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MAGAZINE

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THE DEATH OF COMMODITIES?

PLUS...

JUSTIN URQUHART STEWART

CITY IDOL REVEALS HIS TAKE ON THE MARKET DOWNTURN

DEFLATION OR INFLATION?

WHICH ONE SHOULD WE BE AFRAID OF?

BLUE-CHIP SMALL-CAPS

DOES IT PAY TO BE A BIG FISH IN A SMALL POND?

THE NAKED TRADER

WHAT HAS ROBBIE BURNS BEEN BUYING IN THE SELL-OFF?

WELCOME

Dear Reader,

No other commodity is currently hitting the front pages as often as oil.

I remember the Economist's "End of the Oil Age" cover story from 2003, when oil was trading at $10 and expected to go to $5. How wrong they were. Subsequently, it rose to $145.

My short-term outlook for oil is primarily shaped by anecdotal evidence and personal observations. Having spent a fair amount of time wrapped up in the politics of the small Andean nation of Ecuador, I can say with certainty that this particular country will keep pumping oil at whatever rate it can, to sell it literally for whatever price it can get; so desperate for cash is this particular member state of OPEC. If you were the president of a country that couldn't manage to pay its state employees' Christmas salaries on time because of a liquidity shortage, what would you do? Reduce capital expenditure and pump till the well is dry, of course.

I have no hard evidence about other countries taking the same approach. However, there are worrying signs galore. Most prominently, Saudi Arabia is running an almighty budget deficit instead of cutting its vast army of bureaucrats and benefit recipients. Meanwhile, Iran has extremely low production costs and is eager to generate cash to fund long overdue investments, now that the Islamic Republic is finally in a position to modernise its economy.

None of this bodes well for the oil price in the short run.

However, in the longer run, fundamentals will eventually prevail again. That's why it's important to get the full picture from experts with deep insights into the industry. There could be an opportunity for bottom-fishing.

With this issue, we are delivering hard-hitting analysis and industry insights to you. Where will all these developments take oil and gas prices? What is the outlook for other commodity prices? Read on to find out...

Best regards,

Swen Lorenz,
Editor, Master Investor

P.S. You'll also be able to meet some of these industry experts in person at the Master Investor Show on April 23rd in Islington. If you haven't secured your tickets yet, here is the link to get them: Book your tickets

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BY SWEN LORENZ

AROUND THE WORLD IN A DOZEN PROPERTIES (PART 10)

THE CELTIC TIGER ROARS AGAIN

Ireland may be small in comparison to Europe's major economies, but its property market once packed a real punch. Between 1997 and 2007, property prices rose by a staggering 268%. Ireland's decade-long house price boom was one of the longest and biggest in Europe, and at the time attracted investors from all over the world. Everyone knows what happened next. With seven years having passed since the bursting of the bubble, is now the time to get back into Irish property?

The higher you climb, the further you fall. Ireland's property owners painfully experienced the truth behind this old adage. After the collapse of the mortgage industry in 2007, Ireland's house prices fell by an average of 53%. In comparison, the rest of the OECD saw prices fall by an average of 23%. A few particularly hard-hit segments of the Irish market fell by as much as 80%. It was a bloodbath that cost many an Irish property investor a fortune, and wiped out an entire class of Irish property billionaires.

What happened next could become a case-study for a country quickly managing itself out of the mess it had gotten itself into. In November 2010, the Irish government had no choice but to seek a €67.5bn bailout from the European Union and the International Monetary Fund. To relieve banks of their non-performing loans, a "National Asset Management Agency" was established as a place to park toxic loans so that the banks could repair their balance sheets. In the meantime, the entire country stuck to a stringent austerity programme. It was a belt-tightening that was felt all across the Irish economy.

"IF THERE IS A EUROPEAN COUNTRY THAT COULD SERVE AS A MODEL CASE FOR TURNING AROUND A DEBT-ADDICTED ECONOMY, THAT COUNTRY HAS TO BE IRELAND."

In 2010, the government started with an annual budget deficit equivalent to a mind-boggling 31.2%. This was reduced to 12.5% in 2011 and 8% in 2012. The deficit was subsequently reduced even further, to just 3.9% in 2014. For 2016, the budget deficit is projected to amount to just 0.8% of GDP. If there is a European country that could serve as a model case for turning around a debt-addicted economy, that country has to be Ireland.

The Irish economy eventually stabilised and in 2013 started growing again. After a sluggish 0.2% and 1.4% growth rate in 2012 and 2013 respectively, this nation of 4.5 million residents once again took on the old guise of the "Celtic Tiger". Growth came in at 6.4% in 2014, a remarkable turnaround

by any standard. Final figures for 2015 are likely to show 5.8% growth, and current projections for 2016 are running at just under 5%. The country has found its footing again.

Once viewed as a down-and-out, Ireland has now even seen a major property IPO. In July 2013, what used to be known as Green Property plc came back to the stock market in Dublin and London. Founded in 1965, the company had once been listed, but was taken private in 2002. When the first green shoots of recovery were visible, its management decided to take the plunge. Green Property was renamed Green REIT, and it became the first listed Real Estate Investment Trust in Ireland.

Green REIT (GRN) raised €310 million in equity during its IPO, and another €400 million during a second offering. It now owns a portfolio worth €882 million, consisting of 24 properties that are almost all in and around Dublin. Three quarters of the properties are office buildings, while a further 20% consists of retail space. The current occupancy rate of 96% is projected to rise to 98% in 2016. On average, its leases have a further five years to run.

As the largest listed property company in Ireland, and the first under the new REIT legislation, Green REIT is in the public spotlight. Its management team made a point of building a conservative portfolio, which so far includes just €94 million in debt financing. In fact, it could purchase another €400 million of property and fund it with debt, but still only have a total gearing level of 35%. To all intents and purposes, this is a conservatively funded property portfolio.

Green REIT was set up during the beginning of the recovery cycle and its shareholders have already seen a significant upswing in value. Brought to market at €1 per share, it was last trading at €1.49. (N.B. the listing on the London Stock Exchange ("GRN") is also in Euros, not Pound Sterling.)

As of June 2015, the company's net asset value (NAV) per share had risen to €1.35, following a 24% jump in property values in the preceding 12 months. With the further increase in property values since then, the share is currently trading at roughly the net asset value. The portfolio yields between 6% and 7% p.a., making Green REIT a seemingly attractive alternative to bonds.

The question is: where will property values go from here?

The OECD already warned of a potential "new bubble" in Irish property. The think tank pointed out that "such strong price rises may again spark a reinforcing spiral of higher property prices and credit leading to another misalignment of property prices and eventual burst that causes large losses in the banking sector".

For now, it seems, the Irish property market is nowhere near bubble territory. House prices in Dublin remain nearly 34% lower than their boom time high, recorded in early 2007. Apartments are 41% cheaper than they were in February 2007. In the rest of Ireland, property prices are still 36% lower than their pre-crash highs.

What's more, Ireland remains a dynamic economy. Arriving in Dublin airport during my research for this article, it was impossible to not notice the relative youth of its population, the apparent can-do attitude of the authorities, and the continued position of Dublin as a hub for finance, technology, education and other industries.

The recent rapid rise in prices cannot continue at such a pace, and the market is bound to experience periods of stagnation or even small decreases in price. However, with supply being very limited due to restrictive planning laws, and few places in Europe offering a dynamic environment for companies and enterprising individuals, it seems almost certain that Ireland's property market recovery will continue.

For anyone wanting to invest into Ireland for the next 5-10 years, Green REIT might just be the easy, convenient and safe vehicle that investors should look to.

Next issue: Is now the time to buy in Greece?

"IF THERE IS A EUROPEAN COUNTRY THAT COULD SERVE AS A MODEL CASE FOR TURNING AROUND A DEBT-ADDICTED ECONOMY, THAT COUNTRY HAS TO BE IRELAND."

BY JAMES FAULKNER

AN INTERVIEW WITH JUSTIN URQUHART STEWART OF SEVEN INVESTMENT MANAGEMENT

A well known financial market commentator, Justin Urquhart Stewart has a deep understanding of the market's roles and benefits for the private investor. Having initially trained as a barrister, Justin moved into corporate finance, working in both Africa and Singapore. He then returned to the UK in time for the Big Bang in 1986, during which he helped to found Broker Services.

Broker Services went on to become Barclays Stockbrokers, where Justin was Corporate Development Director. In early 2001, he co-founded Seven Investment Management, an investment management business that shook up the UK investment market with the introduction of the first Sterling Investment Wrap Account. Seven Investment Management now manages and administers around £10 billion on behalf of professional financial wealth managers and intermediaries.

Justin has a keen interest in developing the investment market to break down as many of the traditional barriers as possible for both private investors and smaller companies. As part of this he was involved in the original development of the AIM market and the investor education company Proshare. He writes regularly for national magazines and newspapers, and is a frequent commentator on television and radio, both in the UK and abroad. I caught up with him to glean some of his insights into the current state of the markets.

James Faulkner: Hi Justin. Thanks for taking the time to speak to Master Investor. To many readers, I'm sure you'll need no introduction, but for the benefit of the uninitiated can you give our readers a brief overview of what you do at Seven Investment Management?

Justin Urquhart Stewart: *It's a mystery to me! However, as a co founder it was to drive through the vital innovations and changes in our industry to make it more responsible to investors and for the benefit of investors not the industry.*

As I have been lucky enough to surround myself by far brighter people than I, it means that I can focus on some of the more strategic issues for the business, the industry and for the economy, such as reforming investment mechanisms, reforming communications (i.e. making them understandable), reforming charges (making them clearer and fairer). To this I add education, from colleges and universities to SMEs and private investors, to try to break down the traditional barriers of pomposity and corporate illusion.

JF: 2016 hasn't got off to the best start. Is this the start of a bear market or are we simply looking at a significant correction?

> **"IT IS A BEAR MARKET BUT WHETHER THIS IS A BEAR OF THE GRIZZLY OR TEDDY VARIETY STILL REMAINS TO BE SEEN."**

JUS: *Well it is a bear market but whether this is a bear of the grizzly or teddy variety still remains to be seen. The longer the market gyrations continue, the greater the sapping away of that vital confidence in the economies and markets. What we have is a market dominated by the price of oil, and of all sorts of fears, caring to ignore the economic fundamentals going on around the globe – which are really rather positive.*

JF: Many of the commodities stocks that are driving this sell-off are now trading at a fraction of the prices they commanded just a couple of years ago. Is this a time to go bargain-hunting or are we still looking at the classic 'falling knife' scenario?

"I ACTUALLY QUITE LIKE BOTH US AND JAPANESE EQUITIES, AND EVEN SOME OF THE EMS ARE NOW GAINING MY ATTENTION."

JUS: *Yes, many of the oil, commodity and servicing stocks have already been badly hit. However, we must recall that their position is as much about over-capacity as falling demand. In fact, some of the "falling" data has been completely wrong as often the less experienced commentators forget the effect of the US dollar on the price of commodities.*

The time to buy back in is when those companies affected start making tangible cuts in production and capability and start cutting their cloth to the market. This has already started but there is no doubt much more to come.

JF: Some commentators are less worried about the immediate implications of the commodities crash than they are about the potential impact on the credit markets. Is the possibility of contagion in the financial sector something that concerns you?

JUS: *Yes, there is always a possibility of contagion as the longer the nervous markets continue, the weaker investor confidence will become. If left unchecked by action from, say, the oil producers, the lack of faith in the economy could pull in the fears of an economic recession.*

JF: On top of the commodities fallout, markets also have to contend with rising rates in the US. While some see this as a sign that the US economy is strengthening, others fear that higher rates could expose years of malinvestment and cause a slowdown. Which camp are you in?

JUS: *Actually, I think the US economy is in better shape with more job creation and really quite good results – in the non-resources sectors. However, the market does reflect that and whilst rising rates will show up where cheap money has been wasted, it should not be a reason on its own for a slowdown leading to recession.*

JF: A particular area of concern associated with higher US interest rates is the impact on emerging markets with high levels of dollar-denominated debt. Emerging market equities have thus performed poorly in

recent times. Do you see value there or is it still too early to dive in?

JUS: *The EM nations and especially those who have significant dollar-denominated debt will have suffered as the US dollar strengthened and their local currency fell. Some of those valuations have already fallen very dramatically making them much more appealing than before. Then combine this with those emerging nations where they are not actual major commodity producers but users, and we can start to see some very appealing valuations.*

JF: One notable absence from the economic dashboard – in developed countries at least – is inflation. Do you think we are in a secular deflationary environment or will inflation stage a comeback and take us by surprise? How can investors position their portfolios to take this into account?

JUS: *Yes, the current view is that there is little or no inflation. However, all of that could change very rapidly if commodity prices suddenly turned, for example. All the data from the central banks points to lower for longer as they find it difficult to see any major inflationary areas as yet – but beware.*

JF: There has been much talk of US equities being overvalued by historical measures. Do you share that view? Which markets look most appealing right now?

JUS: *No. During this volatility there are more opportunities popping up all over the place – if, that is, you think we are not off to hell in a handcart. I actually quite like both US and Japanese equities, and even some of the EMs are now gaining my attention.*

JF: Some commentators have been suggesting that the business cycle is getting longer and therefore this bull market has much further to run. With this in mind, do you favour cyclicals or defensives right now? Are there any sectors in particular that you like the look of?

JUS: *Yes, this is an extended time in the cycle, due to the exceptional actions taken by central banks – QE, low rates and bank support. It is the value areas that I specifically like in all the major markets, where good businesses have been hit by the broad brush of emulsion covering all the market participants in those equity indices.*

JF: It's something of a cliché, but we are in a time of accelerating change. This is creating many challenges but also many opportunities for investors. What words of wisdom would you impart to investors looking to navigate this often bewildering investment landscape?

JUS: *If you are planning to invest – don't. Invest in planning! Get the plan for what you need to achieve in the longer term and you will likely find that steady, often quite dull returns are all that is necessary. Whilst in the bear market, don't be the revenant coming back from the dead having been beaten up by the bear; be the sniper picking off the bear value plays with cash put aside for exactly such moments. This can be an opportunity and not necessarily a disaster.*

"IF YOU ARE PLANNING TO INVEST – DON'T. INVEST IN PLANNING!"

About Seven Investment Management

Seven Investment Management – or 7IM – is an investment management business that helps individuals and their families manage their capital to meet their financial needs and aspirations. We look after around £10bn of their money, as well as our own, with around 200 of our people taking care of it and them.

We've been around for over a decade, which means we've probably seen the best and worst the world can throw at us. Yet we've still delivered a strong investment performance consistent with what we've promised our clients.

For further information please contact us on 020 7760 8747.

www.7im.co.uk

BY JIM MELLON

MELLON ON THE MARKETS

Last night, I went to the Hilton in Park Lane, London, to listen to an interview conducted by Jon (yes, that's the way it is spelt – very liberal, trendy) Snow and Elon Musk.

Elon Musk, as readers know, is the polymath founder of PayPal, Tesla and SpaceX, and in his spare time came up with the idea of a Hyper Loop train service between San Francisco and Los Angeles, which would, if built, reduce travelling times between the two West Coast cities to just half an hour or so.

What Elon has in imagination and in his bank balance, he seems to lack in public persona, and the dullard questions asked by Jon (sic) Snow didn't help his cause.

What struck me, and my entrepreneurial female host, was just how laden with puppy-eyed men the whole event was. All eyes gazed adoringly at Elon, presumably in the hope that some of his magic would rub off onto them.

Trust me gents, it won't! People who hang around rich folks or successful entrepreneurs hoping that somehow, by osmosis, they will be dealt the same hand of cards, just don't get it.

There is no easy way to wealth (unless you inherit it or steal it), and the universal characteristics of successful entrepreneurs are hard work, relentless knowledge gathering, and a strategic or scientific vision. Oh, and super adaptability to a world that changes so fast that you can't even say *Schumpeterian Destruction* before the old is gone and the new is in.

"THE UNIVERSAL CHARACTERISTICS OF SUCCESSFUL ENTREPRENEURS ARE HARD WORK, RELENTLESS KNOWLEDGE GATHERING, AND A STRATEGIC OR SCIENTIFIC VISION."

That's why most of the be-suited fellows there last night will be automated or cost-cut out of their jobs in the next twenty years. Most readers of this missive will be familiar with *Fast Forward,* written last year by Al Chalabi and myself, which preceded a blizzard of "robots are coming" books, some of which had dire warnings attached.

The theme of *Fast Forward* is now so obvious, it's become almost boring – but nonetheless, it's true. Elon Musk is a rare example of a human being who is reinventing the term polymath, a curious hybrid being last seen in the 19th century with the likes of Alexander Humboldt of Berlin. These people can change on a dime, dream dreams greater than anyone else, and more importantly marshal the surrounding resources to get things done.

That was the treat in seeing Elon Musk; not to touch his coat, or worship at his temple, but to remind my host and myself of what it truly takes to be entrepreneurial and successful. And that meant getting up this morning at 5am, despite the cocktails and the wine, to get on the plane to Berlin!

And Berlin, dear reader, is where I am writing this missive. It's a city which I love, but something bad is happening. The migration crisis, and the ridiculously lax approach Angela Merkel took to it, is rocking the foundations of Europe's biggest economy, and of the whole European project.


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Application Form

"I HAVE SAID IT BEFORE, AND I'LL SAY IT AGAIN: THE REASON THE EUROZONE COULD EXPLODE IS THAT BOTH ITALY AND FRANCE ARE BUST."

Brexit is on the agenda, and Cameron's ridiculous posturing on his "renegotiations" (has anyone noticed how porky he is getting as he enjoys continental delicacies?) is not helping the IN cause. Nor is the ludicrous choice of leader for the IN campaign, the has-been, never-really-any-good, "forgetful" Lord Rose, formerly chief tailor at M&S.

Mind you, the OUT campaign needs to get its act together, too, and, somehow or other, merge. It is so stupid to be divided at a time like this!

As readers know, I am neutral on the Euro's value and have been for three months, having been an Ursus Magnus (a Gavekal expression for big bear – not a reference to that God-awful and interminable film, *The Revenant*) on it before.

I am close to getting to the point, though, where I feel a downward move may be on the cards again, as Signor Draghi might have to add to his QE arsenal in the near future. Whatever it takes – remember? Sadly, the Eurozone economies are still mired in the wallow, and inflation is a flicker at best.

I have said it before, and I'll say it again: the reason the Eurozone could explode is that BOTH Italy and France are bust. Take a look at Italian bank shares (Euro 230 billion shortfall in capital) this year if you don't believe me. As for France, that walking blancmange Hollande just goes from pathetic to worse, and France is rapidly heading to second-world status. So keep an eye on my twitter account, because I think there may be serious money to be made by shorting the Euro (against the dollar, or maybe against the yen) in the near future.

Meanwhile, the US has come off the boil, which is unsurprising since it is still too expensive. But you may recall that I have been bearish on **Apple (NASDAQ:AAPL)** from about $130 a share; I now think it's cheap, at less that 7x cash adjusted earnings, with next cash, and of course an eco-system of iTunes and services that provides a relatively secure annuity. I would buy AAPL here, at about $93 a share.

Equally, I like **Gilead Sciences (NASDAQ:GILD)** once more, after biotech has fallen from grace. I see it at about 8x earnings, and I like its pipeline.

I am still a big bull of Japan, although that too was hit by China ructions and all the other stuff that has been afflicting the worlds markets; but it is notable that Japan has been somewhat outperforming. I still expect over 22,000 on the Nikkei this year, and I still remain cautious on the US.

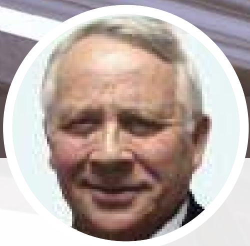
I noticed that **Amazon (NASDAQ:AMZN)** – one of the huge risers in the US last year – fell by 14% in aftermarket trading yesterday, after profit margins were revealed – yet again – to be wafer thin. Amazon is a corporation run for the benefit of consumers, and funded by gullible shareholders. Surely, it must be getting close to a short? 900x historic earnings! And yes, I've heard all the stuff about long-term investment blah...

Now, in my desire to be conformist and fit in with all the fine accountants and lawyers last night, I bid on auction items for the benefit of the Prince's Trust. I find myself the owner, as a result, of some luxury sheets, and a stay for three nights in a luxury hotel, available in most countries of the world. Any ideas?

Happy Hunting!

Jim Mellon

Click here to follow Jim's trades on Twitter



BY ROBERT SUTHERLAND-SMITH

THE LIMPOPO DISPATCHES

PLUMBING THE DEPTHS OF THE COMMODITY MARKET

In which your correspondent ponders the early New Year news; explains how the David Bowie lifestyle has impacted Limpopo politics; examines news on the UK economy; and ends with a consideration of the economics of oil and other hard commodity prices – and an explanation why Royal Dutch looks historically attractive.

The New Year

So here we are in the New Year. I kept my fingers crossed but it does not seem to have worked. A hydrogen bomb; Isis do it yourself rocketry; Saudi Arabia and Iran glowering warlike at each other across the Gulf of Aden (as it used to be known when I was stationed there long ago); China's economy on the brink; stock market rout; Chancellor George Osborne's 'cocktail' of 'new' international dangers'; and David Bowie gone into the great blue beyond with Major Tom. (David Bowie had made a big impact on the development of our Limpopo political philosophy over the years.) It seems that we have landed in even more interesting times across that New Year midnight bridge and time change. And we know what the ancient Chinese used to say about them!

David Bowie and the Limpopo lifestyle

Here on the calm sunlit strand of the great Limpopo, we do not have laws or regulations; just general community understandings. I do not know whether that makes sense in terms of the language and thinking of the somewhat grating daily tribal politics of faraway Blighty. Here, as in Karl Marx's famous tome Das Kapital, the state, such as it is, has just withered away.

It is possible to argue either case for 'right' or 'left'. These things are often pre-determined. It largely depends on your own subjective opinions, prejudices and beliefs. And they, in turn, depend to a large measure on luck (good or ill) of your particular inheritance; your own individual accident of birth; the accident of which historical time, family, nation, upbringing and chemistry into which you were born. We are, as Will Shakespeare put it one evening to Kit Marlow in a Shoreditch tavern, "the stuff that dreams are made of". "Exactly", replied Marlow after a flagon or two of wine, before insulting the barman, failing to draw his dagger to stab someone, and sliding drunkenly under a tavern table.

The androgynous politics of the Limpopo

Allow me to describe the society we have created here, where the hippopotamus wallows in river mud and giraffes look on bemused; the lovely Limpopo, where seldom is heard a discouraging word and the sky is not cloudy all day. We few, we band of brothers, here on the glorious and remote Limpopo, each day sing the

'Red Flag' followed by the 'Eton Boating Song'; removing our caps, worn to sing the former, before donning solar topes with ostrich feathers, to sing the latter. And Englishmen now abed shall think themselves accursed and hold their manhood cheap, who were not here with us who sang upon Limpopo Day!

So here on the Limpopo, we have a community understanding that we change our personal political philosophies and allegiances each day – like our underwear – to avoid the political tribalism of that wet and stormy land of Blighty, from which we have migrated. And here we come to the influence of David Bowie. The best political life is to be politically androgynous; at least that is our conclusion after years of experience of professional politicians elsewhere turning life and its problems into a kind of aching blankness. Our practice is to be a Conservative one day and a Labourite the next. It avoids a great deal of trouble and establishes a total awareness that is beyond the dreams of paranoia, particularly after a coconut shell or two of ferment jungle juice and, of course, the therapeutic effect of a good Cuban cigar. When you are a socialist on Wednesday you cannot slag off the Tories too much because you will be one on Thursday.

The Cuban cigar is more than a mere metaphor when extolling this novel political cross dressing; nature's leafy product turned by socialist labour into an intoxicating balm for capitalists and others; work shared by "hand and brain", as Karl Marx put it, working to produce one of Winston Churchill's objects of passion. And in return, Mr Churchill, as he was then, built brick walls as a horny handed son of toil, before retiring to enjoy a Monte Cristo, a bottle of 'The Widow' and a warm bath run by a manservant, as all good labouring men should. A man may dream, may he not? Dreams, after all, are the stuff we are made of.

The UK economy

Back in frosty Blighty, it seems that they have managed to reach an unemployment figure of 5.1% without triggering even the fear of wage push inflation. In the last quarter of last year, earnings – the kind the people get for working – are reported as down. So no fears of that once anticipated New

Year rise in interest rates! It is what the UK Chambers of Commerce calls a "dynamic and vibrant labour market". Odd, since it is also meant to be the engine of a consumer economy. Britons are still consuming but seem to be doing it with credit cards. That of course helps to finance the nation's ballooning trade deficit as the Treasury pushes forward government retrenchment to include, it seems, reduced tax allowances for long-term pension provision.

Commodities and energy prices: will they ever go up again?

The basic defining characteristic of a commodity is that you cannot differentiate it from other comparable commodities. They are not like consumer products which, with skilled marketing and imaginative advertising, may be invested with intangible attributes to stimulate demand. Unlike cars, you cannot sell more iron ore by implying that ownership of it will make you seem a more exciting person to know. Consequently, the price of a commodity is the function of demand and the suppliers' physical capacity to supply it. Too little of the former and too much of the latter means lower commodity prices.

The abiding nature of metal and metal ore demand and supply

The lack of demand is currently attributed to China's shifting economic policy priorities as it changes the course of the Chinese economy away from capital formation (what they now call 'infrastructure') towards more services and consumption. If UK workers are too poor to buy British goods, it would be nice if the Chinese could step in to help us out.

Oddly, China's oil imports in December 2015 rose to a record high. It strikes me that businesses only buy commodities if they plan to use them at some stage. Consequently, I reasonably assume that China is investing in the current low price for oil as part of a long-term view that it will be advantageous to have the use of cheap oil at some stage; perhaps sooner rather than later, if it is a physical supply. It may also indicate that cautious Chinese planners are securing themselves against a possible cut in supply at some point; for example, if the Middle East oil fields were consumed with the flames of war! That may on balance seem unlikely, but it is the kind of possibility that planners cannot ignore.

In the case of metals and minerals, there was the creation of oversupply as a result of the mining companies over-investing in physical mine supply a few years ago. That has been castigated by City and Wall Street analysts, but then they themselves have never had to undertake investment planning. Big, chunky, long-term capital investment is always difficult to manage, because it can play havoc with shorter term profitability if demand turns down, as it often does.

It is the kind of problem that always stalks capital intensive industries – from chemicals, to computer semi-conductor chips, steel making, ship building, to mining etc. If there is too much slack created by too many companies doing the same thing at once, then investors have to either wait for long-term rising demand to take up that capacity, or for older, less efficient operations to be mothballed or closed. This is a well understood, deep rooted and familiar economic planning problem that has been seen time and time again. When it occurs and pushes down profit expectations and share prices, it offers the opportunity for long-term investors to buy the equity when share prices move lower in response. The calculation, as always, is to know when to jump on the bus.

It may have been forgotten of late, but mining shares are not growth stocks but cyclical stocks. This time, the cycle has long been sustained as a result of the historically exceptional growth and the development of China's economy with its emphasis on infrastructure spending and industrial capital formation in heavy industries like iron and steel production. Resources devoted to that are now being moved to other areas of economic growth, away from too much heavy goods manufacturing, to consumer goods and services. That has been in part successful, as witnessed by the growth in China's services sector. That will bring balance to both China's development and to its trading relationship with the rest of the world. One of the most reassuring things about China's GDP growth figures has been the strong rise in the contribution from services: change is actually occurring.

There are of course longer term sources of growth for mining. First, there is natural growth as part of China's more diversified pattern of economic progress, as the second largest economy in the world. Motor vehicles and white goods consumed by the Chinese will also require metals. Second, growth from the recovering US economy, and of course the Indian economy (which appears to be well behind China in infrastructure spending), will act as stabilising factors over the medium term.

"IT MAY HAVE BEEN FORGOTTEN OF LATE, BUT MINING SHARES ARE NOT GROWTH STOCKS BUT CYCLICAL STOCKS."

I suggest that what we are seeing now in the mining industry is not something new but a somewhat exaggerated example of earlier patterns of supply and demand for the materials that mining companies produce. Moreover, the mining companies, as a result of recent investment, are generally more efficient in terms of operational cost, in comparison with earlier years. **Rio Tinto (RIO)** exemplifies that in iron ore production with its massive, comprehensive and defining investment in Pilbara.

