first hand. He is a keen believer that crowdfunding represents the new order in the finance sector.

About investUP

investUP brings the crowdfunding market together on one, investor-focused site. We are building a site which uniquely allows you to invest in deals from over 20 crowdfunding sites with a single account, and manage your investments via one centralised portfolio. Designed for you (retail investor), investUP, the world's first FCA authorised crowdfunding brokerage, is revolutionising crowdfunding by providing people with wider choice, and increased simplicity and efficiency. Founded by James Tuckett, Dom Wolf and Chris Bradbury in 2014, investUP graduated from Startupbootcamp FinTech in 2014, launched at Finovate in 2015 and was named a Hot 10 company in The FinTech 2015 list. investUP is backed by a board of leading industry experts including Barclays ex-Global Chief Operations Officer, Jim Milby; Phil Bruce, ex-SVP of Corporate Strategy at LSE; and UBS investment Banker George Granville.

For more information visit https://www.investup.co.uk.

BY VICTOR HILL

OPPORTUNITIES IN FOCUS

UK-EUROPE: MYTH AND REALITY

As I wrote on the MI website recently (Mr Cameron's Gamble), we learnt in late October that the Prime Ministers of Finland and Estonia had no idea what Mr Cameron was talking about.

This was not due to a failure to translate Mr Cameron's speeches into all the major Finno-Ugric languages; but the failure by Mr Cameron to tell these gentlemen what were the issues he wanted to renegotiate ahead of the planned UK-Europe ***In-Out referendum*** that is supposed to take place before the end of 2017.

If the Baltic Prime Ministers were in the dark, so were the British public. Eventually, on 09 November, Mr Cameron wrote a letter to Donald Tusk, the Polish President of the European Council setting out four main objectives for his *renegotiation* of the terms of Britain's membership of the EU.

The four points of the *Dear Donald* letter were an exercise in bathos. In essence, Mr Cameron wanted to increase competitiveness in the EU by reducing regulation; to exempt Britain from *ever closer union*; to restrict migrants' access to in-work benefits; and to protect Britain and other non-Eurozone EU members from the effects of greater integration within the Eurozone.

While Mr Juncker, the President of the European Commission, sighed that this was all *deeply problematic*, the Eurosceptics branded Cameron's demands as *unambitious*. So if he does get what he wants, those who are not keen on Europe will vote OUT anyway; and if he doesn't get what he wants, Mr Cameron will vote OUT too. In a speech to the CBI on 09 November, Mr Cameron said: *The argument isn't whether Britain could survive outside the EU; of course it could. The argument is how are we going to be best off...?*

David Cameron has set in train a huge political gamble. At question is the future role of the UK in the world – and actually, though the French and Germans do not see it this way, yet – the future of Europe, too.

All because he thought he could steal the Eurosceptics' thunder. If he were to win on the ticket of renegotiated terms he would give the Tory Europhobe Right nowhere to go and UKIP no reason to live. If the Tories could win back most of UKIP's nearly four million votes, they would remain in power for a generation.

On 18 November an opinion poll was published asking the expected referendum question: *Should the United Kingdom remain a member of the European Union or leave the European Union?* 42% of respondents wished to remain IN; 38% wanted OUT and 20% said they were undecided. So this one is wide open. Though I perceive momentum building for an OUT vote.

Le Point in France immediately described Mr Cameron's demands as *chantage* – blackmail – and this view on the other side of the Channel is likely to persist. After all, in their eyes, Britain is asking for special treatment by getting derogations – opt-outs – from treaty commitments that successive British governments, including Mrs Thatcher's, freely en-

> "DAVID CAMERON HAS SET IN TRAIN A HUGE POLITICAL GAMBLE. AT QUESTION IS THE FUTURE ROLE OF THE UK IN THE WORLD – AND ACTUALLY, THOUGH THE FRENCH AND GERMANS DO NOT SEE IT THIS WAY, YET – THE FUTURE OF EUROPE, TOO."

tered into. But the fact that the up-market French press has even taken note of Britain's demands is progress. When Mr Cameron raised the issue of Britain's renegotiation at a summit in Brussels earlier this year, President Hollande conspicuously used that as a cue for his bathroom break.

On the other hand, Britain has a strong hand to play.

For a start, Britain's is a big economy – second only to Germany in the EU – which runs a trade deficit with the rest. We are, amongst other things, the largest market for German cars and the biggest consumers, outside France, of Champagne. Would France-Germany wish to jeopardise that? Yet the importance of EU trade to the UK is falling. Goods exported to the EU fell to a record low in April, while exports to other major markets like India and China are growing rapidly. Just 45% of the UK's exports are now sold to the EU.

Second, Britain is a massive net contributor to EU coffers, the biggest paymaster after Germany. Britain will make a net contribution of £10.4 billion to the EU budget this year, and this is projected to grow by more than £3 billion over the next five years. About 23 of the 28 member states are net recipients of EU funds which is why, of course, they generally do what they are told (though several Eastern European members have put their foot down recently over the compulsory redistribution of migrants). If Britain really were to walk away, EU finances, already creaking, would be plunged into crisis.

So let's examine each of Mr Cameron's four gambits.

On **EU immigration**, Mr Cameron has changed his tune over the last year. Freedom of movement is a sacrosanct pillar of the EU – he realised that there is no way Britain would be able to permit French hedge fund managers to enter the country and yet to bar Slovakian farm hands. So he doesn't want to limit the flow per se, as Theresa May, Home Secretary, signalled that she wanted to do in her speech to the Tory Party Conference in October. He just wants *to limit the right of new immigrants to claim benefits*, especially Tax Credits which top up incomes for the low-paid. That way, only people who

are genuinely seeking work will come to the UK from Europe.

On 09 November, Downing Street released figures suggesting that 43% of all new EU migrants receive UK benefits – that's 224,000 out of 526,000 new arrivals over the last four years who receive Tax Credits, Housing Benefit and other welfare handouts. Tax Credits claimed averaged out at £5,000 per family, costing the government an estimated £530 million in 2013[i]. What Mr Cameron wants is a four-year moratorium on all benefits for all new EU migrants.

Yet the issue of paying benefits to newly arrived EU migrants could have been addressed without any agonising treaty change at all. Virtually all EU members style their own welfare systems as *contributory* – meaning that citizens get paid out in accordance with what they have paid in. The UK system is, in essence, contributory, in so far as, since the advent of the Welfare State under the post-WWII Labour Government (1945-51) benefits are notionally a function of citizens' National Insurance Contributions (NICs). Even after the new arrangements coming into force next year, your State Retirement Pension will be determined by how much

> “THE ISSUE OF PAYING BENEFITS TO NEWLY ARRIVED EU MIGRANTS COULD HAVE BEEN ADDRESSED WITHOUT ANY AGONISING TREATY CHANGE AT ALL.”

NICs you will have paid. But our system is now described as *universal* because, as the welfare state has expanded, new discretionary benefits like Housing Benefit and Tax Credits have not been linked to cumulative payments of NICs. Mr Cameron could decree tomorrow, if he wished, by secondary legislation that only people who have paid NICs for four years are entitled to such benefits. And there would be no reason to submit himself to the indignity of a wrangle with Brussels.

This would mean, however, that Britain would have to ban British-born workers from such benefits until having worked for four years. The House of Lords, the Bishops amongst them, where the Tories are in a minority, would probably oppose this just as they opposed Mr Osborne's proposed cut in Tax Credits. But that has absolutely nothing to do with Brussels.

> **"THE UK HAS A RECORD OF SIGNING UP TO MEASURES BLITHELY WITHOUT FIGHTING ITS CORNER."**

When I told a French municipal councillor recently that Polish people in the UK claim *Child Benefit* for children who still reside in Poland, he laughed. *That could never happen in France*, he said.

On the thorny question of freedom of movement, it will not have escaped readers' notice that several Schengen area countries, as I write, most prominently France, have re-imposed border controls in view of first, the refugee crisis and second, the IS terrorist attacks in Paris. There is currently a lot of talk in the French press of ditching Schengen altogether. Apparently, EU countries have the right to close their borders in "emergencies". If net EU migration exceeds a specified level, why couldn't Britain just declare a state of emergency and close its borders?

On **regulation**, Mr Cameron opines that there should be less of it. Generally speaking, that is. And yet, the anecdotal evidence is that the UK parliament is quite adept at imposing regulation on the country without help from Brussels. If you speak to Euro hacks, Britain is notorious for implementing EU directives rapidly and unsympathetically, while further south, national parliaments get round to the job in a much more leisured way.

Furthermore, the UK has a record of signing up to measures blithely without fighting its corner. Take the so-called "tampon tax". In the UK, female sanitary products carry the minimum 5% rate of VAT whereas men's razors are zero-rated. They are classified as a "non-essential luxury". Yet there is no VAT on female sanitary products in Ireland – because the Irish simply would not accept it, and they gained an opt-out.

Britain actually enjoyed an opt-out from all European social and employment legislation until that opt-out was surrendered for ideological reasons in the early days of the Blair government.

The Scottish Parliament and the Welsh Assembly have learnt a few tricks about regulation too. In fact, the more levels of government you have the more regulation you will get, since politicians have a tendency to manufacture reactive legislation: that is what they do. Someone gets bitten by a dog: The *Dangerous Dogs' Act, 1997*. You might even think this is all right and proper; or you might think it is pointless red tape. But it has precious little to do with Brussels.

Ever Closer Union? *No thank you*, says Mr Cameron. This is an argument about nothing at all. Politicians spin phrases to bolster solidarity. And this was framed, after all, in the aftermath of the slaughter of WWII. For a country which opted out of the Schengen Agreement and then the Eurozone, it doesn't count for much. Does Mr Cameron really require an amendment to the Treaty of Maastricht to the effect that *all countries aspire to Ever Closer Union except for the United Kingdom*? Precisely what would that achieve?

Finally, Mr Cameron wants a guarantee that **the Eurozone** will not act against

the interests of those EU members who retain their national currencies. (That's the UK, Sweden and Denmark, though Denmark has pegged the *Danske Kronor* to the Euro anyway. Forget Poland, Croatia et al – they don't even know what they want).

Now we get to the real problem. It's one thing to be a member of a common trading area of 28 states, where tariffs and rules are harmonised. It's another thing to be a member of a common trading area where 18 of those states have a *single currency* and where, by reason of the internal (and irreconcilable) disharmonies amongst the 18, the entire 28 are periodically de-stabilised, even though there are 10 states which do not participate in the *single currency*. (Historically, this is simply unprecedented).

When the EU adopted the Euro on 01 January 2002, it effectively became a federation of states whose mutual interests were entwined for evermore. You've only got to consider the Greek tragedy – about which I've written elsewhere – to see that even though the Euro has condemned Greece to penury, the Greeks themselves can see no way out of the *Cretan labyrinth*.

A successful monetary union requires, as we now know, not only a common monetary policy, but common banking supervision and capital adequacy regulation. Furthermore, it requires a substantially uniform fiscal policy (aka taxes), universal labour market regulation and almost continuous governmental intervention in the money markets in the event of any disequilibrium. In other words, *Ever Closer Union*.

On this side of the channel we forget that the Euro was not conceived by economists at all; but rather by politicians. As I explained in a recent piece on the *MI* website (The Secret History of the Euro's Birth) the Euro came about as a direct result of the collapse of the Berlin Wall. In a remarkable book, *Mitterrand: A Study in Ambiguity*, Philip Short reveals that, as late as November 1989, Francois Mitterrand was warning the German foreign minister that the consequences of German reunification could be yet another European war against Germany. The same month, the Soviet leader, Mikhail Gorbachev told Mitterrand that, if German reunification went ahead, he would be toppled by a military coup.

In these extraordinary historical circumstances Mitterrand saw an irreversible common currency as a way of anchoring a unified Germany of 80 million people into Europe, and of spreading Germany's prosperity across the continent. This currency would not just be shared by France and Germany but by all the EEC (as it was then called).

In a historic secret meeting with the German Chancellor, Helmut Kohl, in the spring of 1990, Mitterrand offered a deal. France would not stand in the way of German reunification if Kohl and the German political class committed, irrevocably, to give up the mighty Deutsche Mark and to replace it with a European common currency.

"ON THIS SIDE OF THE CHANNEL WE FORGET THAT THE EURO WAS NOT CONCEIVED BY ECONOMISTS AT ALL; BUT RATHER BY POLITICIANS."

German reunification then became a dead certainty as soon as Kohl decreed that the Deutsche Mark could be exchanged for the hitherto unconvertible *Ostmark* at a rate of one-to-one, in July 1990. East Germans queued at banks to unload their useless *Ostmarks*.

At the Maastricht summit (December 1991 – the same month that the Soviet Union disintegrated) Europe agreed that the new European Central Bank (ECB) would be located in Frankfurt, and that its first president would be a Frenchman.

At Maastricht, John Major, the British Prime Minister, came away with an opt-out for Britain on the single currency project. He explains in his memoirs

that, while he could see the merits of the scheme, he was persuaded that the European economies were just too divergent to impose a one-size-fits-all single currency straight-jacket.

Unlike the French and the Germans, the British saw the issue as an *economic* one, rather than a *political* one. In part, this reflects the differing intellectual and philosophical traditions of Franco-German and Anglo-Saxon thought. The Franco-German tradition starts with the ultimate goal; while the Anglo-Saxon is empirical (it identifies the practical problems you will encounter in trying to get there). Indeed, much of the problem has been that Anglo-Saxons do think differently – and have radically different legal systems.

In a historical perspective, the British, or more particularly the English, have displayed a long-standing antipathy to currency unions. When King James VI of Scotland assumed the throne of England in 1603 as James I, he wished to unite the currencies of the two nations over which he reigned. But the English parliament refused. It was not until the parliaments of both countries were fused, in 1707, that the Scottish Pound (*Pound Scots* to purists) was replaced by the Pound Sterling (at an exchange rate of twelve to one). Moreover, while the French maintained a single currency throughout the French Empire in colonial times, the British Empire never imposed a single currency, preferring for each jurisdiction to maintain its own. So a traveller moving from British India to British East Africa would be required to change rupees into shillings.

Clearly, the roots of these attitudes run deep. In any case, the British have never shared what our French and German neighbours call the *European ideal*. This is a collection of notions

> **"WE SIMPLY CANNOT BE CERTAIN WHAT WOULD LIE ON THE OTHER SIDE OF THIS RUBICON."**

around the fundamental righteousness – moral supremacy – of European integration, which consciously rejects the narrow nationalisms of the past. This is alien to the British who see the EU as a set of arrangements with admittedly generally like-minded and culturally similar neighbours. In fact the British don't really feel *European* at all. As Churchill said, *if we had to choose between Europe and the open sea, we would choose the open sea*.

At Maastricht, though, the die was cast. The timetable for the European currency was set and the Exchange Rate Mechanism (ERM), which Britain had joined in the last month of Mrs Thatcher's premiership, was given the role of stabilising European currencies ahead of the momentous day when all exchange rates would be fixed for good. The following year, however, on Black Wednesday (16 September 1992) Sterling was spat out of the ERM by an FX market that refused to believe that the Bank of England would be able to maintain the Pound at Deutsche Marks 2.95. Sterling fell, in a furious day of trading, to DM 2.30. This was a searing experience which changed the British mind-set forever. It also destroyed the Tories' reputation for economic competence, and opened the way for New Labour.

As Euroland evolved, two types of EU members emerged: the Eurozone and the Non-Eurozone EU. Most non-Eurozone countries still aspire to join the Eurozone (Croatia, Latvia etc.). The Hungarians and the Poles are more circumspect. The ever-outsides (the UK, Sweden, Czech Republic) are now regarded by the Eurozone as the awkward squad.

And then the British found fault with the management of the single currency, especially after the Financial Crisis. Germany has been running a current account surplus which now amounts to over 8% of GDP. German exports have risen from 29% of GDP in 1999 to 51% in 2013. That is entirely admirable; but where Germany runs surpluses, its trading partners will run deficits. In a floating currency system, that would not be a problem as the currencies of deficit counties would depreciate. In a fixed currency system, that is not possible. Instead, *the deficits accumulate as debt*.

