



MAGAZINE

masterinvestor

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HOW TO INVEST LIKE WARREN BUFFETT

PLUS...

SELL IN MAY?

WE INVESTIGATE THE REALITY
BEHIND THIS OLD ADAGE

TURKEY'S FUTURE

HOW TO TAP INTO THE GROWTH
OF THIS RISING POWER

MELLON ON THE MARKETS

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FROM THE MILKEN CONFERENCE

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WELCOME



Dear Reader,

On April 23rd, 4,500 private investors connected with 100 exhibiting global companies and a world-class line-up of speakers at the year's premier private investor event, the 14th Master Investor Show. Keynote talks from celebrated investors and company executives resulted in packed out stages and presentation rooms. Exhibitor zones, sold out since the start of April, were bustling with attendees looking for opportunities to expand their investment portfolios.

I had promised our readers and delegates a revamped and reinvigorated show, and putting all modesty aside for a moment, my team duly delivered. There was a large queue gathered outside the venue 30 minutes before opening. Once inside, delegates mingled with the CEOs and founders of 100 companies from around the world, the majority of them public, who presented their investment cases. From the fin-tech stars of tomorrow to pioneering pharma companies, the Master Investor Show attracted substantial interest from a wide range of organisations.

Jim Mellon's keynote talk was one of the highlights of the show. Jim gave an impassioned and energetic speech which covered the on-going risk of deflation, the interference of central banks in shaping economic policy and the future trends that could provide much-needed returns for investors. Radio 4 MoneyBox Live presenter, Paul Lewis, closed the main-stage with a practical talk on how to keep investments "safe and simple" in challenging economic conditions.

The Rising Stars Stage, sponsored by London South East, the private investor portal, showcased up and coming businesses and the stage was at capacity throughout most of the day. In response to high demand, an additional presentation room was added to accommodate more guest speakers than ever before.

One delegate, Catherine Hardman, stated: "Jim Mellon has put "fire in my belly" again about investing and reminded me how much fun it is. Thank you."

This year's show came off the back of our successful relaunch of our company as an events and media platform, initiated less than two years ago. We are now working to scale up both our events business and our digital media platform, to deliver yet more hard-hitting content to you.

To watch the videos of all of the presentations held at the Master Investor Show, [visit our website](#). You can also download the pdf files of the various presentations. Not to be missed if you weren't able to go yourself!

Best regards,

Swen Lorenz
Editor, Master Investor Magazine



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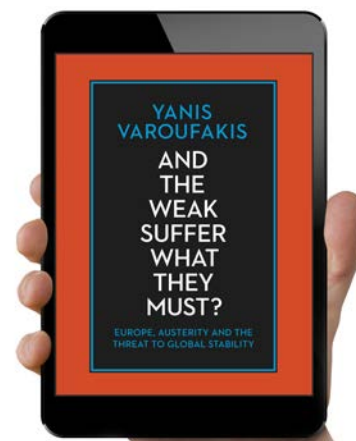
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BY JIM MELLON

MELLON ON THE MARKETS

I'm writing this on an American Airlines flight from LAX to London. The amazing thing is, I will be sending it by email from the plane to the Editor of this magazine in about an hour or so. There has been internet on US domestic planes for a while, but only recently has it become possible for us to remain connected for trans-Atlantic trips. *Fast Forward* in action!

The reason for my trip to the US was to attend the Milken Institute Global Conference. Mike Milken is the world's foremost expert on credit, has made a fortune, and now devotes himself to philanthropy. He is a true renaissance man, and has a particular interest in biomedical research and the impact of medicine on economic development. If he was a British citizen, he would be Earl Milken by now.

From around the world, people gather to network, listen to speakers, largely in panel format, and to learn about new technologies, trends and geopolitical flashpoints. It seems that the whole US Senate and House of Representatives is in attendance, along with just about every heavy hitter in finance, politics and technology.

I was seriously impressed, and without giving away anything I shouldn't, I will reveal a few takeaways in this article.

My own panel consisted of Roger Wicker, a US senator; Paul Wolfowitz, the ex-head of the World Bank; Howard Shore, a fellow Eurosceptic and

a renowned UK based investor; Peter Beyer, a member of the German Parliament (and also a new drinking buddy in Berlin); and a skilled moderator in the form of broadcaster Ross Westgate.

Our subject was "The Forces Shaping Europe" – a theme of endless commentary on our side of the pond, but of lesser interest to Americans, other than in terms of how it affects global (and US) security. Senator Wicker and Paul Wolfowitz leant on the side of Remain, but regarded Brexit as a much less important issue than migration, the failure of most European countries to improve their own defences, and most importantly the destabilising and pernicious effect of Putin's policies, particularly in Ukraine. They warned that something had to be done to bolster Ukraine's economy, or disaster was sure to follow.

Howard and I argued, in different ways, for Brexit, and Peter, as one might expect, for the integrity of the European Union.

I have expounded enough on the subject of the European crisis – and

crisis it is – so will cover other subjects here, with one exception, and that is refugees and migration. I was fortunate enough to meet David Miliband, the leader in waiting, one imagines, of the Labour party. For now, David is the head of a large agency that helps refugees, the International Rescue Organisation. He's a charming chap, and sat on a panel with my tutor from yesteryear, Oxford Professor Sir Paul Collier, to whom I listened. The refugee crisis will only get worse, until the cause of it – conflict and displacement – is solved. Meantime, 60 million people (about 13 per cent of Europe's population) are displaced. Despite the common view that the West "caused" the crisis in Syria, David argued that it is a home-grown war, with another commentator pointing to climate change as being an important proximate cause.

This is interesting, as I saw Al Gore expound on the subject of climate change with fluency and a raft of alarming statistics. The reason why Syria is at war is that 1.5 million people moved to the cities from rural areas, due to a lengthy drought, and those migrants upset the



“RAY KURZWEIL HAS SAID THAT HE EXPECTS US TO ADD ONE YEAR OF LIFE EXPECTANCY FOR EVERY YEAR OF LIFE STARTING IN ABOUT 15 YEARS – AND I AGREE WITH HIM.”



“THE OLD ORDER OF FINANCE IS BEING UPENDED, AND GOVERNMENTS JUST DON'T HAVE THE WHEREWITHAL TO LOOK AFTER THEIR AGEING POPULATIONS. THAT'S WHY WE HAVE TO INVEST CAREFULLY AND COLLABORATIVELY.”

long-standing forces that had held the fractious tribal politics of the country together. I was somewhat sceptical of climate change before I went to this conference – but came away pretty convinced. I guess that's the power of this event – it changes minds and shapes opinions.

Back to migration, and again, my mind has been changed. Frau Merkel made a huge mistake by letting all comers in last summer, and Germany is now facing problems of integration, selection and possible infiltration by bad actors.

But the general principle of being generous is a good one, and I do think that we in the UK should be doing more. In particular, my own home, the Isle of Man, which suffers from an ageing population and too few people, might consider taking some.

Much more needs to be done to help Lebanon and Jordan, both of which have vast amounts of migrants displaced from Syria. Most of these people genuinely want to go back home, but in the meantime, they need jobs, and they need dignity. The majority of migrants don't live in camps, but in the general community, and I was shocked to learn that the average duration of a refugee's exile is about 17 years. There is a strong case for a pan European solution (and I don't mean an EU solution!) to this remarkably awful situation. Without it, more and more of them will turn, though underemployment, boredom and misguided religious fervour, to Isis and its like. Then we will reap the wind.

Technology and biomedical stuff was heavily featured at the Conference, and Mike Milken pointed out that in the first four million years of man's existence, we added 11 years to life expectancy, from 20 years at birth, to 31 years. Yet, thanks to sanitation and medical advances, we have added 40 more in the past 115 years. Ray Kurzweil has said that he expects us to add



one year of life expectancy for every year of life starting in about 15 years – and I agree with him. So, hang on in there, because the future is bright – and its loooong!

Several leading scientists spoke, and I was deeply impressed by the efforts of Lifecode and Craig Venter (father of the Genome project). They have produced the first synthetic living organism, and are now commercially exploiting this, as they can produce just about anything at a molecular level, from scratch, including fuels, food, and biodegradable materials.

I also watched Elizabeth Blackburn talk about telomeres, the little cap ends of your DNA, and vital to life extension. This is a fascinating subject on which my team and I are doing more research. Then there was nuclear fusion, bone printing using stem cells and 3D printing, early stage cancer diagnostics, and artificial intelligence – and the list goes on.

I am speaking in the Isle of Man later this month on technology, and I must say I came away from Milken totally enthused on its acceleration. Al Chalabi and I might do *Even Faster Forward* as a sequel this summer!

Regarding investments, some real superstars were there. People managing vast amounts of money spoke of their strategies in a zero or negative interest rate world. That was my theme at Master Investor 2016, and it was inter-

esting to hear what people like Kyle Bass (who is well known to be a super bear on China) had to say. The fact is that pension schemes are still thinking about 7% returns as the base case for their projections. Talk about pipe dreams. This is a serious problem and one that will affect pensioners or future retirees around the world.

The old order of finance is being upended, and governments just don't have the wherewithal to look after their ageing populations. That's why we have to invest carefully and collaboratively. I loved Master Investor 2016 – I loved the energy and the friendly but serious way in which investors and companies engaged. All my slides, my talk and that of all other participants are now available on the [website of this magazine](#).

Next month, I'll come back with some more specific investment recommendations.

Happy Hunting!

Jim Mellon

Mid Atlantic on American Airlines!



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BY DR DAVID PAUL, MD OF VECTORVEST UK

VECTORVEST

INGENIOUS PRIVATE INVESTOR PLATFORM HELPS TAKE THE GUESSWORK OUT OF TRADING, REDUCE RISK AND BOOST PROFITS, WHICHEVER WAY THE MARKET IS HEADING

VectorVest has been helping private and professional investors alike get more out their portfolios for over 25 years. Many have previously let money managers and brokers handle their investments without much success, so they've turned to VectorVest to help them boost their profits.

With VectorVest you can remove much of the guesswork and gambling from trading stocks and shares, and do what the professionals do: use a state-of-the-art analysis platform to guide you into making the right investments at the right time.

The key to successful investing is simple – it boils down to knowing when to buy and when to sell. But it's notoriously difficult to work out when to buy and when to sell, even if you're an old hand. And when markets are volatile, as they have been and almost certainly will be for the foreseeable future, you're even more likely to make mistakes.

Even though everyone knows you should buy low and sell high, many investors end up doing the opposite. After a crash, investors tend to find it hard to enter the markets and buy. And when things are going well, they feel it will stay that way and ignore, or simply not see, the indicators that stocks are about to fall.

That's where VectorVest comes in.

VectorVest analyses over 21,500 shares all over the world, ranks them every day for Value, Safety and Timing and advises you whether you should

consider BUYING, SELLING or HOLDING certain shares. All VectorVest ratings are based on specific, unemotional, rule-based criteria. It helps you to make the crucial decision of what to buy and then when to buy. This is fundamental to the success of your portfolio and the size of the profits you can make.

The VectorVest Story

VectorVest is the creation of American investor Dr Bart DiLiddo, who learned about investment the hard way – by making those same mistakes many amateur investors make and selling his shares at the bottom of the market.

An engineer by trade, Dr DiLiddo joined a stock club in the early 1970s

and muddled along, winning some, losing some, until discouraged by the falling markets thanks to the oil embargo, he sold all his stock at the very bottom of the bear market, only to watch them all rise up again!

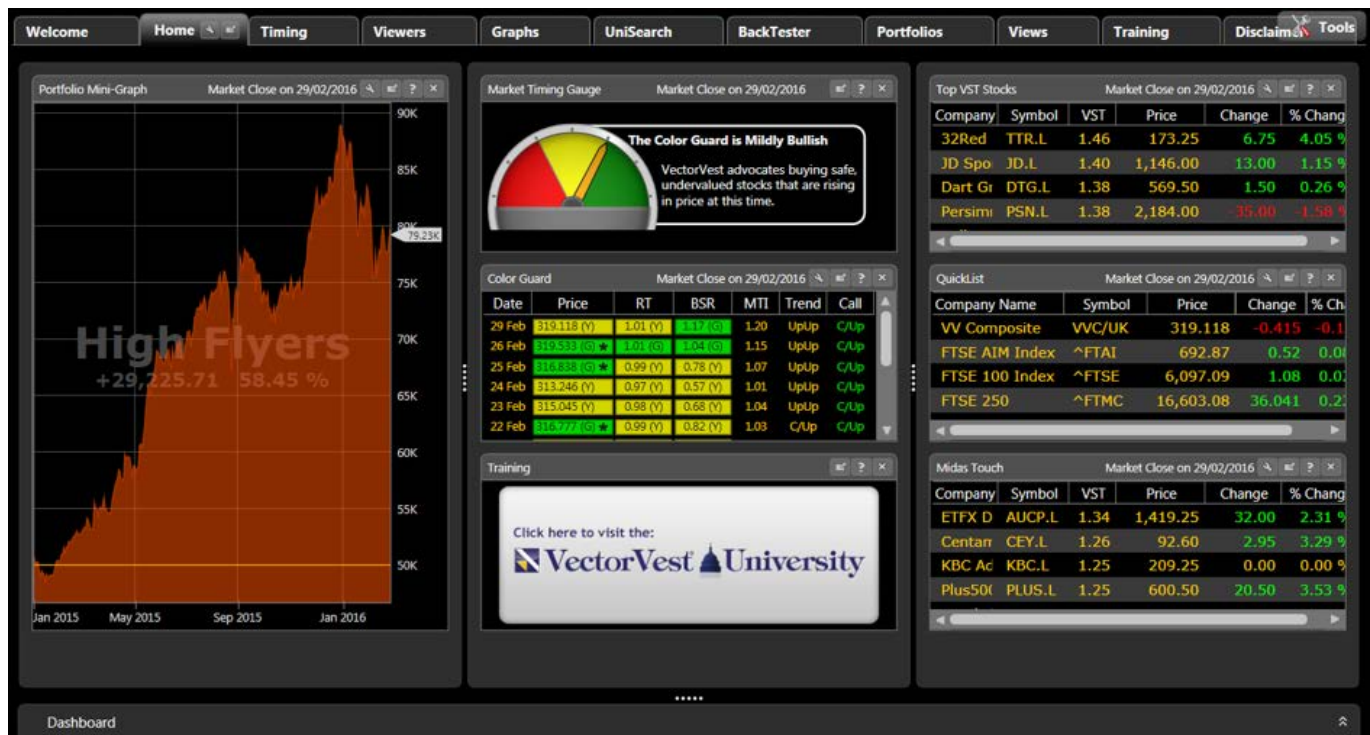
When he started investing again in '78 he realised there were three things he needed to know about stocks to improve his decision making: what they were worth, how safe they were and when to buy, hold and sell. He developed a formula for calculating a stock's value, based on the relationship between the earnings yield of stocks and the interest yield of bonds – the basis for all valuation formulas.

Using this formula suddenly made investing a lot more profitable. Dr DiLiddo launched VectorVest in the late 1980s as a weekly booklet to assist investors. It adapted over time to take advantage of evolving technology and the increasingly sophisticated requirements of its users, until it became what it is now – an invaluable tool that gives investors crucial market information in an instant.

To give just one example of how VectorVest successfully predicted market behaviour, on 25th July 2007 VectorVest issued a confirmed down







call for the UK market, followed by a further six down calls that spanned the next two dismal years as the market shed approximately 40% of its value. Then on 20th March 2009, VectorVest began issuing confirmed up calls alerting its members to the market rally as it began an amazing recovery.

Using VectorVest's clear signal indicators, private and professional investors alike have seen their capital protected and their profits dramatically increased.

How does VectorVest work?

At its heart, VectorVest offers information to investors on when to buy, hold and sell stocks as markets move up and down. It uses mathematical models to clearly define what causes a share's price to rise or fall. No opinions. No guesswork.

VectorVest analyses, sorts and ranks stocks for Value, Safety and Timing to produce an ingenious indicator called the VST (the Value, Safety, Timing vector). This allows VectorVest to rank stocks from those that have the best combination of Value, Safety and Timing to those that have the worst.

Quite simply VectorVest allows investors to analyse stocks better and faster than anything else out there. VectorVest won't make you rich over-



night. But it DOES tell you what a share is worth, how safe it is and whether to buy, sell or hold – the key information successful investors need.

The result is simple: you can protect your portfolio in market selloffs and

build sizable wealth during clearly defined periods of prosperity and bull market conditions.

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- Masses of other data available including charts and technical studies
- The platform is available to use on PC and Macs as well as smart phones and tablets so you can check out your portfolio when you are on the move too
- New strategies each week for you to try, chosen by a team of expert analysts
- The ability to back-test both these new strategies and your own strategies
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BY FILIPE R. COSTA

HOW TO INVEST LIKE...

WARREN BUFFETT

"I never attempt to make money on the stock market. I buy on the assumption that they could close the market the next day and not reopen it for five years."

— Warren Buffett

A Missed Opportunity?

Life is really like a dark box full of surprises! You shouldn't feel all that sad when you fear having missed the biggest opportunity of your life. While missing such a valuable opportunity is certainly a shame, it sometimes means becoming open to other opportunities you just don't know about yet. Certain events that we judge negatively can change our lives forever in an unthinkable way. Take Warren Buffett, for example. Had he been accepted by the business school of his choice – Harvard Business School – I probably wouldn't be writing about him today; Forbes wouldn't rank him in its billionaires list; and Berkshire Hathaway would have been long gone as a failed textile corporation. The Harvard rejection steered Buffett in the direction of Columbia Business School where he learned how to invest from the father of value investing, Benjamin Graham. Fifty-five years after learning from the best, Buffett became one of the most influential investors while amassing a personal fortune of \$67.3 billion.

The "Prodigal Son" of Value Investing

If Benjamin Graham is the father of value investing, Warren Buffett is certainly the prodigal son. The most serious follower of Graham's formula, Buffett has been investing with huge success for more than 50 years. He is living proof of the fallacy of the efficient market hypothesis, which claims that any return in excess of the market return can only be achieved by chance or by embracing extra risk. With a track record of five decades of successful investments behind him, it's hard to attribute Buffett's experience to any of the above.