The economics of oil demand and production

The hardest fact and most enduring characteristic of the oil price is its volatility. A close second is the fact that the oil industry has for some time been an oligopoly, and to some extent a monopoly, under OPEC arrangements. Thirdly, the rising price of oil over the long term has stimulated the demand for new production at ever higher exploration and production costs in terms of money spent on finding and delivering marginal barrels of oil. And finally, more than any other field of economic activity, oil exploration and production has had a very large political dimension to it, largely as a result of changing Middle Eastern and then Russian politics.

The arrival of oil fracking technology in the USA was a clear a response to oil's scarcity value as demonstrated by the rising price of the stuff. It also chimed well with the encouragement of the US Government policy to make the United States less dependent on foreign oil supplies. The arrival of digital technology at the tail end of the twentieth century, made the novel oil fracking production techniques and technology highly competitive given the high marginal costs of getting oil from beneath deep water and tar sands etc.

The consequence of the higher cost hydro carbon prompted the development of new, less costly, technological methods of producing oil, but also other forms of competing energy – a process which was accelerated by growing concerns about the impact of oil and gas on the world's climate. We have reached a point at which the rear guard action by oil companies to defeat the man-made, carbon induced, climate change argument has been overwhelmingly defeated by the

"CHECK THE FINANCES, NOTE THE TREND IN SHARE PRICES AND LOOK FOR VALUE IN SHARES IN ORDER TO TAKE ADVANTAGE OF IT, WHEN THE TREND CHANGES."

empirical evidence of increasing incidence of dramatic droughts and floods and in consequence, by majority world public opinion. As a result, much hydro carbon sources of heating and energy must remain in the ground.

So, why have the Saudis abandoned their long held role as the lever of the oil production cartel based on OPEC? Has it been in response to the hard fact that the long-term demand for oil has been significantly and permanently reduced by alternative, renewable sources of energy and that the old arguments of preserving Saudi reserves for it as long as possible no longer apply? Or is the new Saudi policy of unrestrained pumping at ever lower prices a pure power play response to Iran's new oil exporting liberty after the dropping of US sanctions?

The outlook for crude oil demand

Thankfully, optimism springs eternal in our human hearts (if not always with complete certainty). To make sense, it always needs reasoning. So what is the common sense reasoning that oil prices will eventually return to above $30 per barrel? On an *a priori* basis, here is my analysis:

First, the history of oil prices tells us that after they have fallen sharply they ultimately rise again. Oil prices have always been volatile! It may not be an iron rule for all time but it has been the observed rule over many years.

Second, if part of the purpose of Saudi policy has been a long-term commercial one to reduce US oil production and to get the frackers out of the business, it must surely have met its objective in terms of arithmetic, with a crude oil price at below $30 a barrel. Reported evidence suggests that the breakeven production price for fracked oil is above that – some reports suggest $45 a barrel (although it is conjectured that improving technology is working to lower it further). That makes fracking evidently competitive with high cost marginal oil production (in deep water for example) but not Saudi oil, which is reported to cost c. $10 per barrel to get the stuff above ground.

The market for oil will, in theory, be restricted to the lowest cost of production. If there is one asset that the big integrated oil companies would ideally wish to operate and manage commercially, it is Saudi oil. They may be given that opportunity if Aramco is floated, as proposed by the Saudi government. The Saudis now just want to pump as much of it as possible at the highest possible commercial price to maximise the Kingdom's revenue. Who better to do that than big, commercial oil companies looking for new market opportunity?

Mining and oil shares have outperformed massively on the downside of this general bear market. They are also, in part, the cause of it. If the market generally looks oversold then so too do oil and mining shares. On the basis that we cannot see the future – and that markets always move to discount it, whatever that future may be – there are three things for a private investor to do. Check the finances, note the trend in share prices and look for value in shares in order to take advantage of it, when the trend changes.

Royal Dutch Shell

Among the oil majors, **Royal Dutch Shell (RDSA)** has just produced preliminary, unaudited results for its fourth quarter and 2015 as a whole. There are no accounts but rather an up to date summary of the salient performance yard sticks. Accounting in US dollars, the management expect full year results to produce earnings attributable to ordinary shareholders of between $1.8 billion and $2.0 billion – a huge sum but not so huge when you realise that they are valued at about eighty seven times that at the current, very depressed market valuation.

However, the annual dividend yield per share is indicated at around 7.1%, which in normal circumstances would suggest a dividend cut is on the cards. However, the dividend costs a reported $12 billion annually and the company's annual gross cash flow is reported to be 2.4 times that amount at $29.2 billion. Moreover, management speaks of its commitment to dividends for shareholders.

At the current price of 1,387p (last seen), the shares are also valued at only 5.7 times last year's reported operating cash flow. Furthermore, the company hints at further significant cost cutting again next year together with the synergies expected from the incorporation of BG – a deal which shows every sign of going ahead. This presents a management taking its own informed and confident view of the future of the company.

It strikes me that Royal Dutch Shell offers good and dependable looking value – perhaps a stock to acquire for long-term (and maybe short-term) recovery. The price trend may still be down (it has already fallen 38% over the last twelve months) but arguably it is on a support line and a bounce looks an entirely reasonable proposition.


OIL PRICE
Portfolio Optimisation
FISCAL RISK
Production Profile
Commercial Risk
Expected Monetary Value
CAPEX
POLITICAL RISK
Economics
CONTRACTUAL DUE DILIGENCE
DATA FLOW & VALUE
Subsurface Risk
OPEX
Resources & Reserves
NET PRESENT VALUE
EXPROPRIATION RISK
Decision Risk & Analysis

BY STEPHEN SANDERSON, EXECUTIVE CHAIRMAN, UK OIL & GAS INVESTMENTS PLC

SHALE: A NEW WORLD OIL ORDER?

When my generation of petroleum geologists began our careers in the late 1970s, it was a widely-held belief that oil reserves would be close to exhaustion by now. Prices were forecast to be hundreds of dollars per barrel by 2000; hopes were pinned on new energy technologies to keep the lights on. How things have changed! Instead, the oil and gas industry has reinvented itself and we witness the possibility of a new era in the global economics of oil.

In 2016 the world has so much oil that it's predicted that we'll never exhaust oil reserves. That's quite a sea change in 30-odd years. Global proven reserves (i.e. oil the world has genuine access to) now stand at 2.4 trillion barrels. If we include oil yet to be found by exploration in known oil provinces (oil that has less certain access) the total exceeds a whopping 7 trillion barrels.

Essentially, in the last 35 years, for every barrel of oil we've used, another two have been added to the stockpile. In spite of increased energy efficiencies and new renewable technologies, the world's oil demand still continues to rise in overall terms. Global oil consumption to 2050 is now forecast to be 2.1 trillion barrels. This still leaves plenty in the global oil tank for later generations if they need it.

These new oil reserves come from areas barely on the radar screen 20 years ago. New technologies and efficiencies have been invented to make them work. As a consequence, the extraction costs from areas such as ultra-deepwater South Atlantic, Gulf of Mexico, onshore Arctic, and US shale oil are amongst the highest on the planet. They require high oil prices to justify investment and the inherent risks.

With the exception of Saudi Arabia, Kuwait and the other core Persian Gulf OPEC producers, the majority of

current global oil reserves need prices well above $30-40 per barrel to simply balance day to day operational extraction costs, let alone pay back finance and make money.

Over the past ten years, excepting the 2008-09 slump, oil prices have been over $60 a barrel – a historical high. Prices exceeded $100 in 2008 and from 2011 to late 2014. Resultant extraction has reached record levels. A free market has been operating since 2009, with little or no significant OPEC intervention increasing global oversupply.

Current oversupply is now almost 1.8 to 2 million barrels per day (bopd), which is more than the UK's total consumption of 1.4 million bopd. Roughly just under half of all oversupply comes from OPEC, with the remainder from increased North American tight oil (shale) production. Tanks, pipelines and oil bunkers are full. This oversupply, exacerbated by slightly lower than predicted global demand growth, particularly in Asia and China, has led to yet another spectacular oil price crash, the fourth I've witnessed in my career.

For 30 years until November 2014, the 13 members of OPEC acted as a shock absorber to such oil price fluctuations, levelling off a rocky terrain to help smooth the market's ride.

Indeed, one of the key assumptions in the historic model for the economics of oil, as eloquently described by BP's chief economist Spencer Dale, has been that OPEC is the global swing producer. The model also relies heavily on the assumption that oil is derived from conventional fields that require huge up-front investment and which take years to ramp up or lower production. Shale oil with a fundamentally shorter cycle time than conventional oil likely renders the old model obsolete.

"ESSENTIALLY, IN THE LAST 35 YEARS, FOR EVERY BARREL OF OIL WE'VE USED, ANOTHER TWO HAVE BEEN ADDED TO THE STOCKPILE."

Since about 2011 OPEC have consciously not intervened to cut global supply. As a consequence, oil prices are at a 13-year low hovering at $30. Brent crude has lost three-quarters of its value since mid-2014. Just as in the middle of the 2008-09 recession, when oil prices fell off a proverbial cliff from $145 to $35 a barrel, the collapse, yet again, appears to have taken forecasters somewhat by surprise.

At $30 all oil producers lose. Even Saudi Arabia, reliant on deriving 90% of its budget-funding from its 10 million barrels per day, struggles. It is calculated that to pay off the Saudi 2015 budget requires an oil price of $106.

OPEC members such as Algeria, Angola, Libya, Nigeria, Qatar and Venezuela make precious little money at $30, as only 1% to 10% of their reserves are economically viable. For non-OPEC producers, particularly high cost areas, such as the North Sea and deep water Brazil and West Africa, $30 is an unmitigated disaster. Russia struggles, as does the US and its shale oil.

OPEC's failure to cut production is cited as an effort to crush US shale oil and to restore market share. Failure to intervene also raises questions as to whether the old economic model of oil is broken and needs updating. People point to shale, or tight oil, in the US as the prime reason behind the non-intervention citing economic warfare or simply a failure by OPEC to adapt to the impact and reality of shale.

From a near standing start in 2008, US shale oil production has increased to around 4.5 million bopd in 2015 – almost twice the expansion in global oil demand. Peak US production in June 2015 of 9.6 million bopd was briefly on a par with Saudi output. Even though US shale accounts for only 5% of global supply, this is clearly worrying for OPEC and in particular Saudi Arabia. But what is shale?

As a rock, shale is like a softer version of slates on the roof. It is made of mud and clay particles that settled out, in seasonal layers, over millions of years at the bottom of the sea or, in some cases, large lakes. Certain shales have the remains of gazillions of plankton, bacteria, algae and other microscopic flora and fauna that settled and accumulated along with the mud.

What's exciting for geologists is that when the mix of mud, clay and organic matter is buried and heated in the earth's crust, it generates hydrocarbons. Oil first, then with increasing heat and pressure, natural gas. This is where all the oil and most of the natural gas on the planet originates. Geologists call these shales source rocks.

Conventional oil fields result from a fraction of the generated oil escaping from the source rock, migrating upwards to shallower levels (oil is less dense than water) and then being trapped in a porous permeable rock (a reservoir – typically sandstones and limestones). We suck out the oil from the reservoir using the well as a straw.

The best home-grown example of a shale source rock can be seen along the UK's Dorset heritage coastline around Kimmeridge Bay. This is the Kimmeridge clay. Pick up a fresh piece and it smells of oil; put a flame to it and it burns. Oil seeps can be seen a few metres offshore. It looks a bit like the rock equivalent of brown-coloured chocolate mille-feuille.

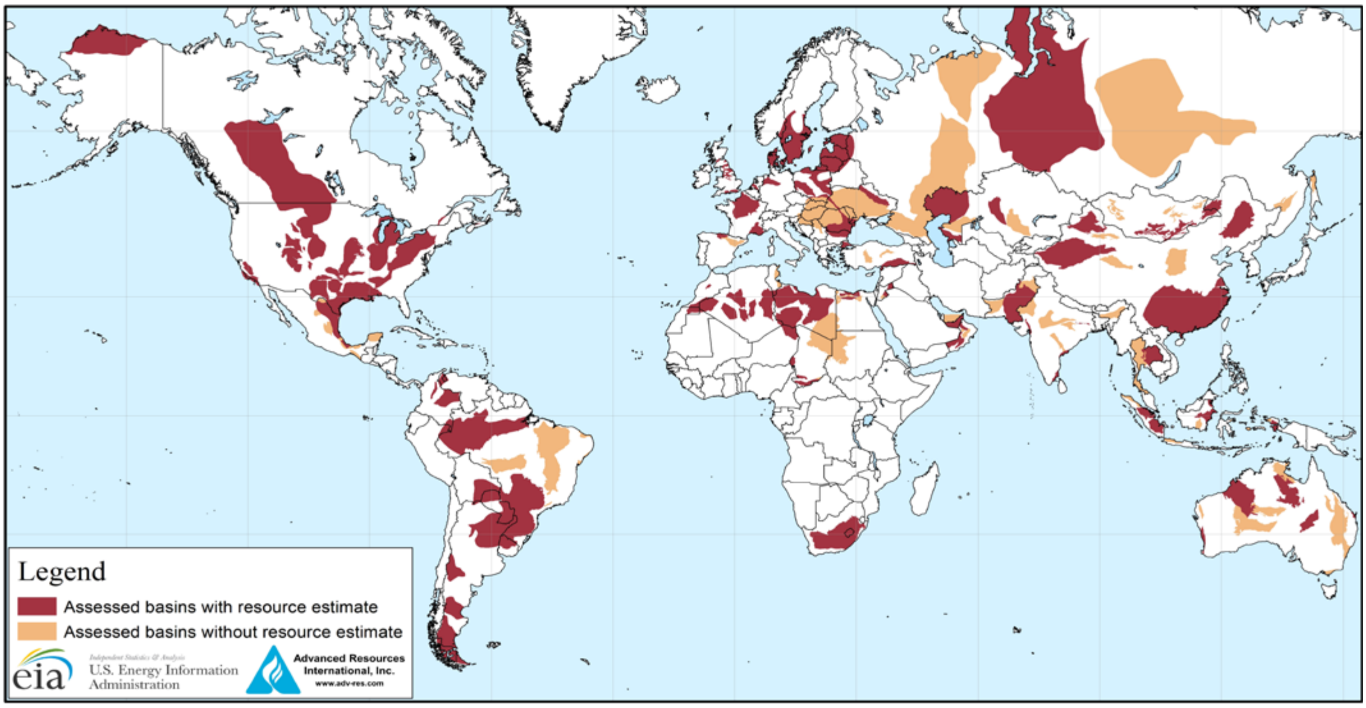
"FROM A NEAR STANDING START IN 2008, US SHALE OIL PRODUCTION HAS INCREASED TO AROUND 4.5 MILLION BOPD IN 2015 – ALMOST TWICE THE EXPANSION IN GLOBAL OIL DEMAND."

The Kimmeridge clay is also found under the North Sea and is the source of the 42 billion barrels of oil produced from its conventional fields. This figure represents only a fraction of oil that migrated from the source rock to be trapped in oil fields. Some 500 billion barrels is estimated to remain in the source rock itself. The same Kimmeridge source rock also underlies the Weald of south east England, but more on this later.

Until 15 years ago geological wisdom decreed that commercial extraction of oil from shale was impossible and uneconomic, since, like their more well-cooked cousins, slates, shales are impermeable. In their natural state oil and gas does not flow readily out of shales.

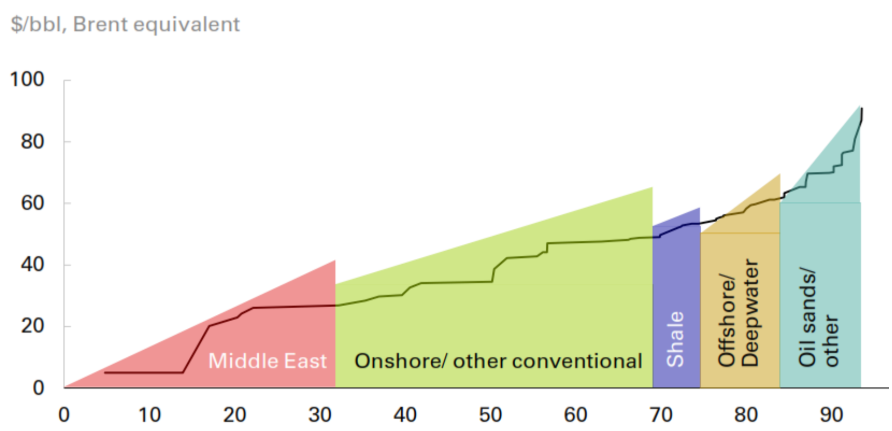
Thirteen or so years ago, smart folks in the United States adapted hydraulic fracturing (fracking) – something that's been around since the 1940s – to solve the problem. This involves injecting high pressure water into shales from horizontal wells to create a new 'man-made' rock fabric that joined up the shale's oil and gas-filled microscopic pore spaces. The oil could then flow into the well bore and to surface. Whilst a very high cost process at first, the costs of the fracking technique, in conjunction with long horizontal wells, has seen major cost reductions and efficiency improvements.

Estimates of oil contained in source rocks are staggering at almost 7 trillion barrels in the ground. The Bashenov shale in western Siberia, the world's largest, is estimated to contain over 1.2 trillion barrels, while the Bakken, one of the two largest shale producers in the US, is about a third of the size at 413 billion barrels. Even with estimated recoveries of about 5% of oil in the ground, the prize is large.



"LIKE MANY INDUSTRIAL PROCESSES, FRACKING HAS GENERATED INCREDIBLE PRODUCTIVITY GAINS."

Stylised oil production cost curve



Source: Based on data from PIRA as of August 2015

Potentially recoverable shale oil resources have been identified in 41 countries, mostly onshore and at shallow to modest depths. Attributed reserves, as of 2013, show that shale accounts for 10% of global oil reserves and over 30% of gas reserves. This is a conservative estimate. According to the US Energy Information Administration, over 50% of oil shale resources lie in Russia, the US, China and Argentina. Libya is the only OPEC member to fall in the global top 10. This is a potentially significant swing in the future balance of oil-supply power.

Shale source rocks are regionally extensive and relatively homogenous geological units. They have far less geological uncertainty than conventional reservoirs. As a consequence, shale can readily support the almost standardised, repeated, manufacturing-like drilling and fracking production process required to reduce costs and grow production. Continual drilling of back-to-back wells is necessary to combat the very steep 60-75% production decline of shale wells in their early lives.

Like many industrial processes, fracking has generated incredible productivity gains. Productivity growth, as measured by initial oil and gas production per rig, averaged over 30% per year between 2007 and 2014. This has clearly helped the economics of shale and made it more robust than expected in the face of a falling oil price.

One of the key points about the meteoric rise of US shale oil is the rapidity from investment decision to production. This has been facilitated by short well-permitting times (less than a month in Texas) and the increasing efficiency of the industrial drilling and fracking process, resulting in drilling to completion times typically of 15 to 30 days.

The short production lags and high decline rates of shale wells also mean there is a far closer correlation between investment and oil production. Investment decisions impact production far more quickly, while production levels fall off equally quickly unless investment is maintained. Shale is also more dependent on the banking and financial system to provide the capital for the small and medium-size companies involved, thereby increasing the exposure of the oil market to financial shocks.

The greater potential responsiveness of US shale to prices means that cyclical movements in shale production could also eventually help to stabilise the market. Shale oil thus has the potential to be an additional short-term shock absorber for the global oil market to help stabilise price volatility. OPEC's ability to stabilise the market in response to short-lived, temporary shocks still remains largely unaffected. But OPEC's role, and particularly Saudi Arabia's, remains dominant. The Saudis are still the only ones with any margin of spare capacity.

US shale oil has been far more resilient to the price drop than OPEC or anyone expected. This has been helped by production efficiencies and also by significant hedging and re-financing. The Russians claim this was worth $150 million a day, which is effectively a subsidy for shale oil preventing a more rapid decline and exacerbating the oil price slump.

The writing is finally on the wall that shale oil production will drop. The number of wells permitted for shale drilling in 2015 in Texas alone dropped from its peak of 5,600 in 2014 to 2,400, a level lower than 2011. Rig counts have also dropped markedly. North Dakota had only 49 active rigs, the lowest since 2009 and well below the peak of 219 in 2012. Analysts now expect US shale production to drop by almost 1 million bopd in the next 12 to 18 months.

Therefore, we are about to see the market corrected by a combination of the removal of supply by a significant drop in US shale production combined with the possibility of a 5% production cut by OPEC, perhaps even in conjunction with Russia. The future is still uncertain, but undoubtedly there is a glimmer of sunshine.

Meanwhile, the potential impact of low prices and shale on the UK is profound. Simply put, the vast majority of the North Sea's current 800,000 bopd makes zero or little return at $30 oil. A breakeven of $50 per barrel is cited by many analysts. So, there is a real prospect that the 375,000 jobs which are directly or indirectly associated are still at risk if prices only recover to $50-60.

We have seen the usual round of knee-jerk job cuts by the majors. This happens during all price downturns. It's very short sighted. Fortunately, for me, the UK onshore sector is far more robust to prices, as its older fields break-

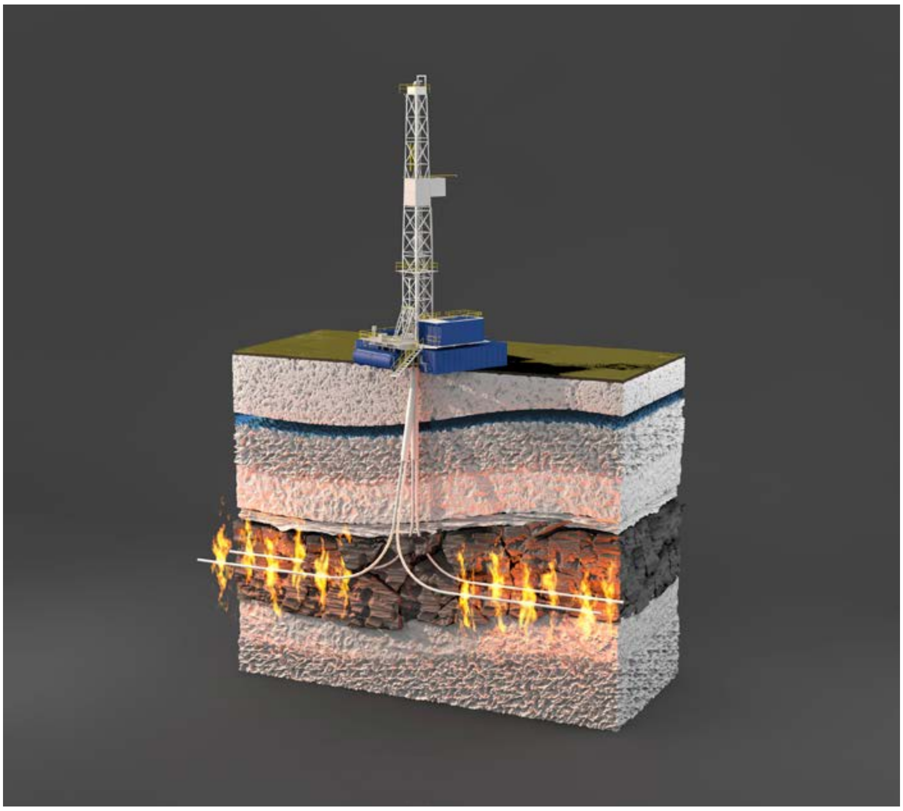
“THE US SHALE REVOLUTION OFFERS A RAY OF HOPE FOR THE UK.”

even at around $18 to $25. However, oil production is small at only 20,000 bopd. New onshore production is looking far more challenged than in 2014.

Tax revenues from North Sea production were significant until the price drop. In 2010 they amounted to £11bn, which fell to £2.2bn in 2014-15, and is now projected to be just £130m in 2015-16. Indirect taxes and revenues were also highly significant. Taxes on the oil industry are high compared to those on other UK industry. The oil industry pays a 30% rate of Corporation Tax, versus the standard 20%, plus a further 20% supplemental tax on oil revenues. Additional levies can take this up to an overall take of 67.5% of profits.

If the government is serious about the economic value of the offshore oil industry and energy security, it should fundamentally re-think the tax structure for oil (and gas) in the UK to help sustain production, jobs and the fantastic oil expertise and knowledge base that the UK industry possesses.

Tax cuts would also serve as a stimulus to new onshore oil and gas activities capable of significantly adding to UK energy security, taxes, jobs and economic growth, such as shale. Interestingly, Mr Putin, not considered one of the world's most enlightened



capitalists, has introduced 'tight oil' tax relief which would grant a discount of 50-100% on mineral extraction tax. Should we buy Russian tight oil when we have the potential of our own UK tight oil?

Tax cuts will still not alter the fact that UK offshore oil (and gas) has a very high cost structure. Innovation is needed to reduce costs and perhaps implement some of the industrial process methodologies used so successfully by US shale.

Stepping back, it's clear that the whole oil price collapse involving the issues with OPEC versus the US, and of Russia as potentially the world's largest producer of shale oil, should ring warning bells in 10 Downing Street. Energy security is more critical than ever. The UK produces about 60% of its daily oil consumption and this is declining rapidly. This means that the UK's energy security is under increased threat.

Obviously the best form of energy security is indigenous production and the tax, jobs, revenue and expertise that arises. The US shale revolution offers a ray of hope for the UK. We have plenty of world class shale here in the UK onshore.

The focus has been initially on gas from the Bowland Shale and others in the north of England. If proven to be technically and commercially feasible, the high activity shale gas scenario could generate 4 to 9 trillion cubic feet of gas – more than six times the gas produced in the UK in 2012, or more than twice the gas consumed in the UK

"WHILST THE POTENTIAL EXISTS IN THE UK FOR SHALE, THERE ARE STILL SIGNIFICANT BARRIERS TO PROVING THAT IT WORKS IN THE UK, WHICH ONLY GOVERNMENT CAN RESOLVE."

per annum. This could create 16,000 to 32,000 direct, indirect and induced jobs: a very significant prize for the UK.

Until very recently, tight oil and oil shale was not even on the UK radar screen. Hopefully **UK Oil & Gas Investments PLC's (UKOG)** activities in the Weald basin of south-east England have raised awareness of the potential for significant tight oil production to help assist UK energy security. If successful, the impact could be similar to that of shale gas.

Following the drilling of UKOG's Horse Hill well in 2014, world renowned analysts Nutech estimated, in October last year, that there are 124 billion barrels of tight oil in the ground in a 1,261 sq mile area of the Weald. Approximately 80 billion barrels are in Kimmeridge clay. The first extraction target lies within two limestones in the Kimmeridge, which Nutech calculate to contain 19.5 billion barrels of oil in the ground. These are serious numbers from a serious business.

Ernst & Young (EY) will soon publish a study which assesses the potential economic impact and benefits of tight oil extraction from these Kimmeridge limestones. EY show that production could contribute between 4% and 27% of the UK's current oil consumption with an associated total value contribution to the economy of £7 to £53 billion over the life of the project.

The Chancellor will be particularly interested to read that tax contributions could be anything from £2-18 billion. Remember that these figures only represent extraction from 19.5 billion barrels in the ground; there is a further 100 billion still in the UK oil tank for later. But let's not get too carried away. UKOG have to test and drill a lot more wells, but the potential is there.

Whilst the potential exists in the UK for shale, there are still significant barriers to proving that it works in the UK, which only government can resolve. One of the key attributes of US shale success is the short cycle time. Investment to production decision is in weeks to months.

Currently we have a major stumbling block here in that it takes up to two years to get a permit to drill. This is a stark contrast to the US. The Government has stepped in with planning consents which theoretically reduce approval times to 16 weeks; however, there are a total of four agencies that are required to grant approval, each with their own bureaucracy and agenda. A single UK-wide authority with the technical knowledge to approve drilling is needed to make shale happen here.

It is the failure of the well permitting system in the UK that has stopped the industry from moving forwards. As a result, to date, due to planning and permit delays, there is not one single well in the UK that demonstrates that shale gas or tight oil is fully technically feasible. This is a ridiculous state of affairs for a government committed to shale.

Another driver for the US boom is the fact that shale landowners are rewarded with a chunk of the royalties, making them fully aligned and incentivised; whereas in this country, and indeed most of the world, oil and gas rights are the property of the state. The industry recognises that local communities surrounding any developments should be similarly rewarded to the US, as should local councils via business rate taxes. Shale gas has openly committed to cash payments and a 1% royalty; but this scheme should be extended to all new onshore oil and gas. Buy in and a share of the reward is absolutely essential to make shale work.