Structural reform is barely even under discussion. Furthermore, the Euroland banking sector remains inefficient and undercapitalised. As a consequence of all this, the Eurozone has lurched from one financial crisis to another on its periphery – and its woes are clearly far from over. So long as unsus tainable deficits persist, there will be bailouts. Who will pay for them?

On one reading of the Maastricht Treaty, the UK is still obliged to join the single currency by 2020. No one believes now that that will happen – the world, and Europe, have moved on. So there will have to be at least one treaty change anyway!

The OUTs in the forthcoming UK referendum are not just ignorant xenophobes, as they are sometimes portrayed in European media. The British are unhappy because they are shackled to an unstable system which was not of their devising (and which they warned against).

So if those *renegotiated terms* turned out to be a damp squib the British people may not give Mr Cameron the answer that he hopes to receive. And if Mr Cameron failed to get concessions, it would be bizarre if he then decided to lead the OUT campaign. Moreover, even if he gets all he wants, some cabinet members (Mrs May and Mr Duncan-Smith?) are still likely to join the OUT campaign; so cabinet *collective responsibility* will be suspended.

The IN-OUT question is not a binary choice. To vote IN entails a preference for the status quo plus or minus whatever revisions to existing treaties Mr Cameron can obtain. A vote for OUT, on the other hand, would be just the beginning of a process of disengagement from Europe. The British government, possibly under Mr Cameron's successor (since that might be a good moment for him to spend more time with his family) would then begin a process of negotiating the precise terms of Britain's withdrawal.

We would not only have to negotiate with Brussels but also, since trade policy has been the province of the EU for the last 40 years or more, with all of our other trading partners at the same time. While it seems rational that some kind of free-trade agreement could be achieved between a detached Britain and the EU (would the Germans really risk our imposing tariffs on their cars?) this might be contingent on what deals we strike with the US, China and the rest. This would therefore be a game of multi-dimensional chess in which all outcomes – positive and negative – were possible. We simply cannot be certain what would lie on the other side of this Rubicon.

So, to paraphrase the great Donald Rumsfeld, the choice is between *a*

“IF CULTURAL EUROPHILES LIKE ME CAN NOW EVEN CONTEMPLATE VOTING OUT, I SUSPECT THE OUTCOME IS HEADING THAT WAY.”

known unknown and an unknown unknown. If the British people were to vote OUT, there would surely have to be a second referendum on the final terms of Britain's withdrawal from the EU in which, in their infinite wisdom, they might vote NO. This state of confusion and uncertainty might endure for years. Notoriously, financial markets abhor uncertainty.

Meanwhile Ms. Sturgeon and her hordes would play havoc with the Union. Even though, if Britain could regain control of her fisheries, Scotland might benefit most. The political settlement in Northern Ireland could be plunged into crisis. We can be sure that any perception of weakness or vacillation by a Tory government would be mercilessly exploited by their enemies. Mr Corbyn, who is agnostic on Europe (he believes, deep-down, that it is a con-trick played on the working class by international capital) could well profit.

Yet the die-hard Eurosceptics will argue that these risks are nonetheless worth taking. Ultimately, they will say, to regain control of our national sovereignty, borders and trade policy and to forego our hefty membership fees will be worth any costs of separation.

I wrote in last month's MI magazine about how India faces the future with confidence. As does China. Both those great countries have a spring in their step. This cannot be said of Europe where the medium-term economic outlook is gloomy. Quite apart from Europe's sclerotic growth record, unemployment and its governments' unsustainable burdens of debt, the continent's demographics are negative. Germany's population will soon be falling as rapidly as Japan's. Deflation has already entered the frame. We are conjoined with a continent in decline.

If Britain could join Switzerland and Norway as members of the European Economic Area, we could retreat to the side-lines. But we would still have to contribute to European coffers and abide by EU regulations. There would still be free flow of labour and capital, so Tory Eurosceptics and UKIP supporters would not be satisfied. Unless we decided to do something bolder; and much riskier.

At the end of WWII, Churchill rebuffed overtures by the Australian prime minister to forge closer economic ties between the Antipodes and the Mother Country. Britain could have created a free trade area throughout the white Commonwealth that would have anticipated the Trans-Pacific Partnership (the TPP, which was finally drafted on 05 October after seven years of negotiations). Instead, weary and broke at the end of the War, Britain let things drift.

Having absented themselves from negotiations leading up to the Treaty of Rome (1957), at which the EEC was founded, the British then sought to join the EEC in the 1960s. Only to be rebuffed by the French. We are now paying the price for an extraordinary lack of strategic planning during the twilight of empire. During this referendum debate we ought to take stock of our mistakes.

If you haven't worked out how I'm going to vote in the referendum, that's because, having thought about the subject all my adult life, I still don't know either. But if cultural Europhiles like me can now even contemplate voting OUT, I suspect the outcome is heading that way.

The timetable will inevitably recede as negotiations seize up. If I were a betting man I'd put my money on a narrow OUT vote in early 2017, with a turnout of less than 60%.

I wish that Mr Cameron hadn't forced me to make this tortured decision. But when I make my mind up, I'll let you know.

i **The Times, 10 November 2015, page 1, *Almost half of migrants from EU are on benefits*.**

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BY SAMUEL RAE

CURRENCY CORNER

DOLLAR, EURO AND YEN: WHERE NEXT?

Early December, the ECB is set to meet to discuss the best approach to current economic conditions in Europe. Despite an ongoing €60 billion monthly asset purchase programme, the region continues to struggle on nearly every level. Employment is down, consumer sentiment and purchase activity are at their lowest levels in years, and despite the current overnight rate being negative commercial bank lending to private industry is stagnant.

If Europe is set to stand a chance in defending itself from the next economic downturn, it needs to boost its current condition fast. We are likely closer to the next downturn than we are from the last, and in its current state, Europe would be in no position to weather a storm. In light of this, speculation is rife that Mario Draghi will dip into his self styled "menu" of monetary policy instruments as we head into 2016, in an attempt to inject some activity into the wider European economy. This speculation has translated to some volatility in the currency markets, as operators rush to price the potential for further stimulus into the majors. This speculation offers us an opportunity to form an underlying bias, and in turn, gives us an advantage going forward. Here's what I'm expecting from my three favorite currencies as we shift into 2016.

First up, the Euro. This one is pretty straightforward. As mentioned, the overnight rate is already negative in Europe, having been set at -0.2% last September. At that time, Draghi suggested he would not cut the rate further; however, it now seems as though a deepening of the negative rates is back on the table. The theory behind it is simple: charge for, and in turn disincentivise, commercial banks holding reserves with the ECB. The banks need somewhere to put their capital and they lend it to private industry seeking a return. In practice, however, things are not so clear. Bank lending is practically non-existent, and private industry seems fearful of borrowing to fund expansion while consumption is so lacklustre. If the ECB cuts the rate further, it becomes more expensive to hold reserves, and should in theory expand the incentive to lend. This should reduce the cost of borrowing, and in turn, increase private industry capital borrowing. Such a cut will almost definitely translate to a concurrent weakening of the Euro, offering up a medium term bearish bias in the EUR/USD, and conversely, a bullish bias in the GBP/USD.

"WE ARE LIKELY CLOSER TO THE NEXT DOWNTURN THAN WE ARE FROM THE LAST, AND IN ITS CURRENT STATE, EUROPE WOULD BE IN NO POSITION TO WEATHER A STORM."

For the US dollar, things are a little less clear. While Europe is floundering, the US equities markets are flirting with all time highs. Employment is up, and consumer sentiment seems optimistic. This has led many to believe we will see a rate hike before the end of the year. However, the huge asset purchase programme we have seen over the last half decade or so is no doubt propping up the equities markets, and the potential for a slowdown in China (alongside the Chinese and Russian unloading of US debt) presents some uncertainty. Can the US economy remain resilient in the wake of an interest rate hike? Inflation is effectively zero and GDP growth leaves a lot to be desired, which suggests that there is some disparity between what the major data shows and what actually lies beneath. Irrespective of this disparity, however, and likely as a result of the deepening situation in Europe, the US dollar is gaining strength. As speculation heats up surrounding a hike, and speculators shift to the risk-off haven that is the greenback (at least relative to the Euro or Yen given current conditions) we should see further strength. Combine this with our bearish EUR bias, and we get a strong bearish EUR/USD bias.

Finally, the Yen. Ever since Shinzo Abe implemented his three arrows policy, markets have been waiting for a return to strength from the Japanese economy after decades of stagnation. Despite the huge stimulus package delivered, however, Japan is still in trouble. A couple of badly timed sales tax rate hikes look to have derailed any stimulus-induced strength, and with an increasingly ageing population, there looks to be further trouble ahead. The Japanese economy recently slipped back into recession, and Abe is calling for what amounts to an emergency budget supplement in an attempt to stop the economy from falling off a cliff. Whether the supplement will be enough to turn the ship around remains to be seen (my personal opinion is that it won't), but one thing is for sure: we are not going to see any monetary policy tightening any time soon. This means likely further weakness for the Yen, and in turn, gives us a firm medium-term bullish USD/JPY bias.

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BY RICHARD GILL, CFA

SMALL-CAP CORNER

KEEPING IT IN THE FAMILY: FAMILY FIRMS IN THE SMALL-CAP MARKET

SME companies are often hailed as the driving force behind the economies of many countries, providing jobs, growth, innovation and wealth creation. But did you know that family owned companies are just as important? According to research from the University of Vermont, family owned businesses make up 57% of US GDP, employ two-thirds of the work force and create 80% of all new jobs. In fact, a 2010 study by Reeb and Anderson found that over 35% of S&P 500 constituent firms were family controlled.

To define "family businesses", I am talking about those where the running of a company is heavily influenced by either several generations of a family or by the descendants of founders. This can be via senior management positions, large ownership stakes, or both. Unfortunately the stock market can often have a negative view of such firms, seeing them as being more conservative, old fashioned and less efficient compared to those run by MBA holding professional managers. But investors with this point of view should look again.

A study by UBS released this summer found that share prices of mid and small cap companies controlled by one family have significantly outperformed in the past ten years. The research suggests a gain of 345% over the period for family owned companies around the world compared to a 72% gain for a global mid-cap index. The reason behind why this effect might occur can be summed up nicely by investment legend Warren Buffett. He once said in a speech to business students, "*Family-owned businesses share our long-term orientation, belief in hard work, and a no-nonsense approach and respect for a strong corporate culture*."

Of course there can always be downsides. Governance can often be compromised in family run companies given the close links between directors; feuds may disrupt the business; and certain family members could be given high ranking jobs for which they are not suitable (the classic case of nepotism). And some unscrupulous families have been seen to run their companies as "lifestyle" businesses. Sometimes worse. For example, in 2007 the founder and CEO of NASDAQ listed cable TV business Adelphia Communications, along with his son, were jailed for fraud. John & Timothy Regas stole $100 million from the family run business for themselves, wiping out other shareholders after the company filed for bankruptcy.

The Adelphia case is the exception rather than the norm, however, and there are plenty of quality family run businesses listed on the London stock market. Here follows three interesting cases:

TOWN CENTRE SECURITIES

Founded in 1959 by entrepreneur Arnold Ziff, **Town Centre Securities (TCSC)** is a property investor and car park operator with an active management philosophy and a long history of delivering strong returns to investors. A £1,000 investment in the company in 1969 would have grown to £562,700 by June 2014.

Arnold Ziff passed away in 2004 and son Edward Ziff took over as Chairman

"SHARE PRICES OF MID AND SMALL CAP COMPANIES CONTROLLED BY ONE FAMILY HAVE SIGNIFICANTLY OUTPERFORMED IN THE PAST TEN YEARS."

Merrion Centre internal view

and Chief Executive in the same year. Son Michael Ziff is a Non-Exec and grandson Ben Ziff is Managing Director of car park business CitiPark. The total family shareholding is 53%.

Town Centre Securities makes the majority of its operating income from the rental of its investment properties, which at the end of June 2015 were valued at £355.4 million. Traditionally based in the North of England, the firm has been extending its reach further in the South in recent years to take advantage of growth opportunities.

At the core of the company's property investment portfolio is the Merrion Centre, a 1,000,000 sq ft shopping centre complex with offices, a 1,100 multi-story car park and hotel, which attracts footfall of over 10 million per annum. Merrion benefits from its prime location in Leeds city centre, opposite the recently opened 13,500 Leeds Arena venue, and near to two universities, offices and transport links. While the main focus is on Leeds, the company has other assets in Glasgow, Edinburgh, Manchester and London.

Elsewhere, trading under the CitiPark brand Town Centre's car park business is one of the leading parking operators in the UK, with 5,200 places at the end of June this year. The business currently has 15 branches at sites in Leeds, Manchester, London and Watford, which have state of the art facilities including CCTV, Automatic Registration Plate Vehicle Recognition Systems, electric car charging points and modern parking management systems.

"IN THE LAST FINANCIAL YEAR THE COMPANY SAW A TOTAL PROPERTY RETURN OF 12.2%, OUTPERFORMING ALL COMPARABLE INDICES."

Over the past ten years the firm's performance has been resilient. The firm maintained a relatively steady level of underlying profits (ignoring non-cash portfolio valuation changes) throughout the 2008-2009 downturn and has never reduced its dividend in its entire history. Like all commercial property firms, however, net asset value and the share price were both significantly hit during the recent recession due to negative portfolio revaluations. But an excellent recovery has been taking place since then. In the last financial year the company saw a total property return of 12.2%, outperforming all comparable indices provided by property research provider IPD.

A REIT good investment?

Town Centre Securities converted to REIT (Real Estate Investment Trust) status in October 2007. This means that the company is effectively exempt from corporation tax, so long as it pays out 90% of taxable income to shareholders. As such the firm has a high payout ratio and attractive dividend.

At the current share price of 323.25p the company is capitalised at £172.8 million. Assuming a flat dividend of 10.44p the current yield is a decent 3.22%. The shares also trade at a modest 6% discount to net assets of 344p per share as at 30th June. Given the current environment of rising commercial property prices it does not seem unreasonable to suggest that the shares should trade (at least) at par to net assets. Add in the dividend and you are looking at a prospective gain of 9.62%. This looks like an attractive return given the consistency of the business, solid annual returns and potential for further revaluation gains.

Town Centre Securities looks like a classic "buy and hold" investment.

SOLID STATE

Operating just over 100 miles south of Town Centre Securities is another "solid" family business.

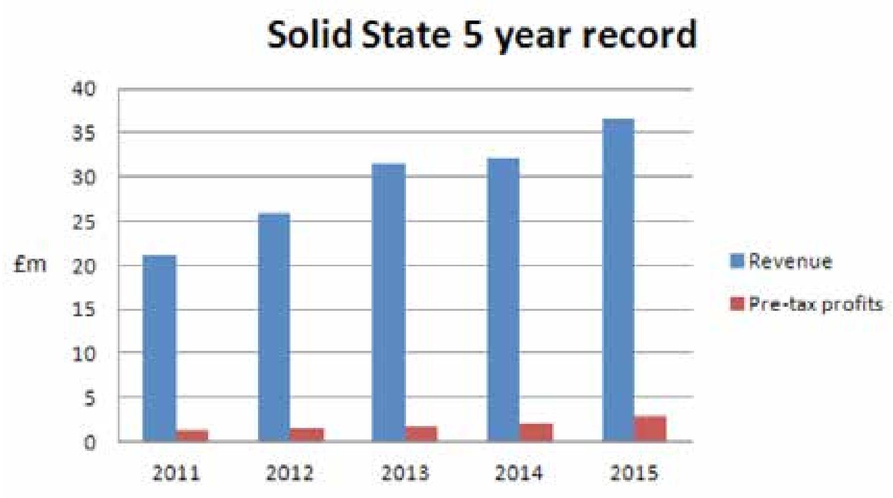
Based in Redditch, **Solid State (SOLI)** is a specialist design-in and manufacturing services company. Across the two divisions of Solid State Supplies and Steatite the firm provides clients with industrial/rugged computing products, batteries, secure communications systems and electronic components. These products are typically used by clients which operate in harsh environments and need to keep equipment safe and free from damage. Sectors served include oil & gas, aerospace, military, security, medical, construction and others.