Because of his great success in business ventures, after finishing college Buffett was not willing to continue studying. There was a world of opportunities out there so why spend time at University? But upon his father's persistence he enrolled at the Wharton School of the University of Pennsylvania and later transferred to the University of Nebraska-Lincoln, where he graduated with a Bachelors of Science in Business Administration, at the age of 19. By then Buffett was willing to enrol at Harvard Business School but his application was rejected.

After learning that Benjamin Graham was teaching at Columbia Business

Forbes - The World's Billionaires

Rank	Name	Net Worth	Source	Age	Country
#1	Bill Gates	\$77.7B	Microsoft	60	United States
#2	Amancio Ortega	\$71.2B	Zara	80	Spain
#3	Warren Buffett	\$67.3B	Berkshire Hathaway	85	United States
#4	Carlos Slim Helu	\$60.1B	telecom	76	Mexico
#5	Jeff Bezos	\$55.0B	Amazon.com	52	United States

* Updated on 17/April/2016

Source: Forbes, The World's Billionaires List



**“IF BENJAMIN GRAHAM IS THE
FATHER OF VALUE INVESTING,
WARREN BUFFETT IS CERTAINLY
THE PRODIGAL SON.”**



Kent Sievers / Shutterstock.com



School, he applied for a Masters course in Economics. The Harvard rejection together with the Columbia enrolment changed his life, through guiding him towards the discipline of value investing and ultimately making him one of the most successful billionaires the world has ever seen.

Graham's rigorous attitude toward investment helped Buffett create strong foundations for his future stock picking. The main principles to retain were few. First, Graham always taught that stocks are real businesses. A stock holding is much more than just a paper holding, as it entitles investors to a piece of the real business. What matters the most are the long-term prospects for that business. As Buffett loves to put it, "it's far better to buy a wonderful company at a fair price than a fair company at a wonderful price". Second, fluctuations in price represent opportunities. Instead of looking at the short-term fluctuations as harmful volatility, an investor should look at them as the market madness (personified as "Mr. Market" by Benjamin Graham) that gives the investor an opportunity to purchase long-term value for a low price. Third, always seek out a margin of safety. An investor cannot predict what lies ahead with precision. "In the business world, the rear-view mirror is always clearer than the windshield", such that an investor should always look for prices that allow for some margin if things go in the wrong direction. These main foundations were later expanded and adapted by Buffett but were always present in his investment style. Benjamin Graham was so influential in Buffett's professional life that Buffett named one of his sons Howard "Graham" Buffett.

Rendezvous with Graham

After graduating in 1951, Buffett was eager to work with Graham, but that would only happen later. Upon graduating, and after enrolling in a course to overcome the fear of speaking in public, Buffett went to the University of Nebraska-Omaha to teach a night class on "Investment Principles", mostly to students double his age. Later he finally persuaded Graham to accept him into his partnership, where he was paid an annual salary of \$109,000 (inflation-adjusted for 2016 dollars). In

“IT’S FAR BETTER TO BUY A WONDERFUL COMPANY AT A FAIR PRICE THAN A FAIR COMPANY AT A WONDERFUL PRICE.”



1956 Graham retired and closed the partnership. By then Buffett had accumulated personal savings of over \$1.5 million (in 2016 dollars) and had learned the tough and rigorous process of stock picking that Graham used to implement. For the next five decades, Buffett would base his investment decisions on the solid foundations he learned from Graham.

During the next few years following the close of Graham's partnership, Buffett started a few other partnerships. In 1962 his businesses had accumulated \$7 million and he decided to merge all ventures into a single one.

Here we reach the second most important professional event in Buffett's life: Buffett was about to invest everything in a lousy textile manufacturing business named Berkshire Hathaway. When I say lousy, I really mean a struggling business at risk of failing in the near future. In fact, Buffett's stake in Berkshire Hathaway was the worst investment of his life.

At first, when Buffett purchased stock in Berkshire, he was not intending to become the majority owner, but simply to benefit from Mr. Market's schiz-

ophrenia through purchasing shares at a low price. In 1964, Berkshire's CEO made an offer to repurchase the shares from Buffett for \$11.50, which Buffett accepted. But the Berkshire CEO reneged on his promises by making a tender offer of \$11.375, short of his initial proposal. This made Buffett angry. Instead of selling his stake, he decided to purchase even more in order to take control of the company and fire the CEO, which he did. That was a huge mistake, as the textile business was failing.





Over the next few years, to avoid bankruptcy, Buffett had to completely revamp Berkshire's business. He expanded into the insurance sector at first, whilst reducing the textile business of the company. He then expanded into other areas, transforming Berkshire into a conglomerate, before finally shutting down the last textile operations in 1985. Buffett turned Berkshire Hathaway into a big success. In March 1980, one share was worth \$260. Ten years later the same share was worth \$6,725. Currently it is worth \$219,000. Over a period of 36 years, the company has experienced an annual compound return of 20.6%, beating any market index and proving that Buffett is in fact one of the best value investors that has ever lived. Nevertheless, Berkshire was a mistake. Had Buffett invested directly in insurance and other businesses, he could have compounded at a much higher return. Nev-

ertheless, it was a lesson he wouldn't forget.

"I'm 85% Benjamin Graham"

Buffett's has two main investment principles: (1) never lose money; and (2) never forget rule one. While this is an extreme simplification that is unhelpful to investors wishing to build a portfolio, it teaches us that investment is about protecting principal before anything else. One of the main points in Graham was about correctly distinguishing between investors and speculators, where he claimed that investment was about purchasing value at a low price and holding for the long term, when value would come out on top of short-term irrationality. Speculation is about taking risks and therefore protecting principal is not a main priority. Buffett goes further than Graham because he believes that most purchases are for life, so an investor wants something that can keep the principal over time and that can provide a decent return for the money invested over a very long period. Before anything, just don't invest in something that may lose you money.

Buffett believes that an investor should (1) pick stock within his circle of competence. There's no need to be an expert in every business, and no one is. Investors should stay away from businesses they don't fully understand. To value a business, an investor needs to project future performance and then estimate the present value of those future cash flows. But, if he doesn't know how the business works, how can he project future performance? How can he estimate future earnings with safety? He certainly can't and would therefore have to rely on market projections, which is exactly what he should avoid. That is the main reason why Buffett preferred to stay away from technology in general. While this may have prevented him from benefiting from the upside the sector enjoyed, it also spared him from a few burst bubbles.

The entry point is of high importance. "Mr. Market is your servant, not your master", so investors should (2) use short-term irrationality in their favour to enter at a very low price. Sometimes equities are exposed to positive sentiment, which drives prices higher without any fundamental reason for it. The upside usually attracts more money into the market. That is exactly what investors should avoid. But more important than purchasing when a price is depressed is purchasing long-term value. Investors should (3) stick to companies with reliable earnings prospects and avoid so-called "growth" companies.

This means that statistics, like number of users, number of clicks and other demonetised metrics, are worth almost nothing and are just a way of disguising the lack of a positive earnings record. This is another reason why Buffett avoids the technology sector.

While Graham concentrated on the numbers, Buffett always takes into



"BUFFETT TURNED BERKSHIRE HATHAWAY INTO A BIG SUCCESS. IN MARCH 1980, ONE SHARE WAS WORTH \$260. TEN YEARS LATER THE SAME SHARE WAS WORTH \$6,725. CURRENTLY IT IS WORTH \$219,000."



consideration the management's friendliness to shareholders and business skills. Investors should (4) purchase stock from companies with a skilled management which acts proactively and doesn't just follow the lead of competitors. Investors should look for leaders, not followers. And they should look for managers that know what to do with the money the company makes. Retaining earnings without investing it back in the core business is certainly not in shareholders' interests. Investors should (5) look for companies with a management team that is not afraid of paying out excess earnings to investors when there are no better prospects to achieve excess profits with that cash by reinvesting it within the business.

“PRICE IS WHAT YOU PAY; VALUE IS WHAT YOU GET.”

While earnings are certainly an important metric, Buffett usually prefers to (6) focus on companies which offer a high return on equity (ROE). These are the companies that make the most money for shareholders. In order to have a good idea about ROE, an investor should take into account the last five to ten years of historical performance. While past performance is certainly not a guarantee of future performance, it at least gives an idea of what the limits are. But, of course, a higher ROE is the result of employing both shareholders' and creditors' money. If leverage is high, the ROE may also increase but at the costs of increasing risk. Buffett does a cross-check by (7) seeking out companies with lower leverage. A good way of accomplishing this task is to rank companies by debt-to-equity ratio (the lower the better), which is equal to total liabilities divided by shareholders' equity. Another way of taking into account steps (6) and (7) is to look at the free cash flow to equity ratio (FCFE), which is equal to net income plus depreciation and amortisation less capital expenditures less additional working capital needs. This ratio derives from the central idea that shareholders have a residual claim in the company and represents what is

left to pay them after everything else is discounted. Additionally, and because what matters is to invest in something capable of providing a stable income through the years, Buffett also believes that an investor (8) should look at profit margins. Earnings involve a number of charges, including interest expenses that depend on a few variables that aren't within the company's control, so sometimes looking at operating margins may give a better understanding about the business. How good are the company margins? Are they stable or is the company losing its pricing power?

Another important concept, mostly developed by Buffett, is the 'economic moat'. Some companies have a distinguishing characteristic that gives them an advantage relative to the competition. These companies have more stable earnings and will maintain their margins over time. An example is Coca-Cola and its impenetrable brand name. Investors (9) should therefore look for businesses with a distinguishing characteristic.

Buffett would (10) always avoid investing in IPOs. Investing in an IPO is more an act of speculation than anything else because no one can reliably estimate the future of a company where no one knows anything about its past. Sticking to companies with a track record is much wiser because over a sufficiently large period of, let's say ten years, the company would have most likely operated under expansion and recession periods. We would then

know that it can survive through tough market conditions. Most IPOs occur during favourable market conditions, which means being priced when sentiment is relatively positive, and are thus something an investor should avoid.

Finally, if an investor decides to proceed with a purchase, there is still one last check he should perform. Just because the intrinsic value is less than market value, it doesn't mean he should invest. Buffett believes an investor should (11) only invest in companies with an intrinsic value that is 25% or more below their market value. This gives a proper margin of safety if things go wrong.

Final Remarks

It is not by chance that an investor presents himself with a long-term rate of return of 20% per year, particularly when running an investment business worth many billions of dollars. The "Sage of Omaha" didn't get his name for guessing that Apple would re-invent personal computing with its iPad. In fact, he doesn't guess anything. He rather prefers to dig where others don't and to base his investments in reasonable assumptions rather than in sentimental guesses. Learning from Benjamin Graham, Buffett turned himself into one of Graham's most skilful disciples perpetuating the concept of value investing. Investing is not about the market price but about how a company makes money over time. "Price is what you pay; value is what you get."



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BY BILL BLAIN

IS BUFFETTOLOGY REDUNDANT IN TODAY'S CLIMATE?

Who wouldn't want to be as successful as Warren Buffett, the Sage of Omaha? His investment record puts almost all others to shame. What's less well known is that Buffett learnt almost everything from a book, "The Intelligent Investor", written by Benjamin Graham, the father of "value investing". Buffett studied under Graham in the 1950s, and it shows in his method-driven approach to investments.

The success of the Buffett/Graham "Value Investing" approach is founded upon sticking to core investment principles – common sense rules to maximise success and avoid failure in the stock market casino. Among the key concepts is the role of bonds in the "margin of safety" calculation. How much more should any investment yield in excess returns over the underlying "safe" government bond? Investments should be market agnostic – you shouldn't care what the stock market is saying about prices: buy stocks when the intrinsic value is higher than the stock price and the returns are sufficient. Use the market's ups and downs, and a disciplined approach, to buy cheap, and sell high.

Of course, the key differentiator is the knowledge, experience and tenacity to carry it off and pick winners – know what you are doing and why. In Buffett's case, his secret sauce is his behaviour as an owner, rather than simply a stock holder. He's not interested in setting price targets of where to sell,

but rather in the potential of the company to grow and maximise his investment over time. Buffett is on record as saying the market is his servant, not his master. Market prices are irrational and based on the collective emotion of participants – a weakness he ruthlessly exploits through experience.

**“IN BUFFETT’S
CASE, HIS SECRET
SAUCE IS HIS
BEHAVIOUR AS AN
OWNER, RATHER
THAN SIMPLY A
STOCK HOLDER.”**

Not everyone has Buffett's skillset to understand and the ability to connect which stocks are undervalued and worth buying. In the modern world we call it "Alpha" – the ability to generate

stock specific superior investment returns. Garnering returns that simply match indices is "Beta" – which is what most of the less gifted market participants are happy to think they achieve. But, how does classic "value investing" work when stock and bond markets are as fundamentally distorted as they are today?

Central bank monetary desperation and experimentation has left a massive portion of the developed world's bonds trading at negative yields. Markets are plagued by frightening illiquidity. Stock markets are proving volatile as a host of technical and fear factors are roiled by uncertainty and contradictions. A never ending run of political ructions and threats around the globe threaten markets. The end of the era of investment banking and regulatory overkill means markets are no longer as efficient as they once were.

Since the global financial crisis began in 2007, we've seen a massive burst of financial evolution across markets. It's



“EVEN THE LARGEST MARKETS ON THE PLANET, INCLUDING THE US TREASURY BOND MARKET, FEEL LESS ACTIVE AND LESS LIQUID THAN PRE-CRISIS. MARKET PARTICIPANTS ARE NOW FIXATED BY COMPLIANCE RATHER THAN RETURNS.”

leaving the financial landscape utterly changed, while the flora and fauna of finance is finding new and surprising niches. The Apex Predators of the Age of Investment Banking age – the global banking behemoths – look unsustainable. They are being forced to de-lever and back out of markets. They are regulated to destruction, but in business they are finding themselves superseded by more nimble fin-tech companies which will replace their banking offerings at a fraction of the cost.

Meanwhile, the herbivores of the age have evolved. The insurance companies and pension funds that were formerly happy to be force fed bonds and stocks by greedy investment banks are now lending direct to corporates and pursuing more diverse investment strategies. And the investment banks themselves are desperately trying to re-invent themselves as private wealth managers – they don't seem to realise how much the world has changed, and changed utterly. (I can't help but giggle at the managerial brilliance that thinks Credit Suisse is going to successfully offer Swiss private banking services to

Far East entrepreneurs. Firstly, the sole unique selling point of Swiss banking was privacy. Second, Far East money is going to work itself hard!)

Even more damaging over the last few years has been the loss of "ancestral memory" across banking. As banks have struggled to cope with rising capital costs (mandated by revengeful regulators), their only option has been to dump staff. It's costly to retain white heads – so anyone with even a modest experience of the market's foibles has been shunted out and replaced by juniors.

It's no surprise that many believe markets are fundamentally broken. The reek of suspicion is everywhere. Even the largest markets on the planet, including the US Treasury bond market, feel less active and less liquid than pre-crisis. Market participants are now fixated by compliance rather than returns.

In order to stimulate economic activity, central bank policy has been to drag yields to unprecedentedly low levels.

One effect has been to crowd investors out of bonds (global central banks hold the bulk of government bonds through QE programmes) through zero or negative interest rate policies. What's the point of holding a zero percent returning Bund when the ECB's stated goal is 2% inflation?

As bond yields tumbled we saw three effects:

Firstly, low interest rates have failed. The only place we've seen inflation is in financial assets – distorted by central bank policies. Economies have resolutely failed to grow despite low rates – many now believe financial asset inflation has been a hindrance rather than a help.



Second, as rates fell, investors scrambled down the credit curve, buying more and more risky corporate credit in search of returns – and lower returns became a closed feedback loop as new buyers pushed the yields of these more risky assets lower as well.

Third, as the whole bond market chased yields towards zero, folk pulled out to buy other assets – property and stocks. The logic is simple: if bond yields are falling and stocks give a better return, buy stocks. But, step back and consider the serious logic that if bond yields are falling, it's because the economy is in trouble, therefore future earnings will decline, and thus stock prices should also fall. Nope.

Today we believe six impossible things before breakfast and stocks rally as bond yields plummet.

Yield tourists from bonds into stocks kept equity prices high even as the global economy remained stalled. At the same time bond issuers – corpo-





rates – took advantage of low interest rates to raise stupendous amounts on the global bond markets – \$23 trillion by our estimate – very little of which paid for new factories or real assets. Much of it was promptly reinvested into stock buy-backs – pushing equity prices higher still.

Where does all that leave the concept of value investing and the safe bond yield? Or the concept of intrinsic stock value higher than the stock price, when market values are so volatile?

There are a couple of ways to navigate these problems.

The first is to invest long term – choose your long-term winners and stick with them. Choose companies where you obey the Buffett/Graham dictates about intrinsic value and stick with it. Buffett's success has been to choose winners remote from the risks of the rapidly changing world! Railways will always make sense in terms of moving bulk from one place to another, but do I really want to invest in Tesla on the basis that it's such a long-term disruptive technology every other car maker in the world will have to buy in? Or do driverless cars mean we're the last generation of folk who will care what we drive? There's nothing wrong with a value-investing approach that spots

“AN INCREASING NUMBER OF INSTITUTIONAL INVESTORS HAVE SHIFTED SERIOUS AMOUNTS OF CASH OUT OF THE STOCK CASINO INTO ‘ALTERNATIVE ASSETS’.”

the properly risk-priced undervalued opportunities.

The second approach is to invest outside the volatile bond and stock markets – and look for investment returns from non-correlated but understandable assets. An increasing number of institutional investors have shifted serious amounts of cash out of the stock casino into "alternative assets" – a broad spectrum of bespoke deals including private placements, SME funding and direct lending.