There are also a number of issues relating to depth ceilings of massive hydraulic fracturing. Currently fracking is not permitted above 1,000m, despite there being no evidence to support this ceiling. To the contrary there are approximately 64,000 wells in the US above this celling that have been massively fracked and produce hydrocarbons with no reported adverse effect on the environment.

This depth ceiling may not impact shale gas as that is located mostly below 1,000m. Tight oil and shale oil are by definition situated at shallower depths and they also do not have the issues of gas seepage and fugitive gas emissions. Some clearer scientific thinking is needed by government in order for significant chunks of oil potential not to be removed by arbitrary regulations.

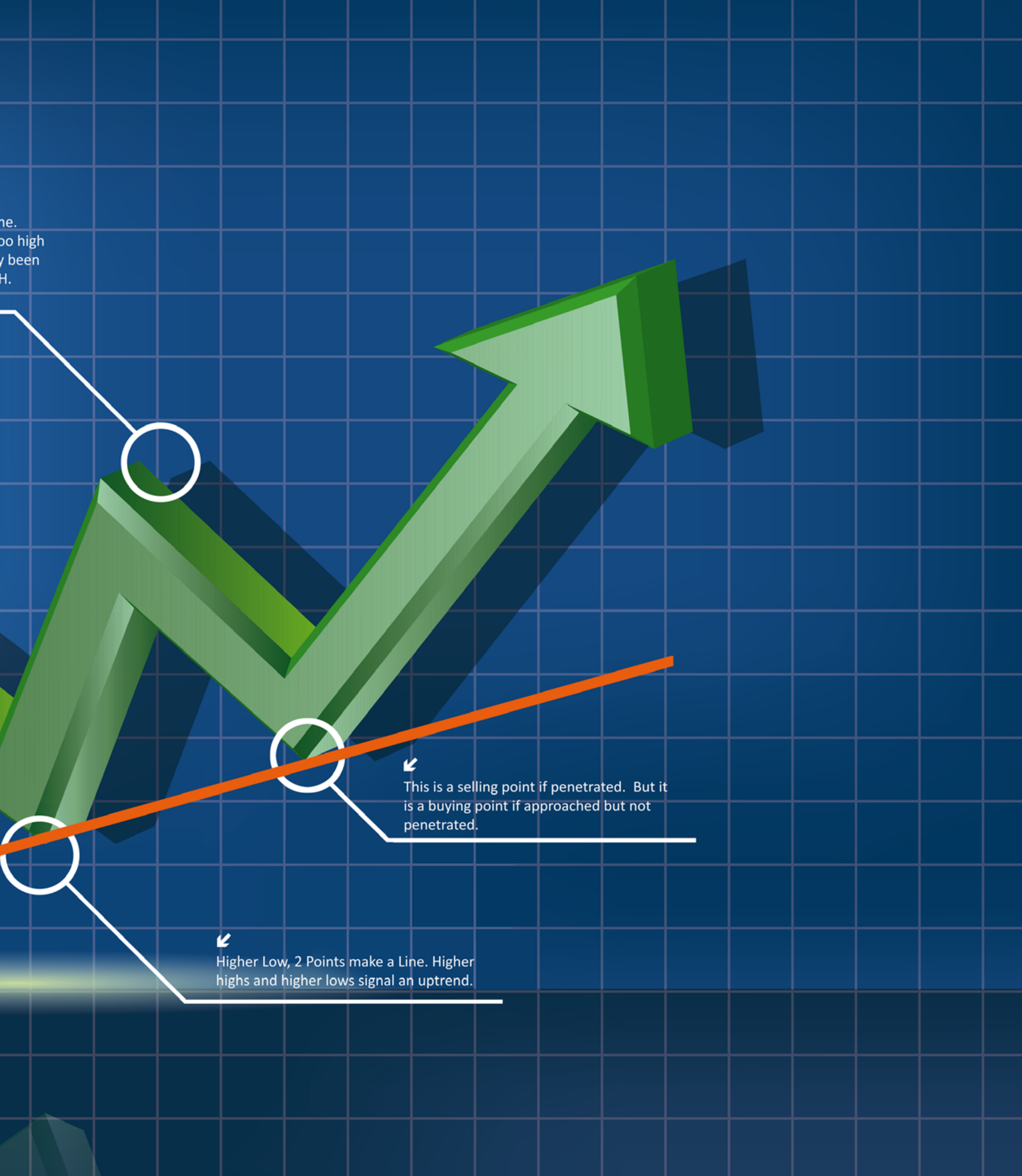
Finally, while the overall low oil prices are worrying in the short term, this is the perfect time for sound companies with good management, good underpinning assets and cash to enlarge their businesses and emerge stronger when prices rise. Rockefeller's maxim of "buy when the blood is running" still rings true.

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

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

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

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



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BY JAMES FAULKNER

SOUND ENERGY: "THE EYE OF THE STORM"

James Faulkner: **Tying in with our resources theme this month, we're joined by James Parsons, CEO of Sound Energy Plc (SOU). Thank you for taking the time to speak with Master Investor, James. To begin with, how about a bit of background information on Sound, for the benefit of those who aren't familiar?**

James Parsons: *Sound Energy is a well-funded Mediterranean upstream company, listed on AIM, with cost-covering production, a cornerstone investor, a strategic partnership with Schlumberger (one of the largest companies in our sector) and an active and potentially transformational drill programme.*

We are pursuing an onshore gas strategy underpinned by strong European gas fundamentals, which is proving very robust to the current oil price environment and to an increasingly carbon conscious world (where gas is, rightly, seen as a cleaner alternative to coal and oil).

JF: **The recent collapse of the oil price has been nothing short of historic. What's your assessment of the current situation in the oil & gas industry and its specific implications for Sound Energy?**

JP: *As you rightly say, the energy sector is in a period of some transition with oil prices having fallen significantly and many household names collapsing on the back of an unsustainable debt burden and an inability to fund capital commitments. The market is littered with strategic reviews, forced asset sales, debt re-determinations, requisitions from activist shareholders and companies defaulting on licence commitments. On the back of that, the AIM oil and gas index is down 41% over the last year. And the general consensus is that it is unlikely to improve any time soon.*

We observe a "new order" emerging, with the market increasingly rewarding companies with low debt levels, strong management, cash on the balance sheet and a bias for gas. Despite the challenging sector backdrop, Sound Energy is positioned in a sweet spot – analogous to being in the peaceful eye of a violent storm – with an opportunity to grow boldly and counter-cyclically whilst valuations are low and competition is limited.

JF: **Sound Energy appears to have had some success in recent years. What roadmap have you been following?**

JP: *Our roadmap so far has been rather straightforward:*

1. *Firstly, we acquired an Italian onshore gas portfolio back in 2011/12.*
2. *Secondly, we secured cost-covering production (back in 2013 we established Rapagnano as our first producing asset and we are now adding the much larger Nervesa).*
3. *Thirdly, we introduced a cornerstone investor to fund the business strategically.*
4. *Next, we acquired a Moroccan onshore gas portfolio.*
5. *And, finally, we introduced Schlumberger as a strategic partner to accelerate our growth.*

This is the foundation of our business today, which differentiates us clearly from our competitors and underpins our business.

"WE OBSERVE A 'NEW ORDER' EMERGING, WITH THE MARKET INCREASINGLY REWARDING COMPANIES WITH LOW DEBT LEVELS, STRONG MANAGEMENT, CASH ON THE BALANCE SHEET AND A BIAS FOR GAS."

JF: I notice your recent expansion into Morocco from your Italian origins. What are your plans in Morocco?

JP: *Our game plan in Morocco has been to consolidate the best onshore gas assets in the country. We have a great team on the ground, we have the funding, we have the right partners, we are developing the right relationships, we have an "eye for a deal", and we also, as in Italy, have an overriding desire to do the right thing for the country – assisting them to stimulate domestic production, reduce dependency on imports and grow the economy.*

JF: The Sound share price has held up remarkably well and in stark contrast to many other companies in the sector. Clearly the cash buffer and the focus on gas assets are both major factors here. However, the company also has a very supportive shareholder roster, with one cornerstone investor holding more than 20% of the equity. I understand that the next year or so should be an eventful one for Sound in terms of news-flow. Can you take us through the year with regard to the upcoming activity that investors should be aware of?

JP: *You are right that Sound Energy has been one of the best performing stocks on AIM of late. We are now the seventh largest energy company and our busiest period of news-flow is around the corner.*

In the next couple of weeks we expect to announce first gas at Nervesa, the finalisation of the permitting of Badile and initiation of ground works at Tendrara (our first Moroccan well).

Immediately afterwards, we will drill two wells and workover one existing well at Tendrara. We also hope to secure first revenues from the extended well test on Sidi Moktar, and intend to farm out and then drill Badile by the end of the year.

Although investors have seen an increased focus lately on Morocco, I do want to reassure them that Italy remains a core component of our portfolio. Not only is it our corporate birthplace, it is the home of our shared technical team and critically it also hosts Badile, which is still the most exciting of our drills. I joined the company to see the success of Badile reflected in the share price and my team and I are completely focused on successfully permitting, farming out and drilling this very exciting onshore gas prospect. We have in recent months announced various improvements in anticipation of the farm out, including a Euro 5m reduction in the cost of drilling and a significant increase in the chance of success. Together, these changes, we believe, make this the most attractive onshore prospect in Europe at the moment.

"WE MAKE NO SECRET OF THE FACT WE HAVE POSITIONED THIS BUSINESS WITH MULTIPLE TRANSFORMATIONAL ASSETS, EACH WITH THREE-DIGIT SHARE PRICE POTENTIAL IN THE UPSIDE CASE."

JF: In the past you've spoken about the upside scenario for the high-impact exploration assets as being "very material". What could a blue-sky scenario look like for Sound?

JP: *We make no secret of the fact we have positioned this business with multiple transformational assets, each with three-digit share price potential in the upside case.*

JF: Interested readers will be pleased to note that Sound Energy will be exhibiting and speaking at the Master Investor show in April. Could you give our readers a sneak peek of what you'll be covering in your presentation to delegates?

JP: *We look forward to providing investors an opportunity to get involved in our journey at the show and hear about how Sound Energy is positioned for success:*

- *The right people… a strong executive team and Board.*
- *The right portfolio… Italy and Morocco, with more to follow; gas; onshore and operated.*
- *The right partners… strong relationships in country; a Strategic Partnership with the best in the sector and a Cornerstone Investor.*

Although we have a lot to talk about, our core focus will be on how investors can maximise the upside by investing counter-cyclically, and how natural gas is the future for our sector.

BY KIRAN MORZARIA, CHIEF EXECUTIVE OFFICER OF RARE EARTH MINERALS PLC

LITHIUM: A BATTERY OF REASONS TO BE CHEERFUL

Sustainable, clean and innovative ways to ensure the energy security of the planet is a subject that preoccupies governments across the world. While oil and gas prices, and the geo-politics attached to those markets, embark on another roller-coaster, the growing demand for electrified vehicles and the exciting new ways of storing energy mean that the extraction of lithium compounds and their use in lithium-ion batteries look to have a very bright and exciting future.

In the wider resource industry, the law of supply and demand has been a cruel force for uncertainty as the world tries to find a balance between huge new supplies and falling demand. The waning demand for iron ore, copper, aluminium and other raw materials has created big questions for investors and those brave souls who risk capital to dig up and process the ingredients that underpin modern society.

The key words at the recent Davos summit were "renewables", "environmentally friendly" and "sustainability". To be fair, those words have been ringing in our ears for many years. The ambitions and fears are the same in 2016 as they have been at the seemingly endless Climate Change Conferences across the planet.

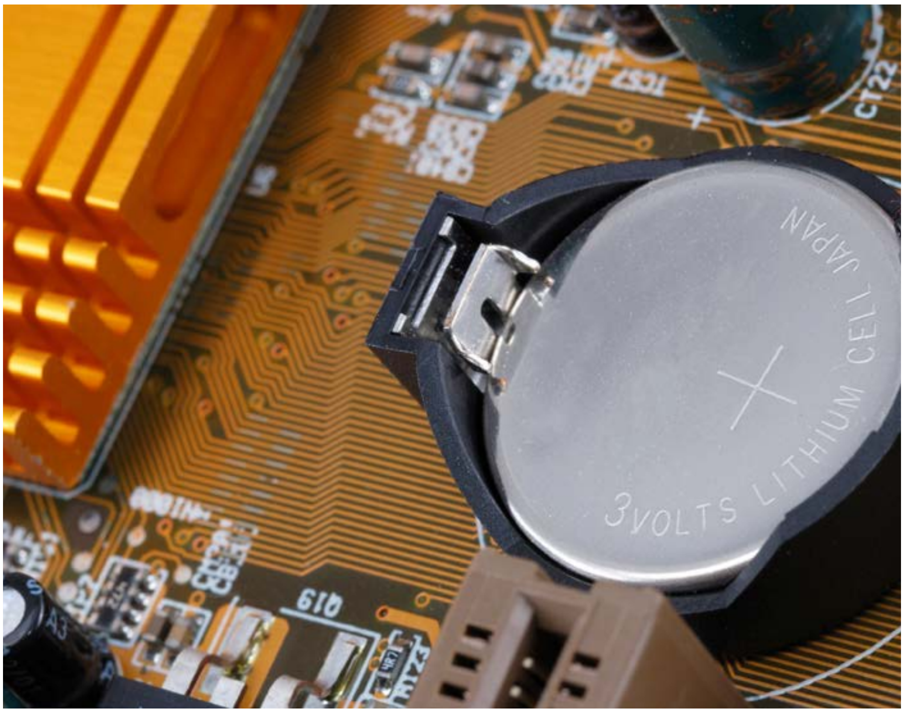
"I AM HUGELY ENCOURAGED BY THE PROGRESS IN THE ENERGY STORAGE MARKET, AND IN PARTICULAR THE ADOPTION OF THE LITHIUM-ION BATTERY IN LARGER MASS MARKETS."

We have created a world that requires energy; without it we cannot cope – even the simplest and the most basic of functions would be deemed virtually impossible. We cannot survive without the trappings of the 21st century: instant and reliable communication; cheap and convenient modes of transport; power to keep us hot and to cool us down, and to process essential foodstuffs. And yet, with these incredible advancements, we are still reliant on technology that dates back over 100 years and more.

With all the above in mind, I am hugely encouraged by the progress in the energy storage market, and in particular the adoption of the lithium-ion battery in larger mass markets. It is no longer a pipe dream, but a reality. The continuing demand for the electrification of cars in 2015 means that growth from a 5% share of the energy market currently to 25% by 2025 is achievable.

For decades we have carried a supply of small batteries to power small gadgets at home, from your children's toys to electric shavers. But batteries are getting big, literally and figuratively speaking. As Goldman


AA Alkaline LR6 1.5 V
AA Alkaline LR6 1.5 V



Sachs reported last autumn, rechargeable lithium batteries will in future power our cars and vehicles, and soon they will be helping to keep the lights on – thus opening up a "massive" and "untapped" opportunity for investors.

"THE ENERGY-STORAGE BUSINESS HAS THE POTENTIAL TO BE A $150 BILLION MARKET 'WITHIN A FEW YEARS'."

The Wall Street firm's analysts confidently predicted (based on real evidence) that energy storage will change the way the power grid operates. They also noted that the ability to store renewable energy has long been "a holy grail" for clean energy, and large-scale battery storage is gaining momentum. That means your car and your home appliances being powered by lithium batteries in the not-too-distant future.

Ford is committed to a programme of investing 40% of its resources in electric or hybrid cars. The Volkswagen diesel emissions scandal was the catalyst for much of this momentum, with most major car manufacturers worldwide investing hugely in electric battery-powered engines. The United States is looking to eventually stop building diesel engines. To Ford and General Motors, batteries are the future, as they climb aboard the well-publicised bandwagon initiated by Tesla Motors and its charismatic chief executive, Elon Musk.

There's the Nissan Leaf, the Renault Zoe, BMW's i3, VW's e-Golf and e-Up, plus other models from Citroen, Peugeot, Kia Mini and Mitsubishi. The cars look distinctive and have ever-improving guaranteed travelling distances before recharging is necessary. They appear to have attracted rather strange names, but that's a minor issue at this stage.

Li-ion batteries provide lightweight, high energy density power sources for a variety of devices. To power larger devices, such as electric cars, connecting many small batteries in a parallel circuit is more effective and efficient than connecting a single large battery. Lithium energy is commonly used in mobile phones, smartphones, laptops and tablets, cameras, game consoles and even electronic cigarettes. Lithium is the source of energy for 'Curiosity', the robotic rover exploring Gale Crater on Mars as part of NASA's Mars Science Laboratory mission.

Other worldwide analysts concur with Goldman Sachs' optimism, thanks to falling costs of production, improving technology, and a marked increase in private and venture-capital funding, while governments across the globe are backing new initiatives. Goldman even went as far as to predict that the energy-storage business has the potential to be a $150 billion market 'within a few years'.

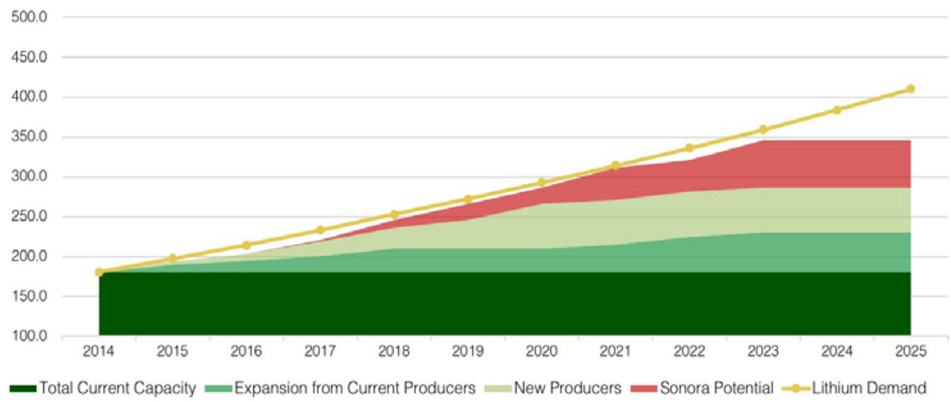
To reinforce the message from Goldman Sachs, Citi Bank reported last October that "The Future Is Electric" and predicted a healthy rise in the price of lithium carbonate (current estimated pricing of long-term contracts are $6,500 per tonne of lithium carbonate), and a "mass adoption" of electric vehicles from all the major manufacturers and continued growth in demand from existing industrial applications, such as ceramics, glass, polymers and alloys.

Nonetheless, with all this potential, I am concerned with the lack of development of upstream sources of material, in particular the extraction, refinement and supply of the lithium compounds that are required for lithium ion batteries.

There are some major players already in the market. Albemarle, SQM and FMC are the largest producers in the world, extracting the product in Argentina, Chile and Australia, either via brines (massive salt flats which rely on water evaporation) or hard rock mines. However, these incumbent producers of lithium are limited in their ability to bring additional supply to the market to satisfy growing demand. The market will need junior producers.

Supply Side Production Challenges

Current producers do not have capacity



Source: Stormcrow Lithium Industry Report & Company Estimates

According to the industry experts, total global production for 2015 was around 200,000 tonnes of lithium carbonate equivalent (LCE) and is expected to jump to 410,000 tonnes per annum by 2025. However, and according to these same market experts, the total current maximum supply rate is around 235,000. The reality is that at this point in time there are very few new producers coming online, which I believe will result in a supply shortfall from 2018 onwards unless new large producers of lithium are funded and developed.

"THE REALITY IS THAT AT THIS POINT IN TIME THERE ARE VERY FEW NEW PRODUCERS COMING ONLINE, WHICH I BELIEVE WILL RESULT IN A SUPPLY SHORTFALL FROM 2018 ONWARDS."

This is where I need to declare an interest. I am chief executive of London-based investment business Rare Earth Minerals. We own both strategic stakes and have joint ventures over very large, scaleable and low cost lithium projects (production costs forecasted to be between $1,000 an $3,000 per tonne of lithium carbonate) which are in either the exploration or development stage.

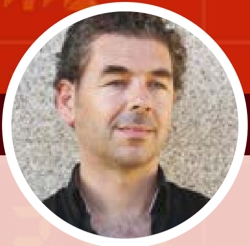
The most advanced of these is the Sonora Lithium Project in the north-western Mexican state of Sonora, 11km south of Bacadehuachi, 180 km north-east of Hermosillo. The site is approximately just 170km south of the USA-Mexico border. We own a total economic interest of between 17% and 40% in the various mining licenses. The remainder is owned by the operator Bacanora Minerals.

The project, involving the El Sauz, El Sauz 1, Fleur and La Ventana concessions, has some nine million tonnes of lithium carbonate contained within the deposit. The pre-feasibility study is due for completion by the end of March 2016, after which we would expect to see the definitive study to be completed in late 2016 to early 2017. From there we would begin the construction and commissioning of a 17,500 tonnes per annum lithium compound plant, which would increase production to 35,000 tonnes per annum. To put this into context, the output of this mine at planned full production would be second only to that of market leader SQM.

A major step was achieved with our announcement last August of a conditional long-term lithium hydroxide supply agreement with a major electrical vehicle manufacturer. The Sonora Lithium Project Partners are working to develop a mineral-rich, lithium-bearing clay deposit into a planned low-cost sustainable and environmentally-conscious open pit mining operation.

We also have an 11% stake in the Cinovec deposit in the Czech Republic, which has some five million tonnes of lithium carbonate. It sits on the Czech-German border and is currently in the early exploration stage. Nonetheless, it is anticipated to be a very low cost producer, with ample scale and in a very strategic location.

So, while the world economies grapple with a dark and gloomy resources backdrop, there is a much brighter alternative image to focus on. Lithium is a real resource that will transform our sustainable energy supplies for generations to come.



BY FILIPE R. COSTA

ECONOMICS CORNER

COMMODITY PRICES ARE IN THE HANDS OF CENTRAL BANKS AND CHINA

Past mistakes guide future pain

The rampant decline in commodity prices that started two years ago seems to have finally put an end to the epic boom most commodities experienced during the early part of this century. Almost no commodity has escaped the furious price correction and prices are yet to find a floor. While the current oil price near $30 seems too depressed by this century's standards, it still looks high by 1998 standards, when oil prices could be found at $10. The current slump is an overreaction, but so was the prior boom. The last thirty years have been marked by double-digit Chinese growth and an artificially low level of interest rates, both of which helped to create a commodities boom that changed the global economy. But the time for a reversion in policy has come and the commodities market is at risk of fully reverting to its 1990s levels.

The latest data show a deceleration in Chinese output growth to a 6.9% level, while in the US interest rates have finally been hiked after years of being held at zero. Both are still at expansionary levels, but judging by the latest price developments, this hasn't been enough to prevent the global economy from turning upside down. With the previous status quo only ever so slightly challenged, one wonders what could happen if the Chinese were to allow for full deleveraging and for monetary policy to revert to normal levels. Current conditions pinpoint the relationship between heavy economic stimulus and asset prices. In applying that logic, we can see how harmful prolonged distortions may become at the time they are reverted. During the last three decades we have witnessed aberrant policy decisions that, whilst hiding inside a Keynesian casing, called for active public intervention to smooth the business cycle. But this has merely served to exacerbate the boom and bust cycle – which would never have been backed by Keynes.

Faced with exploding Chinese demand for commodities and prolonged near-zero cost of capital, commodities producers invested heavily in new exploration. Super mines were established around the world and unexplored, expensive areas were added to the global supply. This resulted in a massive increase in supply levels that will now take years to correct. A good example depicting the madness is the investments made by three commodities giants: Vale, BHP Billiton and Rio Tinto. From the turn of the century, they expanded their combined capacity from 195 million tons to 1.1 billion.

But expanding or contracting capacity is something that may take years in the commodities sector. Companies need to invest heavily for many years, to start reaping the benefits only much later (if ever). Only when they feel that demand growth is picking up for the long term are they willing to expand capacity. In the short term, adjustment is manly processed through prices.

"ONE WONDERS WHAT COULD HAPPEN IF THE CHINESE WERE TO ALLOW FOR FULL DELEVERAGING AND FOR MONETARY POLICY TO REVERT TO NORMAL LEVELS."

By a similar token, these companies only reduce capacity if they believe there is a long-term reduction in demand, and then it takes time for the sector to react to decreasing demand. On one hand, the current low prices may be enough to prevent new companies from entering the market and for the existing ones to delay approved projects; but on the other hand, these prices are still not enough to lead to quick cuts in production levels.

Just look at the example of miners. The very high sunk costs incurred to develop a new exploration project prevent new companies from entering the market at this point. But for all those already in the market, sunk costs don't enter their profit equation anymore and thus it may still be better for them to continue producing rather than abandoning mines. Supply is inelastic and the burden of the adjustment process lies almost entirely in prices over the short to medium term. Under these circumstances it should not be a surprise that price action is usually wrapped with drama, as it recently has been.

An extended bear market

In a list where I track a dozen commodities, a two-digit red number fills almost every instance in the performance column. Oil leads the losers table showing a 70% loss, followed by iron ore with a loss north of 65%. In the sub-sector of metals, copper is down 40%, silver 30% and even the 'safe haven' gold is down 11%. The only exception on the list is cocoa, which is up 6% for the two-year interval.

One way to evaluate the extent of the recent price declines is to look at what I like to call "relative proximity to historical high ratio" and "relative proximity to historical low ratio", which measure the closeness (or proximity) of current prices to their historical limits. The first measure is calculated as (current price – historical low) / (historical high – historical low) while the second is given by (historical high – current price) / (historical high – historical low). If current price is near its historical high, the relative proximity to historical high would then be close to one while the relative proximity to historical low would be close to zero.

By looking at the relative proximity to historical low ratios for the dozen commodities I cover, we quickly perceive how deep the current price correction has been. Coffee, copper, iron ore, natural gas, platinum and soybean all show a figure above 0.90. Brent and light sweet oil show a figure of 0.88 and 0.79 respectively. At mid-range we have gold and palladium. Cocoa is the exception in the list, as the commodity is nearer its historical high. The overall picture depicts a depressed market where price action is nearing historical lows.