CEO Gary Marsh (son of founder William Marsh) and his wife hold a 5.34% stake in the business, with founder Gordon Comben and his wife having a 10.69% stake.

SOLID STATE PLC

Financials & recent trading

Driven by a mixture of organic growth and contributions from several acquisitions, Solid State has delivered a very strong performance over the past five years. Between 2011 and 2015 revenues grew by 73%, pre-tax profits by 141% and the dividend was doubled.



"BETWEEN 2011 AND 2015 REVENUES GREW BY 73%, PRE-TAX PROFITS BY 141% AND THE DIVIDEND WAS DOUBLED."

However, at the end of October the company broke with tradition and announced a shock profits warning. While the firm said it had a reasonable start to the year it has seen a general softening in its markets. But the main reason for the profits warning came as Solid State reported delays in a large contract with the Ministry of Justice for offender tagging hardware. As a result, revenues and profits in the second half of the year will now be significantly lower than previous expectations.

Steatite rugged Windows tablet

Subsequent results for the six months to September reported revenues up by 29% to a record £22 million as the acquisition of display components business Ginsbury Electronics and the Ministry of Justice offender tagging contract made initial contributions. However, like-for-like sales were flat and pre-tax profits were down by 4% as gross margins slipped by 4.4 percentage points. This was mainly due to a change in the product mix and a £77,000 adverse currency impact. Nevertheless, earnings grew by 8.4% to 18.1p per share after a positive tax charge was recognised. Encouragingly, the interim dividend was held at 4p per share, and was covered 4.5 times by earnings. Net debt was £4 million at the period end, with finance costs comfortably covered over 70 times by operating profits.

Share price fall overdone?

In the aftermath of the October profits warning shares in Solid State plunged to a low of just under 400p before recovering to the current 525p. This remains well off the all-time high of 922.5p, seen this summer. But despite the recent bounce back I believe that the shares continue to be marked down unfairly.

To give some context, the deal with The Ministry of Justice was finalised in August last year. Estimated to be worth £34 million over a minimum three year period, this is the largest deal in the company's history. Originally, most of the deliveries under the contract were expected in the 2016 and 2017 financial years. Now, no significant deliveries are expected this financial year (to March 2016) and timings remain uncertain.

Of course, on a net present value basis the delaying of cashflows means that the valuation of a business should be lower. But a near 28% fall in the share price since the profits warning seems very harsh, especially given that the contract is still expected to be entirely fulfilled in time. It is also worth pointing out that Solid State itself has not done anything wrong, with the delays being out of its hands. The overall £300 million project is made up of a number of suppliers upon which the project depends.

Valuation

Despite the recent hiccups Solid State remains a quality, profitable and cash generative business. Forecasts have obviously been revised down by the markets following the profits warning, with the shares currently trading on a multiple of around 14.8 times forecasts for the next financial year. But the crucial element here is that the new forecasts take into account pretty much next to nothing for the delayed MoJ deal. Thus there is significant potential for upgrades over the coming months.

In addition, the company is looking to take out £0.5 million worth of costs following recent market conditions and is still on the lookout for further acquisition opportunities. Last year's 12p per share dividend looks like it will be (at least) maintained, so the shares also offer a modest yield of 2.3%.

Overall, with Solid State remaining a quality business there looks to be further recovery potential.

SAFELAND

Also in the property business is AIM listed **Safeland (SAF)**. The company describes itself as a specialist in property trading, refurbishment, develop-

ment and investment. In contrast to Town Centre Securities the firm has a main focus on the London market and concentrates on property assets where a profit can be made in the relatively short-term, typically after they have been developed or obtained planning permissions.

Safeland was founded in 1986 by Raymond Lipman along with his three sons, Larry, Errol and Steven. Raymond passed away in June this year, with Larry being the current Managing Director and Errol, an Executive Director. The Lipmans, through their various interests, control almost three quarters of the shares.

Building value

Throughout its history the company has gained a track record of creating value for investors via a series of demergers. The most recent of these was the May 2014 demerger of hostel business **Safestay (SSTY)**, which listed on AIM raising £4.8 million. Investors received one new Safestay share for every 4.66 Safeland shares held. From the IPO price of 50p per share Safestay shares have since risen to 64p.

> **"THE FIRM HAD AN ESPECIALLY GOOD YEAR IN 2015 (TO MARCH), SEEING NET PROFITS UP BY OVER 600% AT £5.7 MILLION."**

The company is also responsible for the 1998 demerger of self-storage business **Safestore (SAFE)** which has since gone on to graduate to the FTSE 250, growing its store portfolio from 20 stores to the current 119.

Despite these successes Safestay had a bad few years around the 2008/9 financial crisis after the property market crashed. The shares lost more than 90% of their value from peak to trough between 2006 and 2012. But after bottoming out at 5.25p in 2012 they have since risen almost twelve-fold.

The firm had an especially good year in 2015 (to March), seeing net profits up by over 600% at £5.7 million, driven by the selling of its interest in the Chandos Tennis Club in North London to a housebuilder. Overall, the total shareholder return for the year (share price growth plus the Safestay distribution) was over 150%. This also enabled the company to pay its first final dividend for several years, of 1.75p per share.

A safe investment?

Safeland is a relatively small business, with the company capitalised at £9.49 million at the current share price of 61p. That equates to a discount of 42% to net assets as at the end of September this year. Unfortunately there is an elephant in the room here.

Safeland currently has 15.56 million shares in issue – the number used in the NAV calculation. However, there are an additional 19.865 million of share options, all owned by the Lipman family. These have been exercisable since September last year and are exercisable up until 2021. And at an exercise price of 9.25p they are significantly in the money.

So in effect we are looking at around 35.4 million shares in issue and therefore a market cap of £21.6 million and an NAV per share of around 50p. That equates to a 22% premium to the current share price.

It is clear that Safeland has a good track record in property trading (especially in recent years) and a shrewd management team. And while the London property market continues to boom there are opportunities for further significant property trading gains. But this looks like one case where the controlling family's interests don't look to be completely aligned with minority shareholders.

On balance, the shares only look appropriate for investors with a very high tolerance for risk.

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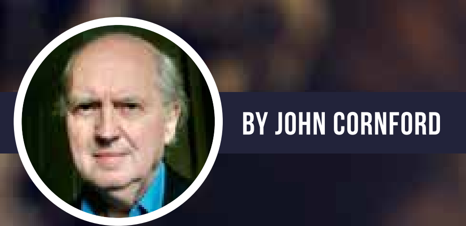


BY JOHN CORNFORD

HOW TO VALUE JUNIOR MINING STOCKS (PART 4)

BACK TO GOLD – AND SOME TRAPS FOR THE UNWARY

Following my coal mine excursion last month the gold price has crashed, so I return to valuation lessons from two other gold miners. ([I continue to write on 'coal-to-power' in the online edition]().)

My close look at **Ariana Resources (AAU)** in October revealed that its economics even then were more marginal than its apparently low cash operating cost would suggest; and a gold price 15% down subsequently reinforces that conclusion, as it must do for all other goldies. And I didn't emphasise enough that the closer look (that many brokers don't bother with) also revealed the not widely realised fact that most of Ariana's mine resource (by volume) is silver and not gold (even though all statements 'convert' silver to gold without overtly mentioning the fact). So in practice when mining the intermittently large silver lodes, costs remain the same as for gold, but revenue is only 1/60th – another annoying detail that investors often are not told. But Ariana might get some short term succour if Eldorado Gold, its partner at the Salinbas exploration project, takes advantage of the lower gold price to make it an offer that Ariana can't refuse for its 49% stake.

The same failure to appreciate annoying detail was affecting yet another gold miner with a seemingly low cost project – **Kefi Minerals (KEFI)** – even before gold dropped. While uncertainty about the last remaining element of funding still to be put in place for its Tulu Kapi project is one factor, another, known by careful institutions if not by private investors, is that highly variable geology means that 2-3 years into the project gold recovery falls off significantly for a year or so before picking up again. With the consequent sharp, if temporary, fall in profits, why buy the shares now?

> **"AISC IS MISLEADING FOR THE SMALL CAP MINERS WE'RE LOOKING AT."**

Before examining two other goldies, let's deal with the so-called ***all-in-sustaining-cost (AISC)*** issue which came to the fore 2-3 years ago when PricewaterhouseCoopers (PwC) highlighted the measure in its annual mining review. Where analysts had always talked of the 'cash' (i.e. 'direct' cost of putting an ounce of gold into the dealers' hands) PwC reminded investors of the other, long term, cost to replace, through exploration or acquisition: the extracted mineral. That frightened investors who had been jogging along believing that a 'cash cost' of around $900/oz (typically for gold) gave plenty of protection against a weakening price – only to be told that the extra cost to 'sustain' a typical goldie was around another $300/oz. It was that, I believe, that really started the rot among mining shares.

However, AISC is misleading for the small cap miners we're looking at. They don't in practice expect to have to sustain their operations and typically have just one project on which they should be valued and not on a permanent PER basis. It is only the large conglomerate miners who are committed to ploughing profit back in order to keep going indefinitely, so (forgetting any benefits of scale) the 'accounting' cost of extraction truly can be lower for a small project.

Another trap for the unwary? Illusion v reality – Scotgold Resources

I showed a chart last time of an "illusion" (a share price) and the "reality" (the same company's market cap, not repeated here), which I can now reveal is for **Scotgold Resources (SGX),** with its high grade but small Cononish gold mine and extensive prospecting rights in the Grampians gold belt in Scotland. I asked whether investors might think that with SGZ's prospects markedly improved, its apparently almost flat shares were flagging an increasingly cheap opportunity.

"HAS SCOTGOLD RAISED SO MUCH CASH IN RECENT YEARS AND HAVE SHARES IN ISSUE BALLOONED SO GREATLY, AS TO HAVE RENDERED THE COMPANY'S MARKET CAP NOW TOO HIGH IN RELATION TO CONONISH'S POTENTIAL?"

Scotgold's fortunes have revived dramatically since new key investor and experienced financier Nathanial Le Roux, a Scot who was obviously frustrated at a bargain sitting right under his own nose, refinanced it in October last year with a 40% stake. Since then, planning permissions and a Banking Feasibility Study have concluded showing extremely attractive economics from enough gold and silver at Cononish at 12 g/tonne (equivalent) to generate annual revenues of £16 million (with gold at $1,100/oz) over eight years from 2017 onwards with a 56% profit margin – all for a capital investment of £24 million (or only £18.5 million at the peak). On top is scope to find more gold through exploration in the Grampians part of the prolific Dalradian gold belt which hosts similarly attractive mines from Scandinavia, through Ireland, to Newfoundland.

The return on investment is over 40% with gold at $1,100/oz, and even at the current $1,060 is over 30%, with the rapid payback of under three years (and proximity to the Scottish Banks – who would probably rather finance something under their noses than in some far away developing country) rendering it relatively easy (one supposes) for much of the required investment to be met by a project loan (and grants) which, even if at a high interest rate, would leave the economics robust. At $1,000/oz the IRR is still 30%, so we have run calculations assuming that 75% of the peak funding can be borrowed at 6% (Libor+4%) on a £15 million five-year loan, with a remaining £5 million funded by a share issue.

My opening question hinted at a snag. Has Scotgold raised so much cash in recent years and have shares in issue ballooned so greatly, as to have rendered the company's market cap now too high in relation to Cononish's potential? At least one respected institutional mining broker thought so even before the gold price fell.

Converting Cononish's stated NPV_{10} of £18.5 million to our standard 8% (the following assumes $1,100/oz) produces £21.4 million, which compares with a current market cap at 0.725p of £8.9 million. However, substantial options and a convertible loan bring the fully diluted market cap to £11.9 million, before any issues to meet the equity contribution. (Even on a high margin between ROI and loan interest, providers will require a borrower to take on some of the risk by way of equity, usually 25%.)

Once the capital investment has been

made, the gross PV_8 for the project (the return to be apportioned between equity and loan providers) will be £21.4 million + £24 million = £45.4 million, and it is this – after the PV of the loan repayments has been deducted – that should be divided among the resulting equity to give the PV/share measure which most brokers struggle towards but don't calculate correctly.

As a more accurate alternative to the PV approach, I have run my usual model (based on the detail in the BFS) to assess the effects on investors' perceptions of value at various share issue prices. As in my Kibo example last month, in addition to assessing the resulting earnings or potential dividends per share I also judge how an institutional investor will view the return on his investment at the capital raise price, which is the key to estimating it.

Take, for example, a capital raise price of 1.75p. While the average EPS would seem cheap at the issue price, the annual earnings return an investor would get over the life of the mine on his 1.75p investment is only 8%, whereas a raise at 0.75p would give him 27% – so which is he going to go for?

My conclusion is that Scotgold won't be able to raise new funds for Cononish at much higher than the present share price. That's not to say it isn't attractive in the longer term for private investors. By the end of the eight-year mine life (assuming gold at $1,100 throughout) it will have accumulated £34 million cash after all taxes, costs, and loan repayments, which it will have been able to devote to the exploration that it hopes will find more of the gold rich veins like Cononish that seemingly are round about. That cash will amount to 1.5p per share (on a 0.75p cash raise) – so how odd (not) that it just about equates to the 1.47p/share NPV of earnings that I calculated in the table!

Hummingbird Resources – "Too good to be true? Or is there shum mishtake?"

Conscious of having set out to find near production miners who, in theory, ought to be worth buying in the run up to production, a close look has revealed the first two to have anticipated the fact – rendered too expensive by excessive fund raisings, even though the share price charts might disguise the fact. (Especially a pity for Scotgold, which has an otherwise attractive project not as badly affected by a weak gold price as are many others. But it has squandered much of its birthright.)

Nevertheless, there might have been a rare case where the simplistic 'target' valuation by dividing project NPVs by shares in issue doesn't produce a grossly inflated figure, but instead is too conservative – i.e. the true value per share after financing becomes greater than the 'project' NPV per share. (Remember that a 'project NPV' is not the same as the 'PV in the hands of the shareholder/owners'.)

In both cases the simplistic method is wrong-footed through ignoring the effects of financing. It omits the effect of share dilution where funding has to be by equity because the IRR isn't good enough for potential loan providers. And since the only research on most small caps tends to be by the house broker, you can't expect him to let the cat of share dilution out of the bag in advance of trying to puff his client company's shares as high as he can.

It all boils down to gearing. At **Hummingbird Resources' (HUM)** Yanfolila project in Mali, the returns when gold was $1,250/oz looked so good as to attract a promise of 100% debt financing by an experienced Australian private equity mining specialist, Taurus Fund Management. Provided there is enough margin between the IRR and loan interest, the effect of 100% debt financing is to increase the shareholders' NPV to above the project NPV.

Naturally, however, Hummingbird's shares have weakened on a gold price now 15% lower, which on the original plan would have rendered Yanfolila only marginally economic (only recently rumbled on the bulletin boards).

When an updated optimisation study in June reported even better results than the February 2015 study's 35% IRR and $72 million (67p per share) NPV8 the shares were 36p and the gold price not far from the $1,250/oz assumed in the study. Since then it is not just the gold price that has slipped, but also the project start date (itself reducing the NPV) while the $75 million loan is not yet signed and sealed, although the lender seemed happy enough only a month ago (just before the gold price crash) to have advanced $15 million to allow earthworks at Yanfolila to proceed. Now, investors must fear that the rest won't be forthcoming.