This "Alternative" market is a function of the current financial evolution. Alternative investment has grown as banks retreat from lending activities and non-bank lenders look for better and more predictable returns. This could take the form of financing aircraft, property, heavy machinery, telecom assets... or basically anything from aluminium deliveries to zoo feedstock on a secured basis.

Many of these assets throw off predictable cash flow at far more realistic spreads than "benchmark" bonds. Until recently such investment opportunities were the preserve of the investment banks, but now pension funds and insurance companies are increasingly lending direct on such assets.

The risks are very different – what fund manager would want the hassle of trying to sell a Jumbo Jet he inadvertently owns after an airline defaults on its lease? That's a matter of financing the right assets for the right people... which is basically what value investing is all about...

That's why the current markets are so interesting – there are solid firms and assets out there looking for finance. The trick is finding them!

Nothing really changes.

About Bill

Bill Blain is a leading market commentator. After 25 years as an investment banker, he took up broking in 2007 and now provides guidance across asset markets.





BY JOHN KINGHAM

THE DIVIDEND HUNTER

DIVIDEND INVESTING A LA WARREN BUFFETT

I'm going to be completely frank with you: you are not Warren Buffett and neither am I. He is quite simply a one in a billion genius and, as if that wasn't enough, his brain has many decades of experience to tap into. The best that the average investor can hope to achieve, if they want to emulate Buffett's style, is to pick a small subset of his approach and to simplify it as much as possible, but without significantly impairing its effectiveness.

The first step – choosing a subset of Buffett's approach – is fairly easy, at least in the context of this Dividend Hunter column. Buffett's main strategy in recent years is the one he's best known for: buying exceptional companies and trying not to over-pay for them – and that's fairly similar to what a lot of dividend investors already do. So here I'll assume that the typical Buffett investor will be focusing on buying high quality companies with some kind of defensible competitive advantage, or "economic moat" as Buffett calls it, and of course trying to pick up those companies when their yield is relatively attractive.

The second step – boiling his approach down into something that the average investor can use – is, I think, a bit more difficult, largely because there are many different ways to define a high quality company and just as many again for deciding what a good price for that company would be. But we have to start somewhere and the best place to begin the

search for high quality companies is with their financial results. There are, I think, a few basic features that a Buffett-type investor should look for in a company's accounts. These include:

Growth – Companies should have a long track record of inflation-beating growth. This record should extend back at least ten years and cover revenues, earnings and dividends.



Consistency – Companies should have paid a dividend in every one of the last ten years and have made a profit in almost every one of those

years. On top of that they should have regularly increased their revenues, earnings and dividends, and the more often the better.

Profitability – Companies with powerful economic moats tend to generate consistently high profits relative to the capital employed within the business. As a result their average return on capital employed (ROCE) should be above average and preferably in double digits.

Conservative finances – Buffett is very wary of borrowed money. Even though it is theoretically optimal to run most companies with some degree of leverage (i.e. debt), Buffett prefers companies that carry little or no debt. This makes them more robust and more likely to survive and thrive through the many decades over which Buffett expects to hold each of his investments. A Buffett-like way to measure debt is by the ratio between a company's borrowings and its five-year average profits.



**“BUFFETT’S MAIN STRATEGY
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FOR: BUYING EXCEPTIONAL
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TO OVERPAY FOR THEM.”**





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Using data from ShareScope it's possible to screen the FTSE All-Share using the metrics above, looking for Buffett-style stocks that are worth investigating in more detail. I'll do that now, using the following criteria: For growth, I'll insist on a 5% growth rate over the last ten years. For consistency, I'll insist that the company has increased its revenues, earnings and dividends at least 75% of the time over the last ten years. For profitability I'll insist on a ten-year average ROCE of at least 12%. Last but not least, I will also insist that borrowings be no more than five-times the company's five-year average profits, which is a reasonable upper limit.

Running that filter over every stock in the FTSE All-Share produces a list of 49 companies. There isn't enough room here to look through all 49, so I'll focus on a handful of companies that are similar, in some respects, to one or more of Buffett's current holdings.

AG Barr (LON:BAG): 9% growth, 16% profitability, 2.4% yield

One of Buffett's most famous decisions was to invest heavily in Coca-Cola during the late 1980s. Coca-Cola has features which are central to the popular view of Buffett's investments: it sells an inexpensive consumer good which millions of people buy every day regardless of the state of the economy, and its main product has an incredibly powerful brand name.

FTSE 250-listed soft drink manufacturer AG Barr also shares those key qualities. Its flagship product, IRN-BRU, has been around for over a century as

"THAT VIRTUOUS CIRCLE OF HIGH PROFITABILITY AND HIGH FREE CASH GENERATION HAS DRIVEN COCA-COLA'S SUCCESS OVER THE LAST 100 YEARS, AND PERHAPS AG BARR CAN REPLICATE THAT OVER THE NEXT 100 YEARS."

one of the best-selling soft drinks in the UK, where its distinctive brand name and look is known to almost everyone.

For both Coca-Cola and AG Barr, the secret to their success is that there are lots of people who will buy a bottle of Coke or IRN-BRU and pay £1.15 for it (for example) rather than buying a near-identical unbranded alternative for £1.05. To the customer the 10p difference is negligible, but if the underlying cost of producing each drink is £1 then Coca-Cola and AG Barr are generating three times the profit of their unbranded competitor on each bottle sold (15p profit versus 5p).

That massive increase in profit margin allows AG Barr to out-market their competitors as the company has more free cash available. Not only that, but each new customer acquired is more profitable than a similar customer acquired by their competitors, thus allowing greater marketing-spend per customer.

That virtuous circle of high profitability and high free cash generation has driven Coca-Cola's success over the last 100 years, and perhaps AG Barr can replicate that over the next 100 years.

At 555p AG Barr has a yield of 2.4%, which is not bad at all given its overall ten-year growth rate of 9% and a dividend growth rate which has been closer to 10%. Relative to other Buffett-style stocks I do think AG Barr is quite attractively priced, although I don't currently own it.

Reckitt Benckiser (LON:RB.): 7% growth, 21% profitability, 2.1% yield

In a similar vein to Coca-Cola and AG Barr, both of which sell small-ticket repeat-purchase items with strong

brands, Buffett also has a major investment in Procter & Gamble (P&G). P&G is the company behind such well-known brands as Fairy Liquid, Duracell and Pampers and a similar company listed on the FTSE All-Share is Reckitt Benckiser. Much like Procter & Gamble, Reckitt is a powerful force in the world of consumer goods, producing many world-leading products such as Dettol, Durex and Nurofen.

The basic business model is exactly the same as it is for Coca-Cola and AG Barr. Strongly branded products are sold at a premium price, which generates abnormal amounts of profit and cash. That cash can then be reinvested into marketing in order to grow the business.

One difference between P&G and RB compared to Coca-Cola and AG Barr, is that the former's products often require significant innovative improvements in order to remain competitive, while the latter's do not. So while Dettol may need new formulations or new dispenser designs in order to keep



up with improvements from its competitors, IRN-BRU typically requires little in the way of similar improvements or innovations. However, the cost of innovation for companies like Reckitt is not so high that it damages the fundamental soundness of its business plan, which is borne out by its extremely high ten-year average profitability figure of more than 20%.

As well as exhibiting exceptional profitability, Reckitt has also grown at more than 7% per year over the last ten years, so it is clearly a very capable company. At 6,750p the shares have a dividend yield of just 2.1%, so they are certainly not a high yield investment. However, companies that combine high quality and high growth are unlikely to be high yield as well, and so despite Reckitt Benckiser's low yield I still think the shares are attractively valued, to the point where I currently own shares in Reckitt Benckiser.

Dunelm Group: 18% growth, 35% profitability, 2.4% yield

Buffett doesn't just invest in strongly-branded small-ticket consumer goods companies. One completely different type of investment was his purchase of the Nebraska Furniture Mart in 1983.

The Nebraska Furniture Mart's competitive advantage is based on it being the lowest cost operator. It sells furniture

and related items for less than its main rivals, and yet still maintains a reasonable profit margin. It does this primarily through economies of scale, and lots of it. Each of the company's four locations are vast, with three of them covering more than a million square feet each and holding hundreds of thousands of items for sale. There is simply no point competing against such scale, as by the time a competitor had built a store big enough to enjoy the same economies of scale, supply of furniture items from the two competing stores would exceed local demand and so neither would likely make attractive profits.

“RELATIVE TO OTHER SIMILARLY SUCCESSFUL COMPANIES I THINK DUNELM IS ONE OF THE MOST ATTRACTIVELY PRICED STOCKS IN THE UK MARKET.”

Dunelm, as the UK's leading homeware retailer, is in some respects quite similar to the Nebraska Furniture Mart. Dunelm's strategy is also based on using scale, in the form of huge out-of-town superstores, to keep costs to a minimum (the company's motto is "Simply Value for Money"). In addition, although its superstores don't have

anything like the million square feet of the Nebraska Furniture Mart, it is able to keep competitors away due to its decision to locate most of its superstores in out-of-town retail parks.

These out-of-town retail parks typically have a limited number of very large stores, each chosen by the landlord to complement the others so that visiting the retail park can be a more complete "shopping experience". If a retail park contains one furniture store then it is unlikely to want another; that space could more sensibly be filled with a store selling electronic goods, clothing or something else complementary.

Of course Dunelm does also have a good brand name and that, combined with its proven ability to roll out a large number of highly profitable superstores, makes it an even more likely candidate for Buffett-style investors. At 900p the shares are not obviously cheap with a dividend yield of 2.4%, but relative to other similarly successful companies I think Dunelm is one of the most attractively priced stocks in the UK market.

Admiral Group (LON:ADM): 12% growth, 54% profitability, 6% yield (including regular special dividend)

I couldn't possibly write about Buffett without mentioning insurance. Insurance operations have historically been the backbone of Buffett's Berkshire



Hathaway conglomerate, including the outright purchase of National Indemnity in 1967, GEICO (Government Employees Insurance Company) in 1996 and many others.

The basic idea behind Buffett's insurance investments is "float". Float is the pool of insurance premiums which have been collected but have yet to be paid out to cover the cost of claims. Insurance companies typically invest this float in order to generate capital gains and income, which then belong to the company rather than the insured. As far as Buffett is concerned, this float represents interest-free money for him to invest.

As for Admiral, it is one of the most successful motor insurance companies in the UK, by any reasonable measure. It's highly profitable, has a long history of very consistent growth and it also has an extremely good brand name. Unlike Buffett, it doesn't invest its float in equities, preferring instead to focus on safety and liquidity by investing primarily in money market accounts. But a cautious investment policy hasn't stopped the company from growing at an impressive rate, and I for one have been a happy Admiral shareholder for several years.

At 1,860p Admiral is the most attractive stock in the UK market, at least ac-



“A CAUTIOUS INVESTMENT POLICY HASN'T STOPPED THE COMPANY FROM GROWING AT AN IMPRESSIVE RATE, AND I FOR ONE HAVE BEEN A HAPPY ADMIRAL SHAREHOLDER FOR SEVERAL YEARS.”

cording to the accounting factors we're using here and its dividend yield. Currently that yield, including its regular special dividend, is just over 6%, which makes Admiral that rarest of things: a stock that is both high quality and high yield.

Of course whether or not Buffett would actually invest in any of these four companies is another matter, but I do think that among UK-listed stocks these are some of the companies he would want to take a second look at.

About John

John Kingham is the managing editor of UK Value Investor, the investment newsletter for defensive value investors which he began publishing in 2011. With a professional background in insurance software analysis, John's approach to high yield, low risk investing is based on the Benjamin Graham tradition of being systematic and fact-based, rather than speculative.

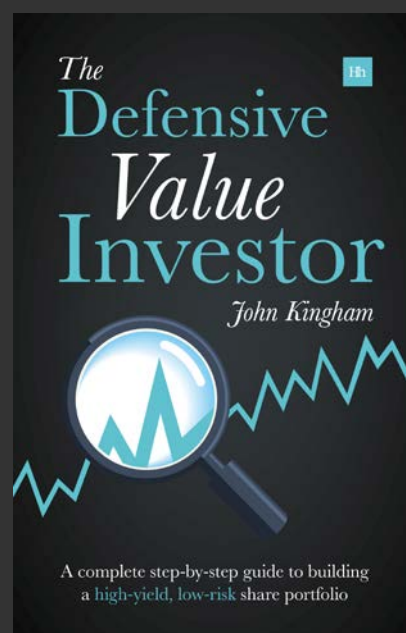
John is also the author of *The Defensive Value Investor: A Complete Step-By-Step Guide to Building a High Yield, Low Risk Share Portfolio*.

His website can be found at: www.ukvalueinvestor.com.

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BY NICK SUDBURY

FUNDS IN FOCUS

CHIP OFF THE OLD BLOCK

Warren Buffett is one of the most successful investors of all time and has amassed a personal fortune of more than \$67 billion over a long career stretching back to the 1950s and beyond. If you want to profit directly from his investment expertise you would need around \$219,000 to buy a single share in his Berkshire Hathaway holding company, but with the 85-year old getting near to retirement it would make more sense to consider one of his many protégés.

The sage of Omaha is obviously unique, yet there are plenty of UK-based fund managers who try to emulate his style and success. Nobody has taken this further than Keith Ashworth-Lord, who runs the £32.5m **ConBrio Sanford DeLand UK Buffettology** fund and is the only one in the UK to have licensed the use of the 'Buffettology' name.

Ashworth-Lord aims to achieve a superior annual compounding rate of return over the long term, defined as between five and ten years, by investing mainly in the equity of UK businesses with strong operating franchises and experienced management teams. These companies are selected according to the principle of 'business perspective investing'.

This means that each business must have an enduring franchise with

pricing power, consistent operational performance, relatively predictable earnings, high returns on capital employed, strong free cash flow, a strong balance sheet, a management team focused on delivering shareholder value, and have no undue reliance on acquisition-led growth.

Ashworth-Lord has put together a concentrated portfolio of 25-30 stocks and justifies this using one of Buffett's famous quotes: "A lot of great fortunes in this world have been made by owning a single wonderful business. If you understand the business, you don't need to own very many of them."

In April 2011, the first month after the fund was created, the manager bought 16 different shares and 11 of them are still in the portfolio today.

He tries to avoid taking short-term profits and has a typical holding period of five to ten years.

The largest positions at the end of March included relatively obscure businesses such as: Bioventix, Scapa Group, Dart Group, NCC and Trifast, as well as better known ones like Domino's Pizza. It seems to work as over the last five years the fund has returned 106.8%, which puts it in fourth place out of the 259 funds in the UK All Companies sector.

Going like a train

It is very similar to the approach taken by Nick Train, whose **CF Lindsell Train UK Equity** fund is just behind it with a five-year return of 104.5%. He and his co-manager, Michael Lindsell, use Buffett's strategy of buying the undervalued shares of

“A LOT OF GREAT FORTUNES IN THIS WORLD HAVE BEEN MADE BY OWNING A SINGLE WONDERFUL BUSINESS. IF YOU UNDERSTAND THE BUSINESS, YOU DON'T NEED TO OWN VERY MANY OF THEM.”

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“SMITH DESCRIBES HIMSELF AS A LONG-TERM INVESTOR AND SAYS THAT HE WILL ONLY BUY HIGH QUALITY BUSINESSES THAT CAN SUSTAIN A HIGH RETURN ON OPERATING CAPITAL EMPLOYED.”

great companies with a view to holding on to them for the long term.

They even have one of the great man's quotes on their website: "Stocks are simple. All you do is buy shares in a great business for less than the business is intrinsically worth, with managers of the highest integrity and ability. Then you own those shares forever."

This may sound straightforward but it is not easy to identify these sorts of exceptional companies. The way that Train goes about it is to look for durable, cash generative franchises, whose shares are undervalued relative to their intrinsic worth based on a discounted cash flow model.

He says that there are very few businesses that meet these demanding criteria and by building a concentrated portfolio of them he can reduce the risk to investors' capital. That is why he will typically only have 20 to 35 holdings and a low level of turnover, normally less than 5% per annum, which also saves on transaction costs.

At the end of March the top 10 holdings accounted for a massive 72.7% of the £2.1bn CF Lindsell Train UK Equity fund. These included the RELX Group, Unilever, Diageo, Sage, Heineken, Har-

groves Lansdown and the London Stock Exchange.

The maverick approach

Buffett is regarded as a bit of a maverick, a man who leads a frugal lifestyle despite his enormous wealth and who still lives in the same house he bought in Omaha, Nebraska in 1958. He has steered clear of the rich trappings of Wall Street and is certainly not your typical financier.

Another outsider is Terry Smith, an outspoken critic of the fund management industry who set up his own investment house, Fundsmith, in 2010 to provide a straightforward alternative for investors. In typically modest fashion he said at the time that it would be "the best fund ever".

The two men have very different personalities, but their investment approach is remarkably similar. Smith describes himself as a long-term investor and says that he will only buy high quality businesses that can sustain a high return on operating capital employed.

His holdings also need to have advantages that are difficult to replicate, must not require significant leverage



to generate returns, have a high degree of certainty of growth from reinvestment of their cash flows at high rates of return, be resilient to change, and be attractively valued.

There are not many companies that meet these stringent criteria, which is why at the end of March the £5.5bn **Fundsmith Equity** fund had just 27 holdings. As he says on his website: "Just a small number of high quality, resilient, global growth companies that are good value and which we intend to hold for a long time, and in which we invest our own money."

The top 10 holdings are mostly household names and include the likes of Microsoft, Philip Morris, Sage, Dr Pepper Snapple and Johnson & Johnson, as well as less familiar businesses such as Stryker, Amadeus and CR Bard.

Over the last five years Fundsmith Equity has been the best performing fund in the Investment Association's Global sector with a return of 138.8%. It is just ahead of **Lindsell Train Global Equity**, which was in fourth place with a gain of 113.5%. This is another concentrated portfolio with many of the same major holdings as their UK fund, although there is no obvious overlap with the Fundsmith portfolio.