A boost from China and central banks

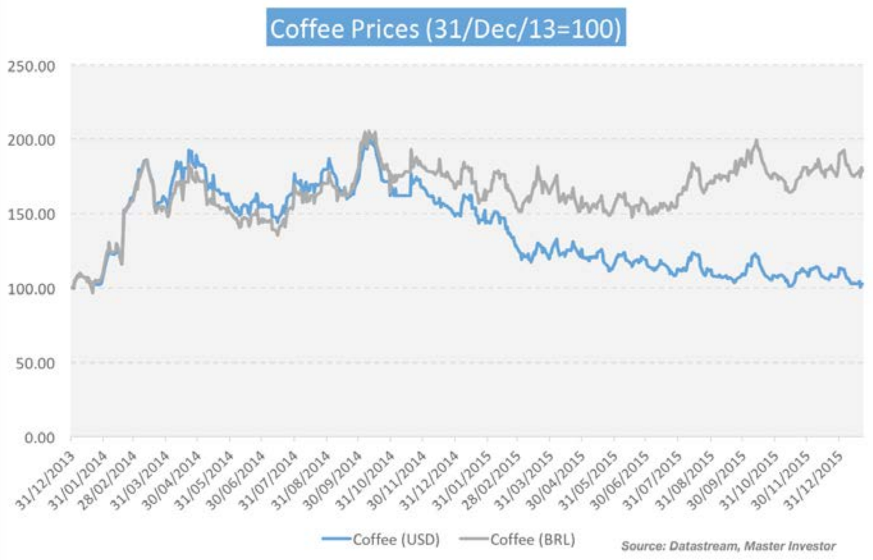
The Austrian school of thought usually attributes a bust to a period of bad allocation of capital due to artificially low cost of credit and an unsustainable increase in the money supply. They claim that the interest rate is the free market mechanism by which resources are allocated in the economy. When the rate is artificially set by a central bank, it loses its informativeness and decisions are taken on forged figures. But that's exactly the aim of public policy: to force

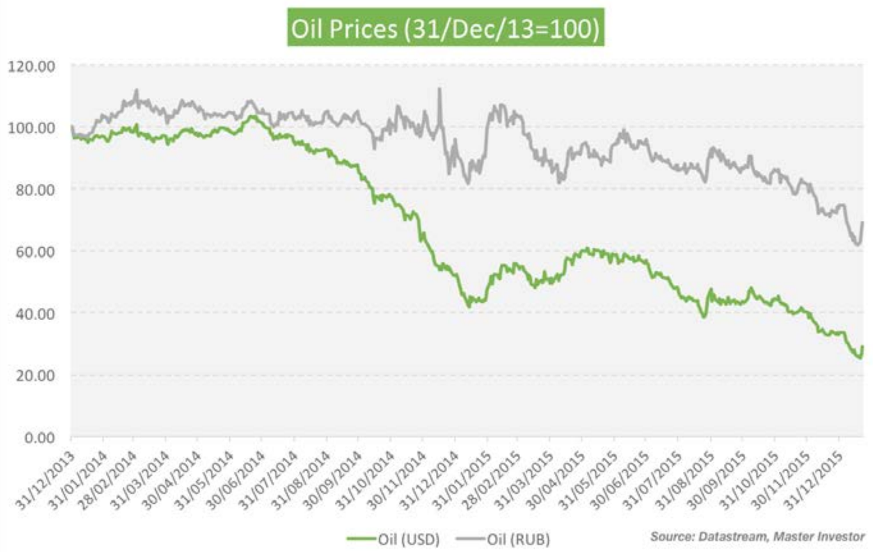
Commodities Data

Commodity	Price	2015 (%)	YTD (%)	1-Year (%)	2-Year (%)	Historical High	Historical Low	Nearness to Historical High (%)	Nearness to Historical Low (%)
Cocoa	$2,855.00	8.60	-11.58	1.96	5.82	$3,788.00	$674.00	70.0	30.0
Coffee	$1.14	-23.70	-9.06	-28.48	-0.24	$3.09	$1.01	6.6	93.4
Copper	$1.99	-25.90	-6.23	-23.36	-39.99	$3.39	$1.94	3.7	96.3
Crude oil (Brent)	$32.19	-35.40	-13.65	-35.21	-70.12	$146.08	$16.50	12.1	87.9
Crude oil (Light Sweet)	$32.25	-31.00	-13.00	-31.85	-66.57	$145.40	$1.17	21.5	78.5
Gold	$1,098.20	-10.40	3.55	-15.58	-11.49	$1,909.80	$256.00	50.9	49.1
Iron Ore	$41.09	-40.70	-3.18	-40.14	-65.92	$132.83	$38.54	2.7	97.3
Natural Gas	$2.13	-19.40	-9.36	-25.58	-54.08	$15.38	$1.75	2.8	97.2
Palladium	$496.80	-29.40	-11.78	-35.77	-33.65	$909.40	$150.00	45.7	54.3
Platinum	$831.90	-26.10	-6.83	-35.15	-43.14	$2,258.30	$780.00	3.5	96.5
Silver	$14.02	-11.90	1.41	-23.53	-29.51	$48.53	$4.05	22.4	77.6
Soybean	$876.00	-15.60	1.41	-10.41	-31.54	$1,518.80	$856.30	3.0	97.0
Sugar (No. 11)	$0.1442	6.00	-6.36	-9.37	-3.99	$0.3439	$0.0845	23.0	77.0

Source: Sharescope & Master Investor

"IN THE MEANTIME, IT IS POSSIBLE THAT THE US DELAYS RATE RISES TO COUNTER SOME VOLATILITY, BUT POLICYMAKERS WILL BE UNABLE TO DAMPEN THE ADJUSTMENT IN THE MEDIUM TERM."





more consumption and investment than the economic conditions advise. When interest rates are lower than the levels resulting from the interaction of free market forces, too much capital is deployed to capital goods. Companies invest in long-term projects instead of producing consumer goods.

During the most part of the century, rates have been low while at the same time the Chinese authorities heavily invested in infrastructure capacity to keep their economy growing at two-digit rates. From $1.2 trillion in 2000, Chinese GDP grew to $3.5 trillion in 2007 and to $10.4 trillion in 2014. Such spectacular growth could never be the result of productivity improvements alone; it could only be the result of an astonishing credit creation that increased the national debt from $1 trillion in 2000 to $25 trillion in 2014. The huge growth experienced by China boosted the appetite for commodities, in particular for those that are important inputs in manufacturing, pushing their prices higher and seducing companies around the world to invest heavily in new mines. But with debt rising from 1x to 3x GDP, one can easily speculate that the current trend is unsustainable. China has been borrowing too much from its own future and boosting an artificial demand for commodities. This process now seems to be unwinding.

What to expect

Whether price declines have reached their full extent or not depends on the path taken by monetary policy and China's tolerance towards lower growth. In the meantime, it is possible that the US delays rate rises to counter some volatility, but policymakers will be unable to dampen the adjustment in the medium term. At the same time, the infrastructure spending, easy credit conditions and heavy exporting that boosted Chinese growth in past decades are losing effectiveness.

Until today, the adjustment has mainly occurred through prices, as the effects of delayed and mothballed projects still need time to be felt in supply levels. But the adjustment in prices has not been as steep as many think because commodities are traded in dollars and produced in countries where the US dollar is not the official currency. The losses observed in commodity prices were in many instances smoothed by the depreciation of local currencies, which prevented a quicker adjustment. There are two good examples of this: one from the coffee market and one from the oil market.

In the case of coffee, prices declined in 2015 as the harvests in Brazil and Colombia were good. But with the Brazilian real losing value at an accelerated pace, instead of cutting output, coffee producers had an incentive to increase it, as lower US dollar prices were not fully reflected in lower real prices.

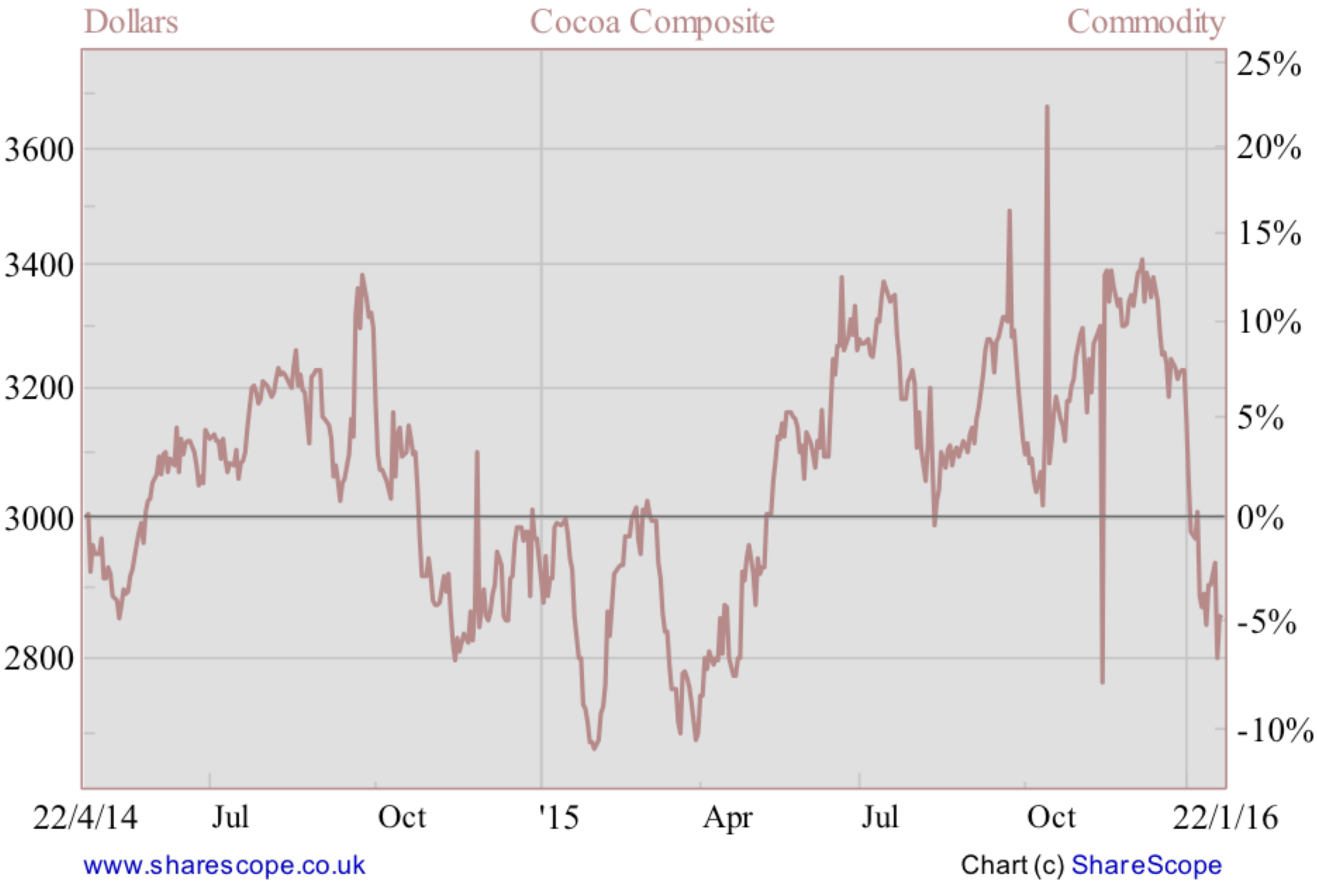
The same reasoning applies to the oil market. Russia, for example, has been increasing output to levels not seen

Commodities Real Prices*

	Crude Oil	Gold	Silver	Copper	Coffee	Cocoa
Average Real Price (2000-2015)	73.83	929.80	16.01	5801.69	130.59	2450.32
Average Real Price (1990s)	29.76	562.92	7.69	3575.59	174.74	2065.03
Price at the end of 2015	35.70	1062.38	13.82	4705.75	127.94	3268.66

*using end of 2015 prices

Source: Datastream, Master investor



since the old USSR, as the steep decline of the rouble provides an incentive for output to be increased.

Currency devaluations work as a stabilisation mechanism for commodity producing countries but prevent an adjustment in supply that is perpetuating the current bear market.

A return to the 1990s?

The commodity slump is the natural consequence of a huge bull market that lasted for years and was artificially boosted by public policy. Now that such policy is reverting, it is very likely that commodity prices need to revert to their 1990s levels – a period where the excesses in terms of monetary policy started gathering pace and when China started driving demand for commodities higher. One way to look at how far we are from those levels is to estimate the average price for commodities during the 1990s, using today's prices, and check the difference.

If we use end of 2015 prices to calculate an average price for commodities during the 1990s, we see that there is still room for further declines, as oil and copper (two important commodities benefitting from the quick industrialisation) are still 20% and 31% respectively above their 1990s averages. Gold and silver are almost double their 1990s averages, but these metals also benefit from monetary policy excesses and may be more in line with the quick expansion of the money supply. The case for cocoa is significantly different, as productivity has been decreasing at a very fast pace and supply is ever more limited. Production essentially comes from small crops in the Ivory Coast and Ghana, run by poor farmers as family businesses. These farmers are finding alternative ways to make a living, as they get just a very small share of the international cocoa price. For this reason, and in stark contrast to other markets, cocoa will continue to live with tight supply conditions driven by growing demand.

"THE ADJUSTMENT IN SUPPLY IN THE COMMODITIES MARKETS IS NOT YET COMPLETE, WHICH MEANS FURTHER PRICE DECLINES AND INCREASES IN VOLATILITY ARE TO BE EXPECTED IN 2016."

Some final remarks

The adjustment in supply in the commodities markets is not yet complete, which means further price declines and increases in volatility are to be expected in 2016. The world needs to adapt to a new reality: one where China will no longer lead global growth and where manufacturing is no longer their top priority. Emerging markets, in particular those used to making a living from exporting commodities, will need to reposition their economies. Saudi Arabia will run into difficulties, as they're no longer in control of oil prices; and while they try to bust everyone by keeping production levels unchanged, they're going to burn the astonishing amount of reserves they have accumulated so far – $100 billion is already gone. They will start taxing the population and the 30-year peg of the riyal to the dollar may be at stake. At a time when Iran is waiting to offload its 150 billion barrels in reserves, Saudi Arabia will need to be creative to counterbalance the expected losses.

BY JOHN CORNFORD

HOW TO VALUE JUNIOR MINING STOCKS (PART 6)

COLLAPSING COMMODITIES – MINERS' MISERY

Are there reasons to be cheerful amidst the commodities fallout? It depends, of course, which side of the fence you're on. Consumers and manufacturers will welcome lower prices, but this column looks at the commodity producers (excluding oil) who one supposes won't – although it also depends! A look at the (maybe recovering) gold price points to at least one type who might start grinning, and some already-producing gold miners' shares seemingly determinedly off their bottoms.

> **"THERE ARE SOME NOT-SO-JUNIOR GOLD MINERS WHO ARE ALREADY IN PRODUCTION, WHO DON'T NEED FINANCING, AND ARE ALREADY THRIVING. IF THE GOLD RECOVERY HOLDS, THEIR INVESTORS' GRINS WILL BROADEN BY THE DAY."**

But are they bottoms, or just ledges on the way down? Writing about prospects for anything related to commodities right now is to take one's reputation in one's hands. Conflicting opinions from legions of apparently well qualified gurus come at you from all sides. For gold there are those who think current uncertainties will provoke a stampede into what is perceived to be the only 'safe haven'. Others point to the disappearance of the inflation against which gold was supposed to be a hedge; some to the continuing strength in the dollar if (a big if!) the US economy continues to (or seems to) outperform the rest of the world; and the rest look to a long-term gold chart showing a possible further drop to the $700/oz level.

Long term gold

Short term gold

But in all this it is worth re-capping why mining stocks – especially juniors – have always been worth considering, even if their attractiveness comes and goes. At the moment it is the lack of finance that is holding back many hopefuls, but there are some not-so-junior gold miners who are already in production, who don't need financing, and are already thriving. If the gold recovery holds, their investors' grins will broaden by the day. I will be commenting on two such hopefuls – **Pan African Resources (PAF)** and **Shanta Gold (SHG)** – in the Master Investor blog, and at least one already pays a decent dividend which has every chance of increasing. As for those waiting to start, I'll be discussing why, for example, the odds are stacked against such an apparently attractive prospect as **Kefi Minerals (KEFI).**

But if gold continues to recover, the cheerfulness will spread – among the goldies at least. Some of miners are highly geared to the gold price, much more so than others. Those with high costs and a slim or negative margin – and thus currently the most depressed – will benefit most, as will those hopefuls close to production but still awaiting funding, like **Hummingbird (HUM),** where a stronger gold outlook should persuade its promised lender to sign up. While it waits, it is interesting that a recent update and restatement of its economics included, for the first time, a reference to the 'cost' of streaming, even though it hasn't yet announced that it might be a component.

Condor Gold (CNR), meanwhile, owns what looks to be a fairly attractive and easily mineable 2Moz gold deposit in Mexico. Having failed to secure finance back in November, Condor briefly put itself up for sale but failed to find a suitor and has now withdrawn and announced it will go it alone for a while, in the hope that things will improve. Already, that brave move (and accompanying restatement upwards of its own economics) has attracted a major institution onto the shareholder register.

But that is gold (and to some extent silver whose drivers are different). As for the other commodities, there are different factors in play. Apart from the big six (iron ore, copper, aluminium, nickel, zinc and lead) and omitting energy and foodstuffs, other commodities all have particular uses where, I suspect, not many of the commentators who are talking their prices down know very much about the real supply/demand balances which determine medium-term prices.

Having said that, however, even the mining journals surmise that the long 'commodities super-cycle' that underpinned the surge in mining exploration and development, not to mention mining shares, between the late '90s (when decades of under-investment had produced genuine under-supply) and 2007/8 really is over and won't bottom for a generation.

Compare that gloomy opinion with one major economist who only in 2013 confidently pronounced that *"today most (metals) markets are trading within one standard deviation of their marginal cost of production, suggesting that prices are at reasonable long-term valuations".*

So bang goes the theory that higher costs are here to stay. Or does it?

Here, again, I suggest, it depends! To decide you'd have to look in detail at each of around 25 industrial metals and their different international supply-demand balances. Lacking the time to do that, investors will have to go by the story that each individual miner will be making in his fund-raising presentations – except that recent

"SOME CHINA SPECIALISTS BELIEVE THE CURRENT GLOOM ABOUT TROUBLE LURKING BELOW THE SURFACE IS OVER-DONE."

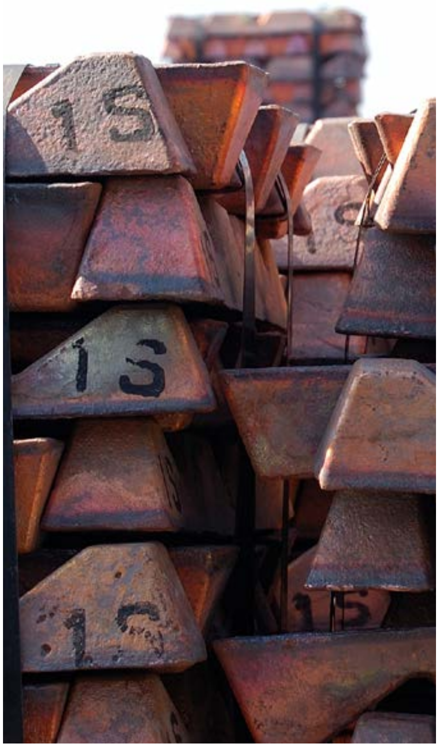
The commodities super-cycle (part of)

history teaches us to be wary. It is only two years or so ago when the few UK based tungsten miners then seeking investment on the basis of the solid price outlook for a 'strategic' metal, otherwise at the mercy of China, were making persuasive arguments for a price twice what is being achieved now.

So, are we in a hysterical phase of over-reaction? Some China specialists believe the current gloom about trouble lurking below the surface is over-done. Headline-grabbing newspapers may describe industrial production growth of 5.9% as "grim" (against expectations for 6% growth), but are they really justified in doing so?

To understand more, we might consider the mathematical realm of 'small differences' (which is what drives prices) between 'large numbers' (absolute supply and absolute demand) – where even a slight error in forecasting can make the difference (the price) fluctuate wildly. And we might also discuss what a 'falling growth rate' really means in absolute terms.

Chinese consumption of copper quadrupled between 2000 and 2012, by when it accounted for almost as much consumption as the rest of the world combined. Aside from iron and steel (and their related nickel, manganese, and chromium use) copper is the most significant of all world metals in production and consumption. Its properties make it ideal for electrical, heat transfer, and corrosion resistant applications, and so its consumption is determined by building, transport, energy production and transmission, and by a host of consumer goods uses – and therefore also by population growth and infrastructure spending. World car use, for example, is still expected to grow fast, and each car contains, it is said, up to 30kg of copper. The electric cars Tesla is developing will need even more.



But the demand (China) and supply (in recent years dominated by South America) balance isn't all, because copper has also become a quasi-financial instrument used by investors and speculators for hedging, where inventory manipulation (or lack of transparency) adds to the price instability caused by supply-demand variations.

With the above in mind, it is not surprising that there are many conflicting predictions for the copper price. But overall, sentiment about it seems to be dominated by fears that Chinese demand is 'slowing'. Here we have to decide whether 'slowing' demand is the same as 'falling' demand, because it is that distinction that a little piece of mathematics (later) throws some light on.

Up until two years ago, the PRC government, aware of the danger of political unrest among its still-numerous rural poor and the growing gap with the urban rich, was still planning phenomenal numbers of new cities, each with their own industries. It was estimated by the relevant Ministries that 300 million Chinese would move from the country into cities in 2010-25. Now, though, the reported 'ghost cities' show that building for them has obviously, for the moment, got well ahead of reality. But this urbanisation drive certainly won't be abandoned – even though with China's real estate construction only 2.8% ahead and new starts significantly down, it may be some time before the old new-build rate is restored.

These 'slowdowns' have translated into an overall decline in growth rate (9% in 2011; 6.9% in 2015) which is frightening the markets. But it is worth pointing out for those politicians (and journalists) possibly challenged in the numeracy department that even if the growth 'rate' declines there is still a useful increase in 'absolute' activity. Even if the sort of decline now being seen continues at the same rate, there will still be the same 'absolute' expansion each year – which is what counts for the external economies who are supplying China. However, its effect in each case obviously 'depends' on the commodity in question.

As for all those other industrial commodities that are mined, the next most important might be zinc, which is widely used for corrosion protection in construction and for transport and consumer (white) goods, as well as being alloyed with copper to make brass (stronger than copper) for electrical equipment and for intricate and light castings in myriad engineering products.

Lead, often found with zinc, is also in demand – for automobile batteries (still a growing new and replacement market) as well as for plumbing and protection – and both lead and zinc were being forecast only recently to be heading for a supply crunch at this very moment, as two major mines run out of ore and close down. Tin is in the same boat.

"LITHIUM IS THE CURRENT FLAVOUR OF THE YEAR."

Lithium is the current flavour of the year (or indeed the decade, some might say) with analysts expecting price rises on the back of growth in lithium-ion batteries (which is not yet its widest use but will become so when Tesla's new 'gigafactory' gets under way). But it is a confusing market, with many players scrambling to get in, and as with uranium there isn't a 'spot' market price. In addition are two main types of lithium mining producing different varieties for particular applications – via brine, of which there are large producers and resources in South America and elsewhere, and for hard rock 'spodumene'. Selecting an investment in the present phase might be risky, especially as commodities guru Sprott thinks the lithium investment market is already overblown. I might discuss the miners exposed to lithium in a later series.

Tantalum, like tungsten, is another commodity which, as the flavour of a few years ago, has burned investors' fingers.

I could go on but don't have space to comment in the same way for all. I suspect that many of the price falls are an over-reaction and wouldn't deter anyone from looking at those specialist miners already in production whose shares are even more depressed than their products. To imagine that each one of the following metals whose miners have come to the market in recent years have the same, depressing, prospects is, I think, unrealistic. Think Antimony, Chromium, Fluorspar, Graphite, Magnesium, Palladium, Platinum, Rare Earths (numerous), Tantalum, Thorium, Tin, Titanium, Tungsten, Uranium, and Vanadium. Tom Lehrer sang about them all.

BY FILIPE R. COSTA

THE GREATEST INVESTORS & TRADES

JIM ROGERS: THE ETERNAL COMMODITIES BULL

"There's going to be a huge shift in American society, American culture, in the places where one is going to get rich. The stock brokers are going to be driving taxis. The smart ones will learn to drive tractors so they can work for the smart farmers. The farmers are going to be driving Lamborghinis. I'm telling you. You should start Forbes Farming."

— Jim Rogers, May 2012, Forbes

It's not like producing an iPhone

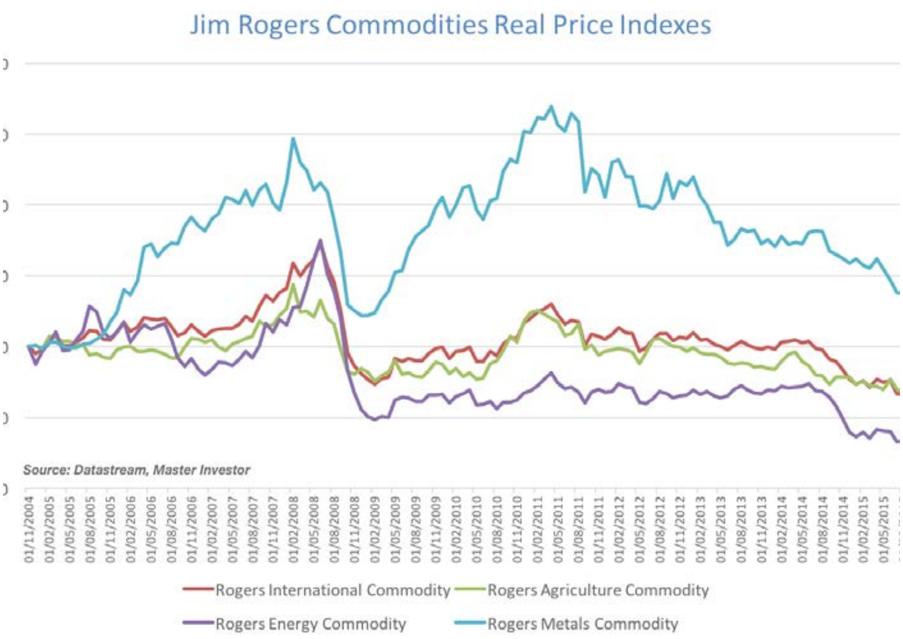
Over the past two years, commodities have been given first page honours throughout the financial media, as the rapid price appreciation we had become used to has been replaced by a blood bath from which almost no commodity has been able to escape. As with any other asset class, there are times when prices rise and there are other times when they just go down. Commodities are no exception: they are exposed to the same boom and bust cycle as equities, bonds, housing, paintings, and any other item with a price tag.

Still, commodities have some specific properties that make them different. Supply is usually constrained by tight availability of the resource. Unlike Apple, which can increase its production of iPhones with relative ease, Rio Tinto needs to deploy huge amounts of capital into new exploration to expand its mining capacity before being able to provide the market with some extra copper, in a process that may take years. At the same time, so long as Apple has all the components needed to produce the final iPhone, it can estimate with relative certainty how many iPhones it will add to the market. The same doesn't apply in mining, where companies invest in a product they're not sure they can ever get at; or in agriculture, where climate conditions play an important role in the final output. Farming is a tough activity: sometimes an entire crop is lost to bad weather conditions; and sometimes the harvest is so good that prices decline abruptly. The risks are so high and the living conditions of many farmers so poor that the new generations are more likely to be found in a suit on Wall Street than driving a tractor.

A man in the Guinness Book of Records

Taking the opportunity provided by the current commodities slump, this month's missive for The Greatest Investors & Trades focuses on a man

who retired at the age of 38, such was the success of his trading activities. In just a decade he accumulated a return north of 4,200% and has been spending his life travelling around the world, making new contacts and gaining new investment insights. James Beeland Rogers, or simply Jim Rogers as he's more commonly known, is one of the most active commodity traders and a long-term bull on the asset class. He believes that supply restrictions will always dominate the market and that prices will always tend to rise over the longer-term, even if demand decreases in the short term. At a point when commodity prices are under intense pressure, one may revisit Jim Rogers' predictions to help work out if now is the time to panic or to simply jump on board a long-term bull.



Jim Rogers was born in Baltimore, raised in Alabama, and used to live in New York. But after travelling around the world for many years he learned that Asia is where the future action will unfold and so he moved to Singapore. Of course Singapore would not be the epicentre of the action, but Hong Kong and Beijing were just too polluted to be taken into consideration as potential homes.

"IN JUST A DECADE HE ACCUMULATED A RETURN NORTH OF 4,200%."

Rogers studied History at Yale University and read Philosophy, Politics and Economics at the University of Oxford. He then landed his first job at Dominick & Dominick on Wall Street. But it was later, when he met George Soros while working at Arnhold & S. Bleichroder, that his life started gaining traction. The two left the company and created the Quantum Fund, which achieved a performance of 4,200% during 1970-80, while the S&P 500 was left with a paltry 47% gain. In 1977 Rogers made his first million and in 1980, at the age of 38, he decided to retire. Not that he'd had enough – Rogers had other projects that would help him improve his investment skills and become one of the most important commodities experts on the planet.