So what now? Having expected to find a miner worth buying in its run up to production, I ran my usual models, only to find what I think is a mistake in the February technical report's Yanfolila NPV and IRR calculations. (I have asked the company to comment but have had no reply.) My calculations show that at $1,250/oz the NPV8 is $55 million against the report's $72.3 million and the IRR is 27%. On the present $1,060/oz the NPV8 on my calculation will have shrivelled away to a mere $2.8 million, and the IRR to only 9%.

Scotgold – Effect of various £5m capital raise prices				
	Resulting	eps	8 yr return on issue price	
Issue price (p)	Shares in issue	7 year average	NPV8	IRR
	(m)	p	per share (p)	%
0.75	2,303	0.30	1.47	27.0%
1.00	2,137	0.33	1.58	21.0%
1.25	2,037	0.34	1.66	15.0%
1.50	1,970	0.35	1.71	11.0%
1.75	1,922	0.36	1.76	8.0%

However, if the promised 100% project loan does materialise, the gearing effect will to some extent rescue the situation for shareholders – in that the PV to them is geared up to higher than the project NPV.

At $1,250/oz, a 100% project loan at 9% would have increased the PV to shareholders to $82 million on my figures and even at $1,060 will have given them $30 million even though the 'project' NPV is almost zero. (It is meaningless in this case to look for a 'project' IRR, since there is no upfront capex, which is met instead by repaying the 100% loan out of project cash flow. Instead, it is the IRR from the shareholders' point of view which is their long term return on the price they pay for their shares.)

There is further hope, because since the February 2015 study on which these figures are based, Hummingbird has reported improvements in its mining plan whereby more efficient open pit design produces significantly more gold in the early years. It has promised to publish an update to the study to reflect this, and meanwhile has estimated the improvements will add $20 million to the NPV (at what gold price isn't mentioned) and will improve the IRR by 15% (whether absolute or a percentage, I don't know).

So, ignoring for the moment those improvements, the viability of Yanfolila looks like boiling down to whether Taurus Fund Management still make that 100% project loan at the new, lower gold price.

No doubt it is reconsideration of all this that is delaying the loan's finalisation, which explains why investors continue to sell Hummingbird. All should become clearer if and when the revised economics are published. And, you never know, the recovery the gold bulls have been forecasting all its way down from $1800/oz might happen, if a faltering world economy calls forth more QE. In which case, a rush into gold would be felt all the more strongly by Hummingbird.

I have one last point to make regarding share price 'targets'. I hope readers now know that even a 'correct' NPV per share is not a real 'target' in any true sense of the word (as if the shares will ever reach it) but merely a long term 'value' which justifies paying whatever an investor wants to pay in order to make the profit he wants. If he pays the 'target' price posited by the broker, he will be merely receiving back that same value – but over the life of the mine. It is only particularly inexperienced private investors bamboozled by the broker who would be silly enough to do that.

A related point is that even at a zero NPV, a project might still be worth pursuing as far as the host country is concerned. It will still receive the benefits of employment wages, taxes, and royalties, and the project's 'owner' will receive back all his investment after repaying any loans. It's just that he won't make a profit.

“HUMMINGBIRD HAS REPORTED IMPROVEMENTS IN ITS MINING PLAN WHEREBY MORE EFFICIENT OPEN PIT DESIGN PRODUCES SIGNIFICANTLY MORE GOLD IN THE EARLY YEARS.”

BY ROBERT SUTHERLAND-SMITH

THE LIMPOPO DISPATCHES

WHATEVER HAPPENED TO INFLATION?

In which your correspondent considers the changes which have made this century, so far, economically different from the last one.

The other morning, I found a crudely scribbled notice nailed to a fine Limpopo Bongo tree by the landing stage from river. It read as follows:

"REWARD OFFERED.

Missing from home, our dearly beloved child known as Inflation!

She went missing some years ago and has not been seen since then by those who want her back. Anyone with information about how to get our Inflation back should apply to the Old Lady, the Bank England, Threadneedle Street, London, EC2 (just ask for the Governor)."

Dismissing the thought that 'Inflation' was the kind of name that celebrities and film stars now give to their children, I naturally assumed that it had been left by Chancellor Osborne, whose visit to the Limpopo in a Chinese nuclear submarine was the subject of last month's Limpopo dispatch to the outside the outside world. Was he carrying a hammer and a bag of nails along with that hard hat?

I was a bit surprised at the heartfelt sentiment of the notice and to learn how much the Authorities – as they like to be known – so dearly miss inflation. Many of us thought they hated inflation! But it is a funny old world.

For much of my adult life, inflation was seen less as a missing child and more an ever present threat; more a carnivorous hunter that stalked our lives like a tiger that appears suddenly from the thickets surrounding our progress through the economic jungle, to tear and shred and then digest the seemingly tangible economic facts of life before our eyes. Was inflation born out of rising economic costs or was it brought about by too much economic demand – "cost push" or "demand pull" as the economic theories in our undergraduate text books used to have it?

Even its causes were the subject of mystery and endless speculation, like much else in the theory of economics. (We all know the old joke about laying all the economists in the world in a straight line but still never reaching a conclusion.) Whatever they were, they seem to have

vanished along with the tiger of inflation itself, because it is now, suddenly, hard to find. Perhaps it is on the verge of extinction like those other endangered big cats on our shrinking and ill used planet that has been with us (well not us exactly because human beings were an afterthought) since the dawn of time and before the moment, relatively recently, when God is reported to have said "Let there be light."

You can see from these opening comments of mine that life here along the Limpopo induces a reflective attitude to existence and its problems, which leads to an unrealistic desire to understand and solve them, without the benefit and intervention of public relations people or spinning politicians (nothing to do with whirling Dervishes). The two – PR and politics – now seem much the same as each other. Politics is PR and PR is politics: a fact that has now given rise to Jeremy Corbyn, ennobling him with the noteworthy scarcity value of being homespun and a refreshing lavender water-like antidote to everything that is slick, modern politics, spin and PR.

Diverting onto the subject of Jeremy Corbyn, we have seen nothing like him since the ascetic, teetotal 'leftie' – I don't think he had a corduroy jacket – wartime and post war Minister Sir Stafford Cripps, who rose from being a highly successful wartime minister of aircraft production and, afterwards, the successful Chancellor of the Exchequer of Attlee's post war Labour government. In that capacity he oversaw post war UK economic revival which gave rise to Britain's entirely revolutionary UK consumer society of the 1960s.

It is good to know that Sir Stafford Cripps had an indirect hand in producing Mick Jagger and the Rolling Stones. I might add that Churchill made him war time ambassador to Moscow but 'Uncle' Joe Stalin found him, as a gentle, well intentioned English socialist, too left wing for his tastes. Cripps and his kind (he was also an Old Wychamist) just did not like massacring people! A weakness that one fears Mr Corbyn shares.

Returning to the subject of the strange disappearance of inflation, anxious commentators on monetary policy await its second coming, like impatient acolytes awaiting a messiah that doesn't come! On their shoulders inflationary perch hawks with hawk talk about the need to raise interest rates as an elementary precaution against a future economic crisis; the point being, how can you lower interest rates when they are already at rock bottom?

But before you can say 'Bank Rate' we were told by the Bank of England that things are so fragile economically that there is now a danger in raising interest rates as those shoulder perching hawks require. It now seems, as we have recently been informed, that we may be a year away from such an event! Where is the tiger of inflation? Where are its claws, its sabre teeth? Is it extinct or merely hiding? It is always the same! When you need inflation there is not a sign of it! Even rising employment doesn't trigger it, as we see from the recent job creation statistics of both the US and the UK. So here are some questions I have gathered with model answers.

“HOW CAN YOU LOWER INTEREST RATES WHEN THEY ARE ALREADY AT ROCK BOTTOM?”

Why is inflation valuable? First, because it gets people demanding goods and services before they go up in price. It is an example of what economists call economic rationality. In economics there is a basic assumption that people act rationally – a pretty heroic assumption when considering the entirety of one’s own activities in life, as well as those of other members of the human race.

A modest degree of inflation – say about two and a bit per cent per annum – is very good for both business and social and political stability. A healthy bit of steady inflation also has

a wonderful impact on reducing fixed coupon historic government debt values in real terms. That is what has been missing from the economic picture in the last five or six years; paying back government loans depreciated over many years by inflation is an old trick that works usefully in our naughty world.

Inflation has also had the tendency to redistribute wealth without the vulgar and regrettable necessity of the mob to storm the Winter Palace, the Tuileries or assemble in London's St. James Square to break the windows of the houses of government ministers – as was sadly the fashion before the extension of the franchise. Hence the old line about the "English working class, love the sound of breaking glass".

So why has inflation gone missing for such a long time? As always in economic analysis, the facts are never easy to find. It's a bit like policing Humphrey Bogart's old Casablanca under the charmingly cynical Inspector Reynaud; that is to say a case of rounding up 'the usual suspects'.

In part, its absence is due to the lack of wage inflation. That is true both in the case of the US and the UK, both of which have slowly climbed out of the recession prompted by the financial crisis, with a restrained but healthier growth in GDP and an increase in jobs. But this time, mysteriously, without wage inflation. The old theory was

"A MODEST DEGREE OF INFLATION – SAY ABOUT TWO AND A BIT PER CENT PER ANNUM – IS VERY GOOD FOR BOTH BUSINESS AND SOCIAL AND POLITICAL STABILITY."

that when unemployment fell below a certain level, the shortage of labour for hire would mean automatic increases in wages. It was once a fact of life, like night following day.

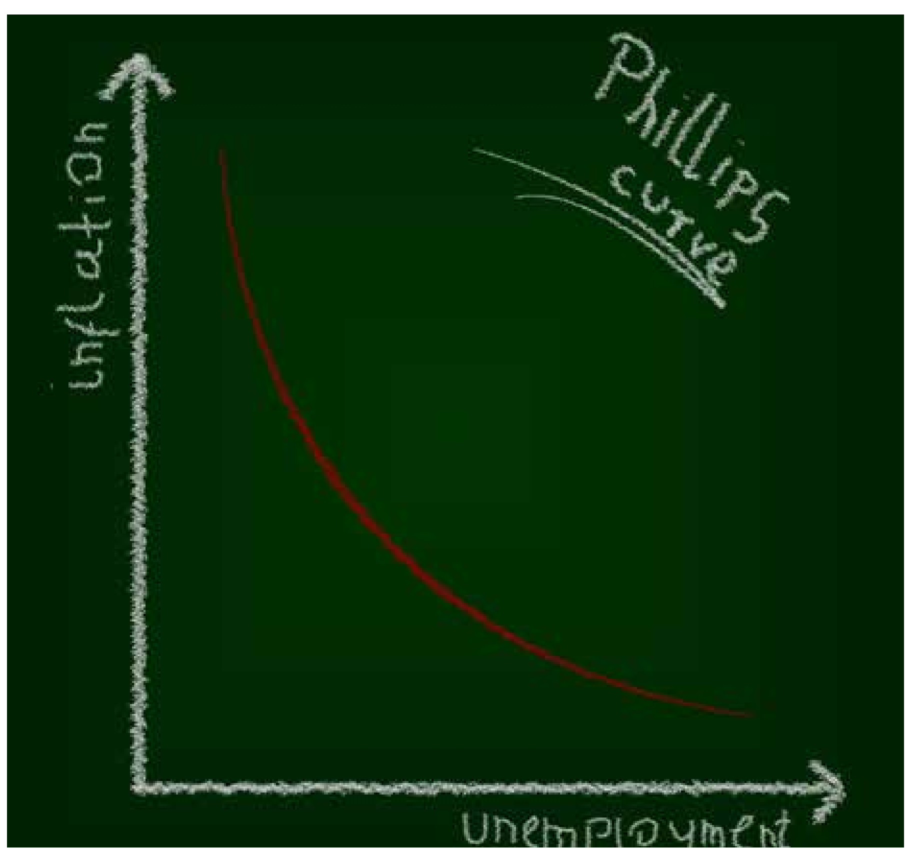
It became so conventional a bit of economic wisdom that that economic undergraduates were taught it as an eternal truth on a graph that became known as the 'Phillips Curve' and could be read as conveniently and easily as a bus time table.

In the US, they are in historical terms now at that wage take off level – with unemployment below 5% – but wages are not budging as they are supposed to. Professor Phillips and his curve have been left to gather dust on a shelf. Hence, partly explaining why the Federal Reserve is, even now, still reluctant to increase interest rates. If they increase the cost of borrowing and some over geared part of the economy goes bust, we presumably need rising wages by way of compensation to stimulate economic demand. We read that hourly pay rates are rising but not as fast as they did for earlier generations. In 2007 they were rising 50% faster in the US than they are now. So what has changed? What is amiss?

Part of the explanation seems to be that many people are on the records as employed but also in reality underemployed. They want more hours work but cannot find them. It is a bit unhelpful to simply say that hourly wages are rising, when many people cannot get enough hours? Thus the hourly wage thing rather overstates those headlines of economic progress. That is reflected in the fact that in the land of Uncle Sam male workers are now reportedly a less visible part of the national work force than they used to be. It is stated that their presence in it has shrunk in the US to only half of what you would expect at this stage of GDP recovery. Many aspiring job hunters, it is suggested, gave up the hope of finding work some time ago.

The numbers from the UK Office for National Statistics – or the Office of National Statistics as it used to be called (the inflation of such name changes is unabated) – for pay in October showed that average earnings increased by 1.9% in real terms in the Financial Year to last April, the first increase in about seven years. But before you order a bottle of Bollinger and a fine Cuban cigar, pause and consider the fact that the increase was down to falling inflation and not something desirable like good old fashioned productivity, which has also gone missing with inflation – both here in our Sceptred Isle set in that silver sea and those United States which stretch from shining sea to shining sea.

In a practical sense, that is a bit like trying to make bricks out of straw. Rather disturbingly, number crunchers have estimated that wage rises are not enough to keep living standards rising in the Land of the Free and probably not here either. That is a fundamental problem for economies that have traditionally been led by economic consumption. The same economic stargazers reckon that as far as they can tell, the tiger of inflation will remain unseen until we get to the second half of



"THAT IS A FUNDAMENTAL PROBLEM FOR ECONOMIES THAT HAVE TRADITIONALLY BEEN LED BY ECONOMIC CONSUMPTION."

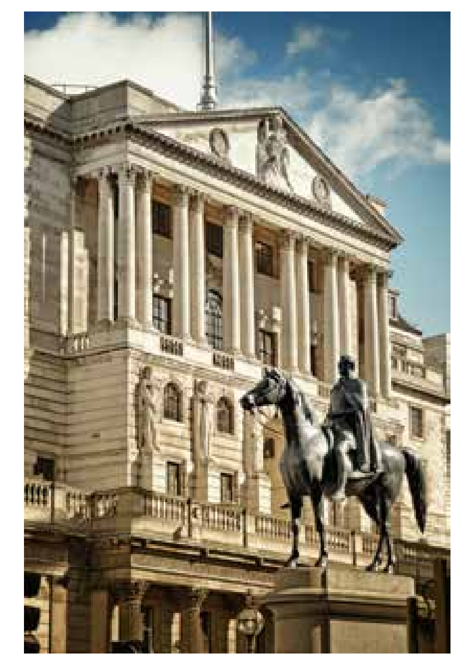
next year. Then – they either forecast or hope – inflation might climb above 2% again. But if it does, the workers of the world will then need some wage rises to maintain real incomes and to keep consumer spending growing.

The facts are so daunting that even the otherwise right of centre politicians, like G. Osborne, have had to try and do something with a new found interest in the usefulness of government intervention to mediate market forces. That is necessary because apart from being consumer economies, we and the USA are also democracies. That means governments have to be seen responding to the needs of the people for whom and, allegedly, by whom, they govern. In that spirit, government has had to pre-empt market forces by raising wages by statute. It is a very much left of centre idea to create a living wage – basically the 'minimum wage', invented by a former Labour administration, but reinvented and rebranded as a Conservative version of the same thing. One supposes that Margaret Thatcher is turning in her grave at the thought of Whitehall calling wage rates and not the market. It is indeed a funny old world as she herself observed.