In June 2014 Terry Smith launched his second fund, an investment trust that focuses on the developing economies. The **Fundsmith Emerging Equities**



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“FROM WHEN IT WAS LAUNCHED IN JUNE 2014 TO THE END OF MARCH 2016 THE CF WOODFORD EQUITY INCOME FUND WAS UP 18.7%, WHILE THE FTSE ALL-SHARE INDEX FELL 2.5%.”

Trust (FEET) uses the same investment strategy as his other fund, but provides exposure to less mature markets. It has had a difficult start to life with the shares down 2% at the end of March from the issue price.

Tried and tested

The best known fund manager operating in this country is Neil Woodford, who made his name at Invesco Perpetual before setting up his own investment company. He has said that Warren Buffett is one of the people who have influenced how he has developed as a portfolio manager.

Woodford ran the **Invesco Perpetual Income Fund** from October 1990 to May 2014 and during this period he

generated a 14.3% annualised compound return, which was significantly ahead of the 9.6% achieved by the FTSE All-Share index and the 9.3% average return from the UK Equity Income Sector. What makes it even more remarkable is that it was achieved at a lower level of volatility and with a smaller maximum drawdown (peak to trough loss) than both of these benchmarks.

In 2014 Woodford set up his own business, Woodford Investment Management, with his first fund – **CF Woodford Equity Income** – being launched in June of that year. This uses the same strategy that he developed so successfully at Invesco Perpetual.

The investment process aims to identify stocks where the market has mispriced the value of the company's prospective cash generating ability within the prevailing macro-economic environment. He will then invest where he believes that the market view will adjust over time, thereby resulting in a higher share price.

His approach is similar to the other Buffett protégés in that he concentrates on a company's future cash flow, which is harder for the Board to manipulate than most of the other figures in the accounts. Where he differs is that he pays more attention to the top down view of the economy.

From when it was launched in June 2014 to the end of March 2016 the CF Woodford Equity Income fund was up 18.7%, while the FTSE All-Share index fell 2.5%. The top 10 holdings account for just under half of the portfolio and include the likes of Imperial Brands, AstraZeneca, GlaxoSmithKline, British American Tobacco, Reynolds American and Roche.

Father figure

The man who inspired Buffett was Benjamin Graham, whose value-based investment strategy is described in his book 'The Intelligent Investor'. Writing in the preface to the revised edition, Buffett says: "To me, Ben Graham was far more than an author or teacher. More than any other man except my father, he influenced my life."

Graham's strategy forms the basis of Church House Investment Manage-

ment's **Deep Value Investment** fund, which invests in small cap companies that are trading at a discount to their net asset value.

These sorts of businesses tend to have strong balance sheets that provide a margin of safety, but have suffered a temporary loss of profitability due to specific short-term factors. This type of scenario makes it possible to buy solid companies at attractive prices.

The £9.5m Church House fund holds a concentrated portfolio of 20 to 25 stocks that exhibit 'deep value' characteristics. These are mainly listed in London, although up to 30% can be invested overseas.



At the end of March there were 28 holdings including a large cash balance of 27.2%. The biggest positions were in companies such as Record plc, H&T Group, French Connection, Icahn Enterprises and Walker Crips.

It has been a difficult time for value investors and the Church House Deep Value Investments fund has suffered along with many others. After returning 17.4% in 2013 it lost 8.8% in 2014 and 10.7% in 2015 and was also in negative territory for the first quarter of 2016.

Those that buy out-of-favour businesses that are trading at less than their intrinsic worth often need a lot of faith and patience in their approach as it can take time for the market to wake up to their true potential. Even Buffett's Berkshire Hathaway lost money last year, but nobody can question the long-term success of this sort of strategy when it is properly executed.





BY RICHARD GILL, CFA

FROM ACORNS TO OAK TREES

SMALL CAPS IN THE SONG OF BUFFETT

Warren Buffett is considered to be a great man for many reasons. For a start, the words of wisdom in his famous Berkshire Hathaway shareholder letters are so influential that they are widely quoted amongst the investment industry. For example, while working on the Master Investor magazine stand at last month's annual conference I managed to catch three company presentations and all contained a quote by Buffett.

He also has the great characteristics of modesty (he's still living in the same three-bed house in Omaha he bought over fifty years ago), philanthropy (having pledged over \$30 billion worth of Berkshire Hathaway shares to the Bill & Melinda Gates Foundation) and self-criticism (admitting, "... I've made some dumb purchases").

But at the bottom line, Buffett is considered such a legend amongst investors because of his track record of delivering consistent market beating returns over a career spanning more than fifty years.

How good is Buffett at investing?

As the chart below shows, the book value of Buffett's investment vehicle Berkshire Hathaway grew at a compound annual rate (CAGR) of 19.2% between 1965 and 2015, equating to a total return over the period of 798,981%. Unsurprisingly, Buffett consistently beats the wider market as well – the S&P 500 with dividends included has only returned a CAGR of 9.7% since

1965. Notably, the firm has seen a fall in book value in only two individual years since 1965 – these, excusably, being during the tech collapse of 2001 and during the global financial crisis of 2008. In both years the falls were substantially lower than those seen in the S&P 500.

But this does not tell the full story. Buffett's underlying performance has actually been much better.

As Berkshire Hathaway's recent shareholder letters explain, the firm's "intrinsic" book value far exceeds its accounting book value mentioned in the calculations above. This is due to a change in strategy during the 1990s, when Berkshire moved from owning partial stakes in companies to owning businesses outright. This resulted in stricter accounting rules being applied to the balance sheet valuation, whereby the value of losers is written down but winners are not revalued upwards. With there having been many more winners than losers, the underlying intrinsic value of the balance sheet

is therefore much larger than its reported accounting book value.

This is reflected in the company's share price having risen at a CAGR of 20.8% since 1965 (or a total return of 1,598,284%), well ahead of book value as investors realise the inherent value in the business. It is also reflected in Berkshire saying it is willing to buy back its own stock should it trade as low as 120% of book value.

Buffett tends to focus his investments on large US focussed companies.

However, his investment concepts can still be applied to UK small caps. The main concept he focuses on is the idea of an "economic moat". This refers to when a company has a number of qualities which give it an economic advantage over its rivals over the long term. These can include a number of things such as strong brands, network effects, low operating costs/economies of scale and strong patents/intellectual property. Companies with such char-



Kent Sievers / Shutterstock.com



acteristics often have a high return on capital/equity (Buffett looks for 12% and above), strong cashflow and create consistent shareholder value.

It is no easy task to find firms with wide economic moats at the smaller end of the market given that small companies will find it harder to generate substantial scale benefits. But in this analysis I think I may have identified two companies which Buffett might just consider investing in.

NICHOLS

Warren Buffett is known for his love of Cherry Coke. But to put a bit more fizz into his returns he might want to try adding another well known soft drink to his portfolio.

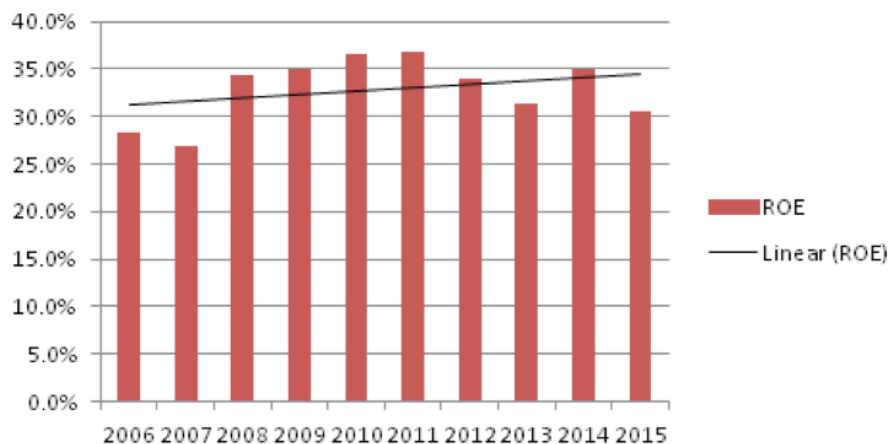
Nichols (NICKL), one of the best small cap performers of the past decade, is a UK based seller of still and carbonated (fizzy) soft drinks. Its own economic moat comes via a strong portfolio of branded products, some of which have been around for over 100 years.

Although the company's products are arguably not quite as well known around the globe as those owned by Coca Cola et al, it does have a solid market presence in the UK as well as a large presence in a number of countries around the world. It also delivers superb returns on equity which have averaged c.33% in the past 10 years – well above Buffett's minimum criteria of 12%.



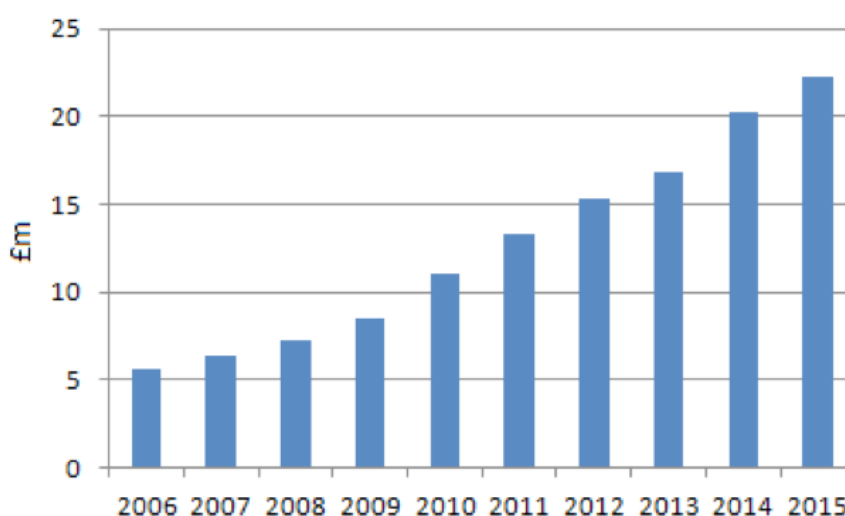
The moat is further strengthened by strong and stable margins which have been driven by operating efficiencies as the company has grown in size. Notably, Nichols' operating margins are actually higher than Coca Cola's (25% vs 20% in 2015).

Nichols' flagship brand is fruit based drink **Vimto**, which was first created in Manchester in 1908 by inventor John Nichols. Other core brands include **Levi Roots**, **Feel Good**, **Sunkist** and **Panda**, all of which are sold in the UK,



Nichols historic return on equity

Nichols net profits



Nichols 10 year net profit growth

the company's core market which contributed 77.5% of revenues in the last financial year. Nichols also has a long history of growth in international markets. Its first overseas shipment was to Guyana in 1919 and now the company exports to over 70 countries worldwide, with key markets being in the Middle East and Africa.

Further fizz in 2015

Nichols posted compound annual growth (CAGR) in net profits of 16.4% between 2006 and 2015 (chart above), with last year being another good one for the company. Revenue growth in 2015 was relatively flat at £109.3 million, with UK sales falling by 0.3%, offset by a 1.5% rise in international sales. But notably, reflecting the firm's "moat" like characteristics, the UK sales performance was ahead of the wider soft drinks market, which according to industry analysts Nielsen fell by 0.6%. At the bottom line, pre-tax profits grew by

“WARREN BUFFETT IS KNOWN FOR HIS LOVE OF CHERRY COKE. BUT TO PUT A BIT MORE FIZZ INTO HIS RETURNS HE MIGHT WANT TO TRY ADDING ANOTHER WELL KNOWN SOFT DRINK TO HIS PORTFOLIO.”



a more pronounced 9% to £28 million mainly as the gross margin increased from 46% to 48.5%.

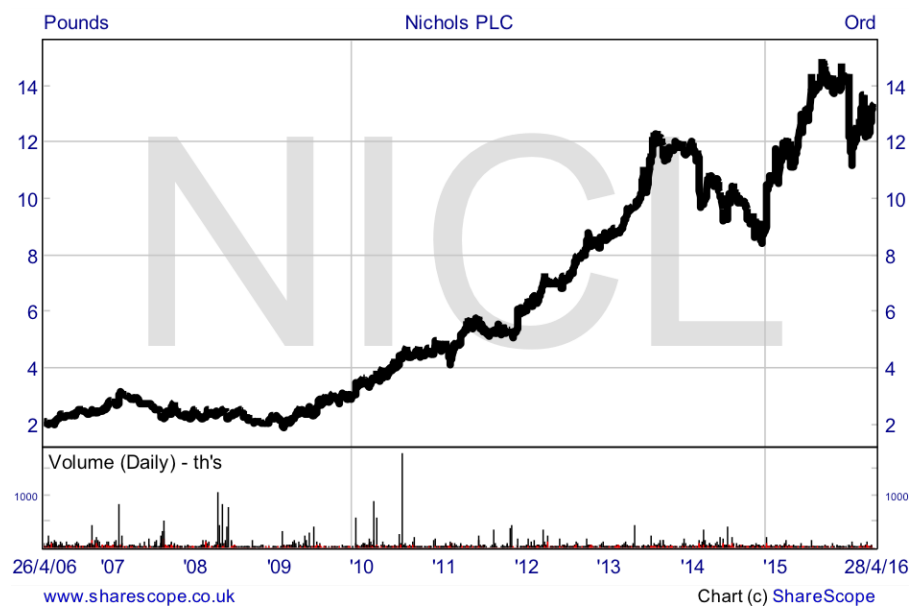
Another highlight of the year came in the form of two acquisitions. In March the company bought a 49% stake in The Noisy Drinks Company, and subsequently (in January) purchased the rest of the business. Noisy Drinks, a £6.6 million revenue company, specialises in frozen/slush drinks, selling the Starslush and Slurp brands to a client list including Merlin Entertainments and Compass Catering. Then in July 2015 Nichols acquired the Feel Good brand, an established range of premium still and sparkling juice drinks containing no added sugar and 100% natural ingredients. This deal may be important, for reasons discussed below.

A subsequent statement at the AGM in April revealed that trading in the year to date was in line with expectations, with the recent acquisitions of Noisy Drinks and Feel Good having an incremental impact.

Shares worth a pop?

Over the past ten years Nichols shares have delivered capital growth of 547% (that's a Buffett-esque CAGR of 20.5%) along with consistent dividend distributions. At the current price of 1,326p the company is capitalised at £490 million and at the time of writing is the 26th largest on AIM.

Despite announcing in January this year that trading was in line with expectations for 2015, the shares lost 22% of their value in little under two weeks.



Then in March a subsequent recovery was set back by the announcement by the UK government of a so called "sugar" tax, which is to be implemented in 2018. Nichols looks to have plenty of time to address this, especially given that it already has a large portfolio of sugar free products – boosted by the acquisition of Feel Good.

In spite of this medium-term threat there still looks to be plenty of room for growth for Nichols. Its UK revenues of £84.8 million in the last financial year only give it a c.1.1% share of the £7.6 billion UK soft drinks market, with an even larger opportunity coming from the burgeoning international operations.

As is the case with most companies with solid economic moats, Nichols shares are not cheap, currently trading on a multiple of 20 times forecast earnings for 2016. Nevertheless,

this looks to be a price worth paying given the firm's track record. Dividend growth has also been consistent over the years, with 2015's payment of 25.6p per share being up by 14.3% and representing a yield of 1.93% at the current share price. There is also the bonus of £35.4 million of net cash on the balance sheet which can be used to invest in further growth or to increase distributions to shareholders.

CVS GROUP

I could not find any evidence that Warren Buffett owns a pet during the research for this article. But if he does he will be well aware of how expensive it is to take them to the vets.

One of the leading vet owners in the UK is **CVS Group (CSVG)**. The company was founded in 1999 in order to acquire and operate established local



“I COULD NOT FIND ANY EVIDENCE THAT WARREN BUFFETT OWNS A PET DURING THE RESEARCH FOR THIS ARTICLE. BUT IF HE DOES HE WILL BE WELL AWARE OF HOW EXPENSIVE IT IS TO TAKE THEM TO THE VETS.”

veterinary practices in the UK with a reputation for high quality service. Since listing in AIM in October 2007 the company, backed by significant debt funding, has increased its portfolio from 128 surgeries to 333 by the end of the last financial period in December last year. The firm's relatively large market share provides it with an economic moat due to its significant buying power.



The veterinary practices are the core of the business, making up around 90% of current revenues. These mainly focus on the companion or small animals market (cats, dogs, hamsters etc.) and CVS estimates that it has a c. 12% share of this market. The equine and larger animal markets, of which the firm has a negligible market share, are also catered for.

Within the division, and providing a further barrier to entry for competitors, is the firm's pet loyalty scheme, Healthy Pet Club. For a monthly fee of around £10 this provides members with a range of discounts and benefits and most importantly for CVS a crucial source of customer data – similar to Tesco's Club-card scheme which helped the supermarket giant build its own economic moat. Membership as at

31st December 2015 was c. 238,000 and contributed 12.6% of the division's income in the last six month period.

The practice division also runs a referrals business which provides high value specialist services both to its own and third party practices. A referral is typically made when access to specialist knowledge or advanced equipment (such as CT scanning or key-hole surgery) is required.

The practices are supported by a number of other related operations, which give the company an integrated internal structure and the potential for significantly improving margins.

For starters there is the Laboratory division, which provides diagnostic services and in-practice laboratory analysers to its own practices as well as third party surgeries. The laboratories also supply in-house analysers

and reagents to CVS's own practices (thus boosting margins) and third parties. Then there is the Crematoria, or "pet cemetery" business which operates six locations around the country where owners can cremate, bury and create a lasting memorial to their pets. Finally, Animated Direct is the company's online dispensary business, which sells prescription drugs, non-prescription drugs, pet food and other animal related products.

Supporting all these businesses is the central administration function which provides finance, IT, HR and property functions, and supports economies of scale as the group grows in size.