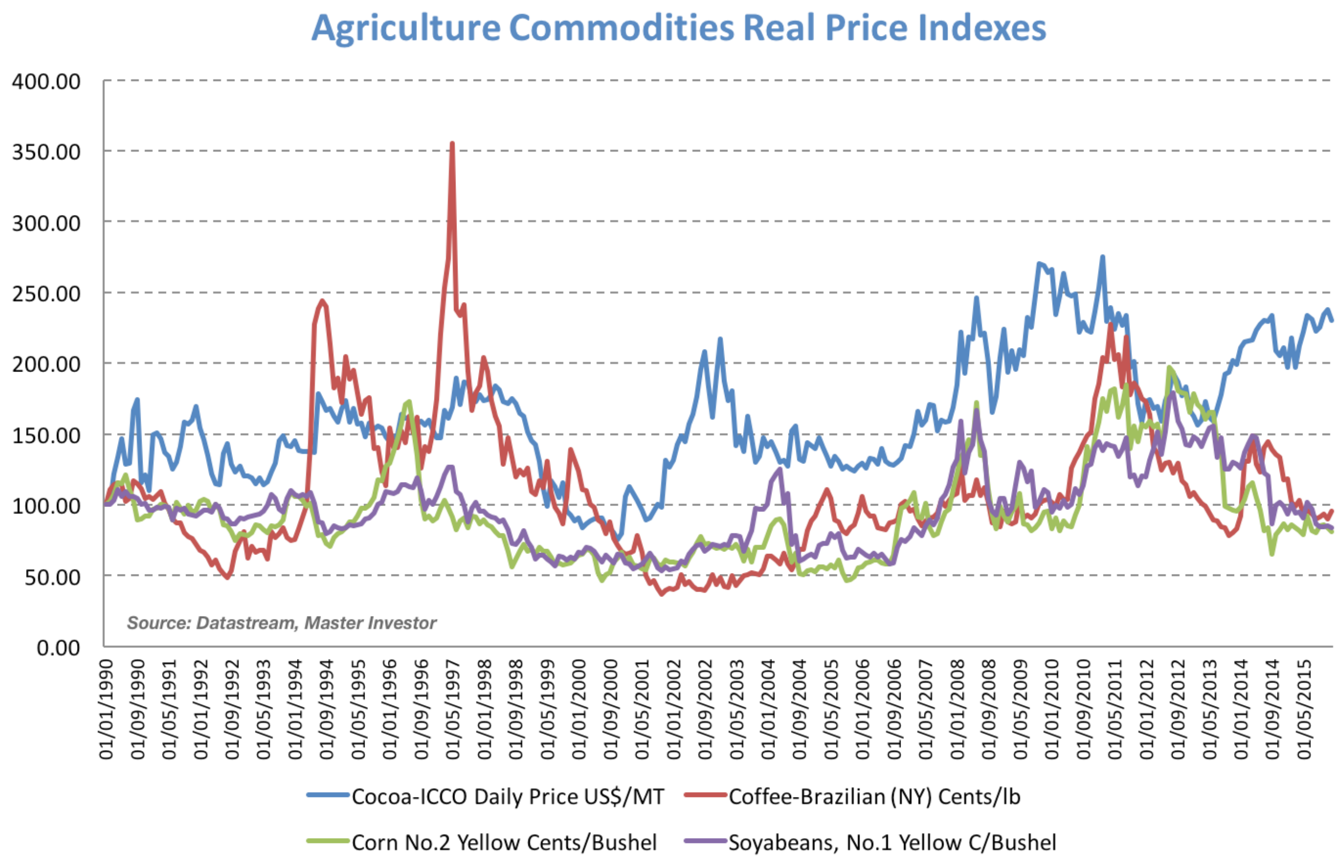
If anything, Rogers has become even more active since 'retiring'. In the early 1990s he travelled around the world on a motorcycle, covering six continents and 160,000km. Between 1999 and 2002 he travelled around the world once again, this time using an adapted Mercedes, and accompanied by his wife. These journeys rendered him entries in the Guinness Book of World Records and improved his understanding about how markets work, in particular regarding global trends and commodities. He even wrote a few books that are worth taking a look at for those interested in gaining a better understanding of the commodity markets.

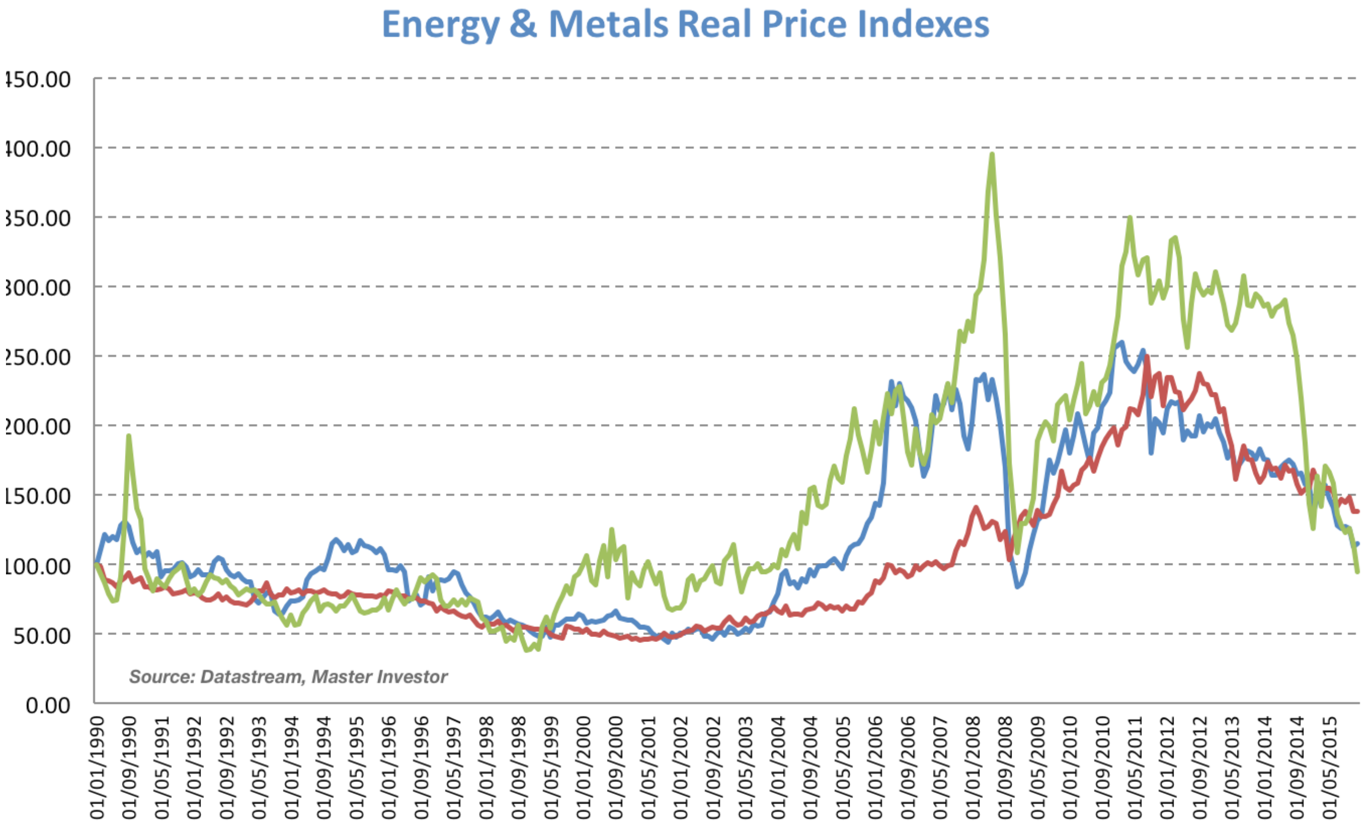
In 1996/1997 Rogers designed a commodities index that started being tracked in 1998 and is still extant today – the Rogers International Commodities Index (RICI). The index covers 38 commodities and is one of the most reliable commodity indices, as it captures not only the performance of commodities but also their relative importance, while also being very stable in terms of the weighting given to each commodity (unlike many other indices). Investors can bet on the index using exchange-traded-notes (ETNs). Rogers' index is sub-divided into three sub-indices to track different categories of commodities: RICI Agriculture, RICI Energy, and RICI Metals.

In the long term commodities will outperform

Rogers is an outspoken advocate of agriculture investments. He believes that investing in commodities is one of the best investments over the long term. It

"ROGERS IS AN OUTSPOKEN ADVOCATE OF AGRICULTURE INVESTMENTS. HE BELIEVES THAT INVESTING IN COMMODITIES IS ONE OF THE BEST INVESTMENTS OVER THE LONG TERM."





doesn't mean commodities don't suffer from bear markets, but they do hold specific characteristics that make them an interesting asset class. Rogers cites a research paper published in 2005 by the National Bureau of Economic Research (NBER) on the benefits of adding commodity futures to an investment portfolio. The authors, Gary Gorton and K. Geert Rouwenhorst, claim that, in the period 1959-2004, commodity futures earned an excess return over treasury bills of about 5% per annum. That figure is similar to the figure for equities, but with the advantage of risk being slightly lower. At the same time, they estimate that the correlation of commodity futures with equities and bonds is negative for almost all time horizons but in particular for longer horizons. This single feature should be enough to attract any serious investor into the asset class, as it provides large diversification benefits.

But Rogers isn't a long-term bull on commodities simply because of past excess returns or diversification matters; he believes that agriculture products are becoming ever scarcer as the younger generations are heading towards Wall Street rather than the farmyard. The average age of a farmer is 58 in America and 66 in Japan. The trend has been going on for some time now. In the particular case of cocoa, the living conditions of farmers in the Ivory Coast and Ghana are so primitive that if nothing is done Nestle and Mondelez will have to find alternative ways of producing chocolate without cocoa. With this in mind, on November 4, 2010, speaking at Balliol College, Oxford, Rogers urged students to scrap their career plans of going to Wall Street and the City and to study agriculture and mining instead, because he believes that "the power is shifting again from the financial centres to the producers of real goods".

The current bear market for commodities doesn't change Rogers' mind. He still believes agriculture products will be the future and that investors should reserve 10% of their portfolios for them. Regarding other commodities, he prefers to wait and see before jumping into the market: "I guess I would buy agriculture with both feet, energy with a toe and watch the others", he says. The current market conditions have been unfavourable but the huge cutbacks in supply will start playing out in time. "You can have a bull market with flat demand or even declining demand if supply is not there", he acknowledges.

"THE AVERAGE AGE OF A FARMER IS 58 IN AMERICA AND 66 IN JAPAN. THE TREND HAS BEEN GOING ON FOR SOME TIME NOW."

Rogers believes that wealth lies in owning real assets such as commodities. Central banks may play with the economy and create boom and bust that spreads throughout all asset classes, including commodities, but in the longer term cocoa and sugar are not going into financial distress and don't need an upgrade to version 5S or 6 to continue engaging customers. The current downtrend is certainly not done yet but a few commodities are starting to look undervalued.

BY SAMUEL RAE

CURRENCY CORNER

CURRENCY AND THE COMMODITIES SLUMP

Global commodities markets have had a rough half decade. Industrial metals such as copper and nickel are down more than 50% on 2012 highs. Soft commodities mirror this decline. Precious metals – well, let's not even talk about precious metals. Oversupply, favorable conditions and stockpiling are just three of the many factors that contributed to the current commodity slump, and analysts don't expect markets to get any reprieve any time soon – with one exception, which we'll get to shortly. As currency traders, then, how can we factor this slump into our operations?

To answer this question, we must first answer another: how does the price of a commodity affect the currency of a nation? There's a pretty simple answer to this, and some pretty well known correlations we can us to form a bias. Here goes...

First, then, let's look at oil. I expect oil to range between $30-50 throughout the majority of this year, as supply stays its course and weighs on the spot price. The first of our correlations is oil and the Canadian dollar. Canada exports a lot more oil than it imports, and its currency is tightly correlated to the price of crude. When crude strengthens, the Canadian dollar picks up. When crude weakens, the reverse is true. With my expectations for weak oil spanning the next twelve months, I'm working on a fundamentally driven bearish CAD bias throughout at least the first half of 2016.

> **"HOW DOES THE PRICE OF A COMMODITY AFFECT THE CURRENCY OF A NATION? THERE'S A PRETTY SIMPLE ANSWER TO THIS, AND SOME PRETTY WELL KNOWN CORRELATIONS WE CAN US TO FORM A BIAS."**

Next, gold. This is the exception I discussed briefly in the introduction to this piece. In my opinion, gold is just around the corner from a long overdue turnaround. Why? Sentiment. Global markets have gained strength for the past five or so years, and even with the correction we've seen across the first few weeks in January, they remain very much in overbought territory (I believe). The US economy, while at first glance looking strong, has some pretty alarming underlying fundamentals (no inflation, rising claims etc.). The Eurozone is about to fall off a cliff and Germany, traditionally its keystone state, is suffering from the slowdown in China and the implications of this slowdown on its manufacturing industry, exports etc. Asia is in real trouble with the aforementioned China shifting its economy to a consumer, rather than manufacturing, driven one, and the implications this has for its import scale.

It's not going to take much for the next recession to become a self-fulfilling prophecy. Imagine a 20% decline in the stock markets –


1.34
1.35
1.36
1.37

something that is not unrealistic given current conditions. Imagine what that would do to an individual's portfolio, and his or her perception of their wealth. Now multiply that out on a global scale, and we've got a huge negative wealth effect rooted in equity market volatility. Given this wealth effect, it will take very little for consumption to dry up and, in turn, output to decline.

The minute this starts to happen, risk sentiment will shift from the risk-on attitudes of business and consumers enjoyed over the last five years to risk-off, very quickly. Gold is very much a benefactor of this shift, and spot gold prices could jump if and when it occurs. It's also very tightly correlated with the Aussie dollar. Australia mines and processes a huge amount of gold, which it then exports to Asia, the US and Europe. When gold rises, the Australian economy benefits, and in turn, the Aussie dollar strengthens. For me, this translates to a medium to long term (six months to two years) bullish AUD bias.

These are the easy ones – there are some that are not so clear. New Zealand is generally correlated with its Aussie neighbor, but relies heavily on Chinese demand for its meat and dairy products to bolster its export revenues. Chinese demand is falling fast, and this could weigh on the NZD, even as the AUD rises.

Japan, on the other hand, is a net importer, and its ability to pick up commodities at discount rates should (theoretically) boost its national output. In turn, this should boost the value of the yen. Its current economic policy, however, is very much geared towards yen weakening to boost exports. Without these policies in place, and if Japan moves to strengthen its currency, one of the top trades of the year could be short CAD/JPY, as Japan benefits from weak commodity prices and Canada takes a hit on low oil. If this scenario plays out, it's one to watch.

All said, weak commodities won't last forever – simple supply and demand economics will take care of that. There is, however, a medium-term opportunity to incorporate their current weakness into market activity and form some pretty solid biases across the currency markets.

Let's see how things play out.

BY VICTOR HILL

OPPORTUNITIES IN FOCUS

DEFLATION? IT'S BEHIND YOU!

If, like me, you've spent your entire adult life fearing inflation as the universal bogie, welcome to the pantomime world of Post-Modern economics. Because there's another bogie even worse: it's called deflation. For those of you who are not familiar with the great British tradition of Christmas pantomime, the heroes of the drama innocently face the audience, while the monster always sneaks up from behind. And the kids all shriek: It's behind you!

Let's be clear about terms. *Inflation* is the rate at which the price level rises over a given period (normally a year); *deflation* is the exact opposite: the rate at which the price level falls. (*Disinflation* – insofar as economists agree at all – is the rate at which inflation falls and is an intellectual nonsense that should be ripped out of the economic textbooks.)

Why all the fuss about deflation?

In the brave new world that emerged after the dust clouds of the Credit Crunch dispersed, *monetary policy*, previously the domain of academic economists, took centre stage. Just as *demand management* (to obtain full employment), the universal mantra from the 1940s to the late 1970s, gave way to *the fight against inflation* in the 1980s, and then to *sustainable non-inflationary economic growth* from the 1990s to the first years of the new century, so changing economic conditions have heralded new economic priorities.

In the September 2015 edition of this magazine (*Interest Rates are Due to Rise – or Maybe Not*) I reflected that central bank chiefs, these days, are more prominent and more influential than finance ministers. The world is actually now run by this high priesthood of unelected sages whose awesome responsibility it is (exercised largely away from the prying eyes of elected legislatures) to do three things.

They set interest rates (essentially, they fix the price of money); they regulate the banking system; and (most obscurely) they maintain price stability. But in practice, these three things amount to *managing the money supply*. Put very crudely, too much money in the system (and most money is in the form of credit) and prices go up (inflation). Too little money in the system and prices go down (deflation).

The arts they use in the pursuit of price stability are obscure. As well as setting interest rates central banks engage in *open market operations*. They can lend money to banks (*inject liquidity*); they can buy banks' bonds; or they can tell their counterparts in the Treasury to issue bonds which they then buy with invented money. As I said before, central banks make the illusionist David Blaine look like an amateur: they can conjure cash out of thin air.

"CENTRAL BANK CHIEFS, THESE DAYS, ARE MORE PROMINENT AND MORE INFLUENTIAL THAN FINANCE MINISTERS."

The politicians have outsourced to their central banks the task of avoiding deflation because economists know from history that deflation can erupt from three scenarios.

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

Moreover, as now, there are always calls after bank failures for bank capital adequacy requirements to be tightened up. You may very well think that is sensible – HBOS and others were woefully under-capitalised before the Crunch. Hence, Basel II was upgraded to Basel III, by terms of which banks had to further increase their risk buffers against loan losses and, for the first time, to maintain *liquidity buffers*. Sensible, you may think; but all this accelerates bank *de-leveraging* (shrinking the balance sheet).

That much-loved British bank, RBS, is a case in point. Its balance sheet is currently well below half the size of what it was in 2007 – and it is still getting smaller. As banks deleverage, remember, they suck money out of the financial system, so the money supply declines.

Secondly, deflation can occur, as in the USA in the 1870s, in times of rapid mechanisation, when labour costs are falling as a result of technological innovation. Does that sound familiar? We are only now beginning to realise that much of the current labour market will be robotised over the next quarter century. Barely a day goes by without news of self-driving cars. So that's a few million cab drivers on the dole.

In the late 19th century, the American experience was related to the opening up of the grain belts of the mid-West by the railroad, which pushed down unit labour costs. Pioneer farmers who had brought farmland from the Federal Government, financed largely by debt, were appalled to find that the value of their real estate, as well as the foodstuffs they sold, was falling in price and thus making their bank debt more difficult to service.

Thirdly, there has been *de facto* deflation in a swathe of consumer products in the first years of this century as a result of cheap imported goods from China, India, Vietnam and the rest. Go to *Primark* and check it out. Basic clothes and shoes are historically inexpensive, as is food. Much as dairy farmers complain (with good reason), the price of milk in the supermarket continues to fall. At 89 pence (ASDA, last week) for four pints of semi-skimmed, every cow must be a liability. No wonder *The Archers* (BBC R4) are in a funk.

The current precipitous oil price collapse, which started around Q1 2015, is certainly deflationary. As I write, the oil price has fallen well below the psychologically important US$30 per barrel threshold – its lowest level for 12 years. Yet a low oil price, of itself, should be a cause of jubilation. How good to fill one's tank for less than £1 per litre. And think of the benefits for manufacturers, logistics companies, retailers and airlines. But the dramatic and sudden fall in the oil price and, given the supply side, the concerns that it may not go back up again in the medium term, have triggered deep anxieties that this will be the catalyst for a major global deflation.

Let's be clear: fear of deflation drives deflation (it's the same with its opposite, inflation). Let's call this phenomenon: *deflationary expectations*. (There is probably an academic economist out there who coined that phrase before I did, but I'll take credit for it for now.) Recall President Franklin D. Roosevelt's line about how *we have nothing to fear but fear itself*.

“DEFLATION CAN OCCUR, AS IN THE USA IN THE 1870S, IN TIMES OF RAPID MECHANISATION, WHEN LABOUR COSTS ARE FALLING AS A RESULT OF TECHNOLOGICAL INNOVATION. DOES THAT SOUND FAMILIAR?”

Commodities across the board, as you will read elsewhere in this issue, are in free-fall. But I am not persuaded that the collapse in the oil price is part of some overall decline in commodities in general, which would be entailed in a

"GLOBALLY, THE RATIO OF NEW WORKERS ENTERING THE LABOUR MARKET TO THE NUMBER OF MATURE WORKERS WITHDRAWING (DUE TO DEATH, ALTERNATIVE LIFESTYLES OR CONVENTIONAL RETIREMENT) FROM THE LABOUR MARKET IS DECLINING."

major global economic slow-down. The supply side of the oil equation is relatively easy to manipulate for political reasons, in a way that the price of cocoa (for example) is not. My own take is that the Saudis originally started to increase production (supply) to spite the US frackers, but then realised that a sustained bear market in oil might take out some of their more conventional competitors as well. Plans to exploit the Arctic Ocean for its huge as yet untapped reserves (principally by the Russians) have been shelved. (Excuse the pun – Arctic Shelf... Never mind).

Fourthly, demographic changes are driving a fundamental re-balancing of the global economy. Many recent studies show that, currently, global demographics are conducive to deflation as the baby boomers retire. Globally, the ratio of new workers entering the labour market to the number of mature workers withdrawing (due to death, *alternative lifestyles* or conventional retirement) from the labour market is declining. At some point in the next 20 years it will fall below 1:1. That's what armchair economists call a *tipping point*.

In fact, this critical, but little monitored ratio, has already fallen below 1:1 in Japan, which is, in so many ways, the only model that we have of what life is likely to be like in the world of Post-Modern, Post-Keynesian economics. I believe that we are now beginning to see that even *Abenomics* – quantitative easing on steroids, damn the consequences – will not return Japan to long-term growth, despite unparalleled levels of productivity. Ultimately, if Japan wants to grow, it will have to import people – which it is culturally and politically disinclined to do. Therefore, logically, it should manage GDP decline as the population declines in a way that maintains, if not improves, the quality of life for its people.

If Japan could do this it might indeed become a model to other nations which face similar demographic challenges, like Germany. It is already becoming a world leader in robotics – of necessity. Robots already care for old folk and even pets in Tokyo. Though there is a snag with this scenario. Japan already has a debt-to-GDP ratio of around 225% and as the economy shrinks, this will grow. Admittedly – a key strength – nearly all of this debt is domestic, as the fiscal regulations benefit citizens who lend to the Government. But there will come a point when the interest payments on this debt become unsustainable, even if super-low interest rates are perpetuated. Default would hit retirees worst: all those good people who have providently prepared for their old age by patriotically lending to the nation.

Granted, the world's population is still getting bigger (though the rate of growth is slowing). But it is also getting older – fast[i]. People about to retire tend to stash cash and, once in retirement, they curtail consumption. (This is all linked to economists' notion of *the consumption function* – the idea that, over their lifetime, people save while in employment and dis-save in retirement.) An ageing global population is deflationary; but the impulse towards deflation (because of *deflationary expectations*) will manifest itself well before the *tipping point* occurs.

"THE CHIMERA OF THE INFINITE WELFARE STATE WILL DIE SUDDENLY, NOT BECAUSE BRAVE POLITICIANS TAKE DELIBERATE ACTION, BUT BECAUSE THE GOVERNMENTS OF LIBERAL DEFLATIONARY STATES HAVE NO MORE CASH MACHINE."

Would global deflation really be so terrible? The policy makers fear deflation even more than their former enemy, inflation – because they think that it would render the management of government finances a nightmare. And they are right. This is especially problematic for debt-laden governments, which would struggle to service their debt repayments as the economy contracts and tax revenues dwindle.

And after just a few years of creeping deflation, the finances of already debt-strapped governments would go into melt-down. Tax receipts would dwindle though spending commitments would initially be sustained. (Look at the so-called advanced European economies after the 2008 Crash: they proved quite incapable of cutting welfare. Despite years of bluster about *austerity* in the UK, Lord Sugar and Rupert Murdoch will still receive generous *winter fuel payments* come December.) Therefore deficits will burgeon further at a time when debt-to-GDP ratios are already under severe strain. Over time, the situation will only get worse.

Down they all would go, one after another, like a row of skittles; Japan technically defaulting amongst the first; France, of course, the United Kingdom, all of the Eurozone, even immigrant-loving Germany. And they would take the bond and stock markets with them. The chimera of the infinite welfare state will die suddenly, not because brave politicians take deliberate action, but because the governments of liberal deflationary states have no more cash machine.

I wrote about sovereign default at some length back in the MI Magazine of July last year (*Sovereign Default is a Funny Old Business*). Spain has gone bust about six times since the Napoleonic Wars. But a modern "welfare state", which Spain is, has not really gone under yet (we'll put Greece in a separate box). The consequences for the millions who have been weaned on unlimited welfare will not be happy.

And there is another economic reason for concern. John Maynard Keynes, in the *General Theory* of 1936, points out that there is an apparent asymmetry between inflation and deflation. Inflation, he says, just effects prices. But deflation diminishes both prices *and employment*[ii]. This is because, in the Keynesian model, deflation stifles investment and therefore reduces demand. I admit that many right-of-centre economists these days are dubious about Keynes's policy prescriptions (deficit spending, and so on). But his fundamental model of how the economy works is still very influential.

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

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

I was researching this last year when I downloaded a remarkable spreadsheet from one of the outposts of the US Federal Reserve. In fact, in the USA, over the 214 years between 1800 and 2014 for which we have data, *in no fewer than 54 of those years the price level fell*[iii]. Though, for my peers who gained economic consciousness in the late 1970s, it will always seem that inflation is the ogre.

My parents' generation, who came into the labour market just after the end of WWII, rode an inflationary escalator for virtually all of their working lives. This enabled them to buy houses with borrowed money and to watch as the value of those houses steadily rose and the relative value of their original debt declined. Moreover, as the value of their wages rose in real terms, the burden of servicing that debt grew lighter as a result of persistent inflation. All this was possible despite

"ULTIMATELY, QE DOESN'T ACTUALLY CREATE VALUE, IT JUST MAINTAINS CONFIDENCE. AND THAT CONFIDENCE IS NOW EBBING. "

nominal interest rates of 8-12% which then obtained.

But just imagine a world in which this scenario is reversed. Putting aside the problem that most young people can't afford to enter the property market today, suppose that a young professional couple scrape together sufficient finance to purchase a median level London flat (which would cost them nearly £500,000 today) with a 25% deposit. They then spend the next 25 years repaying their £375,000 mortgage on declining wages as the value of their flat declines, putting them into negative equity, with little chance of escape. (A deflationary property market seizes up: once liquidity is drained there is no natural floor, and prices just keep falling. The Spanish residential property market over 2007-12 is such a case study.)

The response to the deflationary threat, of course, has been a historically unprecedented programme of money creation by central banks called *quantitative easing* or QE. True, QE may now be *officially* over in the USA and the UK, but in Japan the central bank's foot is hard down on the accelerator, and the money printers are working round the clock. Back in Europe, the European Central Bank (ECB) Chief Mario Draghi announced on 22 January that QE in the Eurozone will be ramped up further. The ECB, it seems, is even buying Eurozone government bonds – much against the Germans' better instincts.

Here in the UK, Bank of England Governor Mark Carney is agnostic on QE; but, as his tenure has evolved, the signals on the future of interest rates (and of future QE) have grown more obscure. So that's all right then. Central banks will pump money into the system by buying government bonds (whatever) and price stability will be maintained.

Except that, just as hiking interest rates to combat inflation is often termed a *blunt instrument* by economists because it kills investment, QE may also be regarded as crude. With interest rates at effectively zero or negative, savings are dis-incentivised and, ultimately, investment is funded by savings. The tangible outcome of five to seven years of printing money has been that asset prices (houses and the stock market) have exploded – great news for the rich, of course – but with no real change to the volume of corporate investment which drives growth.

Ultimately, QE doesn't actually create value, *it just maintains confidence*. And that confidence is now ebbing. Arguably, as the macro hedge fund manager Hugh Hendry has argued, QE stimulates growth in one part of the world economy while taking it away from another[iv]. Hendry thinks the rise in US growth was directly related to the fall in growth in China. So it's not just a zero-sum game; it's a sleight of hand. If QE was a long-term wonder-cure, you would expect Japan (ferociously conscientious workforce, state-of-the-art technology) to be doing better.

One view is that QE has *diminishing marginal returns*. The more you do it, the less it works. Like the druggie who finds that he needs a bigger and bigger dose to get the same kick. Money creation in this way may be ultimately ineffective – much of it ends up on the bloated balance sheets of the central banks themselves, who hold deposits of currency with one another! Very little of this wave of new money seems to have found its way into new investment.

So there is a possibility that, even despite QE, or even QEII, deflation may gain traction anyway. This is especially so in the Eurozone where, frankly, normal growth is unlikely to be resumed until the inherent structural problems of monetary union are resolved. And they are unlikely to be resolved in the short term. In a Reinholt-Rogoff[v] perspective, the Eurozone is a classic emerging market which is likely *collectively or partially* to default sometime soon.

The USA would probably escape official default by bilateral negotiations with its largest creditor (China) as it still holds, for now, the trump card of the world's most desired currency. But it would not emerge as the sole global superpower. Perhaps there are parties for whom such an outcome is devoutly to be wished.

What are the chances of this scenario becoming reality? The odds have been rising of late as a number of financial pigeons come home to roost. George Osborne is right to be worried about a cocktail of risks. My own view is that, over the three to ten year window (crystal ball territory, I admit), unless there is some fundamental development that I cannot foresee that changes the model (and there often is), it is now more likely than not.

When Gordon Brown handed over control of interest rates to the Bank of England in 1997 – following the trend in other major economies – we thought that the Old Lady of Threadneedle Street would be compelled to set a *natural rate of interest* – that, is technically, one which keeps savings and investments in equilibrium. That is not how things have turned out. Instead, the model changed. Central banks, like health and safety nannies wearing high-viz jackets, just set rates that would minimise risk for the children.