There is clearly some link between the difficulty we are having in returning to our old inflationary ways and the recent past. The hard fact is that UK hourly earnings are now 9% (or £1.15) below where they were some six years ago in 2009. Moreover, on the basis of current trends, it is estimated that it will take another five years to get hourly wages back up to their 2009 level, assuming that such a process is sustainable. If that is true, it would mean that the UK as a whole will by 2020, have seen no real increase in hourly wages for twelve long years.

Clearly, wages have got too low. Economic star gazers have got round to the fairly obvious realisation – it's obvious to me – that labour has been so cheap that you can use more of it and spend less on capital investment, even though that too has been cheap thanks to quantitative easing. In the past, before 2009, companies have had to invest to render scarce and increasingly costly employees more productive. In the last half decade or so companies have been able to rely on more enduringly cheap labour, in a way reminiscent of what industrialists did, or were obliged to do, in the early 19th century. Lost productivity is another early 21st century conundrum, which reminds us that economics, apart from being the gloomy science, also remains the myopic science. Why exactly is productivity growth not what it has been during the better part of our lives? To judge from its price in the UK and US it is clearly in surplus supply. Is that something attributable to the economic dislocation of the banking crisis? Is it something to do with free trade in capital? Could it be that technology is no longer able to deliver the forward leaps in efficiency to which we have become accustomed? Or is it due to global free trade in workers?

I head off up the river bank just in case I can spot our lost inflation and economic productivity in the hope of claiming the reward from the Old Lady of Threadneedle Street. There is an air of tranquillity here. If I get the money, I shall buy some claret and cigars and head back here at once.



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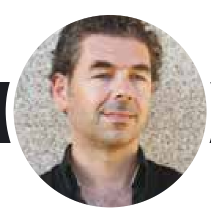


BY FILIPE R. COSTA

PAULSON AND PELLEGRINI

AN UNLIKELY DUO

Most investors are attracted to price increases. In the fear of missing out on further upside, they throw their weight behind the buying spree, to purchase assets at any price, in the hope that others will do the same. They almost always fail to foresee any trouble – and while sentiment remains at high levels, the market just keeps on rising. Between 2000 and 2006, the housing market experienced one of those bullish cycles, in which homeowners could get a mortgage, purchase a house, and refinance after just a few months: such was the price increase. House prices had been growing before, but during this period they accelerated, attracting the attention of Wall Street investors, who were excited about the prospects of owning a share of this high-flying market. Only a few were able to perceive the risks; but almost none of would translate it into a trade… almost none, that is, because there was one individual who prepared himself and went against the herd to place many believe to be the greatest trade ever – or at least the most profitable single trade in history.

The story I'm about to tell is not the success story of a model investor who stands out from the crowd; but rather the story of two ordinary and relatively unsuccessful men, whose lives intersected and led to their accumulating $20 billion (£13.2 billion). The complex trade they put in place depended on a simple drawing depicting past real house prices between 1975 and 2005 for the US. That single chart was worth $20 billion.

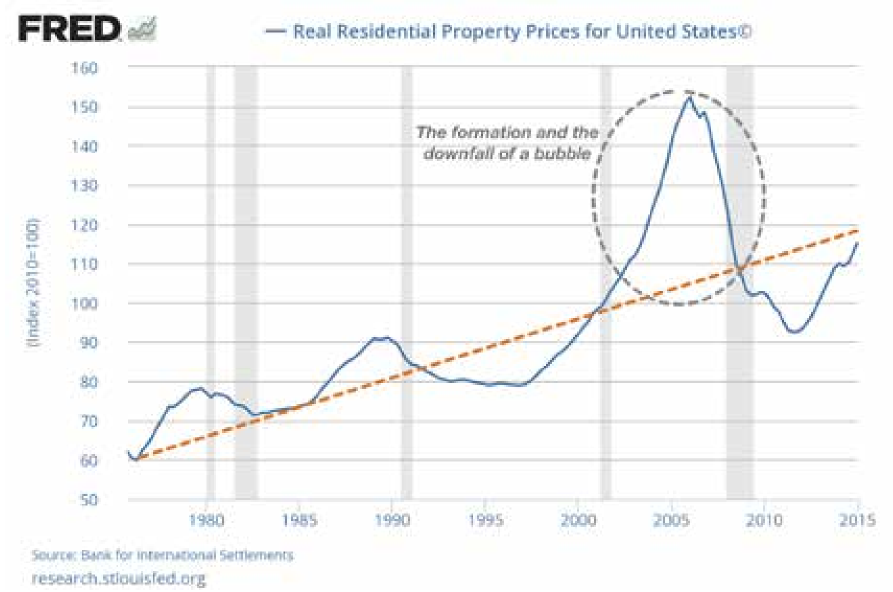
This is the story of how Paolo Pellegrini, aged 47 and more senior than the entire Paulson team, upon his third wife and after unsuccessfully trying several different investment jobs, was able to convince John Paulson to give him one last chance in the investment world. This is also the story of how a man who had dedicated his life to the safe arena of the merger and event arbitrage market would be persuaded to take a shot at a distant market and make a killing. This unlikely story shows how near to success one can be when just about to give up. It also serves as clear evidence of the irrationality of the market, and how important it is to stand out from the crowd and to think independently.

Figuring it out

When Pellegrini arrived at Paulson & Co, Paulson was running a relatively successful business but nothing more than ordinary. He was sticking to the lowest risk possible for a hedge fund, through mainly investing in corporate mergers that are likely to be completed, and having missed four years of housing upside many hedge funds had profited from. Tired of boring profits and convinced the housing market was getting overpriced, Paulson was open to new ideas. He ended up hiring Pellegrini, who, despite not carrying a successful career with him, had a good knowledge of the housing market.

"TIRED OF BORING PROFITS AND CONVINCED THE HOUSING MARKET WAS GETTING OVERPRICED, PAULSON WAS OPEN TO NEW IDEAS."

Paulson assigned Pellegrini to housing research to investigate if there was any investment opportunity – a task that Pellegrini conducted with full commitment. Pellegrini tracked home prices between 1975 and 2005, spotting a significant change in the market from 2001 to 2005. With the help of regression analysis, he estimated a trend line for real house prices for the period between 1975 and 2000 and then for the period between 2001 and 2005. Pellegrini found that while prices rose 1.4% per year in the first interval, they soared 7% per year in the second. The excessive rise accumulated across five years would need a 40% decline for prices to return to their long-term trend. This left room for a large price correction. Combined with the fact that during past corrections prices usually declined below the trend line – as investors always tend to overreact – Pellegrini concluded that this could be the opportunity of a lifetime to make a killing.



"THE UPSIDE POTENTIAL SEEN BY PAULSON WAS NOT A VIEW SHARED BY OTHERS, AS MOST PROSPECTIVE INVESTORS JUST COULDN'T FORESEE ANY RISK OF COLLAPSE IN THE HOUSING MARKET."

Pellegrini convinced Paulson that the housing market was about to collapse and that risky mortgages would tumble in value, as borrowers would no longer be able to repay the mortgages, in particular those on subprime loans.
The next step would be to find out how to profit from the collapse of the housing market. As houses cannot be sold short, an indirect way of shorting prices needed to be found, something highly correlated with them. Paulson discovered that insurance on risky home mortgages was trading at very cheap prices, as no one saw a great deal of risk in the market. The reasoning was simple: even in the event that subprime borrowers couldn't repay their loans, it would always be possible to sell the mortgaged house and recover the money, as house prices were rising. Risk was almost non-existent. But Pellegrini and Paulson were a step ahead, asking themselves what would happen if house prices collapsed. That would certainly boost their insurance contracts, which would have been bought very cheaply...

A difficult task: finding investors and convincing them

While the idea seemed great, they still needed money to execute the strategy. Paulson needed to address a few investors and convince them that the housing market was about to collapse and that he could generate alpha from betting against the market. But nothing could be more difficult than convincing people to act against the herd. In fact, this should not come as a surprise, because it is exactly due to the herd mentality that bubbles form. Investors follow what other investors do without any logical underpinning, and prices lose value as a trading signal. There is not much independent thinking on Wall Street; all hedge funds do is to leverage themselves above the trend to achieve fatter profits. An investor buys at a high price just because he believes there will be another fool behind him buying at an even higher price.

Paulson explained his market views and intentions to Novar Randolph, an executive at Crestline Investors (and also a Paulson client). He came out empty handed as Randolph quickly dismissed the proposal, claiming he couldn't see any alpha accruing from it. Next in the queue was Mark Taborsky, who helped pick hedge funds for Harvard University's endowment, but again the meeting ended fruitless. The upside potential seen by Paulson was not a view shared by others, as most prospective investors just couldn't foresee any risk of collapse in the housing market. With a potential loss of 8% per year, Paulson's ideas were just insane...

However, there were some, like Jack Doveck, who were more open to the idea of a housing collapse, but thought that the proposed bet would be difficult to unwind due to the low liquidity in the market. He too turned Paulson down. This fixation on the housing market collapse could have cost Paulson heavily, as some clients started raising doubts about the firm's focus. But instead it was this fixation that turned Paulson into a billionaire. Unable to convince Wall Street, Paulson was only

able to raise $147 million (£97 million) through the help of family and friends.

Another hurdle: find who could oppose the trade

It was relatively easy to find someone willing to sell Paulson and Pellegrini the insurance they were willing to buy. As Josh Birnbaum, a top Goldman Sachs trader put it, "we have done the work and we don't see them [the mortgages] taking losses". Goldman was happy to oppose the trade. Birnbaum felt so confident on the mortgage packages that Brad Rosenberg, a trader at Paulson & Co, once walked into Paulson's office looking a bit shaky about the trade. Paulson just said: "Keep buying, Brad!"

Pellegrini's research was certainly key in figuring it out, but it was Paulson's conviction that made it all possible. Paulson was by then aiming to make a killing, but the insurance they were purchasing was not enough. They had to convince investment bankers to sell derivatives on a much larger pool of debt obligations. Paulson met with bankers at Bear Stearns, Deutsche Bank, Goldman Sachs and a few others to ask them to create packages of mortgages he could bet against. The investment banks created a collateralised debt obligation (CDO), which they marketed to investors willing to profit from the bull housing market. At the same time, they sold credit default swaps (CDS) on those CDOs to Paulson and friends.

“BRAD ROSENBERG, A TRADER AT PAULSON & CO, ONCE WALKED INTO PAULSON’S OFFICE LOOKING A BIT SHAKY ABOUT THE TRADE. PAULSON JUST SAID: ‘KEEP BUYING, BRAD!’”

With mortgage risk evaluated at very low levels, the CDS contracts written by investment banks were cheap, allowing Paulson to achieve a high degree of leverage. He ended up betting against a notional value of $5 billion in CDOs. If the market collapsed, Paulson would make a fortune.

By mid-2006, the housing market peaked and reversed its trend. Due to the high degree of leverage present in the market, when prices started falling, credit conditions quickly tightened, and delinquent mortgages peaked. The more house prices declined, the greater the number of delinquent loans. The collapse was unavoidable and Paulson's trade was working. Paulson & Co reaped $15 billion in profits in just one year plus another $5 billion in the next. A trade deriving from the simple notion that housing prices could not diverge from their historical mean for long was worth $20 billion (£13.2 billion). Paulson took home $4 billion (£2.6 billion) in a single year, the largest payout in the history of the financial markets, and Pellegrini received a bonus of $175 million (£115.5 million).

A few final words

Paulson & Pellegrini later went their separate ways. Paulson kept his Paulson & Co hedge fund while Pellegrini opened his own shop. But neither of them has subsequently been as successful as they both were when working together. Paulson executed a few other bets against the dollar that led him to huge losses; Pellegrini was caught out by the market and returned external funds to investors. But at some point, they were able to stand out from the crowd, to think independently and oppose the market. Their trade will be remembered for many years to come as the greatest ever up to that point and will serve as evidence of how irrationally markets can behave. (For more about this trade read "The Greatest Trade Ever" from Gregory Zuckerman.)

BY MARIA PSARRA

SCHOOL CORNER

STAYING FLEXIBLE

Staying flexible in your views in trading and investing: this is today's topic and the twelfth in my series of educational articles for Master Investor Magazine.

As I wrote in November, *"trading and investing is NOT about being always right, it is not even about being fundamentally right but letting this cost you money, it IS just about making money. As follows, in an environment of increased volatility, you have to stay flexible."*

What do I mean by this? I mean that financial markets and economic conditions – and, as follows, the price of any financial product you invest in – are not static. On the contrary, they are always more prone to change than not. Now this is all great when things are changing in one's favour, but what happens when they don't? Should you just stay put and watch the value of your holdings decrease? Well, in some case you should, and in other cases you shouldn't. Let's try to separate the two cases.

I should start by noting that there are as many trading and investing styles as there are investors and traders. There is no single best one – even though I have come across many that could rightfully be named the worst. Nevertheless, there is bound to be one that is best suited to your own personality. For this article, I shall use my own personality as an example to show you how I try to stay flexible in my own trading; then hopefully you can adjust this to your own.

I tend to be a relatively short-term equities trader. I hold on to positions anywhere from a few days to a few weeks. I buy what I believe has a higher fundamental value than its current price, and go short of what I believe has a lower one. I have never been a huge fan of technical analysis; but I do always take into account important support/resistance levels as well as daily candlesticks. I do this because even though I do not personally believe in the magic of technical formations with exotic names, I do hugely believe in market sentiment, and both the shape of daily candlesticks and the levels where an asset's price has stalled before allow me to understand what other traders and investors are feeling and thinking.

> **“FEAR CAN BE A VERY POWERFUL EMOTION IN EVERY ASPECT OF ONE’S LIFE. THE PROBLEM WITH IT IS THAT IT OFTEN LEADS TO THE WRONG DECISIONS BEING MADE.”**

In a practical sense, this means that at the time of writing this article, my portfolios have a number of long CFDs and cash equities positions. These are all holdings in companies that I believe have solid fundamentals and whose valuation according to my fundamental analysis is above the price at which the stocks were bought. However, again at the moment of writing, the European and US indices have been coming down for a few sessions, and the world is rather wary of the economic situation in China and other emerging markets, as well as the fallout from the atrocious terrorist attacks in Paris. So what does staying flexible in this particular situation involve? Does it involve panicking and selling out of all existing positions *even at a loss* for fear of losing more? Fear can be a very powerful emotion in every aspect of one's life. The problem with it is that it often leads to the wrong decisions being made. So the answer is no, I for one shall not sell out of all positions based on fear. However, as I have written in the past "arrogance IS a sin", so the fact that the fundamental valuations of certain stocks are above their current market prices should in no way make me become blind to their falling prices.

So how have I dealt with this? At time of writing, I have short index positions in the indices to which these stocks belong. I also have short positions in individual stocks in certain sectors, especially the mining sector. In addition to these, or perhaps even because I have these in place to protect the monetary value of my long positions (in situations like the current one), I can afford

THIS YEAR
STOCK MARKET
+83.0
+41.9
+22.6
+12.0
+10.3
+0.83%
+1.5%
+0.12%

to take a bit more pain seeing my long positions move lower.

"STAYING FLEXIBLE INVOLVES ADMITTING THAT WHAT ONCE SEEMED RIGHT (AND PERHAPS AT THE TIME EVEN WAS) IS NOW WRONG, AND ACTING ACCORDINGLY."

I have taken these short positions because over my years of trading, I have learnt that part of being flexible is understanding that there are times when the market as a whole may temporarily move lower. When you anticipate this you should stop simply being focused on your fundamental long positions, and instead find a way to protect both the value of these and move at least to an extent with the market and not against it. I am also happy in situations like this to increase the flexibility I give to my long positions, and look to weather the storm.

Now this in no way means that you should give more flexibility to each single trade that starts moving against you and your profits. You most definitely shouldn't. The above is only a rough roadmap of what you could do in specific market circumstances. There are, however, situations where it is not the overall market that is negative; it is rather a case of the fundamental situation of a specific company whose stock you hold that has changed.