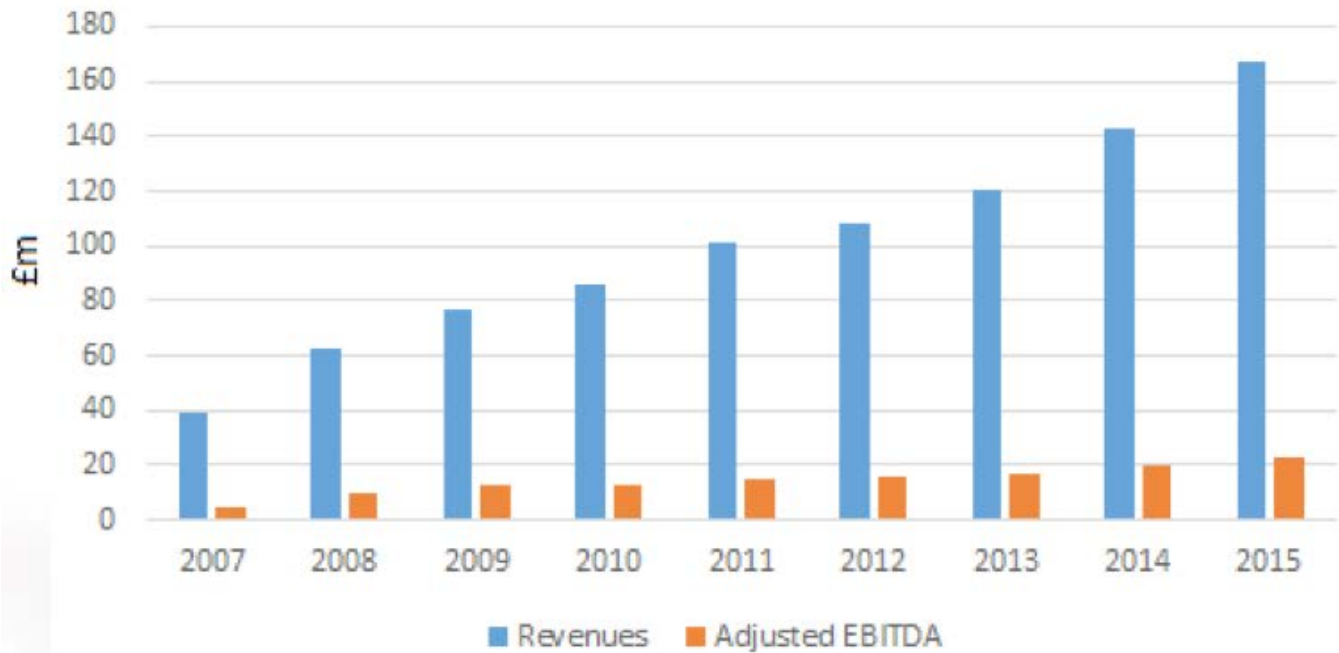
Growing the kitty

CVS's rapid business expansion delivered revenue growth at a CAGR of 20% between 2007 and 2015, with adjusted EBITDA growing at a CAGR of 20.8%. I believe that adjusted EBITDA, which strips out amortisation and depreciation costs, is a better reflection of performance than statutory profits given large amortisation costs associated with the acquisitions. This is especially so given that EBITDA more closely matches the company's net operational cashflow – the true measure of business performance.

For the six months to December 2015 further growth was seen, with revenues of £100.7



CVS Group end customers



CVS revenue and EBITA growth since IPO

million up by 23% and surpassing the nine figure mark at the interim stage for the first time. Acquisitions were the main driver of growth but like-for-like sales were also up by a steady 3%. Adjusted pre-profits were up by 18% at £11.2 million.

Notably, the six month period was the most intensive in terms of acquisitions in the company's history, seeing the purchase of 42 surgeries, two crematoria, the Vetshare buying group and the VETisco instrumentation sales business. As a result net debt rose from £46.2 million to £84.8 million by the period end. In November CVS entered into a new bank facility agreement which provides total borrowing facilities of £115 million, due for repayment in November 2021.

A purr-fect investment?

Warren Buffett would likely be pleased with CVS's share price performance, it having delivered a CAGR of 16.2% since IPO in October 2007. My calculation of return on capital employed (adjusted net profits divided by equity + debt) of 16.4% last year would also meet his requirements.

At the current 739.5p the company is capitalised at £444 million. Like Nichols, the shares are not cheap as the market rates the company's quality highly. The current PE multiple for forecast current year (to June) earnings is 23.5 times. CVS also pays a dividend, 3p per

share in the last financial year. But with this representing a yield of only 0.4% I think the cash would be much better spent on reducing debt.

The large borrowings are one of the primary risks here, although I note that

the position looks comfortable at present. Interest payments were covered 17.7 times by adjusted operating profits in the last financial year, leaving the company plenty of room for further deals to be done, and even to absorb any interest rate rises.

“CVS’S RAPID BUSINESS EXPANSION DELIVERED REVENUE GROWTH AT A CAGR OF 20% BETWEEN 2007 AND 2015, WITH ADJUSTED EBITDA GROWING AT A CAGR OF 20.8%.”





BY VICTOR HILL

OPPORTUNITIES IN FOCUS

TURKEY'S FUTURE AFFECTS US ALL

Turkey is now a key regional player with a dynamic economy but it sits on intersecting geopolitical fault lines. An ancient rivalry could trigger an earthquake.

Writing in *The Spectator* recently, Charles Moore, that veteran commentator and author of the magisterial authorised biography of Margaret Thatcher, reflected that it is a long time since decisions made by Turkey's leaders have been so keenly awaited in Whitehallⁱ (and on the Quai d'Orsay and the Werderscher Marktⁱⁱ, for that matter).

Perhaps not for one hundred and fifty years. In the 1860s Turkey was still a huge empire ruled by Sultans from the Topkapi Palace in Istanbul, with possessions stretching from the Balkans, through the Levant and Egypt, deep down into the Arabian Peninsula and across the Maghreb of North Africa as far as Morocco. In practice, day-to-day control of the North African territories was vested with local elites and European colonialists were encroaching. The French were already well entrenched in Algeria and the British were poised to move on Egypt. Turkey was *the sick man of Europe* – an empire in decline. That empire finally collapsed in 1923 with the declaration of the Turkish

Republic by General Mustapha Kemal, known to history as Atatürk (*Father of the Turks*). But the new state occupied much reduced boundaries. It still retained about three percent of its remaining territory in the continent of Europe, the rest in Anatolia, called until recently *Asia Minor*.

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For some eighty years or so the Turks virtually withdrew from the world stage. Having been allied to the Central Powers (Germany, Aus-

tria-Hungary, Bulgaria et al) in WWI, Turkey remained neutral throughout WWII. (Actually, the Turks finally declared war on Nazi Germany in February 1945. Symbolism counts.) Thereafter, the Turks joined NATO in 1952 and became loyal allies of the USA with a strategically critical role as one of only two NATO states which bordered the USSRⁱⁱⁱ. This alliance never fully obscured a strong undercurrent of anti-American sentiment; but essentially, the Turks lived the quiet life, albeit with periodic currency crises and IMF bailouts.

But, Turkey is now a player once more. There are three reasons for this. First, it has emerged as a regional power in a geopolitical sense, with extensive interests in Central Asia, and a pivotal role in the Syrian Civil War. Second, Turkey's economy has finally reached take-off under the steadfast, though increasingly authoritarian, stewardship of strongman Recep Tayyip Erdoğan (correctly pronounced *Erdoo-wan*). Third, Turkey has Europe by the proverbial extremities because she, and





she alone, can turn the tide of refugees from Syria on and off, like a tap. She is now in a position to play with Europe as a cat plays with a mouse. Hence the grotesque charade of Europe laying a red carpet for Turkey's accession to the EU and Turkey's pocketing generous cheques and demanding visa-free travel across Europe. *When, really, the Europeans have no intention of letting Turkey in; and the Turks, like Groucho Marx, would never join a club that would have them.*

But let's give credit where credit is due. Turkey has come a long way.

The status of Turkey was transformed by the collapse of the Soviet Union in 1991. Suddenly, Turkey became the natural gateway to the vast hinterland of Central Asia which is "Turkic" in culture and language. The term "Turkic" is a broad ethno-linguistic one and refers to a large number of historic tribes – like the Huns (who were *not* Germans, despite the British epithet) – some of which are now extinct; as well as the five extant Turkic nations of Kazakhstan, Uzbekistan, Turkmenistan, Azerbaijan and Kyrgyzstan. (These nations are now bound together with Turkey in an international body called the *Turkic Council*). The languages of these countries are sufficiently similar for Turks to make themselves understood and these new nations are avid consumers

of Turkish media. Kazakh bankers and Azerbaijani textile merchants regard Istanbul as the navel of the world. Uzbek students dream of studying in Ankara.

(There is even a significant Turkic minority in Moldova – the *Gagauz* – many of whom have now immigrated to Catalonia. Thus Turks can hail a taxi in Barcelona and instruct the driver in their own language!)



The Turkic-speaking countries of the former Soviet Union such as Azerbaijan and Kazakhstan have become hugely important markets for Turkey, as evidenced by **Turkish Airlines' (IST:THY)** unrivalled route network across the region and the visa-free travel regime that Turkey enjoys with its Eastern

neighbours. (We Brits have to queue up and pay £20 or €25 – cash only, thanks very much – to get into Turkey.)

Turkey is a key player in the development of Azerbaijan's extensive oil and gas reserves. In June 2014 Turkey and Azerbaijan agreed to construct a massive oil refinery at Aliaga on Turkey's Aegean coast. This came shortly after the signing of agreements for TPAO, Turkey's state oil company, to buy Total's 10 percent stake in Azerbaijan's Shah Deniz gas field, and for Botaş, Turkey's state gas transit company, to take a 30 percent stake in the Turkish Trans Anatolian Gas Pipeline (Tanap) which carries gas from Shah Deniz to Europe^{iv}.

Turkish construction companies like **Enka Insaat (IST:ENKA)** are big in Central Asia, but they are also busy at home. There is a construction boom in Turkey with an estimated US\$350 billion of projects currently underway. This is a symptom of a dynamic economy. One of the most high-profile of Turkey's current construction projects is Istanbul New Airport. Costing US\$11 billion for the first phase alone, this project includes the construction of six runways and four terminals, giving it enough capacity to serve 150 million passengers a year – and with the potential to increase this number to 200 million in the future^v.

Turkey is by far the most populous of the Turkic nations and boasts the largest economy. Its population has almost tripled since 1960 to around 77 million now. And it has enjoyed headlong economic growth as well as historically exceptional political stability.

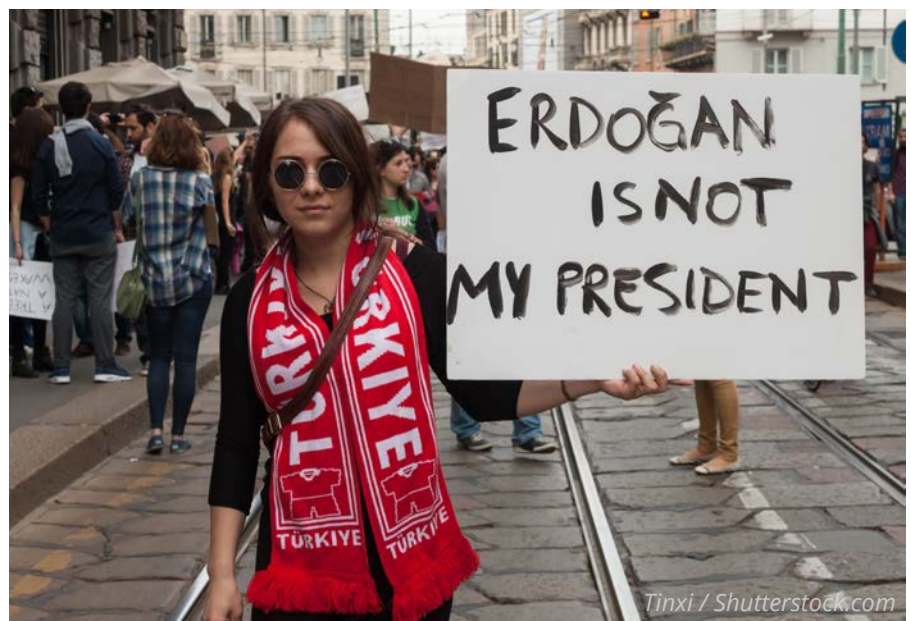
Mr Erdoğan's ten-year premiership and now presidency have been marked by increasing authoritarianism. But at least the army has been definitively put back in its box thanks to a stern regime of courts martial for uppity officers. Hitherto, the Turkish military considered itself the ultimate guardian of the state. And they took power in numerous putsches since Atatürk's death (1938) if they thought the civilian politicians lacked moral fibre. During periods of military rule, human rights abuses and arbitrary arrest were notorious. (Mr Erdoğan himself, while Mayor of Istanbul (1994-98), spent four months in prison for reciting a poem which the military authorities considered subversive.) And he has changed the constitution fundamentally. He has instigated a Presidential model, like in France, where the head of state is also head of government. No commentators now foresee a military coup. Despite concessions to the Islamic conservatives, Erdoğan's party is still committed to the principle of a secular, modern state as ordained by Atatürk. At least in theory.

The violent street protests of 2013-14, mostly centred on Taksim Square, Istanbul, were instigated by younger, middle class urbanites who were warning Erdoğan not to go too far in the conservative direction. The Justice and Development Party (AKP – Mr Erdoğan's political machine) attracts support from Islamic conservative elements (but not from Islamists – something quite different) who live mostly in the countryside. One trigger was a change in the laws concerning the purchase of alcohol, which can only now be accomplished (outside Western hotels and restaurants), as in India, from surreptitious outlets. Frankly though, compared with much of the Arab world, Iran and Pakistan, this is still *Islam-lite*.

Back in the noughties, Turkey's initial enthusiasm to join the EU, a club of the rich – as it then seemed – enabled the Europeans to pressurise Turkey to improve its human rights record. Now the



“THE PRESS FREEDOM INDEX FOR 2016 RANKS TURKEY AT 151 OUT OF 180 COUNTRIES.”



boot is on the other foot. Europe must now pay Turkey for preventing a hundred thousand refugees and migrants or more from crossing the Aegean Sea every month. Of course the Turks claim that, for humanitarian reasons, they have given shelter to possibly two million displaced people in makeshift camps along the Turkish-Syrian border. This is true; but it seems that none of these people are granted "asylum" in the sense that Europeans understand it – and certainly not work permits. In a country with a massive army and police force, it is curious that the

people traffickers have been allowed to flourish openly in the streets of Izmir and elsewhere.

During Erdoğan's tenure of power, Turkey has become less free. The Press Freedom Index for 2016 ranks Turkey at 151 out of 180 countries^{vi}. Despite the amnesty for PKK activists in 2011 and the permission granted to the Kurds to use their language in schools, Turkey is still far from being an open society. On 4 March 2016 the Turkish government seized control of *Zaman*, a dissenting newspaper, using para-



military police. *Zaman's* website was closed with a message that it was being updated. Archived news and content became inaccessible: some claim the data has been wiped. Two days later, the first government-controlled edition appeared. There was no mention of the newspaper's seizure: the front page carried a series of pro-government articles, and a picture of a smiling, benign President Erdoğan.

Now there is one complex relationship in international affairs which I think is little understood – that between Turkey and Russia. While Turkey's upside potential is bright, there is a significant downside risk elephant (so to speak) in the room. Namely, that the probability of war between Turkey and Russia over the next two years or so is frighteningly high. They are coming into direct conflict wherever they meet.

In fact, Turkey and Russia, in their various incarnations, have been in a long drawn-out conflict for more than three centuries. They first came to blows in the First Russo-Turkish War of 1686-1700. Under the Treaty of Constantinople, Peter the Great first secured Russian access to the Black Sea. Later, in 1774, Catherine the Great ejected the Turks from what is now Southern Ukraine and Moldova – and obtained Crimea for Russia. (Crimea is still home

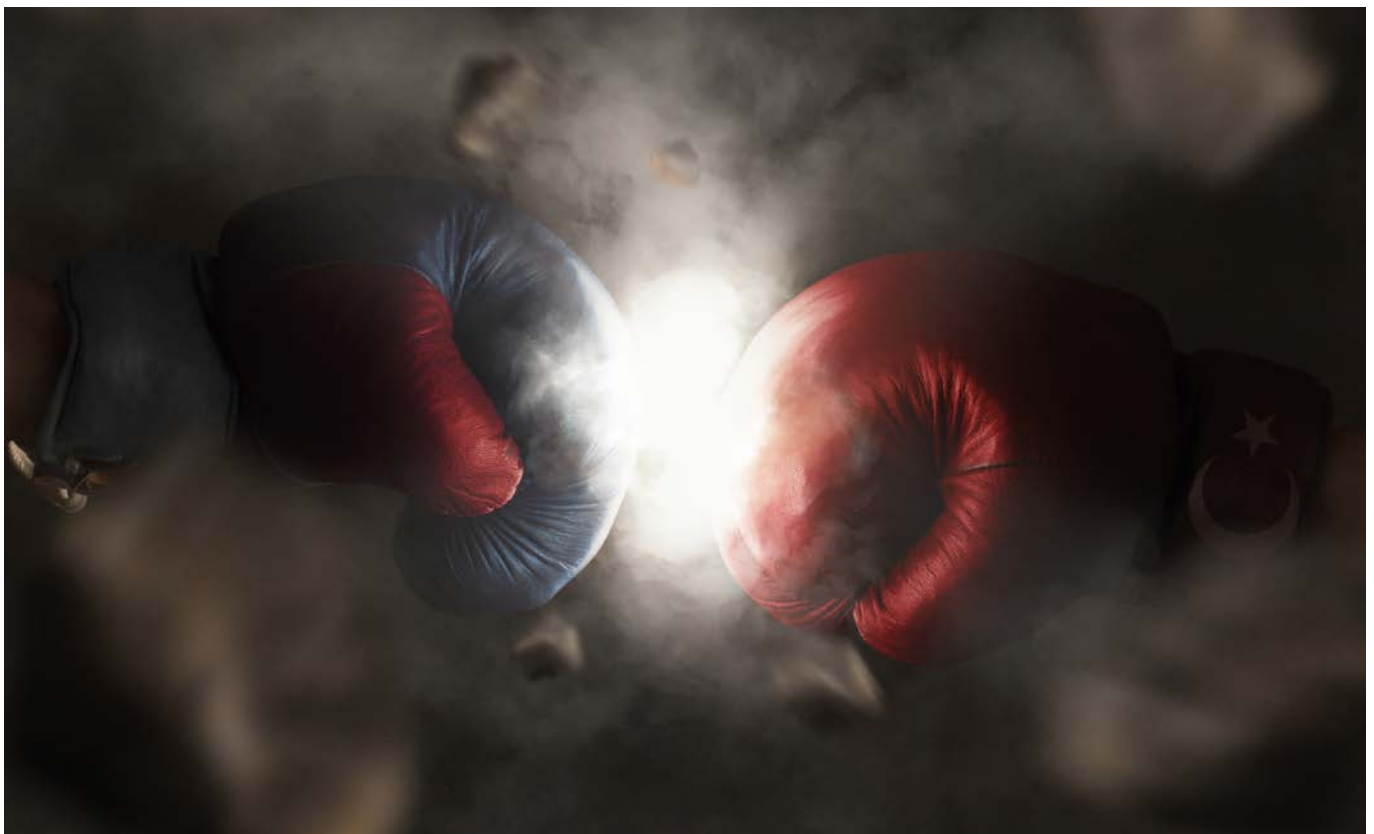
to a Turkic tribe, the Crimean Tartars – and Erdoğan has recently appointed himself their champion.)