What do rational money managers do if they fear deflation? Of course they pay down debt. Household debt has been rising again in the UK. But if you have the cash, it may be a good idea to pay off your mortgage, your credit card balance, your car loans – the lot. A recent research note issued by RBS apparently advised: *sell everything!* In a deflationary world, only cash appreciates in value in real terms as goods decline in price.

Big corporations on both sides of the Atlantic have been deleveraging for some time. But, ay, there's the rub: this deleveraging further accelerates contraction in the money supply and so the fear of deflation risks becoming a self-fulfilling prophecy.

During the great American deflation of the last quarter of the 19th Century, the renowned William Jennings Bryan made a bid for the presidency on the platform of replacing the gold standard with the *silver standard*. The idea was that silver, which was more widely held, could restore price stability. If deflation does take hold you can be sure that the champions of silver will re-emerge, as when the Hunt Brothers tried to corner the silver market in the 1970s (at a time of rampant *inflation*).

I am not sure if it is reassuring to reflect that central bankers probably understand economic history better than finance ministers. But what if they have got it wrong over the last seven years or so? What if they really are facing the audience with those silly two percent inflation targets? And canny investors are the clever kids watching the pantomime closely – the ones who can see things the *Ugly Sisters* can't. *It's behind you!*

i ***Falling populations in richer countries fuel fears for future*, Leo Lewis, The Times, Saturday, 22/11/2014.**

ii ***The General Theory of Employment, Interest and Money*. JM Keynes, Macmillan, 1936. See the final paragraph of Chapter 20, The Employment Function (on page 291 of the 170 Macmillan edition).**

iii **My calculation sheet, based on Fed data is available. The price level data comes from the Federal Reserve Bank of Minneapolis website at: https://www.minneapolisfed.org/community_education/teacher/calc/hist1800.cfm**

iv **MoneyWeek, December 2014.**

v ***This Time is Different*, Carmen M Reinhart & Kenneth S Rogoff, Princeton University Press, 2009.**

BY ADRIAN KEMPTON-CUMBER

TECHNICAL ANALYSIS CORNER

DEFINED BENEFITS BECOME INDEFINABLE LIABILITIES

If you've been paying attention over the last 50 years (or for as many of them as you were around), then it can't have escaped your attention that there is a bit of a problem in the pensions department. I wrote about how The Baby Boomers Stole My Pension in my Final Word column in the November 2015 issue of Master Investor Magazine. The problem is basically a demographic one: a larger than average generation retiring while fewer of us are working to support the ridiculous gold-plated having-a-laugh final salary pension schemes of people who already lucked out by actually living through, if not remembering, the '60s.

We now face (well they don't, but the rest of us still working do) the problem of companies which, in the same way successive governments ignored the well-known demographic time-bomb, have not dealt with the problem of funding these Rolls Royce Cash Cows. This is akin to a successful accumulator bet for which the rest of us are on the wrong side.

Putting actual numbers on these sorts of things is notoriously difficult, but estimates by various pension expert groups make for dismal reading. The fact that there are still defined benefits schemes live today is shocking to me; but either way, their legacy is a very big black hole.

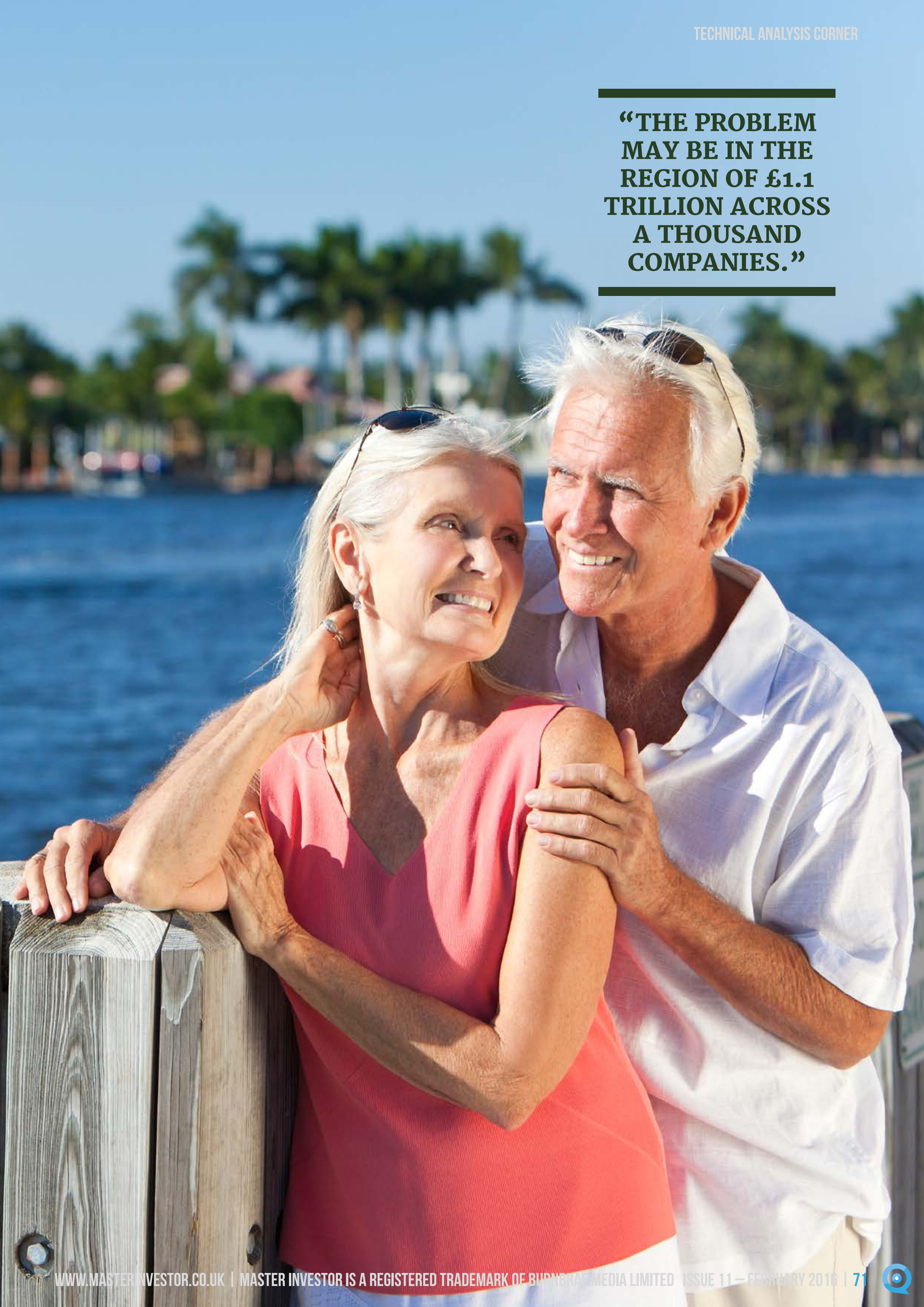
When the financial crisis of 2007 was coming it was seen in investment bank circles as better to get it wrong with everyone else as a trader, than to get it right and be at odds with the majority. So anyone inside the major investment banks who took a stance similar to John Paulson, who masterminded the biggest trade in history by anticipating the sub-prime disaster, became persona non grata. Something like that appears to be happening here. The Pensions Regulator thinks everything will be OK. And that alone should ring alarm bells.

The problem may be in the region of £1.1 trillion across a thousand companies. To give that number some perspective, all the residential housing in the UK amounts to £5.75 trillion. It's a pretty big deal.

Given the regulator is not that bothered, I thought I'd have a look at the numbers and see how right they're getting it, and what the future may likely hold.

Not surprisingly we are at a crossroads. What I've done here is to take the data going back to March 2006 published by the Pension Protection Fund. As the total number of pensions reported varies from month to month, I've created an index based on the overall surplus, or deficit, divided by the number of companies. It was last published to include figures to the end of 2015.

Looking at the Surplus Index first, we can see that it is rather weakly trying to break up above that resistance level. It's falling shy of it though so it's not that encouraging. If we look on the other hand at the Deficit Index then we find a clearer picture,



"THE PROBLEM MAY BE IN THE REGION OF £1.1 TRILLION ACROSS A THOUSAND COMPANIES."

although also incomplete at this time. That looks like a Head + Shoulders to me. That said it would be stronger if the right shoulder was a bit lower, but in fact it's higher than the left shoulder. The MACD is nicely crossing over downwards though, which would support a move down.

If the H+S plays out it will mean the break out on the Surplus chart also works. That being the case, disaster will have been narrowly averted, at least for a few years. It's a fairly trending chart, too, so we might expect the MACD to work here, as it has in the past, supporting the move where the crossover takes place. As far as the Surplus Index goes, the Higher Lows are encouraging. However, the MACD is not so convincing here.

As with all these things you can find people who will say that some companies could be brought down by this toxic pension debt. More than a few companies in the FTSE 100 have pension liabilities which exceed their market value! Bizarrely 23 companies in the FTSE 100 still offer defined benefits schemes to employees. In spite of the confidence of the regulator, JLT Employee Benefits' research suggests that as many as 25 of the largest UK companies are "highly unlikely" to honour their pension commitments adequately. Yikes!

The companies affected by shortfalls equivalent to their market value include **BAE (BA.)**, **BT (BT.A)** and **IAG (IAG)**. Not much of a surprise there, I suppose, because they were once government corporations, and no doubt the pensions from that era are very generous indeed.

I would be very surprised if only a few companies went to the wall as a result of this. It only takes a perfect storm for those companies to deteriorate, and almost whatever happens is likely to be a perfect storm for one company or another. Imagine **Sainsbury (SBRY)** or BT being up for grabs in a pension debt fire sale. The government may well end up having to step in to sweeten the deal and guarantee those pension benefits themselves, by which I mean, of course, ourselves, the tax payers.

Given that most of these companies will likely see smaller, more efficient workforces over time, there will be lower and lower contributions to those schemes that remain open. Lower contributions are one of the problem factors – and it's not restricted to the UK. There are systemic problems in the US, too, where public pension plans have $1 trillion of unfunded liabilities. Over half of all states fail the test level of fiscal soundness, which means a funded ratio of less than 70%.

Low interest rates mean that those already retired are seeing their pension income not being eroded by inflation, and their bricks and mortar earning far more than they probably ever did. I guess they don't have to worry which of those bubbles bursts first unless they've leveraged their property.

Either way we should know in the next six to nine months if the H+S has held up on the Deficit Index and pension liabilities are decreasing or not. It really is a mine field for every employee now. It is becoming more and more an imperative to manage your own destiny, and therefore pension fund.

You should have seen in my articles over the months that I will use TA on about anything. I correctly predicted a mild winter back in October using TA on the weather. I've used it to analyse company directors, Corporation Tax and so on. The point is that it is a very useful tool that is by no means limited to the share price alone. Of course, it takes a bit of leg work in the sense that these figures have to be modelled into data sets that can be manipulated using TA. But it can be done if you're prepared to put a bit of time and effort in. Think outside the box.

Pension Surplus Index (created using TradeStation)

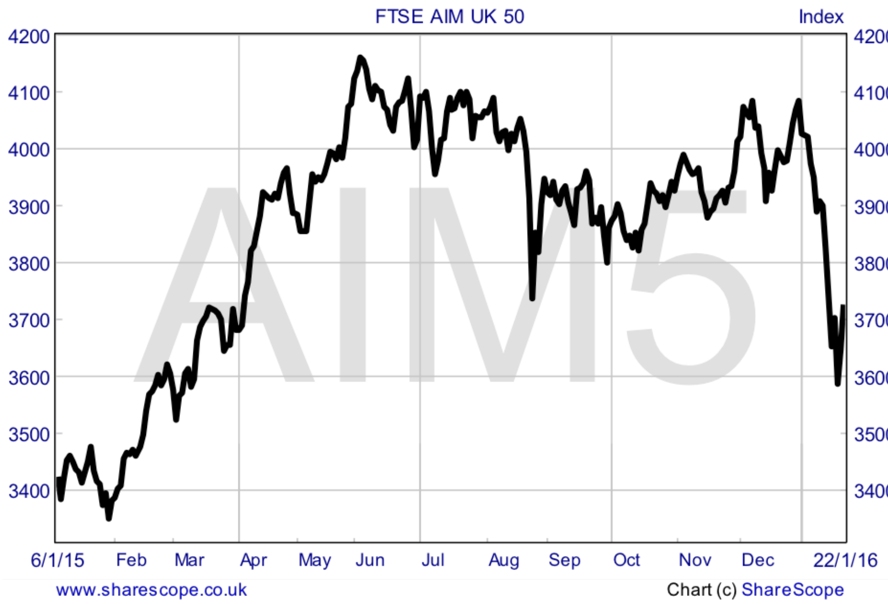
Pension Deficit Index (created using TradeStation)

"I WOULD BE VERY SURPRISED IF ONLY A FEW COMPANIES WENT TO THE WALL AS A RESULT OF THIS."

BY RICHARD GILL, CFA

SMALL-CAP CORNER

TRADING OPPORTUNITIES AMONGST THE SMALL-CAP BLUE-CHIPS



As I mentioned in last month's Master Investor Magazine, 2015 was not a good year in general for small-cap investors. Scandals at Quindell and Globo rocked the market and the commodity sector crash destroyed the share prices of numerous small-cap resources companies. While the AIM All Share index showed a modest gain, the majority of shares on an individual basis actually lost money.

In contrast, the larger companies listed on AIM had a very good year. The AIM 50 Index – which unsurprisingly is comprised of the 50 largest AIM companies – showed an 18.6% gain over 2015, significantly outperforming the FTSE 100, the FTSE 250 and wider small-cap indices. Driving the performance were a 34% gain from online fashion business and the indexes' largest constituent **ASOS (ASC)**, a doubling in value at airline owner **Dart Group (DTG)** and a 50% gain from floorings retailer **James Halstead (JHD)**.

However, as the chart above demonstrates, in 2016 the index has fallen back sharply (down by 8.8% in the year to date as I write) as a result of the wider market turmoil. As such I see a few interesting buying opportunities amongst the AIM "blue-chips". Then again, I also see downside potential for one stock in particular.

CONVIVIALITY

Selling cheap booze has always been a lucrative business. Sell it to Northerners and you've got a potential goldmine on your hands (I should know – I'm from Bradford).

This is exactly how **Conviviality (CVR)** began life, setting up its first Bargain Booze branded off licence in Cheshire in 1981. The firm flourished and in July 2013 listed on AIM (under the name Conviviality Retail) with a portfolio of 611 stores. The firm does not run the stores itself, however, but runs a franchise model, generating income primarily from wholesaling stock to its franchisees, as well as earning franchise fees.

The business has expanded significantly by acquisition during its time as a public company. The first deal came in September 2013 when Wine Rack, a retailer of wine, spirits, tobacco and related products, was purchased for £1.65

million. This was in line with the firm's strategy to expand its wine business, as well as to widen its presence in the South of England from its traditional North-West base. The deal brought with it 22 stores, mainly located in the Greater London area.

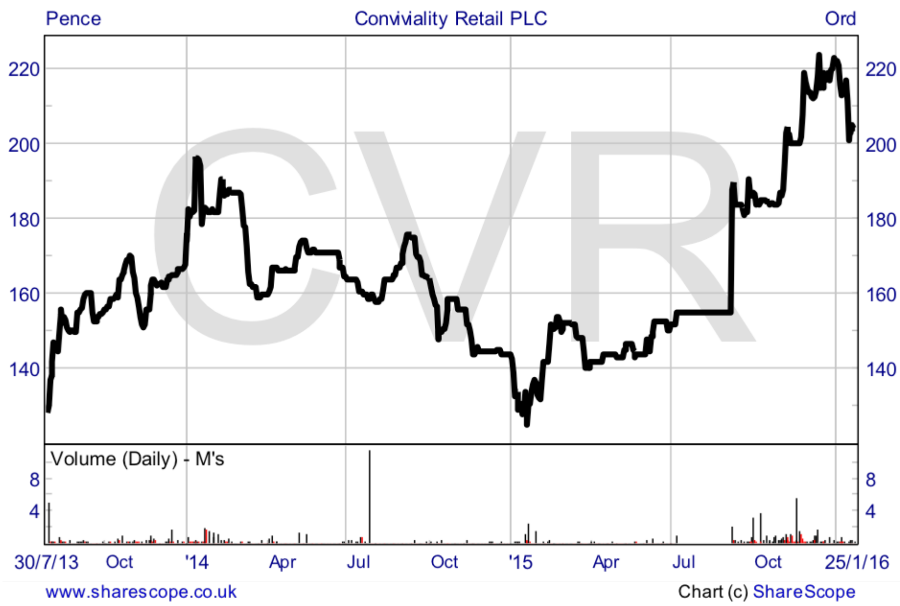
May 2014 saw the £1.7 million acquisition of Rhythm and Booze, an alcohol retailer with 31 stores in Yorkshire and the North East. Then in February 2015 Conviviality spent £6 million on GT News, an independent convenience retailer with 37 stores largely in the East Midlands and Yorkshire. All these have since been rebranded under the company's own trading names.

Company making deal

But the most significant acquisition in the company's history came in September last year when Conviviality agreed to buy the alcohol and soft drinks wholesaler Matthew Clark, for an enterprise value of £200 million. To pay for the deal, which amounted to a reverse takeover under AIM rules, £130 million was raised in a placing at 150p per share, and £80 million of new bank facilities were agreed.

Matthew Clark supplies its wares to around 17,000 on-trade premises around the UK (such as pubs, bars, hotels, and restaurants) via its nationwide distribution network. In the year to 28th February 2015, it made revenues of £811.2 million and adjusted EBITDA of £25.3 million after delivering 48 million bottles of wine, 22 million bottles of spirits, 171 million pints of beer and 16 million bottles of cider.

The deal creates an enlarged business with combined annual sales of over £1.1 billion, making it a major player in the UK on-trade and off-trade drinks wholesaling industry. Crucially, the business is independent of major drinks brands, which lets it supply an unrestricted selection of products to its customers. Significant synergies are expected to be achieved via increased buying power, cross selling products, combining distribution networks and other operational efficiencies, with the



deal expected to be earnings enhancing from the first full year of ownership (financial year 2017).

Following completion of the deal the business changed its name from Conviviality Retail to just Conviviality in order to reflect the nature of the expanded operations.

Recent trading

The first results since the reverse takeover confirmed that total sales had grown by 38% to £252 million in the 27 weeks to 1st November. The Conviviality Retail business grew sales by 4.4% in the period. Like-for-like sales were down by 1.3% but did improve on the 1.7% fall seen in the year to November 2015. However, like-for-likes were up by 5.3% at Wine Rack and the overall store opening pipeline is said to be strong for the remainder of the year.

"THE SHARES HAVE MORE THAN DOUBLED FROM THEIR IPO PRICE OF 100P."

Matthew Clark contributed £61 million of revenues since its acquisition on 7th October, up by 3.4% compared to the same period in the previous year. Good progress is said to have been made integrating the business, with plans being significantly ahead of schedule. As expected, net debt rose, to £98.5 million at the period end, reflecting borrowings taken on for the acquisition. Overall, Conviviality continues to perform in line with market expectations for the full year to 1st May.

Bargain Booze, bargain shares?

Conviviality has performed well as a public company through consistently hitting market forecasts and with management showing that they have a sound and successful business plan. The shares have more than doubled from their IPO price of 100p, with a substantial part of these gains coming on the back of the market's reaction to the Matthew Clark acquisition.

At the current price of 204p per share Conviviality is capitalised at £317 million and trades on a multiple of 15 times market forecasts for around 13.5p of earnings in the year to 1st May 2016. The multiple falls to 11.1 times for 2017 as the first full year of trading from Matthew Clark comes through. For a solid growth company that looks like a good value rating in my opinion.

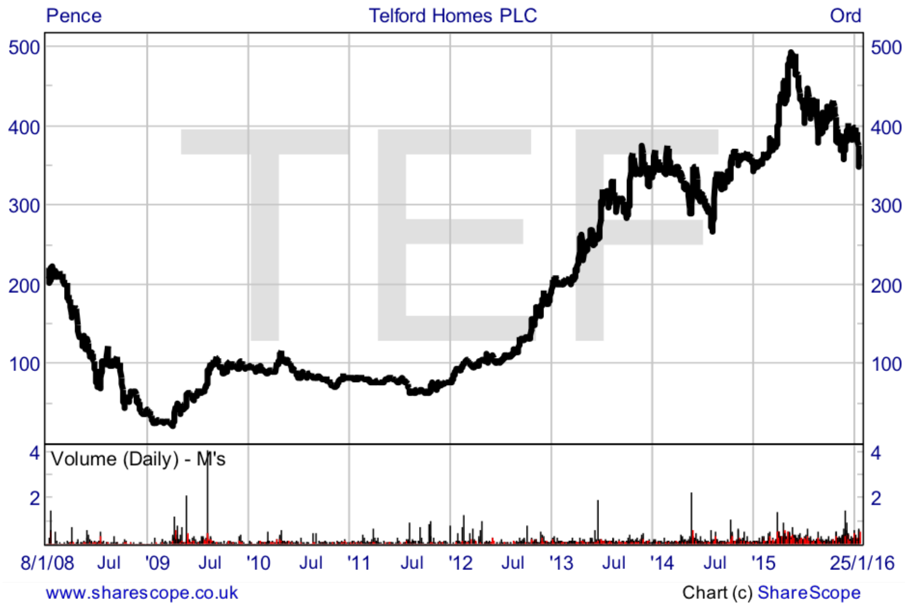
Broker WH Ireland has a 250p target price for the shares, implying 22.5% upside. There is also a decent dividend yield of 4.2% on offer should, as expected, an 8.5p payment be made for 2016. I see potential for further increases in the dividend given the company's progressive policy and forecast earnings growth. **For steady long-term growth and income the shares look like a decent buy and hold.**

TELFORD HOMES

There aren't many sectors which have performed better than Home Construction since the markets bottomed out in March 2009. Investors have seen gains of 932% from **Barratt Developments (BDEV)**, 893% from **Taylor Wimpey (TW.)** and a range of triple digit profits elsewhere in the sector.

telfordhomes

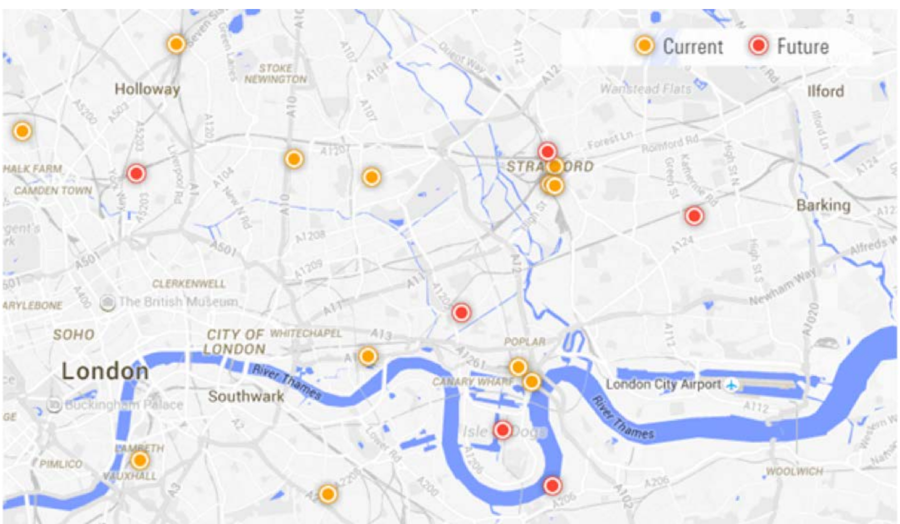
Outperforming them all is AIM listed **Telford Homes (TEF)** whose shares have gained a stunning 1,272% since 1st March 2009. However, despite the company having just posted a record set of results and having made a decent acquisition, the shares have fallen by 27% since June last year. As such, I see a good buying opportunity here.



"TELFORD IS NOW TARGETING AN ANNUAL PRE-TAX PROFIT OF £45 MILLION FROM 2019, INCREASING TO £60 MILLION THEREAFTER."

Building growth

Telford Homes is a London focussed residential property developer. Unlike many of its competitors, however, it has a focus on inner-city areas, away from the so called "prime" locations of the City, Central and West-End where prices have been bid up to silly levels by Russian oligarchs and Saudi billionaires. The company's current pipeline consists of developments in areas such as Stratford, Camden and Canary Wharf. Prices have also been bid up in these areas too – this time due to the likes of affluent hipsters, financial services workers and buy-to-let entrepreneurs.



But as the London market continues to suffer from a fundamental lack of supply, and helped by record low mortgage rates and increasingly lengthy mortgage terms on the demand side, Telford is able to make sizeable profits in these locations. In the six months to September 2015 pre-tax profits more than doubled to £21 million after the firm completed 282 open market transactions, up from 140 in the first half of the previous year.

Last year was an important one for Telford as it put together a number of initiatives to both sustain and drive long-term growth. Firstly, in March 2015 a new £180 million corporate loan was arranged with a number of banks to replace a £120 million facility and to provide the funds for further site purchases and development. Then in October the company raised £50 million in a placing at 360p per share. The funds are to be used for acquiring new developments and are expected to be fully committed within a year.

There was also an acquisition in the year, with the company buying the regeneration business of United House Developments (UHD) for £23 million. UHD has interests in four developments in North and East London, located at Finsbury Park, Poplar and near where I live at the Royal Albert Dock. Overall, while the developments are at various stages in the planning process, the company believes the UHD assets have the combined potential to add c. £500 million to the firm's total development pipeline.

As a result of the recent actions Telford is now targeting an annual pre-tax profit of £45 million from 2019, increasing to £60 million thereafter.

Des res. Computer generated image of interior at the Finsbury Park development. Source: Company website

Safe as houses?

Boosted by the Conservatives' general election victory, shares in Telford Homes hit an all-time high of 492p last year. But they have slipped back to 363p following the recent market turmoil and as investors have had concerns over the pace at which the London property market will continue to grow. I believe that the fall has been overdone and that Telford looks one of the most attractive opportunities in the sector.

There is good earnings visibility here with the development pipeline being worth over £1.5 billion of revenues. There are also forward sales of more than £700 million to be recognised from the 2016 financial year onwards, equivalent to four years of historic annual sales. Gearing was just 37.3% as at 30th September. This is expected to increase due to investment in site development but should remain well beneath the banking covenant of 150%.

Despite this, Telford trades on a multiple of just 9.9 times consensus market forecasts for 2017 and yields 4.4% for the year. These figures compare favourably to the rest of the sector. **Combined with the highly achievable medium-term profit targets, that makes shares in Telford Homes a buy**.

FEVERTREE DRINKS

Founded in 2005, Fevertree Drinks has a simple business model. It makes, markets and sells premium carbonated mixers for use with alcoholic spirits to a range of customers including hotels, restaurants, bars, cafes and retail outlets. The company's focus is on providing high quality drinks, only made with natural ingredients, for consumers who have trended towards buying more premium quality spirits. Core products include a range of tonics, mainly used for mixing with gin and vodka, along with lemonades, ginger ale and ginger beer. The firm has won a raft of industry awards for its brand, products and business success.

While the company focuses on the development, marketing and selling of its products, manufacturing is outsourced. This is mainly to a UK based bottler, although in 2014 an operation was signed up in Germany, which uses reusable glass bottles which are required in that market.

In the last financial year Fevertree made around 70% of its sales from outside of the UK, with the firm distributing to c.50 countries, including its key markets in the US, Spain and Belgium. The company even sells tonic water to India, the county of its invention – a successful case of selling coal to Newcastle! The UK, however, remains the company's largest geographical market, with products being stocked by key retailers including Waitrose, Tesco and Fortnum & Mason, amongst many others.

Fevertree operates in a global mixer market which, according to consultants EY, is estimated to be worth a retail value of £7.7 billion. However, the premium mixer segment in which the company operates makes up just 2-2.5% of this and EY sees the proportion rising to 7.9% by 2018.