A good example of this is a company that issues a profit warning and cautions investors that, for example, they "expect no improvement in their financial situation in the foreseeable future". In this case, you are better off biting the bullet and selling out of your position. Yes, at a loss as this unfortunately is not a temporary hiccup; it is, as one of my favourite UK bands sings, "Grounds for Divorce". And I know how horrible "getting out" feels when it happens, but things ARE bound to get a lot uglier if you stay. As follows, in this case, staying flexible involves admitting that what once seemed right (and perhaps at the time even was) is now wrong, and acting accordingly.

There are of course numerous other situations you can come across in your trading and investing that will require you to stay flexible. These two are just examples based on my own experience – and even in my own, this is just the ''tip of the iceberg'' – but if nothing else, my article will make you think a bit more, and hopefully make you more flexible in your trading and investing. Who knows, it may even form part of your New Year's resolution!

Until next month,

Happy trading and Happy Christmas 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

WHY SAVING IN YOUR TWENTIES IS A MUST

There's no easy way of telling Millennials that they should be saving in their twenties. It is a necessity for anyone that wants security in their thirties and forties; yet it seems to kill all conversation when brought up with those asking for advice. It even instills fear into some of my friends who refuse to discuss finances. It's ingrained in us Brits to avoid financial conversations, so maybe it's no wonder that government figures suggest that UK consumers spend £90bn a month without a second thought.

To us twenty-somethings, the idea of saving seems to signal a move from a care-free city life towards one of the joy-killing hermit. Social media is littered with quotes telling us to sieze life by the scruff of the neck, with helpful comments such as "you only have one life, this is not a rehearsal!" and other seemingly wise clichés to inspire us on a miserable Monday morning. It particularly hits home when, on close inspection of the wallet, we are greeted on Sunday morning with the reality that the weekly food budget went on one drunken Saturday night, and as a result, we convince ourselves it was worth it for a weekend we'll never be able to experience again. Work hard, play hard, let the good times roll.

> "IT'S INGRAINED IN US BRITS TO AVOID FINANCIAL CONVERSATIONS, SO MAYBE IT'S NO WONDER THAT GOVERNMENT FIGURES SUGGEST THAT UK CONSUMERS SPEND £90BN A MONTH WITHOUT A SECOND THOUGHT."

But what most of us don't realise is that saving doesn't mean disappearing off the face of the earth. It is not a life sentence, and can actually be enjoyable. Is life really about Black Friday deals? After all, 50% off tat is still tat. Saving in your twenties is about prioritising; it's about choosing which parts of your life are most important to you, and which ones you can easily live without. Some you won't even notice are gone. Saving shouldn't be a stagnant decision that limits you, but rather it should be a positive change that gives you freedom. Everyone will have different priorities so there is no set rule of what to change, but the key is that change shouldn't be negative. If someone told you that changing your daily lunch habits could make you a homeowner by 30, you'd probably laugh. But it's not as far from the truth as you'd think.

So why bother making the adjustments? Firstly, it's the easiest time to save. Post-university you can still claim all the perks of being a student but with the added benefit of a salary. Interest-free overdrafts, interest-free credits, and discount cards galore for shops, restaurants and holiday companies like STA Travel. All those savings could either go into a hotel upgrade, or they could go into a pot which might be the first step towards the holy grail of all investments, a deposit for your own home.

Secondly, responsibility is at an all-time low in your twenties. Most British women are now not having their first child until they reach 30, and men even later, so your salary is, most likely, entirely for you. The biggest expense will be getting an invite to a wedding and splashing out on accommodation, a present, a new outfit and train fare (or plane fare) to the far flung destination.

Finally, and most importantly, your savings will grow exponentially; with property growth in London now out-weighing wage growth, you can't afford not to save. Getting on the property ladder is crucial if you want control of your life, and it will make a difference to your future if you start saving now. And it's not just in London where house prices are growing. According to research firm Hometrack, property in Cambridge has surged by 44.7% since 2007, with Oxford following closely behind with a 37.4% rise in prices. All it takes is some careful thought and shrewd research into the market.

So how to start saving? It's all about prioritising, and regardless of how much you earn, it can be whittled down to three main expenditures: food and drink, travel, and accommodation. As they say, it's not your earnings that make you wealthy; it's your spending habits.

Food and drink

Living on a budget doesn't mean never enjoying yourself. But there are certain times to splurge, and certain times to save. M&S food should be limited to when you fancy a treat or a night in at the weekend, not for everyday at your desk when you're mindlessly slurping and not noticing what you're eating. When you consider that a regular coffee from a chain now averages £3, if you either cut out your daily fix, move to office coffee, or bring in your own flask, you've saved yourself an astronomical £720 a year. Add that up over the decade and you're half way to a deposit for a flat.

“GETTING ON THE PROPERTY LADDER IS CRUCIAL IF YOU WANT CONTROL OF YOUR LIFE, AND IT WILL MAKE A DIFFERENCE TO YOUR FUTURE IF YOU START SAVING NOW.”

Equally, evenings and weekends don't need to be spent at home alone eating soggy pesto pasta, feeling like a finance martyr. With the UK restaurant scene now competing for patrons, there are deals in abundance. Bring Your Own Bottle is becoming increasingly popular in the major cities for independent restaurants who can't compete with the chains for low food prices. Restaurants offering this option range from local African cuisine in Brixton such as Negril (£2.50 per person for bring your own per day) to Hawksmoor in Knightsbridge, an upmarket steak and seafood restaurant which charges £5 corkage per bottle every Monday. With their own Prosecco starting at £40, they recommend maximising BYOB Mondays with a Nebuchadnezzar of champagne and a jolly good knees up!

Travelling

The belief that travelling is the only thing you can buy that will make you richer may be clichéd, but it is fundamentally true. Virtually my entire spending budget goes on seeing the world, discovering new cultures, and expanding my mind. And just because it's enjoyable, travelling doesn't have to be a one-way drain on your bank account. These days there are a number of organisations which can earn you good money from leaving your home empty. The more well known companies like Airbnb and Home Exchange are easy to use, flexible, trustworthy, and will provide you with a steady income. In Manchester, a private room on Airbnb typically goes from £32-50 per night or in Liverpool you could charge £30-70 depending on location and the quality of room. Airbnb claim the average UK host earns £2822 per year by letting their property for 33 days. Suddenly a weekend away from your flat is an opportunity. If you are savvy, it is possible to earn every penny of your trip back, if you are just prepared to open your house to other likeminded people and explore short-term rental options. If you happen to have a slightly more up-market home and don't fancy the hassle of cleaning it between stays, companies such as OneFineStay offer up to £250 per night for your one bedroom apartment in Central London.

Rent

By far the biggest monthly outgoing comes from rent, so stopping it as soon as possible is all the more important. Too often we Millennials get over-excited by our first proper-paying job and decide to rent a lovely two bed in the centre of a city to start enjoying life. Out comes the flat screen, surround sound, and all the kitchen mod-cons. You've officially arrived in the working world. But when you consider how little time you spend enjoying your apartment every week, the hours barely hit double figures. Between sleeping, working, gymming and going out, how luxurious do you really need your apartment to be? The average one bed flat in London is now over £400 *per week.* It comes as no surprise that the West London weekly average is £623, but even Peckham is now £298. That's £15,496 down the drain every year, just to rent a Peckham one-bed. Getting on the property ladder in your twenties is the best start you can give yourself to ensure that by the time your forties arrive, you're not house hunting whilst also balancing school fees, bills, and trying to justify a family holiday.

So maybe living in shared accommodation is not as enjoyable as the freedom of your own flat, especially if you're living with a partner and want to enjoy being a couple. You want to make your flat homely, cosy and yours to share – except it's not yours, so making it homely for your landlord isn't useful for your future finances.

Your money works hardest for you in property, so the quicker you can invest in it, the better – if that means living in a shared flat for five years in a grimy part of town, it'll be worth it. That annual £720 we saved earlier on coffee seems nothing compared to £15,000 on rent. But is a house really worth it?

"ONE OF THE BIGGEST MISCONCEPTIONS IS THAT BORROWING FROM THE BANK LOSES YOU MONEY. YES, YOU PAY INTEREST, BUT AS YOU BORROW, YOU CAN ALSO EARN."

One of the biggest misconceptions is that borrowing from the bank loses you money. Yes, you pay interest, but as you borrow, you can also earn. Interest rates are so low at the moment that if you were to get a 90% LTV mortgage on the average one bed in Peckham, you would only pay £576 interest a month. Compared to the £1,291 monthly average rent, that's a pretty good saving. And as a mortgage is the cheapest way to borrow; envisage the interest as an offset against capital growth. A few years ago I bought a two bed in Brixton for £295,000 to save me from having to rent. Yes, it's not the most glamorous of areas, especially a few years ago, and my neighbours were either on drugs or drunk pretty almost 24 hours a day; but I'd researched that the area was going up, so aged 23 I took my first punt in the real world. With monthly interest of £700 going straight to the bank, it initially seemed like I was losing a lot, so I took in a housemate. That way, although I wasn't making money, I also wasn't losing any. That was, until it went on the market earlier this year, and sold for £530,000.

If someone had told me I could earn £235,000 through simply being frugal and putting in a few hours scouring property trends, I perhaps wouldn't have believed them. But much of the necessary savings really did come down to a combination of making lunch at home, living in shared accommodation or back at home for periods, and restricting restaurants to BYOB evenings (and this was a rarity – in the first three years of setting up my business I restricted dining out to as little as possible, preferring dinner parties where spending can't get out of control). Yes, it's not as fun as getting trollied in swanky cocktail bars four nights a week, but it means that within a few years, the luxuries attributed to wealthy forty-somethings are now within my reach. People say "live your life the way you want to, not the way you have to" as if happiness equates to spending money on booze and clothes that you don't need. But maybe it refers to being in control of your life, being debt free, owning a house, and feeling secure. Saving in your twenties might just be a lot more than it's cracked up to be once you're in the driving seat; you can't really afford not to.

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 November.

2nd November

Get off the pot: Was Shakoor, who is right on these matters, declares that **African Potash (AFPO)** is absurdly overpriced at 2p. When I collared him last Friday evening he could not go into detail since he was on his way to football practice (I quite understand). But holding AFPO is a high risk exercise.

Lucian Miers's view/approach is slightly different. He notes Lord (Peter) Hain's accession to the board and the orange-toned one's remark that "AFPO would promote the African fertiliser industry and thereby improve food production, reduce child immortality (sic) and poverty." Did Pete use these words? Hard to say. But I suspect it was just an utterance from a PR person who put this drivel in Pete's mouth. Because Pete cannot believe in the project – or so I suppose – he does not issue a written record of his own words. It is perhaps best to share his indifference and distance oneself.

4th November

I am a glutton for punishment when it comes to resource stocks. So when a voice comes on this morning pointing me in the direction of **Berkeley Energy (BKY),** putative uranium producer, chaired by my neighbour Paul Atherley, I am drawn as a moth to a candle.

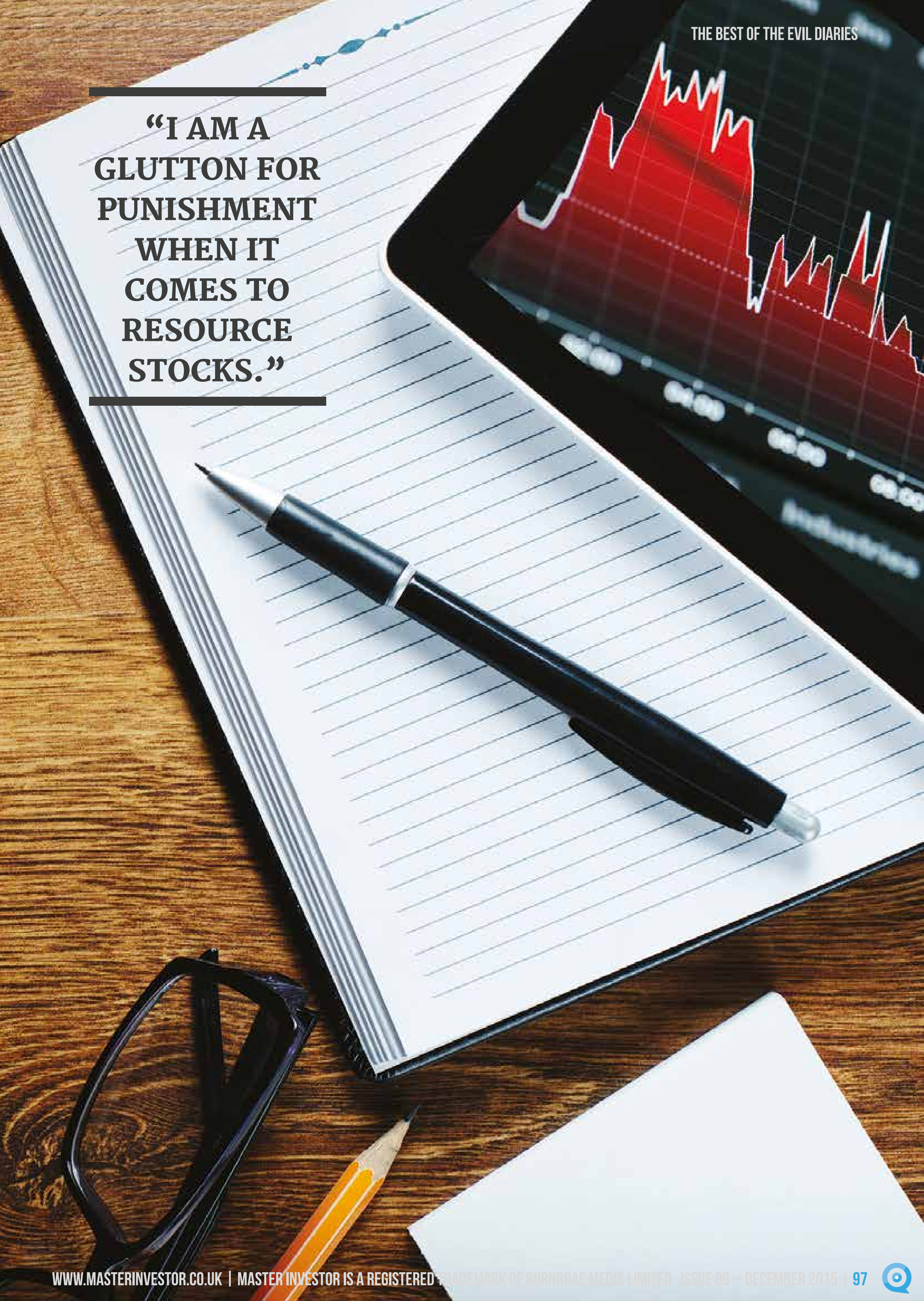
However, the RNS is explicit in advising that "The project now has a Net Present Value of US$871.3 million (GBP580.9 million) with an internal rate of return of 93% based on a discount rate of 8% and a long term uranium price of US$65 per pound. This valuation represents around GBP3.22 per share on an undiluted and unfinanced basis compared with the current share price of around GBP0.22 per share." (The 22p refers to this morning's opening price.)

So, if one believes the 322p figure, one buys. That is true even if, as one must suspect, a placing is on the way.

6th November

I had slightly decided not to say anything about **Plethora (PLE)** and the bid since the chairman owns 29% of PLE and is the controlling luminary at Regent Pacific, whose number on the HKSE is 575. This modesty was partly occasioned by my ignorance but principally because the chairman also controls this site.

However, I can restrain myself no further. On Day One of the possible



“I AM A GLUTTON FOR PUNISHMENT WHEN IT COMES TO RESOURCE STOCKS.”

bid, Wednesday, I paid 7p for PLE since, ostensibly, the offer was worth 12.5p. However, the offer is only in RP paper whose value I could not then check since HK was closed. I therefore resigned myself to a sharp sell-off of RP when HK reopened yesterday morning (c. 1.30 a.m. London time). You may therefore imagine my surprise when I checked the HK closing price yesterday morning. It was unchanged from Tuesday night and volume was about 35m shares. Given that the offer is 15.7 RP shares for each PLE share, that is the equivalent of 12.5p, I therefore decided that the RP price is real and not a fake.