Vladimir Putin and Recep Tayyip Erdoğan, the tsar and the sultan, although representing very different states and traditions, have lived curiously parallel lives. While Putin became President of the Russian Federation on 01 January 2000, Erdoğan became Prime Minister of Turkey on 14 March 2003; and then he transitioned to a revamped executive presidency on 28 August 2014. Both have dominated their country's politics ever since first gaining power. Both regret the loss of empire that each country has endured. They are the same age^{vii}. Both are legitimised by religion. Both are secretive, choleric, ruthless introverts who are nonetheless the objects of popular adulation.

The similarities continue. Russia and Turkey are home to highly sophisticated intellectual elites and great writers whose intellectual acrobatics have been interrupted by governments which seek to control the media and the internet in order to suppress criticism. Journalists who fail to toe the line may end up in jail. Yet, despite the superficial similarities, Turkey and Russia have radically divergent geopolitical interests. This is most apparent in two arenas. The first is Syria and the second is the Caucasus.

The Syrian Civil War, which erupted in 2011, has proven to be the most intractable, and bitter, conflict of the post-Cold War world. It has had huge geopolitical consequences. All the great regional powers – Turkey, Saudi Arabia and Iran – have irons in this fire; and the great powers, with the pos-

**“THE PROBABILITY OF WAR
BETWEEN TURKEY AND RUSSIA
OVER THE NEXT TWO YEARS OR SO
IS FRIGHTENINGLY HIGH. THEY ARE
COMING INTO DIRECT CONFLICT
WHEREVER THEY MEET.”**



“IN YEARS TO COME HISTORIANS MIGHT REGARD THE SYRIAN CIVIL WAR AS THEY NOW REGARD THE SPANISH CIVIL WAR (1936-39) – THE FORERUNNER OF SOMETHING WORSE.”

sible exception of China (for now, at least) have all deployed *materiel*. It has been a unique testing ground – it pains me to write this – for new military technology, not least killer drones which have now indeed come of age. The Turks have some of the best of these new toys: they are supplied by Israel. If you want to understand how they have changed the nature of warfare, then I strongly recommend the movie *Eye in the Sky*^{viii}, the technology depicted in which is only marginally sexed up.

In years to come historians might regard the Syrian Civil War as they now regard the Spanish Civil War (1936-39) – the forerunner of something worse. But already the conflict in Syria has dragged on longer than the Spanish Civil War, and there may have been more casualties^{ix}.

From the first the Russians have unwaveringly backed Bashar al-Assad as the legitimate President of Syria who is in a war against "terrorists". The West, in contrast, vilified Assad as a dictator and plotted his demise. Then they found that Assad's enemies were so beyond the pale (IS amongst others) that they began to fear what a Syria after Assad might look like. What about Turkey? She has been sucked, unwillingly, into a bitter war in which ordinary Syrians are being forced to choose between "moderate" Sunni Turkey, Wahhabi Sunni Arabia and Shia Iran. There is nothing nice on the menu. But Putin's Russia has Orthodox Christians, Alawites and warm-water naval bases to defend. As the old pluralist (if despotic) Syria disintegrates, its large neighbours are sucked into the vortex.

What we now call the Refugee Crisis began as a trickle early on in the Syrian Civil War but became a tsunami by the early summer of 2015. The German response – and the reaction of much of the rest of Europe to that response – has engendered a sense of crisis within



the European Union which is unprecedented, and which may yet have massive consequences.

And there is currently another slow-burn war underway in which Turkey and Russia are on opposite sides – one which has hardly been reported by the mainstream Western media. It's the war between Azerbaijan and Armenia over control of the ethnically Armenian enclave of Nagorno-Karabakh which resides well inside the official territory of Azerbaijan.

(By the way, don't confuse Nagorno-Karabakh with the separate Azerbaijani enclave of Nakhichevan, which is peaceful, though its border with Armenia is firmly closed. Fortunately, it has a border with Turkey from where it gets supplies of food. Politics in the Caucasus makes the Balkans look straightforward.)

The problem in a nutshell: after the two states wrested their independence from the collapsed Soviet Union in 1991, Armenia invaded Nagorno-Karabakh and created a new state there, which, since the cease-fire of 1994, has been *de facto* in union with Armenia

proper. Of course no other country recognised this parallel Armenian mini-state. Azerbaijan has never given up its claim to the territory and sporadic skirmishes over the last quarter century have resulted in occasional loss of life. If you drive into Armenia by car from Georgia, as I did some years ago, the road crosses a valley which is exposed to Azerbaijani^x gun posts. It is affectionately called the *duck run* because, occasionally, Azerbaijani militias open fire.

In the summer of 2014 fighting broke out, killing at least nineteen soldiers. Azerbaijan downed an Armenian helicopter in November 2014. There was further loss of life in 2015. During the first week of April this year, the snow in the high passes barely melting, the burning embers of this dispute have erupted into flame^{xi}. Clashes between Armenian and Azerbaijani forces claimed an estimated sixty lives last month.

The critical matter is that while Moscow backs Armenia (fellow Orthodox Christians), Ankara backs Azerbaijan (fellow Turks and Muslims). Surprisingly perhaps, Iran, fearful of an oil-rich Azer-





“IN ANY WAR BETWEEN TURKEY AND RUSSIA, TURKEY WOULD INVOKE ARTICLE V OF THE ATLANTIC TREATY. BUT SUCH A SCENARIO MIGHT JUST BE ANOTHER NAIL IN NATO’S COFFIN.”

baijan on its borders (and with its own significant Azerbaijani minority in the north western provinces), has swung behind Christian Armenia and Russia.

Is a war between Russia and Turkey a real possibility? You might say it's already started.

On 24 November last year a Russian SU-24 bomber was shot down by a Turkish (American-supplied) F-16 Falcon over Syria. As I wrote at the time, this provocative act was almost certainly pre-meditated. The Russian bomber aircraft had been bombing Turkoman targets. (The Turkoman are yet another Turkic tribe.) One of the Russian pilots who bailed out was slaughtered by Turkoman militias. Turkey claims that the Russian aircraft violated its territory – a sliver of Turkey which digs into Syria – but this is highly questionable. Given that it was travelling at nearly 1,000 kilometres per hour, it could only have been in Turkish airspace for a matter of seconds – if it was in Turkish airspace at all, that is.

You will not find a persuasive explanation of why Turkey raised the stakes in this way in mainstream media. The conspiracy theorists (not all of whom are mad) will tell you that what was really going on was that Turkey had been complicit with IS in the sale of oil out of northern Syria and Iraq, and that the Russians had been disrupting this illicit trade through their aerial bombing campaign.

Or was Turkey punishing Russia for indirectly helping the Kurds? The Kurds,

let us recall, a people spread across four nations^{xii}, have been implacable enemies of IS since its inception. The autonomous Kurdish region of Northern Iraq has given asylum to, amongst others, persecuted Yazidis. For the Turks, however, the nightmare scenario is that the Kurds overrun the territory now held by IS and declare a Kurdish homeland. This would be an open invitation to Kurds in Turkey (of which there are, according to the CIA, 14.5 million) to affiliate themselves. It would mean Turkey effectively losing control of huge swaths of its territory, and a possible civil war. This is why even relatively "moderate" factions within the PKK (Kurdistan Workers' Party), which have sought to negotiate with Ankara, have been branded as terrorists – a label still endorsed by the US and the UK. A spokesman for the PKK, Tahir Elci^{xiii}, was assassinated in Turkey just after the shooting down of the Russian jet. And on 25 April Turkey announced that it will *never* negotiate with the PKK.

In reaction to the shoot-down, President Putin announced sanctions. Russian tourists no longer cavort on Turkey's beaches, and the sweatshops of Kumkapi^{xiv}, though still plastered with signage in Russian, have fallen quiet. A huge gas pipeline project linking the two countries is now in doubt.

If anything, since the incident, relations between the two countries have worsened. On 18 December 2015 the Turkish Minister of Foreign Affairs, Mevlüt Cavusoğlu, boasted on Turkish television that Russia should be wary

of Turkey. "We call on Russia, which is one of our major trading partners, to stay quiet; but we also say that our patience is limited." This was not an idle threat. With universal national conscription, Turkey has the second largest army in NATO after the United States with 610,000 soldiers equipped with advanced military technology. Its air force, equipped with largely American planes, is also formidable. But is it really a match for Russia?

Of course, in any war between Turkey and Russia, Turkey would invoke Article V of the Atlantic Treaty. But such a scenario might just be another nail in NATO's coffin. Why should moderate European democracies come to the defence of a rampant authoritarian Muslim neighbour which only plays hard ball? And why should the USA go to war with Russia to satisfy Turkish machinations in Syria and Central Asia? In any case, if Turkey attacks Russia first (as Putin might trick them into doing) the NATO Charter may be invalidated. There is already a view abroad that Turkey is a strange bed-fellow within the alliance.

And by the way, military analysts think that Russia would probably win, just by pulverising Turkish strategic targets, like the Black Sea naval bases, from the air. They could decide to launch a land invasion through Georgia (just as Germany invaded France through Belgium in 1914) but I think that Putin is too cautious to do that. But if Russia's friend, Iran, joined in, that could be a game-changer. They might decide that the moment was propitious to take

out Saudi Arabia, America's kind-of-friend^{xv}. They could create a Kurdish state, quell Syria, annihilate IS, asphyxiate Wahhabism and wrest control of the global oil supply in one fell swoop – while an isolationist America and a refugee-panicked Europe look on, blinking and gulping.

In the second half of the 19th century Britain and France sought to prop up Turkey against Russian encroachment. Eventually, they dropped her and fought alongside Russia. History always repeats itself – first as tragedy and then as farce. Mind you, I don't think *we* (nor Frau Merkel) would miss Mr Erdoğan too much.

Action: There are huge opportunities in Turkey but downside risks (threats) are severe. That means, in old-fashioned terms, that investors should require a significant risk premium. Given

“GIVEN THAT RETURNS IN THE ZERO-INTEREST WORLD ARE THREADBARE, INVESTORS CANNOT IGNORE THE HIGH-YIELD POTENTIAL OF THE TURKISH MARKET.”

that returns in the zero-interest world are threadbare, investors cannot ignore the high-yield potential of the Turkish market. Turkish banks, unlike their European counterparts, enjoy excellent returns on capital. I like **Türkiye Garanti Bankası (IST:GARAN)**. There is huge potential upside in the Turkish stock market^{xvi}. The **JP Morgan Turkey Equity Fund (A)** was up 18.5% in the first three months of this year. I am particularly excited by Turkish-financed projects in Turkic countries: the “Turkic” world will not go away

even if a Kurdish state emerges, with all the convulsions that that would bring. Check out the IFC-sponsored **Aureos Central Asia Fund LLC**^{xvii}.

Current equity markets have not been discounted for the inexorable rise in geopolitical risk over the last eight years or so, which (though, correlation is not causation) has accompanied the presidency of Barack Obama. One day, soon I think, those discount factors will kick in. Big time. What is certain is that we shall all be surprised.

- i The Spectator's Notes, by Charles Moore, *The Spectator*, 19 March 2016.
- ii The locations of the French and German foreign ministries respectively.
- iii The other was Norway which of course retains its border with the Russian Federation. With the independence of Armenia, Georgia and Azerbaijan, Turkey has frontiers with those states, but not directly with Russia.
- iv See <http://blogs.ft.com/beyond-brics/2014/06/09/azerbaijans-star-rising-in-turkey> posted 09 June 2014.
- v See: <https://www.buildingshows.com/market-insights/turkey/turkey-active-construction-projects-valued-at-350bn/801794509> posted 17 July 2015.
- vi See: <http://rsf.org/en/ranking> For comparison, the UK is ranked at 38, the USA at 41 and France at 45.
- vii Putin was born October 1952 and Erdogan in February 1954.
- viii Directed by Gavin Hood, it was premiered in Toronto on 11 September 2015 and released in the US in March and in the UK in April 2016.
- ix Approximately 500,000 people died in the Spanish Civil War and at least 450,000 Spaniards fled to France. See Antony Beevor, *The Battle for Spain*. The Syrian Centre for Policy Research reckons that 470,000 people have been killed in Syria between March 2011 and February 2016, though the UN puts the figure at 250,000. (See: https://en.wikipedia.org/wiki/Casualties_of_the_Syrian_Civil_War). Probably more than one million people have been displaced, of which about 300,000 have made their way to Europe.
- x The adjectival form preferred by academics is *Azeri*, but I like to keep things simple, hence *Azerbaijani*.
- xi See *Vladimir Putin's Next European Front* by Svante Cornell in the *Wall Street Journal*, 07 April 2016. Mr Cornell is the director of the Central Asia-Caucasus Institute at Johns Hopkins University.
- xii Principally Turkey, Syria, Iraq and Iran although there are also Kurdish enclaves in Georgia, Armenia and Azerbaijan.
- xiii Tahir Elci was the President of the Bar Association for Diyarbakir province (which has a largely Kurdish population) and is hailed by supporters as a human rights lawyer. Supposedly, he was shot just after making a speech advocating that Turkey recognise the PKK as a legitimate political party and enter into negotiations with it. British readers should understand that any discussion of the Turkish-Kurdish issue is at least as loaded as a discussion of *the Troubles* in Northern Ireland – perhaps more so.
- xiv A district in old Istanbul with a thriving garment trade much patronised by Russian retailers.
- xv See my article on Saudi-Iranian relations at: <http://masterinvestor.co.uk/economics/war-on-terror-ii-kingdom-and-republic-on-the-brink>
- xvi See: <http://www.morningstar.co.uk/uk/funds/snapshot/snapshot.aspx?id=F0GBR05VWU>
- xvii See: <http://ifcext.ifc.org/ifcext/spiwebsite1.nsf/2bc34f011b50ff6e85256a550073ff1c/384ed4ac42835318852576ba000e2a7c?OpenDocument>





BY ADRIAN KEMPTON-CUMBER

CHART NAVIGATOR

"SELL IN MAY"?

"Sell in May and go away, do not return until St. Leger's Day."


There's generally a perception that there was lots of wisdom in times gone by, but the reality is there wasn't. Mostly it was statistically unsound superstition with the very occasional gem thrown in, probably more by luck than judgement. People used to live more by stock phrases than they do now. I remember when I was first working the older employees used to repeat the same lines day in day out. Emetic

classics like "what day is it?" To which the reply was "Tuesday", or whatever day it was, followed by the inevitable cringe-worthy "Tuesday all day". Delays would inevitably be described as "we're all behind like the cow's tail". There's no wisdom in sayings like "if your aunt'd had balls she'd have been your uncle", and "if the wind changes your face will stay like that". Some of these sayings were delightfully inap-

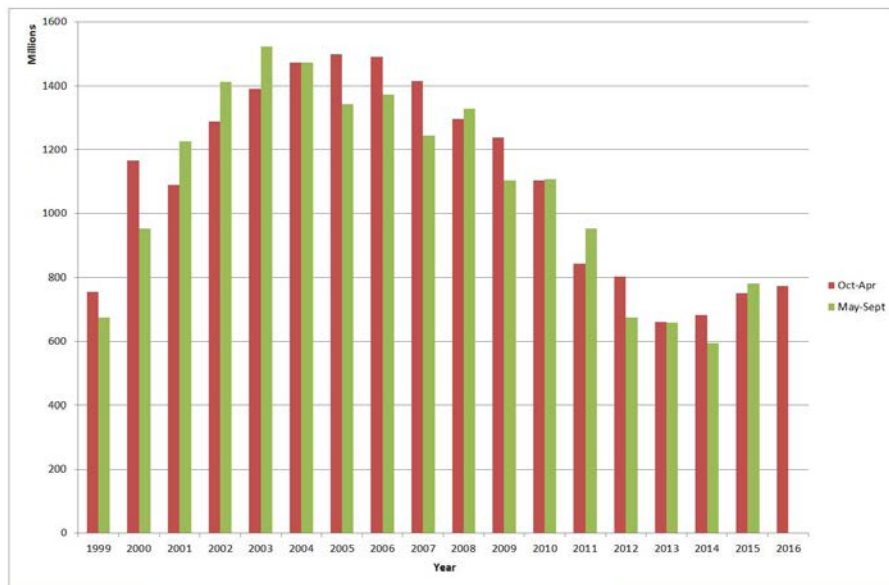
propriate. Generously proportioned women were described as "once round her, twice round the gas works". My Nan used to come out with something you never hear these days: if something was annoying her it would be "stop doing that it's giving me the palsy". I could go on.