Win & Tonic

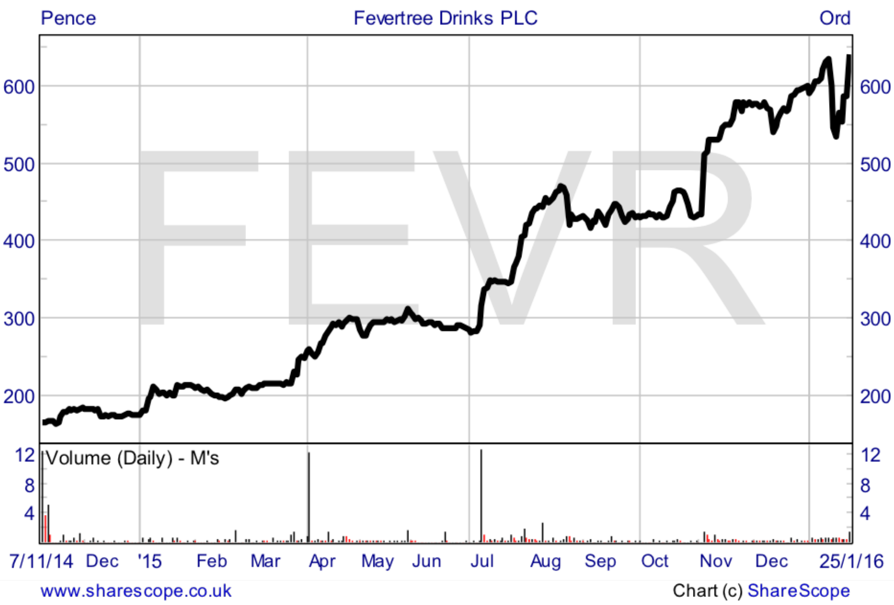
The past few years have seen very strong growth at Fevertree. In just a decade the company has grown to become the world's leading supplier of premium carbonated mixers by sales value. Between 2011 and 2014 revenues grew at a compound annual rate (CAGR) of 43% to £34.7 million. While operating profits were hit by £3.15 million of exceptional expenses in 2013, they grew at a CAGR of 37% over the period.

"THE FIRM HAS WON A RAFT OF INDUSTRY AWARDS FOR ITS BRAND, PRODUCTS AND BUSINESS SUCCESS."

A key moment in Fevertree's history came in November 2014 when the firm listed on AIM. The IPO saw the company raise £87.5 million for selling shareholders – namely private equity firm LDC and Fevertree directors – and just £3 million net for itself. Crucially, a £50 million loan note was converted to equity at IPO, significantly reducing overall borrowings.

Interims for the six months to June 2015 showed further growth, with revenues up by 62% to £24.1 million. Pretax profits rose almost six-fold to £6.6 million, the bottom line being boosted

> **“SHARES IN FEVERTREE HAVE DELIVERED AN OUTSTANDING PERFORMANCE SINCE THE COMPANY LISTED, CURRENTLY TRADING UP BY 337% ON THE IPO PLACING PRICE OF 134P.”**



after finance costs reduced substantially, from £2.6 million to £0.2 million. At the period end, net cash stood at £7.9 million, with operating cashflow being strong at 101% of net profits. An interim dividend of 0.78p per share was declared.

A brief trading update released in late January confirmed that the company had traded strongly in the second half, with 71% sales growth (to £59.2 million) expected for the full year. As a result, numbers for the full year to December will now be comfortably ahead of previous expectations.

Worth a tipple?

Shares in Fevertree have delivered an outstanding performance since the company listed, currently trading up by 337% on the IPO placing price of 134p. The firm has pretty much had a model start to public life, announcing four times in a just over a year that trading would be ahead of previous expectations. And there is no doubt that Fevertree has an excellent business – the brand is strong, the operations are highly profitable and cash generative, capex is low due to outsourcing and there looks to be room for further growth.

The problem I have with the shares is the valuation.

At the current price of 640p Fevertree is capitalised at £738 million. That values the business on a multiple of 49 times forecast earnings for 2016. While growth companies deserve high ratings this looks to price in a lot of good news which hasn't happened yet. Even the price to earnings growth ratio (PEG) for 2016 looks high at 2.7 times – with a figure of 1 being the standard measure for fair value. What's more, the dividend yield on offer is just 0.43% and if we strip intangibles out of the balance sheet net assets are just £14 million.

I conclude with the words of my colleague Simon Cawkwell, who recently commented on Fevertree, *"This is surely staggeringly overrated. But it's a bold bunny that shorts it here. After all, lunacy has taken the price up here. Who's to say the lunatics will not continue hard at it?"*

BY ROBBIE BURNS

ROBBIE BURNS' TRADING DIARY

Well, 2016 has not exactly got off to a distinguished start – at least not in a positive sense! I am sure a lot of investors, even some who thought they were masterful, scratched their heads as the market hurtled down on fears of... well, you name it really... Actually, just name any country – we are all in trouble apparently.

That makes life as a master investor pretty tricky. Sell up? Buy on dips? Go short? Hide behind the sofa? Don't ask me; I can't predict the future and anyone who says they can needs to write or broadcast to make some money.

But hiding behind the sofa actually isn't as silly as it sounds. If you bought a few decent shares now and stuck them away for a couple of years without looking, you may well find a nice surprise waiting for you. There is a tendency in volatile markets to overtrade through trying to second guess what the indices will do next. It is a zero sum game and the chances are you will lose more than you win.

That said, there's nothing wrong with a short on the indices to bring in some money and hedge a long portfolio. This is how I handle it: a short FTSE spreadbet and a short ETF for the ISA. It's worked well so far. If the markets start to rise, I can get out with probably not much damage. If they fall heavily shorts will pay out and cover some of the long money.

I do little in volatile markets. I'm generally happy to ride it out, with the shorts for cover. But I also like to buy my favourites on bad market days when everything is being sold due to fear. So the two I topped up on massive dips were Worldpay and Paysafe. And yes, both of these are in the same sector: electronic payments.

I bought more of both as electronic payments will be one of the sectors of the year and maybe next year, too, and I think there is massive upside in both. Worldpay has just gone into the FTSE 100 and Paysafe has transferred from the AIM market to the main market and so should hit the FTSE 250 in March. We ought to see some funds buying in then.

Out of the two, the smaller company Paysafe probably has more upside. Indeed I tend to wonder whether Paysafe will be around at all by 2018. It would be no surprise if it was bought out, possibly even by Worldpay. It would make a lot of sense – but remember this is pure speculation on my part.

Both companies look to have decent management, good fundamentals and a bright future. While they would of course go down if the market tanks some more, I would continue to buy on the really bad days and buy shares from the Corporal Joneses out there who are panicking.

I'm currently writing a book on market psychology... if you would like to contribute a story for it please contact me at robbiethetrader@aol.com**. Did you lose a lot of money? If so, then why? Did you make a lot of mistakes and learn from them (or not)? If you make good money what makes you such a good trader? How do you think you have used your brain, whether you did well or badly?**

There will be a free copy of the book for anyone whose story I use.

> **"I DO LITTLE IN VOLATILE MARKETS. I'M GENERALLY HAPPY TO RIDE IT OUT, WITH THE SHORTS FOR COVER."**

BY MARIA PSARRA

SCHOOL CORNER

WHAT NOW?

"What now?" many of you have asked me on the face of what has indisputably been the worst start to a year for stock markets in a long time – it has been the worst start for the Dow Jones index in 95 years (if I am not mistaken). So should you sell everything, like RBS analysts recently advised? Should you instead let the market move lower, then buy because, in the words of Goldman Sachs "it will soon be the right time, just not yet"? Should you take advantage of current volatility to make money?

You can do all of the above and be successful or unsuccessful to varying degrees. I do not have your answers – but I do have mine.

Financial markets constantly change as they are largely comprised of human beings, and human beings have feelings. They also have beliefs (founded and unfounded), tend to refuse to change and adapt, and often are in denial of objective reality and convinced that if they only find this one perfect trading system, they will become rich overnight. They just have to pick the right night.

Paul Tudor Jones once said that "in the markets, you have to change and adapt, or die". Now, I started my City career at a proprietary trading desk where some of the world's best traders made huge sums of money by making 100 trades per day each in Fixed Income and Indices Futures. One day that was over: the markets changed in a way that meant that algorithms could perform this task more efficiently than humans. Those who adapted lived through that period, while the rest left the market.

> **"PAUL TUDOR JONES ONCE SAID THAT 'IN THE MARKETS, YOU HAVE TO CHANGE AND ADAPT, OR DIE'."**

I moved to a CFD trading desk where people were making money by trading stocks and indices using 1-2% stops. That "died", too, so I left. Then the stock markets turned bullish, and if you were a reasonably good trader, you could make consistent money by buying stocks that had fundamental value, or alternatively selling-short stocks that did not, using 5% stops and trusting that soon enough the stock's price and value would converge (that is that price will soon revert to the stock's real fundamental value). The time for this strategy has ended, too.

We are currently in an environment where price and value do not converge quickly enough for anyone to make consistent money this way anymore. Why? Because there is too much fear and uncertainty among market participants. Are there fundamental reasons for this? Of course there are. But you can read about these reasons in the Financial Times, Bloomberg, and the rest of the financial press, so I shall spare you from repeating them myself. Instead, I will just describe what I do in this environment.

I still believe in the real fundamental value of certain companies' stock and in the lack of value of certain others. For example, I do see value in Royal Dutch Shell shares. At time of writing, RDSA.L shares offer a dividend yield of 9.43%. The dividend cover is 2.44, which means that the company's net income is enough to pay out the total annual dividend announced to all shareholders more than twice. I personally believe that even though the price of oil may move lower, it will not reach a level where Royal Dutch Shell will stop paying chunky dividends, and go bankrupt. Of course I may be wrong, but I am most happy to take a view, and buy in.


BUY OR SELL??

I also believe that Sainsbury's will soon (today is the 24/01/2016) make an offer for Home Retail, and that Ab Inbev is most likely to buy SABMiller, so I am most happy to hold both Home Retail and SABMiller shares. Of course, these deals may fall through, and then I'll lose money, but once again, this is a risk I am willing to take.

So, if I am still willing to take risks, what has changed in the way I trade/invest? Well, for someone who spent the best part of her career trading short term, I now have a longer timeframe. I have always believed that both in the markets and in life one should go for things they believe in, and stick with them unless proven wrong. This means that in the current market environment, my trading/investing timeframe has moved up from a few days to a few months, years even. My stop loss orders' percentages have also increased. (That is if they are there at all, and they are not for cash equities.) I trust myself to exit when the market proves me wrong.

"I CARE ABOUT VALUE, AND I HAVE THE TIME TO SIT AND WAIT, AND THE MATURITY TO QUESTION MYSELF AND EXIT MY BAD INVESTMENTS WHEN I OUGHT TO."

Would I still use 2 or 5% stops for any of my trades? No. Why would I? The Average True Range (ATR) of many FTSE 100 and 250 stocks is routinely above this these days, so why would I hand money to the markets out of plain fear? I have a view, and until such point when my view changes (and it may), what happens intraday has stopped mattering to me. See, I care about value, and I have the time to sit and wait, and the maturity to question myself and exit my bad investments when I ought to. Not when I am scared, not when I hit an arbitrarily chosen x% stop, BUT when I am really fundamentally wrong. And I have accepted that sometimes I will be.

Do I still trade derivatives? Yes, but given my longer timeframe, sometimes I am better off just buying or selling short the actual underlying stocks.

In many ways, all I am saying is, a few days, a few weeks, a few moves the "wrong way" make no real difference to the real fundamental value of most things in the markets and in life. All you have to do is be selective, be patient, be really honest with yourself, ignore the daily noise, and focus on creating wealth. Not just money, but long-term, lasting wealth. And yes, there is a huge difference between the two, but we can discuss this another time.

Until next month,

Happy trading and investing 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.

BY CAROLINE DREWETT

DEBT: FRIEND OR FOE?

As we constantly read and hear, Millennials are tarnished by the presumption that we are a lazy, self-obsessed and entitled generation. Of course, there are always a few who give the rest of us a bad name. But many are not; they have just been given, time and again, unfortunate advice from their baby-boomer parents, who base their supposed knowledge on the social and economic paradigms of 30 years ago, when they were in our shoes. And one of the biggest misconceptions they pass down to us is the idea that all debt should be avoided.

For many Millennials, the word *debt* has gravely negative connotations when judging how reliable and restrained someone is. But debt is not just for emergency student situations; it is regularly used by wealthy and successful individuals and organisations to expand and advance their market reach. If approached in the right way, debt can help to kick-start success through freeing up cashflow or through capital investments.

Whether you are considering a mortgage, a student loan, or a credit card, not all debt is useful in equal measures, yet it can be necessary if you want to start a business, buy a house, or simply further your career prospects through university. The burdens of debt fluctuate with economic cycles. In an economic downturn, interest rates are lowered to prop-up the economy, so borrowing becomes cheap, although it is also admittedly considerably harder to become accepted for a loan. When the 2008 recession hit, those that were able to borrow could buy properties within Britain when house prices were low, and they borrowed with low interest rates. Given that the banks were offering virtually no interest on any savings accounts, putting your money into property was a sensible option.

> **"DEBT IS NOT JUST FOR EMERGENCY STUDENT SITUATIONS; IT IS REGULARLY USED BY WEALTHY AND SUCCESSFUL INDIVIDUALS AND ORGANISATIONS TO EXPAND AND ADVANCE THEIR MARKET REACH."**

The result was that successful landlords were able to remortgage their current properties and use the cash to increase their home ownership elsewhere with even more properties. As the economy has subsequently improved, prices have increased and many of those landlords have ended up on top, with many having sold their properties at a profit just as interest rates start to rise. As rates rise, the hardest part is knowing when to sell to ensure maximum profit, but the mathematics is simple; when you're earning 100% of the capital gains from every house you sell, owning five, each with an 80% loan to value (LTV) mortgage, will make you considerably more than buying one outright and not having a mortgage on it, just because you're scared of the debt. With the Bank of England base rate currently at the incredibly low 0.5%, this has set the bench mark for interest rates across various markets, including mortgage rates.


DEBT

Taking out a mortgage

I generally see mortgages as good debt. They are the key to being a homeowner, and are the one of the cheapest forms of borrowing. Britain has the fortune of not being reliant on oil for its economy which has meant the Sterling has stayed strong whilst other economies have been dragged down along with the oil price. Britain's economy is currently buoyant and steady. Unless you are one of the lucky few with the bank of Mum and Dad behind you, buying a flat will require a mortgage. For first-time buyers, the interest can be as low as 1.94% with Yorkshire Building Society, based on a 90% LTV tracker. Of course, if the rates go up, your mortgage payments increase with it, but even a fixed mortgage with the Co-operative bank is only 2.14%. Compare that to New York's 4.75% or Australia's 4% and you realise that you're in a good position if you're buying in Britain. Moreover, considering the situation of oil-reliant countries in South America, such as Brazil, Argentina or Ecuador, all of which have mortgage rates over 20% for first time buyers, we Brits should appreciate the comparatively positive situation we are in compared to other Millennials around the world.

Student debt

Student debt, like a mortgage, is also a cheap form of debt. Yes, you have to pay it back, but by the time you're paying it back, you'll be earning over £15,000 GBP so life will already be infinitely better than when you borrowed the money and lived off Pot Noodles for three years at university. As with mortgages, Brits are often unaware just what a fortunate position they are in compared to some of their neighbours. Unless you live in Scotland or Scandinavia, higher education costs money, and usually lots of it. But it's money well spent if you're doing a worthwhile qualification. Upon deciding whether to attend university, Millennials are now required to carefully consider the economic benefits before accepting a position. Medics are often worst hit, and leave with £70,000 worth of debt; but that doesn't mean that they should ignore medicine and go into a blue collar job or the City; it just means they need to make sure they want to be a doctor before starting the course and dropping out. If university debt is your only route to your chosen career path, and either the salary or career fulfilment (or preferably both) will be worth it, then it's of course an unavoidable hurdle, and no doubt

a good one if you are playing the long game. Compared to studying medicine at an Ivy League university in the US, you're forking out roughly 20% of what Americans need to pay, so things are looking up. Not only do they pay four times more in fees, but they usually train for two years longer, so leaving Stanford with a medical degree will leave you in $400,000 worth of debt, and other universities are even pricier.

"I GENERALLY SEE MORTGAGES AS GOOD DEBT. THEY ARE THE KEY TO BEING A HOMEOWNER, AND ARE THE ONE OF THE CHEAPEST FORMS OF BORROWING."

Student loans are different to most loans, which you are usually forced to start repaying immediately. You will only be asked for repayment when you are earning £15,000 a year, which means that if you want to go travelling after university for a year, you won't be chased for repayments until you start a paying job back in the UK, and even then the repayments are set in line with your earnings. Given that interest rates are set at less than 1%, you almost can't afford not to take on the debt in return for an enhanced career.

Credit card debt

This is the best, worst and most useful kind of debt, all at once. It's the best debt in that credit cards want to lure you into using their cards, which means that there are plenty of 0% interest cards around, many of which last for 12 months. That equates to a year of borrowing, with not a penny of interest paid. The card will allow you to buy supplies for your business,

improve your home, or further your educational studies, so it's the perfect way to have a free loan which you pay back in full at the end of the 12 months.

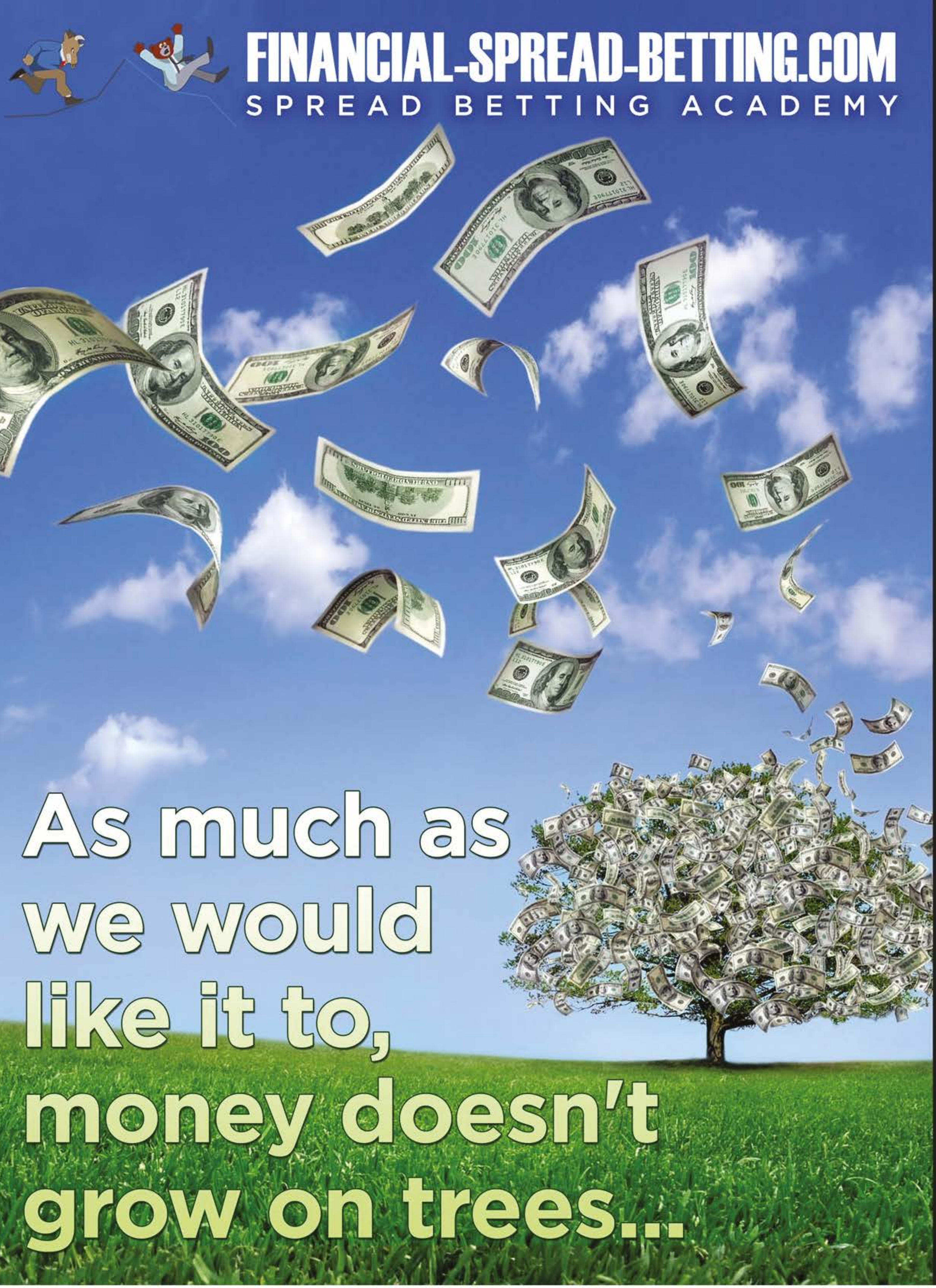
Of course, not everyone is restrained and it is easy to become careless with spending, especially if you're a shopaholic. At the end of the 12 months, interest rates can rocket. American Express cards range from 17-35% per annum, and to make matters worse, they'll charge you interest on your interest if you don't pay it off immediately. Spiralling into debt is all too common for consumers who buy without even considering whether they'll be able to pay off their debts after the honeymoon period of interest-free credit has ended. It's important to remember that credit-card interest rates are nowhere near as high as 'pay day' loans, so they are useful in an emergency, but should be treated with caution.

Whether you use them or not, credit cards are useful for Millennials with very little credit history. UK Mortgage lenders will very rarely approve a loan without some proof of payment history, and credit cards are the perfect way to boost your credit rating if you've never had a loan or a mortgage before. Unlike with debit cards, credit cards are tracked, so the more you spend, and the more you pay off on time, the better your rating will be. It shows lenders that you are in control of your finances and that you are accustomed to paying balances on the deadline. Aside from these benefits, credit cards protect your purchases, and many offer perks for spending. For instance, my American Express British Airways card gives me enough air miles for a return flight to Rome every year, just for using the card for day to day food and living purchases.

The key when going into debt is to be aware. Understand your spending, and understand your debt. There are some great options out there, and it is important to realise which are best for your personal situation. For many, a change of mindset might be necessary. Rather than being scared of debt, embrace the right sorts of debt. Using it for significant aspects of your life, like getting on the property ladder, or accessing a higher education course, can be worth the initial fear you might feel. Be aware and keep tracking rates and economic cycles, but don't avoid it altogether.

So if you're thinking about applying for that MA, or you are worried about the burden of owing £200,000 of debt to the bank when you buy your own home, remember the positives. Remember that with debt, you are also in line as a homeowner to gain 100% of capital gains increases when you sell, and that it is usually the only option if you want to get out of the renting trap. Why not take out a loan and go for your dream, rather than wondering how many pennies you'll earn from this year's measly ISA contribution? It's all about getting your foot in the door. Being in debt to the bank may seem daunting, but with interest rates as low as they are, and with the property market still bouyant, debt really shouldn't be a dirty word.

"WHETHER YOU USE THEM OR NOT, CREDIT CARDS ARE USEFUL FOR MILLENNIALS WITH VERY LITTLE CREDIT HISTORY."


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

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 January.

4th January

Ocado (OCDO) has been a slam dunk sell for as long as I can remember. But it has cost me a lot of dough. The fear has always been that Amazon, deus ex machina, might descend to thrash the shorters. However, it is as clear as one cares to dream that Amazon have no such intentions – just look at the expansion of its online food operation. So what is there to hold Ocado up? The answer is nothing at all. OCDO is now below 300p. My guess is that it will never see that level again.

8th January

This morning's note from Natixis offers the following resume about Quantitative Easing and what will eventually happen. I think the eventually is now:

If quantitative easing is effective, will it not inevitably lead to a financial crisis?

To be effective, quantitative easing must:

- *Drive up asset prices above the normal level: central banks buy risk-free bonds, and this drives up prices of risk-free assets (bond bubble) and/or of risky assets (equities, real estate, corporate bonds, foreign assets) to an abnormal extent if investors switch from risk-free assets to risky assets. The excessive rise in asset prices is necessary to trigger the wealth effects that stimulate demand;*
- *If these wealth effects are powerful enough, they jump-start activity and, thanks to a fall in unemployment, ultimately lead to an acceleration in wages that contributes to an upswing in growth. We can then see the trap;*
- *If a quantitative easing programme is effective, the central bank must exit this programme and switch to a more restrictive monetary policy when growth returns and wages rise more rapidly;*
- *But since quantitative easing must give rise to asset price bubbles to be effective, these bubbles will burst as a result of this exit, creating the risk of a financial crisis.*

This should give pause for thought about the merits (risks) of using quantitative easing.

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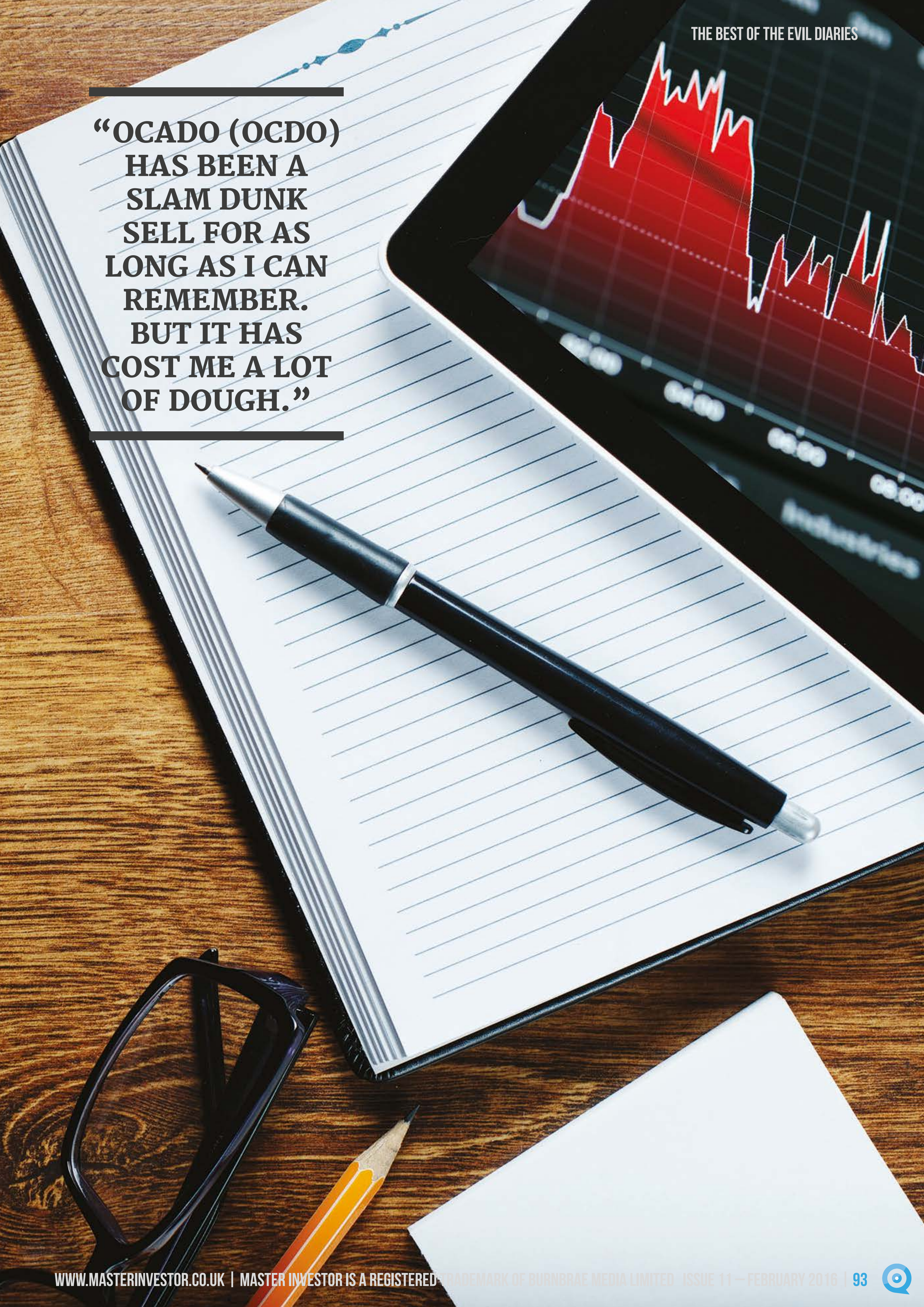
Mulberry (MUL) today reported its



“OCADO (OCDO) HAS BEEN A SLAM DUNK SELL FOR AS LONG AS I CAN REMEMBER. BUT IT HAS COST ME A LOT OF DOUGH.”

If readers have a couple of minutes I urge them to visit John Hempton's Bronte Capital. John is an Australian and has been known to nip up to China. He has published a devastating attack article on **Alibaba (BABA on NYSE).** This looks quite likely to be a massive fraud – it closed at $72 last night. There is plenty of borrow.

"POOR OLD NEIL WOODFORD. THE INVESTING PUBLIC HAVE REALLY GOT IT IN FOR HIM NOW."