So I checked RP's HK price at the close first thing this morning and it still stands at 0.097 or put another way the equivalent of c. 12.5p. Volume in HK last night was only 6m but even so it smells real enough to me. So I again bought PLE this morning – this time at 5p.

Realistically, we have seen this discount before. Some may remember London-quoted issues going east a few years back and the discount was colossal – of the order of 40%. The wise guys said "You'll learn". Fortunately I did not learn since I went on to sell the former London counters in HK at the full price. So what was and is going on? I'm afraid to say that UK retail investors are just being silly and selling out in London whereas it is perfectly possible to sell London-acquired PLE as HK-quoted RP. All that is required is a little patience and persistence.

And the chairman? He has been as far as I am concerned on this subject as quiet as a mouse. But I know he hopes that RP will emerge as a serious "drug firm". Make of that what you will. He is certainly serious.

9th November

Fever-tree (FEVR) stands on AIM at 530p or £610m. It is not tonic water that makes a gin and tonic but the aromatics in the gin. So Fever-tree's rating is almost entirely down to a fever in the minds of investors. Tnav is of the order of £15m.

17th November

The chairman draws my attention to the SunTimes article on **Just Eat (JE.).**

This now stands at 425p or so and is on a prospective PE of 80 for 2015. Tnav is nothing about which to write home. So it is all in the earnings story.

Forget that one of its big backers, Index Ventures, is selling out. The point upon which to concentrate is that JE enjoys a 12% commission rate on orders placed through its site. The June 2015 half year figures disclosed turnover (i.e. commission) received of £108m as against admin costs of £75m. Given that this latter figure includes what are in effect start up costs it can readily be seen that the business would still make a profit at 10% commission and, quite possibly, 8% commission. That being so, the competition are on their way. Even if that is not so, the competition are still on their way. Therefore JE cannot justify a price of 425p.

*****

Blinkx (BLNX) reported this morning on the six months ended 30th September 2015. These figures are appalling. There is the persistent declaration of intentions to make money but there is no sign of it actually happening. At 24.5p Blinkx is capitalised at £100m whereas, after stripping out intangibles, tnav at 30th September was £65m and declining since the company is still losing money heavily. Given that one can buy a growth company which is making money and stands at a heavy discount to tnav quite why Blinx stands above 15p is beyond me. 10p looks closer to the mark.

"IT IS NOT TONIC WATER THAT MAKES A GIN AND TONIC BUT THE AROMATICS IN THE GIN. SO FEVER-TREE'S RATING IS ALMOST ENTIRELY DOWN TO A FEVER IN THE MINDS OF INVESTORS."

20th November

Jim Slater has died, aged 86. I revelled in his friendship.

A few years ago, the BBC featured a rather lurid documentary claiming that a number of financiers regularly gathered at The Clermont Club in a private dining room to organise the finances of British industry and commerce to suit themselves. This was nonsense as far as Jim was concerned since he eschewed any suggestion of conspiracy.

But there was a phase in the late sixties when seemingly every deal was promoted or consummated by Slater Walker – indeed, if memory serves me right, the day came when no less than three takeover deals emerged on the same day.

Jim was never a slouch in developing and promoting the momentum of the team he had gathered together. This of course had the effect of causing a very high morale which led to even further success for Slater Walker.

He was an exceptional judge of the state of play. As I found to my cost in that having thought through the evidence for a sportsbook proposition he gently offered me the opportunity to accommodate him. A thick five figure sum later I came to know better.

Leaving aside his huge and ultimately persistent success in the stock market he was entirely dedicated to his family. He described his wife, Helen, as a strong long term hold and was hugely and rightly proud of their four children and, of course, the ensuing grandchildren.

23rd November

Not entirely surprisingly, the **Plus 500 (PLUS)** bid from Playtech has broken down since the FCA was not prepared to give PLUS clearance. Good old FCA (I never thought I'd write that).

But the share price is barely changed down at 355p. Take PLUS's declaration this morning that "Regulatory compliance capability has been strengthened." One can read this in all sorts of ways and I am sure that the silliness (because of the vagueness) of the remark has been deliberately cooked up to deflect sensible assessment. However, the fact is that PLUS operated a basically fraudulent business and the FCA was not prepared to tolerate that as far as the British end goes. The question then is: can the business continue to operate successfully in share price terms notwithstanding its basically fraudulent approach? Perhaps.

But the general rule is that a fraud is a fraud and should be steered well clear of. I'm staying short.

30th November

Little fish are sweet: I have been sat in **BCB (BCB)** for years. It's Lord (Michael) Ashcroft's Belizean toy bank. It reported last week, showing net assets of £38m as against a capitalisation at 7p of £7m. Further, annualising the first quarter's results gives a profit expectation of £4.8m net of tax. Or put another way the PE ratio is of the order of 1.5.

I had a long chat with the erstwhile FD, Peter Gaze, some months ago and he cautioned me against rushing ahead since the politics of Belize are well to the left and, I was left to conclude (he was discreet), well capable of proving remarkably silly. But, however one looks at it, Belize has to have a bank which recycles savings and this business is extremely profitable since there is little competition to bid for deposits and, as always, no end of potential borrowers.

I still held back since the balance sheet holds advances to the Belizean government where the recoverability of such an advance is difficult for an external investor to assess. But, late on Friday afternoon last, BCB announced that it had bought back 550,000 at 5p. And I regard that as the signal that all is well. So I paid 8p for 100,000 this morning. All I now want is the hint of a dividend. 2p per share is easily afforded.

"ALL I NOW WANT IS THE HINT OF A DIVIDEND."

NOVEMBER 2015

BEST OF THE BLOG

Post Card from Cyprus

When Swen asked me to get down to Cyprus to cover the olive harvest I thought this would be a dull assignment.

But since arriving on Aphrodite's enchanted island, I now understand that this country is a living case study in *Eurozone post-bailout recovery.* Let me explain.

Cyprus is the most Easterly country in Europe. As I write, I am but a few pigeon flaps away from Alexandria, the historic capital of Egypt. The Holy Land is a four hour boat ride. Surrounded by the land masses of Asia and Africa, geographically, this is hardly Europe at all.

Since 1974, this beautiful island has been dissected by a barbed wire fence which divides the Turkish north from the Greek south. With the help of field glasses, I can spy a huge Turkish flag cut into the hillside above Morphou Bay. One has to be careful not to incur exorbitant Turkish roaming charges if one strays into an area served by Turkish telephone networks – easily done.

So actually, Greek Cyprus is half a country clinging desperately to the EU (and the Eurozone) to assure

"GREEK CYPRUS IS HALF A COUNTRY CLINGING DESPERATELY TO THE EU (AND THE EUROZONE) TO ASSURE ITS PRECARIOUS EXISTENCE."

its precarious existence. Although, thankfully, relations between the two halves of the island are more cordial than previously. The border is open at specific checkpoints and trade between the two mini-states is brisk; and there is talk that a *major breakthrough* is imminent (nothing new about that though).

The Russians are still here in force. The Greeks and the Russians share the Orthodox church and a love of icons. And the climate here beats Moscow. The tragic downing of a Russian passenger jet over Sinai on 31 October will probably mean that, in the near future at least, even more Russians will choose Cyprus for their vacation in preference to Egypt.

By Victor Hill

A golden opportunity: A chance to buy gold mining funds at rock bottom prices

The price of gold has been trending lower and is now trading at less than $1,100 per ounce, which is close to a six year low. One of the main reasons is the growing likelihood of an increase in US interest rates that has driven the dollar higher. The strong currency makes the dollar denominated commodity more expensive for non US investors and forces the price lower to compensate.

It is the gold mining companies that have been the biggest casualties with their share prices suffering heavy falls, but there could now be a golden opportunity to pick up a real bargain. The current price of gold is close to the marginal cost of production for many of these operations so even a small increase would have a dramatically beneficial impact on their profitability.

There is a good chance that the share prices would react very positively to an increase in the price of gold because it would make their businesses that much more viable. That is why the shares tend to provide a geared exposure to the underlying spot price and offer the greater upside potential albeit with more volatility.

Ben Conway, one of the managers of the PFS Hawksmoor Vanbrugh fund of funds, has recently increased his exposure to this area by buying CF Ruffer Gold. This is an open-ended fund that aims to provide long-term capital growth by investing in gold and precious metal related companies, but it has had a difficult time along with the rest of the sector. Over the last five years it is down almost 75% with the manager sticking to his core holdings with names such as Silver Wheaton, Regis Resources and Northern Star Resources.

Other similar funds include Investec Global Gold, BlackRock Gold & General, and Smith & Williamson Global Gold and Resources.

By Nick Sudbury

The end is nigh for the old order in commodities

Some thought commodity prices were going to rise forever due to the mismatch between supposedly unlimited demand growth from industrialising nations and limited supply of much-needed and irreplaceable raw materials. Others even believed that a new world order was rising, where a homogeneous group of wannabe industrialised countries would support the growth of the rest of the world, forever. Some even believed that a few inside this group were so strong and different from the others that they should be offered to investors as a special 'BRICS' asset class. That world is about to end, as commodity demand is not rising anymore, supply is not as tight as many thought, and Goldman Sachs is about to dismantle its BRICS fund. The world is about to change and what has driven growth up to now won't continue driving it in the future: China is not going to be the world's engine anymore, the commodity exporters will have to find alternative ways of fuelling growth, and massive differences among the emerging players are arising, such that they can no longer be treated as a single asset class.

The OECD just released its economic outlook, predicting the world economy will expand 2.9% in 2015 and 3.3% in 2016, which is not only a flat pace but also a downward revision on the previous projected growth of 3.0% and 3.6%, respectively. These projections come on top of the IMF projections, which show the world growing at its slowest pace since the crisis. All reports and predictions point to the same problems: continuing weakness in EM, slower growth in China, declining commodity demand, and slower global trade growth.

> **"MASSIVE DIFFERENCES AMONG THE EMERGING PLAYERS ARE ARISING, SUCH THAT THEY CAN NO LONGER BE TREATED AS A SINGLE ASSET CLASS."**

It is difficult to find the root of the current problems because all the above factors join together in a vicious cycle where no one knows exactly what ignites what. That said, the changes observed in China, where the government has been trying to turn the investment-driven economy into a consumer-oriented one, are often mentioned as the main reason behind the sluggish global performance. With China being the second largest economy – and one that has been furiously

demanding raw materials to fuel its growth – it is not difficult to foresee the implications of a stall in Chinese infrastructure investment for global commodities demand. With the supply of commodities relatively sticky in the short term, any sudden change in demand would lead to huge price volatility. Over time, if the sluggish demand persists, decisions will be taken to reduce spare capacity, and the burden of the adjustment will be split between price and quantity. But for an industry requiring heavy machinery, huge capital investment, difficult-to-acquire exploration licences, and extreme logistics, it takes time to adjust capacity. Volumes react slowly to demand incentives and the short-to-medium term adjustment falls on prices. This makes prices extremely volatile, particularly when there are sudden changes in the world economy.

By Filipe R. Costa

HSBC: leaner and meaner

HSBC has done remarkably well for a bank that has most of its business in China and Asia. Moreover, it looks bombed out in valuation terms and appears, on the current share price, to have more upside than downside. I suspect, that even the near term share price is more likely to be up than down, even if modestly so. It is an equity that serious long term investors should have a good look at, in my opinion.

The third-quarter and nine-month figures just published by HSBC (HSBA) were, as usual, encyclopaedic in their minutiae and in their financial excavations, dauntingly a bit like one of those widely scattered, cinematic, archaeological digs for some long lost pharaoh's tomb in the Valley of the Kings. You need both a telescope and a magnifying glass for the task.

Basically, for the full nine months, you have the picture of a shrinking bank, which is the well understood policy of its management. The plan is to get its riskier assets down in order to trim back regulatory risk (risk weighted assets – to use the jargon) and in due course, boost profits.

One would be forgiven for thinking that the latter objective had been achieved with miraculous speed to judge from the reported statutory increase of 32% in reported profits before tax in the last quarter to September. But this is only one quarter's figures and they can be distorted when and if big significant accounting items occur in that quarter as they obviously did in the last third quarter. Positive, exceptional, accounting items in one quarter, with none or contrary items the previous quarter can make global bank's financial reporting dramatic and volatile, which in turn makes it difficult for us punters to reach any hard conclusions. Consequently, I shall concentrate on the nine-month results.

Over the nine months pre tax profits reported in accordance with statutory reporting requirements rose a still significant 16% year-on-year. However, when they are adjusted to take account of significant one off items, they are shown to have been down 3%, not up 16%. Basically, the bank tells us that it has reduced its risk weighted assets by nearly one third of the amount it promises to reduce them by the end of 2017. So, much done and much more to do.

By Robert Sutherland Smith

BY RICHARD GILL, CFA

READ TO SUCCEED

THE UK STOCK MARKET ALMANAC 2016

BY STEPHEN ECKETT

A BOOK REVIEW

With another year soon to be upon us investors are welcoming the return of an annual classic, *The UK Stock Market Almanac.* Author Stephen Eckett has once again updated his seminal handbook in order to guide investors and traders through the markets in 2016.

As ever, the Stock Market Almanac provides a detailed preview of the upcoming year in the financial markets. The weekly goings on in the investment world, such as important economic events, expected company announcements and detailed month-by-month statistics, are all covered in a well laid out diary style format.

But the real juice comes from the unique and original seasonality analysis provided by Eckett. Here we are given a detailed and entertaining review of stock market performance throughout history and how events expected to occur in 2016 could provide investors with profit opportunities.

2016 – the year of Rio, the monkey and Donald Trump?

It seems like only yesterday that the Olympic Games were held here in London. Yet we are now only around nine months away from the next quadrennial sporting spectacular, to be held in Brazil. There is some solid economic rationale around the Olympics having a positive effect on stock markets given that host countries often spend many billions of pounds on construction, transport, consultants and many other many things which drive the economy. But with host countries typically being announced seven years before the event is held, potential investors in Brazil have already missed their chance.

However, Eckett provides an analysis of the Olympics which shows some interesting opportunities. He finds that markets typically under-perform in the months running up to the games as the media typically reports on potential missed deadlines and cost overruns, creating a negative mood. Conversely, while the games are being held stock markets of host counties have risen by an average of 3% since 1984, arguably as a "feel good factor" encourages investment.

Elsewhere in 2016 we are expecting the latest US presidential election. UK investors will be interested to know that since 1948 the FTSE All-Share has risen 14 times out of 17 in US election years, with the market typically rising in the weeks leading up to the November vote. Next year will also see the beginning of the Chinese Year of the Monkey. Since 1950 "monkey" years have seen the markets go bananas, with the S&P 500 rising by an average of 7.3%. Numerous other signs mentioned in the book suggest that 2016 will be a moderately bullish year for the markets.

How did 2015 go?

The almanac has been running for a number of years now. So investors will be interested in how the suggestions of previous years have performed.

Last year's publication flagged up the UK general election, pointing out that the FTSE All-Share had risen by an average 0.67% on the past 11 election days, with there being an average 1.9% rise on the day following a Conservative victory. True to form, the index surged ahead by 2.37% following the Tories' surprise victory this year.

But just as with a visit to a fortune teller, there are always predictions which don't come true. Followers of monthly seasonality analysis will know that markets tend to perform strongly in December – the so called Santa Rally. As last year's almanac pointed out, the FTSE 100 rose 87% of the time in December between 1984 and 2014 and had only lost value once in the previous 19 years. But December 2014 saw the FTSE fall by 2.3% as the oil price plunged and as China released disappointing growth figures.

> **"THE UK STOCK MARKET ALMANAC IS PACKED WITH INFORMATIVE, STIMULATING AND ACTIONABLE INVESTMENT ANALYSIS."**

Back to the Chinese New Year effect and the Year of the Goat, which started on 19th February, had previously seen an average return of 17.9% on the S&P 500 since 1950. But with the index currently down by 0.8% you'd be kidding me if you said these returns would be repeated this year.