So my general expectation is that the old adage "Sell in May and go away, do





**“COMMUNICATION
AND INFORMATION
WOULD HAVE BEEN
AT A PREMIUM IN
YEARS GONE BY.
NOWADAYS WE CAN
SIT ON A BEACH
SOMEWHERE AND
CHECK THE ALERT
EMAIL WE’VE JUST
RECEIVED TELLING
US A STOP LOSS HAS
BEEN HIT.”**



not return until St. Leger's Day" is probably complete bollocks. Most useful information is hard to put into one line. This is why Twitter is a more or less complete waste of time: not enough characters to qualify a statement.

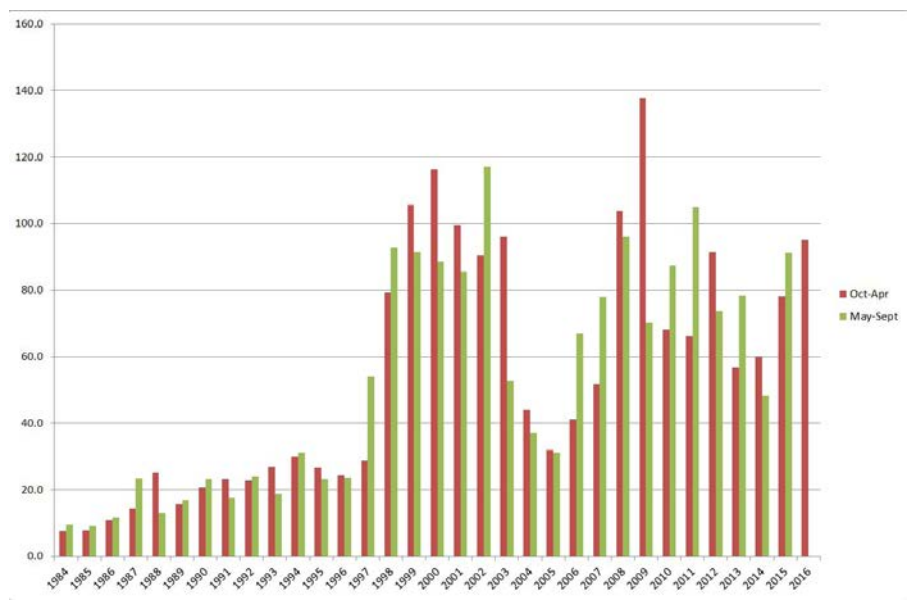
The saying, it seems, is an old English one. Stock brokers would toddle off on their holidays for the summer. I imagine there was a lot less market activity overall, and evidently very little at all in the warmer months. Lack of activity may tend to depress prices so perhaps once upon a time it was sound advice. The St Leger is the classic horse racing meeting in Doncaster, a week or so into September. This year it'll be on September 10th. Communication and information would have been at a premium in years gone by. Nowadays we can sit on a beach somewhere and check the alert email we've just received telling us a stop loss has been hit. Not up Mount Everest though. The line about being able to do business literally anywhere is literally not true. You can do business figuratively anywhere, not literally.

Being as the saying is English I'm going to look at the FTSE 100 and see whether it tells us to support, or trash, the saying. I've used the periods from the first trading day of May to around St Leger's Day and from St Leger's Day to the last trading day of April.

Firstly then, we want to know whether volume changes perceptibly in the summer months. ShareScope offers volume data on the **FTSE 100 (UKX)**

going back to 1999. I'd like a bigger dataset, but it's not too small to use. I'd say there's no clear correlation to suggest lower volumes during the summer months. I've taken the average daily volume traded during each of the time periods each year. You can see from the chart that it's really six of one, half a dozen of the other, which of course is yet another of those lines everyone used to say, but it is at least quite a good one. Interestingly, volume has fallen significantly since 2008 and not really recovered. But the two periods have moved in tandem with time nevertheless.

Secondly, then, let's look at the average daily range on offer during the two periods. We'd expect volatility to be lower in the summer months, if there is any wisdom in this phrase. Again it's



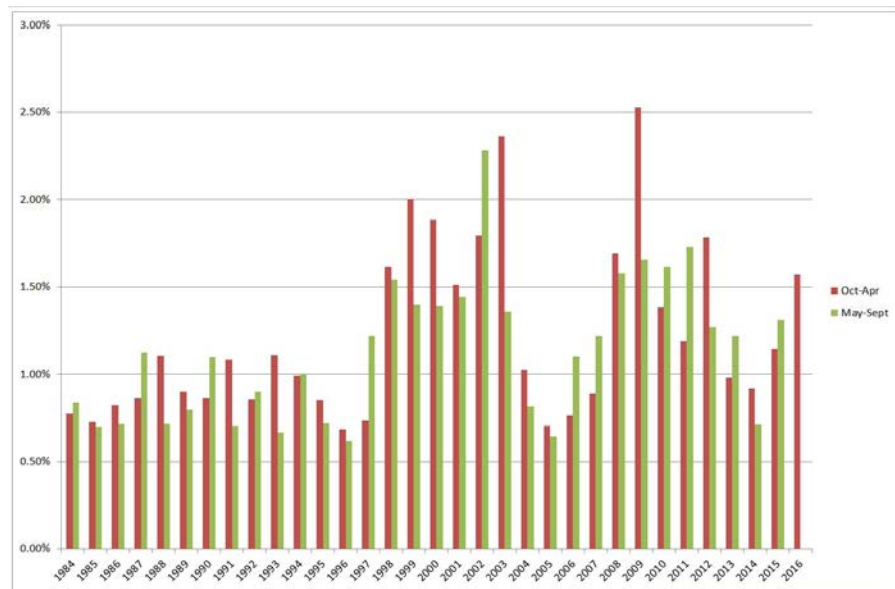
a mixed bag. Any significant change in the average daily range is usually preceded by a volatile May-September. We see this in 1987 and in 1997 and so on. It's worth noting that October 1987 was the 1987 crash. How wise would it have been to buy back into a market about to crash? It was the same in 1929. October 2008 wasn't too rosy either. But of course these are absolute values for the daily tradable range.

Let's look at the average daily trading range for these two periods, but this time expressed as a percentage of the opening price (i.e. early September and



the first trading day of May for each year). We can see that volatility was much higher during the 90s and 2008-2012. It's starting to creep up again. It's still a mixed bag. That said, most of the highest values occur in the winter session. But that's just telling us there was a trading opportunity. We know some of those periods were bearish.

So the final chart is the one that shows gains and losses during the two periods. We're used to being able to make money from volatility and not from just market rallies. Certainly in the US shorting has been around for a very



long time, but it's not so popular here though, so let's have a look at actual returns had you bought and sold your long stock portfolio each September and May.

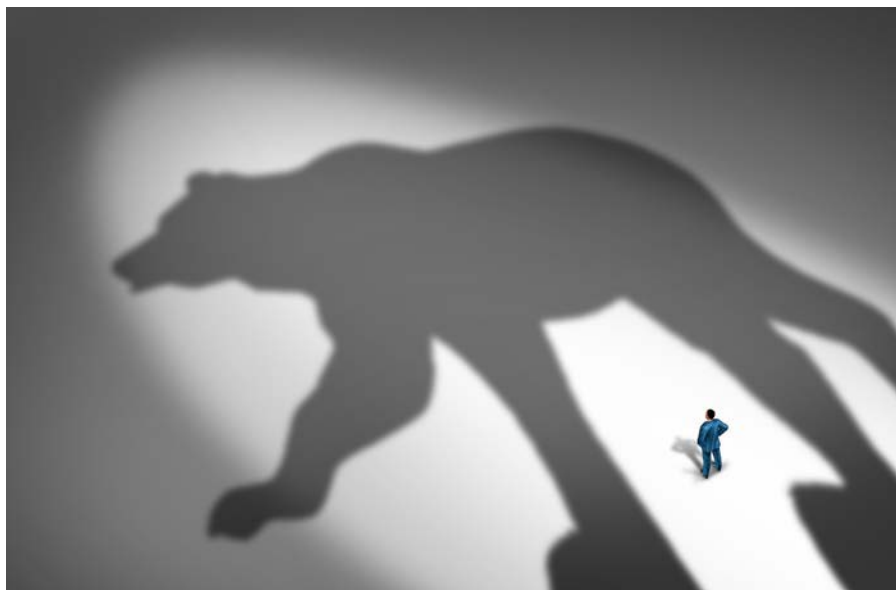
It would be fair to say that most of the winter sessions have been profitable. However the drawdowns in the bad years, happening three times out of 32, were pretty significant loss makers, with 1987 losing over 20%. However, there've been 11 bad summers, seven of which saw losses of more than 10%.

So how about our portfolio if we'd followed the advice, as opposed to simply staying in the market? Had we bought the market in early September 1984 and held on to it we'd have made 568% up until 29th April 2016. If we'd followed the advice and stayed

out during the summer months then we'd have made 690%. A reasonable amount more. The bad summers seem to come along about every three to five years. Last summer was a bad one. But that doesn't mean this summer can't be worse! After a seven year bull market I'd have to err on the side of caution for the next couple of years until we see a real downturn. It's well overdue.

“THE BAD SUMMERS SEEM TO COME ALONG ABOUT EVERY THREE TO FIVE YEARS.”

Perhaps part of the reason it used to be true was simply because stock brokers took such long holidays. If the stock brokers were away people might have been less inclined to place orders. In effect the market was on holiday. Bear in mind though that in those days they would have been Bed and Breakfasting on 5th April anyway. Did people really then buy back in for a few weeks and sell again? Seems 'Sell in April and Go Away a Few Weeks Later' might have been better advice. Anyway, we can say the old saying has proved to be true at least for the last 30-odd years, and if you're sitting on some gains now then prudence might suggest selling in May.





BY ROBBIE BURNS

ROBBIE BURNS' TRADING DIARY

LET'S TALK ABOUT SEX, SHALL WE?

There – thought that would get your attention! OK, sorry. There's nothing even remotely Game of Thrones like here but I thought it would give the editor of the magazine a chance to put up a sexy picture.

Did you know sex hormones are often responsible for traders losing out if they're men (sorry lads)? They lie behind some of the most risky stock market behaviour. High testosterone levels in men have been shown to make them confident and successful in competitive situations. Previous research has shown that male traders make significantly higher profits on days when their morning testosterone levels are above their daily average.

In a test, scientists measured natural levels of the hormones in 142 male and female volunteers while they played a trading game in groups of ten. Men who had higher levels of the hormone cortisol were more likely to take risks, which led to instability in prices. But there didn't appear to be a link between cortisol and risky trading in the women who took part, which is consistent with other research showing that women respond to stress in different ways.

Cortisol appeared to encourage riskier investments, while testosterone increased the feeling that they were on a winning streak. Put another way, women are much safer and often better traders than men. And it is crazy for me to write that when I know that 90% of the readers of this magazine will be male.

“GENERALLY, IF I’M IN A ROOM OF TRADERS AND ASK ‘WHO IS HOLDING A TRADE WITH A LOSS OF MORE THAN 25%?’ YOU CAN GUARANTEE MOST OF THE MEN PUT THEIR HAND UP.”

So, ego-fuelled men reading this (yes, that's YOU!), women do tend to make better traders and investors. Above all, this is because women are more likely to let losing trades go. This is perhaps not a surprise as they tend to be better at cutting a relationship that's a bit of a loser. (I have been on the end of that!) Women traders tell me they just can't cope with the thought of something running into a big loss. Generally, if I'm in a room of traders and ask "Who is holding a trade with a loss of more than 25%?" you can guarantee

most of the men put their hand up. The women? Rarely.

However – and here is where I can stick up for the blokes – men do tend to be better at letting profits run than women. Men seem to enjoy the delayed gratification of waiting for the profits to build.

Here is top trader Alexander Elder with his thoughts on women traders:

"Women traders are much more likely to ask a simple question: Where's the money? They like to take profits and avoid losses instead of trying to prove themselves right. Women are more likely to bend with the wind and go with the flow, catch trends, and hop off a little earlier, booking profits."

"When I tell traders that keeping records is a hugely important aspect of success, women are more likely to keep them than men. If you are looking to hire a trader, all other factors being equal, I'd recommend looking for a woman."

Mr Elder confirms my view that women are excellent loss takers, though they could try and run the profits further. He also points out that women are much better at keeping records, which helps their success too. That's true: one of the best female traders I know keeps

**“WOMEN ARE
EXCELLENT
LOSS TAKERS,
THOUGH THEY
COULD TRY AND
RUN THE PROFITS
FURTHER.”**



immaculate records. She knows all her buy and sell points and stops, she even keeps track of her performances using a chart she calls her "equity curve". (She also goes to meetings with CEOs and only buys if their shoes have been carefully looked after and fully buffed. She finds all that very helpful. Personally I struggle with that kind of thing.)

One excellent female trader shared her thoughts with me. She has some excellent insight into the advantages and disadvantages of sex as a trader:

"We women like a stash of cash for a rainy day. Nothing like a good hoard to cheer me up. Generally that really helps me get out of trades early because I tend to use tight stops and I don't have too much of a problem taking a loss.

"Letting profits run is another matter and here I still struggle. Honestly I think it requires a much bigger psychological shift than learning to cut and run. There is a great temptation once a share is slightly in profit to take the money and clear off to the nearest shoe shop. The problem is you end up forever trading and never making serious money.

"Taking a loss, though hard, opens a script in my head which is about getting it wrong, being rubbish at stock picking, doing badly while everyone else is coining it and so on. Though painful, it is familiar and therefore I am biased towards it – a lovely bit of self-sabotage if ever there was one. I bet a lot of other people are the same.

"Letting profits run is about delayed gratification, being bold and maybe being successful – stepping into a brave new



world. That's a very different script to have running in your head and I feel really uncomfortable with it. I haven't mastered it yet."

So what's the conclusion here?

We have to marry the two: men and women's best bits in a lovely marriage – cut the loss, run the profit.

**Until next time,
Robbie**

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.



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

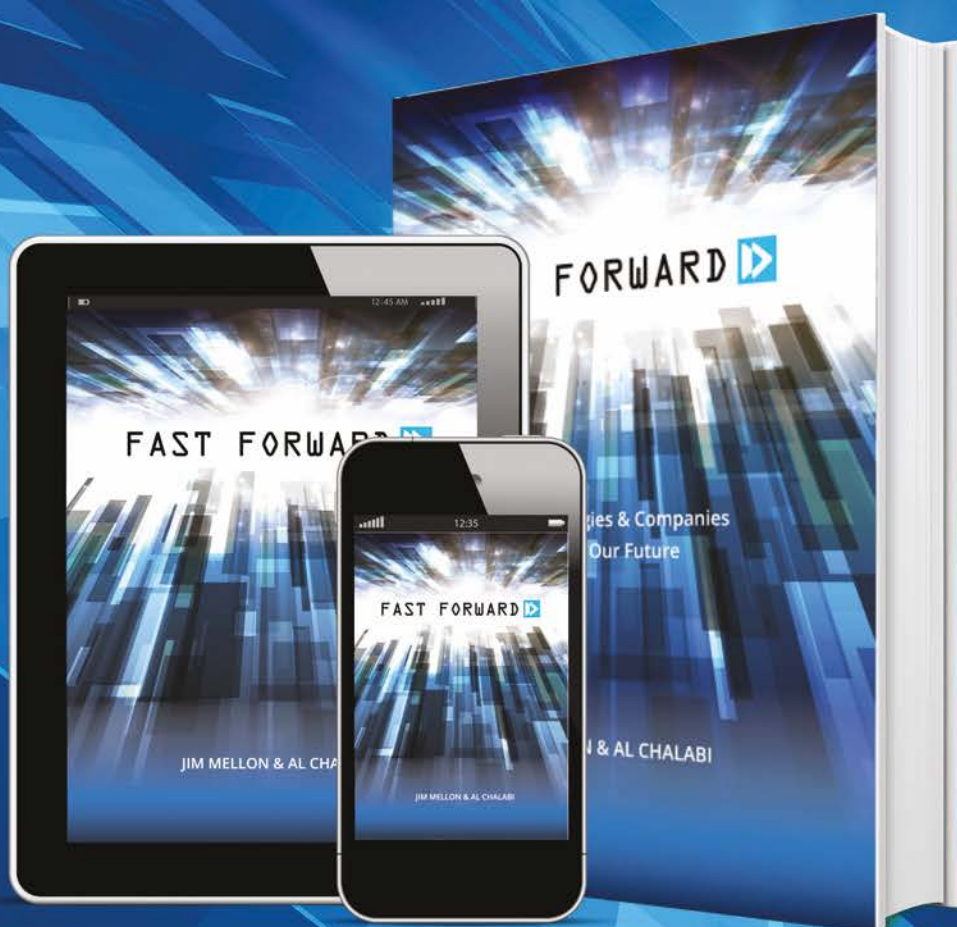
The book updates *The Naked Trader 3* which I wrote in 2011 – a lot has happened in the market since then and I cover all the changes. There are tons of ideas, trader stories, psychology, biggest trading mistakes and 20 trading strategies to make money.

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

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BY FILIPE R. COSTA

THE MACRO INVESTOR

MONETARY POLICY IS DRIVING A RECOVERY IN EMERGING MARKETS

Global gyrations

During the last decade we have played witness to massive capital movements around the world. Money has flowed from developed countries towards emerging markets, just to flow back in the opposite direction at a later date. While lifting barriers to capital movement has helped intensify global trade and accelerate the development process of the emerging world, it has also helped

to favour speculative money flows that today move from country to country in a permanent global gyration seeking out the best yields money can buy. The truth is that money flows help to boost growth, but the speculative money flows are short term by nature and can also help to destabilise these economies.

Nevertheless, it would be naïve to blame free capital movements for the final result, as global instability seems to have much more to do with the fierce competition among central banks rather than anything else.



The FED is the major player in this game. Looking at what the FED is doing is sometimes all an investor needs to do to determine where to put his money. Commodities and emerging markets are two asset classes that are heavily demanded as a function of the FED's policy. At a point when the FED is delaying its tightening, these asset classes have become bullish again. With equities becoming overvalued in most of the developed world, the best opportunities now lie in the emerging world.