13th January

Every now and then I regret not having been a scamster – one makes far more money for far less work. Take the strange affair of Invexstar Capital Management, as reported in Monday's Times. This tiny firm (capital of £630,000) has gone into liquidation with a shortfall of £97m – and some think £250m. Apparently, it had from time to time an outstanding advances/investments book of the order of £2bn (or c. 3,000 times Invexstar's capital). One day it all went pear-shaped. Well, are you surprised? And just where does one get credit like that?

15th January

Poor old Neil Woodford. The investing public have really got it in for him now. He's an example of the longstanding observation that first they put you on a pedestal and then they knock you down. His investment in Circassia (CIR) seems to be another example. Anyway, it seems that there is nothing in this company whatsoever. At 315p it is capitalised at £900m as against ntav of £169m at 30th June 2015. This figure is falling since losses are running at around £50m p.a.!

There is circa £200m of cash. Which is a lot for a deadbeat proposition. However, the end result is the same.

22nd January

My long oil trade has started to go the right way. It was showing a £30,000 loss but has now obliged by moving into a £30,000 profit. To he who waits all shall come.

*****

Finally, as part of my campaign to be better informed as to how to bet on the Oscars, my wife and I went off to The Revenant yesterday night (well, it finished getting on for midnight). This is really an advert for the benefits of visiting the barber, shampooing one's hair and combing it. The trouble is that the ad goes on for two and a half hours. Too long. But Di Caprio presumably gets the best actor award: his locks are really really greasy.

25th January

I do not wish to be thought perpetually to claim a vastly superior knowledge of tax law, but all the politicians' talk about Google's settlement with HMRC is so much deliberately deceptive drivel. As explained here many months ago, Google relied upon very long established taxation laws when paying virtually nothing, so it is impossible to argue that Google was/has been at fault. But, at least as I inferred from Sunday Times articles on Google's tax affairs, there were clear grounds for an enquiry by HMRC. What is not clear is whether this £130m settlement reflects undisclosed profits now taxed, penalties or interest.

In any event, it doesn't make any difference to Google since tax paid in the UK

"ALL THE POLITICIANS' TALK ABOUT GOOGLE'S SETTLEMENT WITH HMRC IS SO MUCH DELIBERATELY DECEPTIVE DRIVEL."

is simply knocked off the tax payable in the United States. HM Treasury know this of course and it is possible that Labour's spokespersons do as well (although, I grant you that they might not – they are that thick).

*****

ADDENDUM: On the Home run...

Plane Watch: My friend is so addicted to watching from his garden planes coming into Heathrow that he managed to pick up the arrival of a clutch of Walmart executives. They think that **Home Retail (HOME)** is worth 200p and that they can therefore eclipse Sainsbury's. So I bought lots of HOME.

Apparently, there is c. £5bn of annual sales, no debt and TNAV of the order of £800m in contrast to a market value of the order of £1.2bn at 144p. Hurry along now. This should suit Asda.

27th January

I sold **TalkTalk (TALK)** at 205p since I do not see their way out.

*****

But I discounted the placing rumour at **Pantheon (PANR),** since that is already in the price, and bought again.

*****

I think I see that the LibDems propose half price tube fares for Tube journeys started before 7.30 a.m. This makes a lot of a sense since the fixed cost of the underground operation is high and more effectively recovered if it is used over as many operational hours as possible. Further, it is reasonable to suppose that other (or later) journeys would be less packed.

*****

I think I know how to run a business, even though (or perhaps particularly because) I learnt later than others. But one of the things I have noticed about successful businessmen is that, as a result of their success, they really rate themselves at politics. That, I presume, is why Lord Rose let his name go forward to be chairman of Britain Stronger in Europe.

However, listening to him a couple of days ago on BBC Radio 4's Today programme. I heard him utter the most amazingly muddled tosh. He simply spouts figures where he has no evidence to support them and he muddles up the arguments that he should be able to recite/reel off instantly.

It gets worse. Here I copy Guido Fawkes. When questioned, Rose answers that he leads:

"First attempt: *"Stay in Britain." Wrong.*
Second attempt: *"Better in Britain Campaign." What?*
Third time lucky? *"The Better in Britain Campaign." Nope...*
Attempt number four: *"Better Stay in Britain Campaign." Err...*
There's a very easy way to remember the Britain Stronger in Europe campaign, Stuart. *It's BSE..."*

Incidentally, he is on wages for this work. Either that or an upgrade to an earldom.

Perhaps all this is Cameron's handiwork in pursuit of a hidden agenda to Brexit. One never knows.

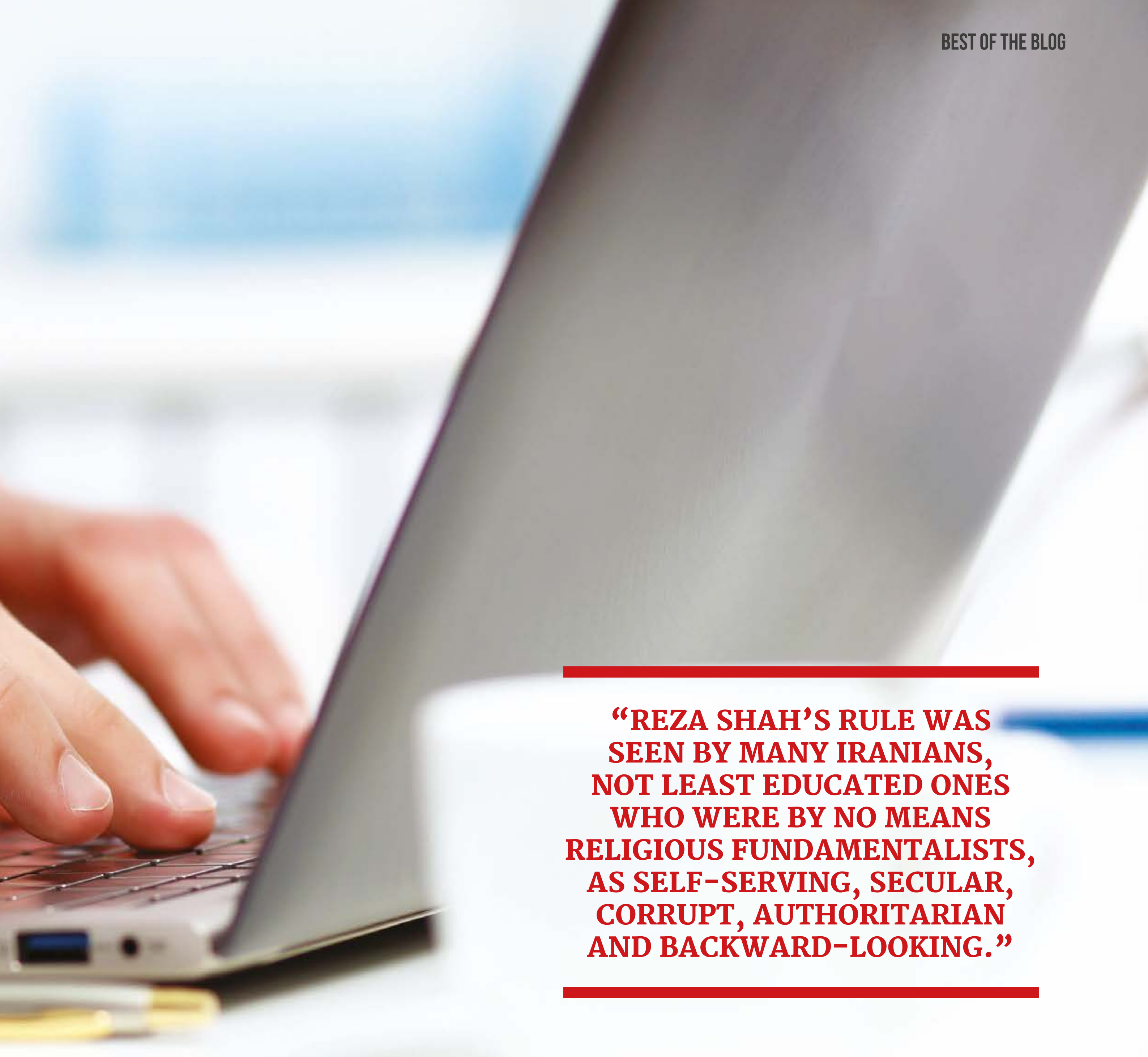
JANUARY 2016

BEST OF THE BLOG

War on Terror II: Kingdom and Republic on the Brink

Last month on these pages I explained how the Kingdom of Saudi Arabia emerged from the deserts of Arabia in the early 20th century as an alliance between the ruling House of Saud and the al-Wahhabi clan ([*War on Terror II: The Janus-Faced Kingdom*]), who wielded unique religious authority. The conflation of politics and religion in the Kingdom was perhaps inevitable, at least in Muslim eyes, because it was within its territory that the Holy Prophet was born, lived, spread the word of God and died. The two holiest sites in Islam – Mecca, where the prophet was born and where the Holy Book was revealed to him, and Medina, where the Prophet was laid to rest – are both modern Saudi cities as well as places of pilgrimage for all Muslims. Yet it was only in 1986 that King Fahd of Saudi Arabia assumed the title of *Custodian of the Two Holy Mosques.* This singular title, which was first held by Saladin, the 12th-century Sultan of Egypt and Syria (the one who trounced Richard the Lionheart in the Crusades), bestows huge symbolic resonance.

Why did the fifth King of *Sunni* Saudi Arabia assume this important title, which has been inherited by all subsequent Saudi Kings, including the present one, King Salman, at precisely that time? One can see this in terms of the attempts by the Saudi monarchy to entrench their



> **"REZA SHAH'S RULE WAS SEEN BY MANY IRANIANS, NOT LEAST EDUCATED ONES WHO WERE BY NO MEANS RELIGIOUS FUNDAMENTALISTS, AS SELF-SERVING, SECULAR, CORRUPT, AUTHORITARIAN AND BACKWARD-LOOKING."**

standing as a major bulwark of the Muslim faith – despite the fact that some Muslims believe that hereditary monarchy is un-Islamic – at a time when the Islamic Republic of Iran was asserting itself as the first modern state to be founded and run on Muslim principles.

In 1979, as we know, Reza Shah Pahlavi, was toppled as monarch of the ancient land of Persia/Iran in what came to be called the *Islamic Revolution.* Reza Shah's rule was seen by many Iranians, not least educated ones who were by no means religious fundamentalists, as self-serving, secular, corrupt, authoritarian and backward-looking. The millions who went out onto the streets of Tehran and other main cities of the country to protest were not particularly religiously motivated. Many wanted a democratic western-style secular republic. It was the exiled mullah, Ayatollah Khomeini, who seized control of the revolution after his return from Paris and began to forge a state based entirely on *Shia* Muslim principles.

By Victor Hill

Click here
to read the full article

Should you take heed of RBS's market warning?

RBS has issued a warning that the coming year is not about return on capital, but return of capital. Should you listen to a bank that so monumentally cocked up that they are now really Royal Bank of England, having been bailed out by the government? There were very serious errors of judgement as they failed to control risk back before the credit crisis. BBC Scotland made a fascinating documentary about the massive failings at RBS.

The problem with a really long bull market, as I've said before, is that everyone now has a prediction of when and how it will fail, and of course someone will be spot on, and probably be right for the wrong reason. It starts to get like monkeys and typewriters, although I imagine they've been quite busy writing the Top 40, the new Star Wars movie, and getting quite upset that Animal Rights Group lost the copyright case over the monkey photo, creating a legal precedent that monkeys have no rights after all.

The Dow Jones is so far off a bear market at the moment that we would need to see some decent downside for the bull market to end. It has more than another 11% to fall before it touches the level required for a technical bull market – 80% of the bull market high. Of course it's possible, but the reasons why the market is where it is, and the issues it faces, are more useful than scare-mongering. In any case we should be completely calm in trading at all times, and RBS sounds more neurotic than a Woody Allen film character.

This whole bull market is based on a number of unusual elements. We've had an enormous amount of QE at the beginning of the market, both here in Europe and in the US. That immediately results in the market having to rise simply to correct its value relative to the extra money floating around. We've also had very low interest rates, but at the same time a real inflation rate which is higher than the headline rates published by the statistical departments of governments. Companies have been maintaining dividends without justifiable profits more recently, and the whole shebang is based on numbers and bits of paper, not real growth underpinning the rise in the market.

By Adrian Kempton-Cumber

Click here to read the full article

Get back into gold with Caledonia Mining

Investors hoping that the 4.9% losses seen from the FTSE 100 in 2015 will be reversed quickly have been disappointed so far this year. The blue-chip index has fallen by over 300 points already as contagion from a stock market plunge in China has spread, caused by the ever present growth slowdown fears.

In reaction, the traditional "safe haven" investment of gold has sprung back into life, gaining 3.3% to $1,096 an ounce in the first few trading days of the year.

While the gold price continues to be depressed, still trading at a c.6 year low, I see some positive signs for the yellow metal heading into 2016, as the fundamentals of supply and demand should continue to improve in gold bugs' favour.

Demonstrating this, recent figures from the World Gold Council showed that demand for gold outstripped supply by around 21 tonnes in the third quarter of 2015. The core jewellery market continued to perform well in the period, with demand up by 6% year-on-year. But the real market driver was a 33% increase in demand for physical bars and coins. Overall demand rose by 8%, with a significant slowdown in outflows from gold ETFs also helping the numbers.

On the supply side mine production fell by 1% due to falling output from older mines and as growth slowed at newer ones. Supply of recycled gold fell by 6% as the low price put off sellers. With the gold price hovering around the all-in sustaining costs of production of many producers, we are likely to see the closure of unprofitable operations, resulting in a further tightening of supply.

"I SEE SOME POSITIVE SIGNS FOR THE YELLOW METAL HEADING INTO 2016, AS THE FUNDAMENTALS OF SUPPLY AND DEMAND SHOULD CONTINUE TO IMPROVE IN GOLD BUGS' FAVOUR."

This excellent chart from a presentation by US listed miner Goldcorp further shows the medium- to long-term supply issue, with gold discoveries having fallen dramatically since 2007. What's more the chart shows that production tends to lag discoveries by around 20 years. With peak discoveries being in 1995 this suggests gold production may have already hit its highest level.

By Richard Gill, CFA

Click here
to read the full article

Is Royal Mail delivering?

I offer an updated view of Royal Mail (RMG) equity after the share price bounces 10% from its recent low. The shares look attractive with an above average dividend yield and a fair valuation of estimated earnings.

I note that the Royal Mail Group (RMG) has rallied ten per cent this month – an occasion then, for beating the bushes! I note that a couple of brokers are reported as having some positive views on the shares so I have gone back to the fundamentals myself, for a good look.

"THINGS APPEAR TO BE SETTLING DOWN AS ITS TRACK RECORD AS A PUBLICALLY QUOTED COMPANY GETS ESTABLISHED."

The first thing to observe is that the share price chart indicates that the shares have been trading for some time in a 'trading range' of between about 425p and 525p – roughly speaking. The share price last seen was 443p, leaving plenty of headroom within the trading range for an upward movement in the share price, should circumstances dictate. Assuming that the fundamentals seem to support that prospect, then the move to 525p implies a possible 18% capital uplift. Adding the dividend to that makes it look an interesting and attractive proposition.

The share price is now well above it issue price of 330p, although that price was, to judge from the immediate and subsequent significant rise in its value, indicative of a politically embarrassing undervaluation – at least until the share price fell again as analysts got to grips with the reality of its immediate prospects and problems. It became, as a result, a pretty volatile share. However, things appear to be settling down as its track record as a publically quoted company gets established.

The problems are well known: it has a declining letters business as the nation grows less literate and less familiar; letters from maiden aunts in Tunbridge Wells are vanishing under a flood of e-mails from the rest of the world with cookies attached; and Royal Mail has a less dominant position in parcel deliveries in part generated by those pesky and often impertinent e-mails and other electronic, so called, electronic media, which I am far too grown-up to wish to get involved with.

By Robert Sutherland-Smith

Click here
to read the full article

BY SWEN LORENZ

READ TO SUCCEED

THE FOURTH INDUSTRIAL REVOLUTION

BY PROF. KLAUS SCHWAB

A BOOK REVIEW

It took John D. Rockefeller nearly 50 years to become a billionaire. Bill Gates managed to amass the same level of wealth in 14 years. The founders of Yahoo became billionaires in four years, and the founder of Snapchat, a mobile application that allows you to chat via photo messages, did the same in just two years.

We are currently experiencing a rapid acceleration in virtually all walks of life. With billions of people connected through mobile devices, any new technology or trend can spread like the proverbial wildfire. The velocity and scope of change we are experiencing has no precedent in human history, and it is estimated that the next 100 years will bring the equivalent of 20,000 years of human progress.

Professor Klaus Schwab is best-known as the founder and Executive Chairman of the World Economic Forum, the yearly gathering of statesmen, entrepreneurs and academia in the Swiss mountain-side village of Davos. Having been at the centre of global affairs for over 45 years, he has unique access to the people who are shaping and driving these trends. With "The Fourth Industrial Revolution", Schwab has decided to distil his views, insights and experiences in an easily readable 180-page book.

Schwab outlines what we are likely to see in terms of artificially-intelligent robots, self-driving cars, neuro-technological brain enhancements, and genetic editing. He takes his readers on a breathtaking journey through the dramatic changes that are happening all around us and at exponential speed. In Schwab's view, these developments deserve the epithet "the Fourth Industrial Revolution", as they will once again fundamentally change the way we live, work and relate to one another, just like previous industrial revolutions did.

"THE VELOCITY AND SCOPE OF CHANGE WE ARE EXPERIENCING HAS NO PRECEDENT IN HUMAN HISTORY, AND IT IS ESTIMATED THAT THE NEXT 100 YEARS WILL BRING THE EQUIVALENT OF 20,000 YEARS OF HUMAN PROGRESS."

Breakthroughs in fields such as artificial intelligence, robotics, the Internet of Things, autonomous vehicles, 3-D printing, nanotechnology, biotechnology, materials science, energy storage, and quantum computing can create new wealth and improve quality of life. However, the current revolution is almost certain to also yield greater inequality. The disruption that it may bring to labour markets could have huge political ramifications. Manual labour will in many areas be replaced by technology, and considerable parts of the population will have to adapt to a world where creative talent and intellect are rated much higher in the labour market. It's unlikely that this ongoing segregation of the labour market into "low-skill/low-pay" and "high-skill/high-pay" will go without social tensions.

Investors also need to take heed. Many industries will be affected by new technologies creating entirely new ways of serving existing needs and significantly disrupt existing industry value chains. Companies will have to deal with ever-increasing transparency, growing consumer engagement, and new patterns of behaviour. Companies have to re-examine the way they do business, and shareholders will need to be constantly on the lookout to determine how these rapid changes will affect their wealth.

Schwab's book delivers a highly readable, well-informed overview of the Fourth Industrial Revolution. He sets the drivers of the revolution against the historic context and the likely future impact. A useful appendix provides brief overviews of 23 areas where deep shifts will occur. His conclusions are primarily driven by questions about how these developments will affect the way we live, how we are governed, and what risks they will bring. One of his key messages is that the world needs to prioritise human values above all else in this new landscape in order to help pre-empt inequality.

What the book doesn't do is give investors an outline of how to profit from these developments. For the latter, Jim Mellon's "Fast Forward" (www.fastforwardbook.com) delivers a more practical guide. For readers who'd like a more philosophical overview of the subject, Schwab's book is a timely overview of the most extensive and profound transformation of the technological landscape in more than two centuries since the First Industrial Revolution.

£6.99 (Paperback)
Published by World Economic Forum (www.weforum.org)

BY ADRIAN KEMPTON-CUMBER

THE FINAL WORD

TIMID NEW WORLD – FROM SUBVERSION TO SUBMISSION

The pluckiest nation in the world might well be Finland. Defending against the Russian invasion in 1939, they sacrificed around 25,000 lives whilst killing possibly in excess of 160,000 Russians. Not far behind would be Great Britain standing up, pretty much singlehandedly, against Hitler. Look on a map and see how tiny these islands look compared to the territory that Hitler had occupied by 1939. For years we stood alone against fascism.

Life was simple then, as we knew we were the best. We were taught it as fact, and proud to tell everyone – especially if they didn't ask. We developed sayings about just what jolly decent sorts we were – perhaps the most well-known being "that's just not cricket". Not only were we unequivocally the best, but so were the games we invented; lesser nations would obviously be better people for playing by what were inevitably decent English rules.

In the aftermath of World War II we had to call on our subversive tendencies, learnt over centuries of pendulum-swinging religion that had to be observed from one decade to the next, it seemed. The BBC's censorious "Aunty" would take out all the best jokes from radio broadcasts. It was the Goons who most famously got jokes through that were common knowledge to the man in the street, but didn't register with the naïve censor at Broadcasting House. Fred Bog was Winston Churchill (W.C.), for example. We developed a world class skill for innuendo.

The Pythons and other satirists fought against the class system, and the slow demise of religion began as people took control of their own lives, inspired by art, music, fashion, and freedom. Individuals could finally be individual. People were not afraid to wear their heart on their sleeve and demonstrate against what they considered injustices. They wanted their world (as opposed to the world) to be a fairer place. And they succeeded in many areas. Equality is enshrined in law, if not always in practise. We gained security in employment and tenure, and free expression as blasphemy laws were swept aside as the medieval relic they were.


More
Political
Correctness
Ahead

So what went wrong? We have become a pathetic bunch of sycophants to political correctness. The Great Undoshed have now become the Grime of the Century. We have a bullying mentality in this country. That's why we used to be subversive, but now it seems that everyone, particularly the younger generations, just take it on the nose. They've made stiff upper lip into a form of submission.

This is the problem with 'movements'. They swing too far. Now the politically correct are becoming fascistic. They don't like Donald Trump. So what?! They want him banned from the UK. Why? He hasn't broken any laws. He's just exercising his right to free speech. And my description of free speech is other people's right to say things you don't want to hear. On the one hand these are the people who want to ban Trump (which is not going to happen while there's any chance he may become President, and also while he has a c.£700m project in development in Scotland); on the other, they allow terrorists to tell us what cartoons we can draw.

They want to have a say in Trident, spurred on by a largely politically irrelevant man with no power and who isn't likely to get any. We don't get a say in Trident or any other government policy. It's a moot point. Democracy here doesn't care what you think between elections. We get to choose who will get to choose, using an electoral system we chose to keep in a recent referendum. It doesn't matter what we think. But rather than show their faces and demonstrate, these days it's just namby-pamby memes on Facebook and Twitter, with holier-than-thou posts attached to be 'liked' by a bunch of carefully combed friends who never disagree.

The Russians during the Soviet era were probably the most sophisticated society, in terms of art, that ever lived. Everyone went to the ballet, the opera, read Tolstoy. The Baby Boomers were much more politically aware, when they were younger, than young people are today. Today it seems it's OK to get your opinions second hand. There are (almost) no conviction politicians, no great orators. It's all politics by numbers. Whatever the focus group says, that's what the establishment spokes-model, presently David Cameron, will spout. This is why politicians aren't believable any more. And they speak to a hub of Utopian PC drongos.

"WE HAVE BECOME A PATHETIC BUNCH OF SYCOPHANTS TO POLITICAL CORRECTNESS. THE GREAT UNDOSHED HAVE NOW BECOME THE GRIME OF THE CENTURY."

But this concept that precisely because you don't like who got elected you should therefore have some say in what they do is not a sense of democratic right; it's a misplaced sense of entitlement. We have become supercilious instead of arrogant. I don't think arrogance is necessarily a bad trait by the way; but then it is often confused with justifiable confidence. We have people who are so afraid of the rainbow of opinion of real dialogue that many UK universities now have so-called 'safe spaces' where debate is not allowed.

Corbyn typifies this pathetic submissive trait: a man who would be PM but wouldn't even protect us if push came to shove. The role of government is to maintain or improve the living standards of its electorate at the cost of other competing nations. Not to try and make the world a fairer place. He has confused humanitarianism with politics. I want to maintain my differential with other nations, not become some third-world backwater because people feel guilty about doing well for themselves like a bunch of inverted snobs.

I was involved in the world of stand-up comedy for many years, during which time my claim to fame was discovering a comic who had been dismissed by all the major clubs as irrelevant, who, as it turns out (read his autobiography), was on the verge of giving up when I spotted him. He's done quite well since has Michael McIntyre. So I feel I have some qualification when I say there are no limits in comedy. No subject is off limits. The Pythons say they wouldn't make Life of Brian in the current climate, and right there we see what's gone wrong. Have we lost the ability to find humour where it exists? It seems we're afraid to be who we are in case it offends someone else. Well tough titty. The pendulum is starting to swing back the other way. I remember doing a celebratory comedy night when Mary Whitehouse died. But the problem with people, as I often say, is that if you free them from tyranny they will simply invent some of their own. Stop being afraid to live, to speak, to express. Think Magna Carta, think Jarrow March, think Tolpuddle Martyrs. We don't have a pathetic past – let's not have a pathetic future.

MARKETS IN FOCUS

JAN 2016

GLOBAL EQUITIES

Index	Last Month %	YTD %	Proximity to 52w High*
Russian Trading System	-1.6	-1.6	
FTSE 100	-2.5	-2.5	
Euronext 100	-3.5	-3.5	
CAC 40	-4.7	-4.8	
S&P 500	-5.1	-5.1	
Dow Jones	-5.5	-5.5	
S&P/ASX 200	-5.5	-5.5	
NASDAQ 100	-6.8	-6.8	
Bovespa	-6.8	-6.8	
IBEX 35	-7.6	-7.6	
Nikkei 225	-8.0	-8.0	
DAX Xetra	-8.8	-8.8	
Hang Seng	-10.2	-10.2	

COMMODITIES

Commodity	Last Month %	YTD %	Proximity to 52w High*
Gold	5.5	5.5	
Silver	3.1	3.1	
Soybean	2.0	2.1	
Natural Gas	-1.9	-1.9	
Platinum	-2.4	-2.4	
Iron Ore	-3.4	-3.4	
Copper	-3.6	-3.6	
Crude oil (Brent)	-3.8	-3.8	
Coffee	-5.3	-5.3	
Crude oil (Light Sweet)	-9.0	-9.0	
Palladium	-11.2	-11.2	
Cocoa	-13.9	-13.9	
Sugar (No. 11)	-14.0	-14.0	

FOREX

Pair/Cross	Last Month %	YTD %	Proximity to 52w High*
EUR/GBP	3.1	3.1	
USD/CHF	2.1	2.1	
EUR/CHF	1.7	1.8	
USD/CAD	1.0	1.0	
USD/JPY	0.8	0.8	
EUR/JPY	0.5	0.5	
EUR/USD	-0.3	-0.3	
GBP/AUD	-0.4	-0.4	
AUD/USD	-2.8	-2.8	
GBP/USD	-3.3	-3.3	

CENTRAL BANKS - RATES & MEETINGS

Central Bank	Key Rate	Next	After
BOE	0.50%	Feb 04	Mar 17
ECB	0.05%	Mar 10	Apr 21
FED	0.50%	Mar 16	Apr 27
BOJ	-0.10%	Mar 15	Apr 28
SNB	-0.75%	Mar 17	Jun 16
BOC	0.50%	Mar 09	Apr 13
RBA	2.00%	Feb 02	Mar 01
RBNZ	2.50%	Mar 10	Apr 28
BOS	-0.35%	Feb 10	Apr 20
BON	0.75%	Mar 17	May 12

FTSE 350 TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Home Retail Group PLC	37.3	37.3	
Randgold Resources Ltd	19.9	19.9	
Morrison Supermkt. PLC	17.7	17.8	
Tesco PLC	16.0	16.0	
NMC Health PLC	15.3	15.3	

FTSE 350 BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Nostrum Oil & Gas PLC	-32.1	-32.1	
Poundland Group PLC	-31.7	-31.7	
Allied Minds PLC	-29.4	-29.4	
Sports Direct Int PLC	-28.0	-28.0	
Just Eat PLC	-24.4	-24.4	

FTSE 350 SECTORS TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Food & Drug Retailers	6.6	6.6	
Personal Goods	4.2	4.2	
Tobacco	4.1	4.1	
Oil & Gas Producers	2.7	2.7	
Gas, Water & Multi	2.3	2.3	

FTSE 350 SECTORS BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Industrial Metals	-14.9	-14.9	
Forestry & Paper	-14.8	-14.8	
Banks	-10.8	-10.8	
Automobiles & Parts	-9.6	-9.6	
Financial Services	-9.2	-9.2