History doesn't always repeat itself

In previous reviews of the almanac I have always highlighted that, while analysis of historical data can flag up potential "anomalies" that investors could exploit to their advantage, the old saying "correlation does not imply causation" should always be remembered. Many of the anomalies highlighted in the book do have a fundamental economic reason behind their existence – volumes being light in December for example can lead to prices being driven higher. But extensive "mining" of data can always find links which aren't really there.

In previous years, to demonstrate this effect, I analysed stock market returns following my football club, Bradford City, being promoted (incidentally there is a very good review in the July chapter of the book regarding the relationship between football and the stock market). But this year I take a different approach – the performance of stocks based on letters of the alphabet.

From my analysis of the FTSE 100 I found that if you had invested only in stocks beginning with B, S or E you would have outperformed the index every year going back to 2009 by an average of 14.1 percentage points.

Of course, this is a classic example of data mining. The way a company's name is spelt has no influence whatsoever on its performance. The outperforming letters above were driven by strong individual performances from companies such as Barratt Developments, easyJet and Sports Direct, along with their low weighting in the FTSE boosting the index by a relatively lower amount. So I do not endorse the crazy "BSE" strategy and, as ever, recommend traditional fundamental analysis before any investment is made.

Stuff it in your stocking...

Just like in previous years the latest edition of the UK Stock Market Almanac is packed with informative, stimulating and actionable investment analysis. Readers are treated to a raft of ideas which will help them potentially gain an edge in the market in 2016. It is the ideal Christmas gift for any investor.

Purchase **The UK Stock Market Almanac 2016** by **Stephen Eckett** for the special price of £18.00 plus P&P for the print edition or £15.00 for the eBook – a saving of over 25% off the RRP. Simply enter the promo code **"MASTERALM16"** at the checkout to receive your discount.

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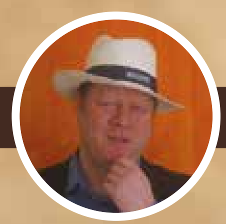


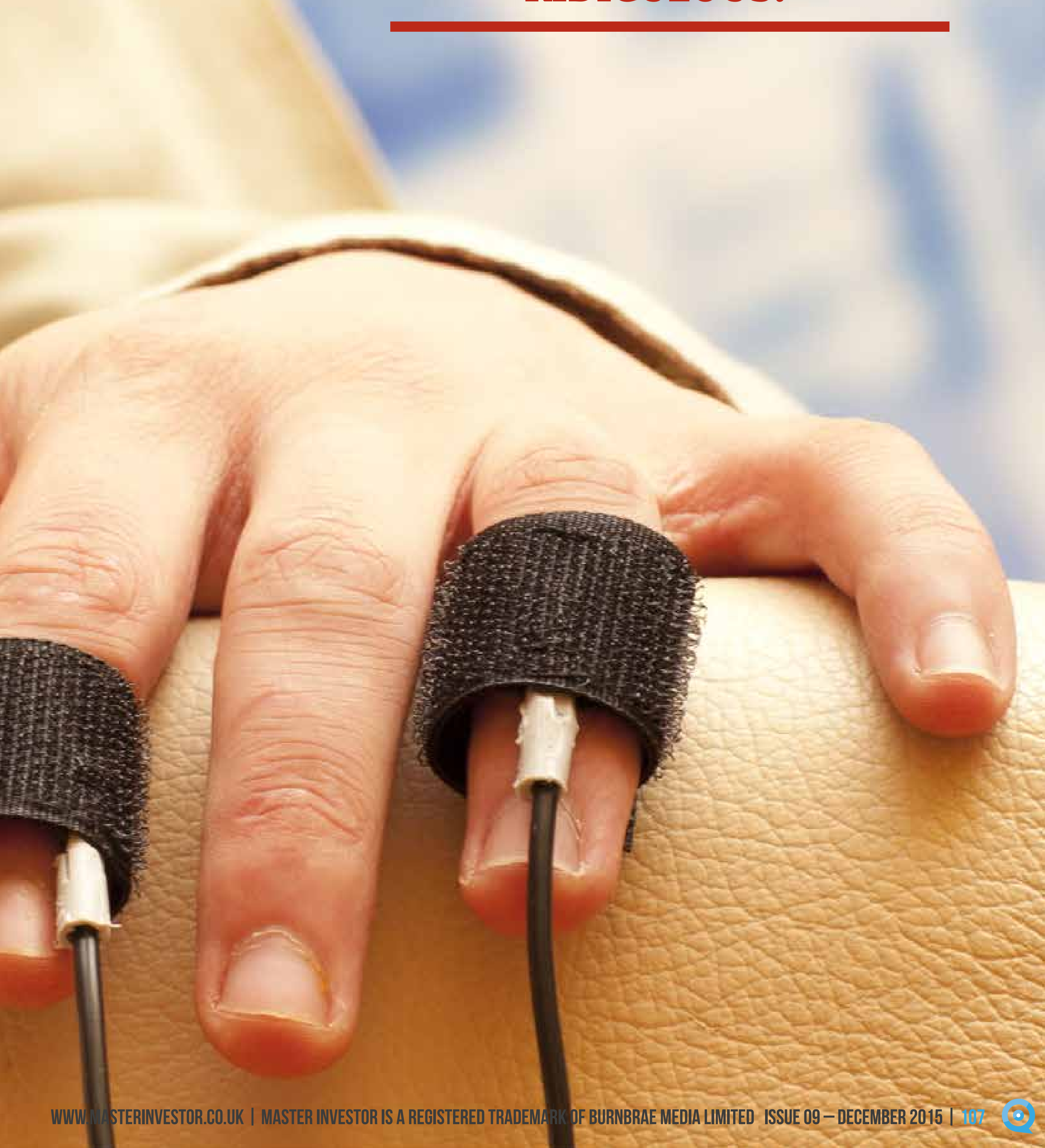
BY ADRIAN KEMPTON-CUMBER

THE FINAL WORD

THE UNCOMFORTABLE TRUTH

This is that time of year when people harp on about 'Peace on Earth and Goodwill to all Men'. I find that most often the behaviour of people fails to support the narrative. My view is that if you can't be nice all year round, then fuck off and stop using a hijacked pagan winter festival to ingratiate yourself. So I thought that for the festive season I'd just run over a few home truths. The things that pay for and underpin this lovely western life we all lead. The problem isn't that it's built on a lie, (although to an extent it is), but that people don't want to hear or speak the truth about how it's paid for.

> **"THE NOTION OF BUYING A NEW CAR TO REDUCE YOUR IMPACT ON THE ENVIRONMENT IS RIDICULOUS."**



Peace on Earth? I used to say as a joke, "if you ever find an old oil lamp, happen to polish it and a genie gives you three wishes, then don't wish for world peace because our economy is based on arms sales." Many a true word. Defence provides 250,000 jobs across 9,000 companies in the UK. Our exports exceed our expenditure by a significant margin. We should also hire our highly trained military out as mercenaries to 'friendly' nations.

Instead of controlling smoking in an honest way, our government pussyfoots about using, well, smoke and mirrors, to claim that it's too dangerous to smoke in the workplace, while at the same time it's apparently not a problem to smoke at home in the same room as your kids. Meanwhile, we make a lot of money from tobacco sales overseas where, if BBC's Panorama is to be believed, British American Tobacco (BAT) have been bribing all and sundry to maintain market share and deflect smoking health awareness initiatives in the African countries where they see the majority of their future growth. (On that note, I wrote a blog piece back in June on BAT and their bright future.)

Idiots who thought that buying one of those VWs that would 'save the planet', but as it turned out cheated emissions tests, deserved to be caught out. The notion of buying a new car to reduce your impact on the environment is ridiculous. The impact of manufacture, consumption and disposal of that car is a net impact, added to which the previous vehicle is still out there impacting on the environment too, and also has ultimately to be disposed of. Consuming things to protect the environment is like trying to wean yourself off heroin by taking crack cocaine. It's tantamount to superstitious behaviour.

Incidentally, next time you are wondering if your inter-continental holiday is damaging the environment, remember two things. Firstly, of course it is, but not as much as your continued existence... So what now Holier-Than-Thou Tree Huggers? Secondly, the Saudis consume 1.5 million barrels of oil per day to desalinate water. That's enough to fuel almost 1,900 Airbus A380s every single day. Feeling green now? Green in the sense of naïve, perhaps?

Inequality is a natural state. We're born unequal and we determine that it's the job of politicians to make things fairer. But when we say 'fairer' what we mean is 'fairer in a vacuum'. For example, a lot of namby-pamby hipster do-gooder types buy Fair Trade goods. In turn these so-called Fair Trade goods upset an economic equilibrium halfway round the globe. This means more inequality, since it creates a new class of people richer than the ones who don't work for Fair Trade. And all that just to help western people feel better about themselves. Charity is the same by the way. Pretty much all charities represent a failure in government policy. People give a few quid to make themselves feel better and then abdicate responsibility.

"THE SAUDIS CONSUME 1.5 MILLION BARRELS OF OIL PER DAY TO DESALINATE WATER. THAT'S ENOUGH TO FUEL ALMOST 1,900 AIRBUS A380s EVERY SINGLE DAY."

Over the last ten years over £14 billion in corporation tax was paid by tobacco companies.

A lot of people naively think we can wean ourselves off fossil fuels. In some cases maybe we can, but good luck getting a passenger jet off the ground without oil based fuel. Oil & gas companies paid £180 billion in corporation tax over the last ten years. Don't bite the hand that feeds you one might say, or, dare I say, greases your palm.

And so to vegetarianism. There is a general naivety that it's possible to make the world a fair place tomorrow and all we have to do is give up meat. Well it doesn't work like that. We'd actually have to give up 85% of everything we own to create some sort of global fairness. It would be like that scene in Dr Zhivago where Omar Sharif comes back to his house to find lots of people living in it. No thank you. Do-gooders and socialists are always ready to sacrifice things *I've* got to make things 'better'. No thank you. More to the point, they wouldn't actually give up their own lifestyle and homes for it either. Once again the narrative is not supported by action.

What's the world's most expensive commodity? Gold? Oil? Saffron? No. In fact it's Greed. The drive for growth is really a drive for the perpetuation of global inequality. It's one way we can defend the lifestyle we have. I don't want the world to be a much 'fairer place'. Not the way 'lefties' mean it

“IT WOULD BE MORE HONEST IF WE HAD A GREED PARTY IN POLITICS (SOME MIGHT SAY WE DO).”

anyway. There isn't enough cake to go around so, although it would be nice if there were, I have to say let us eat cake. I'm very happy to have won the lottery of life and been born in a major first world country. Truth be told so are you, or you'd have sloped off to deepest darkest nowhere and given it all up. I vote for governments to defend all our good fortune, and so do you. We can't expect to defend it without bloodshed, cheating and lies. But don't worry, that's how the whole world works. Bribery is a cost of doing business, not just in the developing world but here as well, let's not be naïve about that.

It would be more honest if we had a Greed Party in politics (some might say we do), and I don't think there's any shame in that. Actually it would be a refreshing piece of honesty. No I don't want to share with the rest of the world. I don't want the world to be a fairer place. I do want the world to respect the individual and treat everyone the same under the law. I do want free speech to be a global right in reality. I do want education to be available to all. I actively support campaigns for those things. But I'm keeping my assets and capital, thank you very much.

I remember in 1986 when Big Bang meant on-screen trading replaced open outcry, there was a television interview with, if memory serves, Patrick Minford-White, who was the Stock Market Rehearsal Chairman for the LSE. He was being interviewed about the traders testing the computer system on Christmas Day ahead of going live. A spokes person for the church was whining on about how awful it was that these poor people had to work on Christmas Day of all days, when they should be with their families. Patrick responded that it was unfortunate but necessary, and of course was a one off, unlike people in the priesthood who have to be away from their families every year.

This is pertinent because the Pope, using figures I've extrapolated from a study by The Economist, presides over a global cash business that is worth way more than Apple Inc. Trillions of dollars. It also pays less tax than Starbucks – you know the deal. If they were to sell up they could actually end world poverty for Christmas. What are they waiting for? I thought that was their gig. No, they too want to hold on to what they've got.

The world isn't fair, life isn't fair. This is why we can have nice things. So eat, drink and be merry because everything isn't going to be alright, but it probably is for us.

Happy X-MyArse!

MARKETS IN FOCUS

NOV 2015

GLOBAL EQUITIES

Index	Last Month %	YTD %	Proximity to 52w High*
DAX (Xetra)	4.9	16.1	
Nikkei 225	3.5	14.7	
Euronext 100	2.1	14.6	
CAC 40	1.2	16.0	
Russian Trading System	1.1	9.0	
NASDAQ 100	0.3	10.1	
Dow Jones	0.3	-0.6	
IBEX 35	0.3	1.0	
S&P 500	0.1	1.0	
FTSE 100	-0.1	-3.2	
S&P/ASX 200	-1.4	-2.7	
Bovespa	-1.6	-9.8	
Hang Seng	-2.8	-5.2	

COMMODITIES

Commodity	Last Month %	YTD %	Proximity to 52w High*
Cocoa	2.7	12.4	
Coffee	2.1	-25.5	
Sugar (No. 11)	1.8	1.9	
Soybean	-0.4	-13.8	
Natural Gas	-3.7	-23.9	
Gold	-6.8	-10.1	
Silver	-9.5	-10.3	
Crude oil (Brent)	-9.9	-22.8	
Crude oil (Light Sweet)	-10.2	-22.4	
Copper	-11.7	-28.7	
Iron Ore	-14.5	-43.0	
Platinum	-15.6	-31.2	
Palladium	-19.4	-31.6	

FOREX

Pair/Cross	Last Month %	YTD %	Proximity to 52w High*
USD/CHF	4.2	3.5	
USD/JPY	2.1	3.0	
USD/CAD	2.0	14.9	
AUD/USD	1.3	-11.4	
EUR/CHF	0.0	-9.6	
EUR/GBP	-1.6	-9.6	
EUR/JPY	-1.9	-10.1	
GBP/USD	-2.4	-3.3	
GBP/AUD	-3.6	9.2	
EUR/USD	-4.0	-12.6	

CENTRAL BANKS - RATES & MEETINGS

Central Bank	Key Rate	Next	After
BOE	0.50%	Dec 10	Dec 10
ECB	0.05%	Dec 03	Jan 21
FED	0.25%	Dec 16	Jan 27
BOJ	0.10%	Dec 18	Jan 29
SNB	-0.75%	Dec 10	Mar 17
BOC	0.50%	Dec 02	Jan 20
RBA	2.00%	Feb 02	Mar 01
RBNZ	2.75%	Dec 10	Jan 28
BOS	-0.35%	Dec 14	Feb 10
BON	0.75%	Dec 17	Mar 17

FTSE 350 TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Ultra Electron. Hold PLC	18.1	10.4	
Electrocomponents PLC	17.9	12.5	
Serco Group PLC	17.9	-15.1	
NMC Health PLC	17.5	94.6	
RPC Group PLC	17.5	53.9	

FTSE 350 BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Amec Foster PLC	-38.8	-49.0	
Anglo American PLC	-25.2	-66.0	
Vedanta Resources PLC	-23.8	-34.4	
BHP Billiton PLC	-23.4	-42.6	
Poundland Group PLC	-21.6	-34.3	

FTSE 350 SECTORS TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Tech. Hardware & Equip	9.2	14.4	
General Industrials	7.7	14.5	
Construction & Materials	7.6	23.8	
Fixed Line Telecom	6.2	22.5	
Support Services	5.7	8.3	

FTSE 350 SECTORS BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Oil Equip, Services & Dist	-17.1	-21.4	
Mining	-13.9	-44.1	
Food & Drug Retailers	-6.8	-5.8	
Electricity	-5.9	-15.8	
Real Estate Inv Trusts	-3.9	10.3	

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