It's all about monetary policy

While the gold standard lasted, there was relative stability in terms of capital movements because exchange rates between countries were stable. A participating country could not increase the money supply at its discretion, because people would start selling the home currency in exchange for foreign currency. In the end the central bank would be forced to buy back the currency. When that was the case, international capital movements were more related to fundamentals and international investments generally had a longer-term significance. But when Nixon announced the death of the gold standard in 1971, central banks got a licence to do whatever it takes to accomplish their goals – a licence to print money, in fact. The money supply regained life and was expanded at much faster rates than before, leading

“LOOKING AT WHAT THE FED IS DOING IS SOMETIMES ALL AN INVESTOR NEEDS TO DO TO DETERMINE WHERE TO PUT HIS MONEY.”

to volatile hot money flows around the world.

Forty-five years without the gold standard have shown us that the world is currently much more exposed to currency crisis than before, as a result of massive capital gyrations that are the main output of central bank action.

After the Lehman collapse, the FED engaged in a massive purchase of assets while it also cut interest rates to near zero. Such policies reduced the yields on lower risk assets. The main idea was to force money to flow from savings to consumption and investment, at a time when the economy was in a recession. The policy adopted by the FED was so bold that investors started looking elsewhere to get a yield on their money. Capital flowed out of the US in the direction of emerging markets, thus enabling these countries to secure cheap financing and to expand the production of commodities. But after igniting a recovery in the US, the FED started threatening an inversion in policy, which led to a sudden, massive outflow of money from emerging

markets towards the developed world again. That moment became known as the "taper tantrum" in 2013. The effect was so nefarious to emerging markets and commodities that Bernanke was forced to retreat for a while. Later, in 2015, Janet Yellen prepared the world for an inversion in the FED's interest rate policy. That moment became known as the "super taper tantrum". Due to massive shifts in FED policy, emerging markets have been accumulating large losses for the last few years.

The year of 2015 was a tough one for emerging economies. The main reason for this was the expectation, created by the FED, that rate hikes would occur very soon. In fact, the first rate hike was done in December, when the FED decided to hike its target rate from 0-0.25% to 0.25-0.50%. While the increase in rates was small, investors felt the FED would hike them a few more – perhaps four more – times in 2016. As a result, equities reversed their bullish trend and the S&P 500 closed the year flat. Emerging markets (as measured by the MSCI EM index) lost 15%.



“WHEN THE FED SNEEZES, THE EMERGING WORLD CATCHES A COLD.”

The expectation of increasing yields in the US accelerated emerging market outflows, boosting the value of the US dollar, depressing the value of emerging markets currencies and trashing commodities.

While there was no currency crisis, in some cases the losses experienced were extreme. Brazilian equities lost 40%, Turkish equities 28% and many others experienced double-digit losses. In terms of currencies, the US dollar gains were expressive: 49% against the Brazilian real, 34% against the South African rand, 20% against the Russian rouble, and 17% against the Mexican peso, just to name a few.

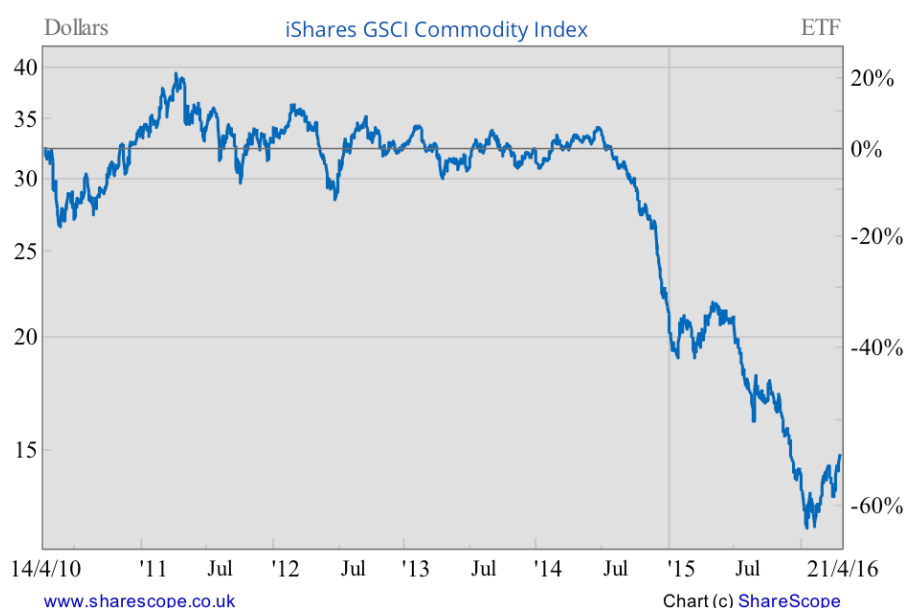
When the FED sneezes, the emerging world catches a cold. The influence the main central banks can have in emerging markets is so great that investors may be better off at looking at central bank policy than at the market fundamentals. At this point, it seems that central banks are retreating again and money is flowing in the direction of emerging markets once more. Commodities are recovering, and equities and emerging markets currencies are improving. While this flow may very well revert again when central banks re-focus on rate hikes, it may still be some time until that happens.

To hike or not to hike

In December the FED hiked its target rate to 0.25-0.50%, at a time when the ECB decided to do nothing. These hawkish decisions led to a bearish Christmas and a lousy New Year for investors. But since mid-January things have changed, as the FED has retreated from its initial hawkish tone and the ECB has been delivering negative rates packed with large asset purchases to keep the system oiled with lots of liquidity. With 10-year Swiss government bonds now negative and many of the shorter maturities inside the

Emerging Markets Currencies		
Pair	YTD (%)	2015 (%)
USD/MXN - Mexican Peso per US\$	1.3	16.8
USD/INR - Indian Rupee per US\$	0.0	5.4
USD/CNY - Chinese Yuan per US\$	-0.2	4.6
USD/KRW - Korean Won per US\$	-3.5	7.9
USD/IDR - Indonesian Rupiah per \$	-4.5	11.3
USD/CLP - Chilean Peso per \$	-6.0	16.8
USD/ZAR - Rand per US\$	-7.5	33.9
USD/RUB - Russian Ruble (Rouble) per US\$	-8.7	20.4
USD/MYR - Malaysian Ringgit per \$	-9.6	22.9
USD/BRL - Brazilian Real per US\$	-10.9	49.0

Data Source: Sharescope



Equities Around the World		
Asset	YTD (%)	2015 (%)
iShares MSCI Brazil	41.2	-40.6
iShares MSCI Turkey	28.4	-28.4
iShares MSCI Russia ADR/GDR UCITS ETF	26.6	2.7
iShares MSCI South Africa	24.2	-22.4
iShares MSCI Thailand Index Fund	17.9	-24.3
iShares MSCI Chile Investable Mkt Idx Fund	17.5	-20.0
iShares MSCI Indonesia Investable Market	14.0	-23.9
iShares MSCI Emerging Markets	11.9	-13.5
iShares MSCI Korea	9.9	-3.3
iShares MSCI Mexico Index Fund	6.3	-16.1
iShares MSCI World	5.3	1.9
iShares MSCI USA Index Fund	3.4	-4.8
iShares MSCI UK Index Fund	0.7	-10.5
iShares MSCI India Index Fund	-0.9	-8.2
iShares MSCI China Index Fund	-2.6	-11.2

Data Source: Sharescope



prices and emerging markets. While the uptrend this year has been strong, many of these markets are still deep in the red for the last three years. Brazil is still down 43%, Indonesia is down 32%, Turkey is down 30%, Mexico 27% and Russia 21%. Taken as a whole, emerging markets are down 11% for the last three years, which still leaves room for recovery.

In terms of fundamental value, many of these economies present investors with low CAPE ratios, which provide an extra margin of safety in terms of valuation risk.

The Russian equity market trades on a CAPE of 4.9x and on a price-to-book of 0.8x. Even China trades on low valuations, despite revising GDP down. The best opportunities are in emerging economies and a few peripheral European economies. They have been battered in the past but are now recovering fast, as the financial system stabilises.

Eurozone also negative, the yields offered in Europe are no longer decent, which has been favouring emerging markets once again. The new inversion in money flows led by renewed central bank dovishness is depressing the dollar and helping commodities recover from record losses. The crude oil composite hit an intraday low at \$7.11 on January 20, but since then has gained 65% to \$44.77. Gold, which had been on a five-year-long bearish trend, has also recovered well, gaining 18% this year on expectations of further easing. Almost every commodity is now edging higher year-to-date.

All emerging markets have benefited from the dollar weakness, but the commodity producers were those that benefited the most. The Brazilian market is now up 41% year-to-date, followed by Turkey, Russia and South Africa, which have all recovered by more than 20%. These countries have seen their prospects impaired by a commodity slump and are now rallying on the price inversion.

Low rates for a long time

The near future for emerging markets will continue to depend heavily on the path followed by the FED and the ECB. Central banks have so far failed to invert their policy, as world GDP growth is still weak. From an expectation that the FED would hike its target rate four times in 2016, investors now believe it will hike rates just once. The US is growing faster than the rest of the developed world but not enough to be able to accommodate a significant

tightening, as the argument goes. Europe is closer to a helicopter drop than to a rate hike, and looks set to remain that way for some time, unless consumer prices start showing signs of life, which seems unlikely for now. In the meantime, this will favour commodity

“TAKEN AS A WHOLE, EMERGING MARKETS ARE DOWN 11% FOR THE LAST THREE YEARS, WHICH STILL LEAVES ROOM FOR RECOVERY.”

Fundamental Valuation Ratios				
Country	CAPE	PE	PB	PS
Russia	4.9	9.4	0.8	0.7
Hungary	10.3	21.4	1.2	0.6
Czech	9.4	12.8	1.3	1.0
Turkey	10.6	11.8	1.4	1.0
Brazil	8.2	42.0	1.4	1.0
Korea (South)	12.8	11.9	1.0	0.6
Portugal	10.9	27.2	1.4	0.6
Austria	12.3	20.9	1.0	0.6
Poland	9.8	28.2	1.2	0.7
China	12.8	6.0	0.8	0.6
Singapore	11.5	13.6	1.1	1.0
Taiwan	18.3	13.2	1.7	1.0

Data Source: Star Capital

Last Updated Date: 31/03/2016





BY JAMES FAULKNER

SALVARX: FIGHTING CANCER FROM WITHIN

AN INTERVIEW WITH IAN WALTERS, MD, CEO OF SALVARX PLC

James Faulkner: Hi Ian. SalvaRx (AIM:SALV) describes itself as a drug discovery and development company focused on immune-oncology. To the layman such as myself, that's stimulating the immune system to fight cancer, right?

Ian Walters: Yes, some describe immunotherapy as fighting cancer from within. If your body's immune system can find the cancer and identify it, it can clear the tumour. Cancer has many ways of evading the immune system, and our approaches to treating it focus on stimulating the immune system to recognise cancer and prevent cancer from evading the immune system.

JF: Can you begin by giving our readers a little background information on the company?

IW: Dr. Kramer and I both focused on immunology during our academic careers, and we both worked at BMS, championing and developing the two key drugs that started the modern cancer immunotherapy field (Yervoy and Opdivo). These drugs are called checkpoint inhibitors,

and they prevent cancer from counterfeiting a signal that healthy cells use to keep immune cells from attacking them.

I have personally met patients who were given fewer than four months to live before treatment with these drugs and who have survived over ten years since their diagnosis with no evidence of cancer recurrence. I left BMS with a vision of how this field would unfold, and I wanted to be on the cutting edge of the field. Rob and I started SalvaRx to help other scientists and drug developers bring their immunotherapies to market, in a nimble and fast-paced environment. Jim Mellon and Gregory Bailey incubated the company and financed our first investment in iOx. We have looked through hundreds of immune-oncology companies and have identified some gems that could bring great value to patients.

JF: Both yourself and fellow co-founder Rob Kramer are former Bristol-Myers Squibb drug developers with a history of championing immune-oncology and developing immune-oncology therapeutics. How did your time at BMS pre-

pare you for your current roles at SalvaRx? With all due respect, don't they say that good scientists tend to make poor businessmen?

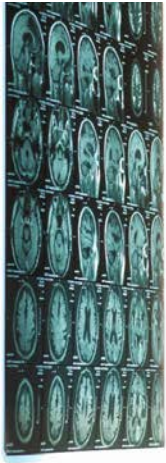


IW: When I first transitioned from academia to the private sector, I worked on a programme to develop a treatment for a fatal disease. The other scientists and I were excited about the project and very upset when the marketing and business folks stopped the programme because they believed it would never recoup its costs (net present value calculations were negative). That was a wakeup call for me: it showed me both that something was wrong with the way we developed drugs and that I needed new and different skills to succeed at my career goals. This inspired me to go back to school; I received an MBA from the Wharton School of Business and specialised in evaluating and prioritising life science projects.



“I HAVE PERSONALLY MET PATIENTS WHO WERE GIVEN FEWER THAN FOUR MONTHS TO LIVE BEFORE TREATMENT WITH THESE DRUGS AND WHO HAVE SURVIVED OVER TEN YEARS SINCE THEIR DIAGNOSIS WITH NO EVIDENCE OF CANCER RECURRENCE.”



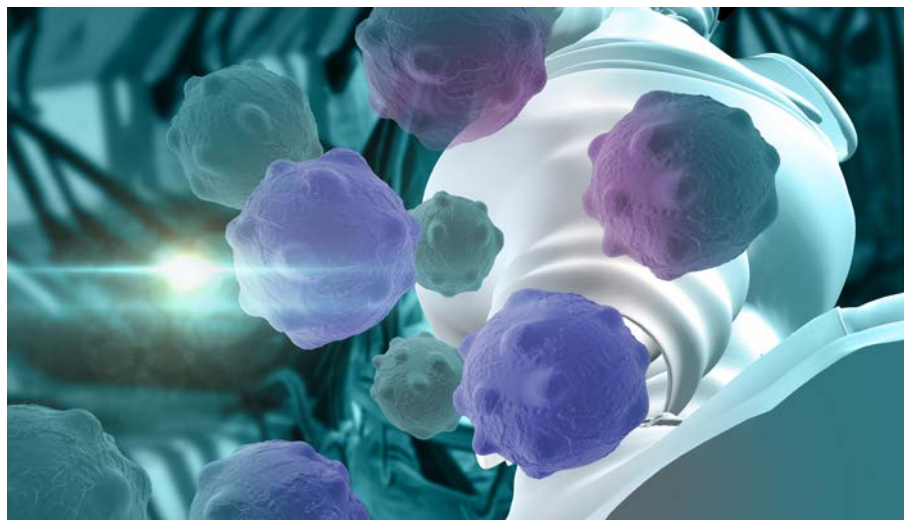


Since that time I have worked in commercial, corporate, and business development groups of a few small companies and later BMS. I have had P&L responsibility for large teams with budgets of more than \$300 million. I have chosen advisers and board members who can provide good business and financial advice, and my board is confident that I have the required business skills to make the company successful.

In my view, our experience as drug developers at BMS is more essential to the future success of the company. While at BMS, Rob and I learned how these drugs work, why they work, in which patients they might work, how to test them, how to develop them with an eye to the market, how to market and sell them, how to finance health authorities to approve them, and how to get insurers and health authorities to pay for them. On top of that, I worked in the business development group evaluating small companies that were developing similar technologies, setting up acquisitions and licensing deals, and negotiating collaborations with other academic and corporate partners. Our team has a unique skillset and the right blend of academic and commercial know-how that is well suited to bring immunotherapies to the market.

JF: In 2015, SalvaRx made its first investment in iOx Therapeutics, a University of Oxford spin-out that is developing compounds that stim-

“OUR TEAM HAS A UNIQUE SKILLSET AND THE RIGHT BLEND OF ACADEMIC AND COMMERCIAL KNOW-HOW THAT IS WELL SUITED TO BRING IMMUNOTHERAPIES TO THE MARKET.”



ulate Natural Killer T Cells. What is the significance of this investment for SalvaRx?

IW: iOx is a core investment for SalvaRx, and Rob and I continue to manage its day-to-day operations. iOx was born of a collaboration between the University of Oxford and the Ludwig Institute for Cancer Research (LICR). Oxford scientists had learned a great deal about a key

cell type in the immune system called a natural killer T-cell (NKT cells), and they partnered with the LICR to transform this research into a therapeutic.

NKT Cells both kill tumour cells directly and collaborate with the rest of the immune system, educating it on the tumour and stimulating them to attack. iOx has licensed multiple compounds that stimulate these cells. Our collaboration with

“THE BEAUTY OF IMMUNOTHERAPY IS THAT IF WE CAN TEACH YOUR IMMUNE SYSTEM TO FIGHT YOUR CANCER, IT WILL KEEP FIGHTING CANCER NOT JUST ON THE DAY THAT YOU STEP OUT OF THE HOSPITAL BUT FOR THE REST OF YOUR LIFE.”

Oxford and LICR has been tremendously valuable, both for our collaborators' deep knowledge of tumour biology and for the institutional support that the University has provided. Oxford will conduct a sixty-patient study that not only tests the safety of the drug but also examines its efficacy, comparing iOx's compounds with Opdivo and testing the combination of the two to see if our technology can make the other drugs work better. It is unusual for a first clinical trial to provide such a detailed understanding of a drug's pharmacology, and the results of this trial may be the basis of later partnering discussions.

On Thursday, iOx announced a second collaboration, this time with a public/private consortium named PRECIOUS. The European Commission is funding the consortium to develop new immunotherapies. This grant, provided through the Horizon 2020 programme, will fund a new product that combines one of iOx's compounds with an anti-tumour vaccine from the Ludwig Cancer Center using novel formulation technology from one of our partners. The grant will fund the development of this combination product, its manufacture, and its testing in two different clinical trials. We value our connections and collaborations with academic and governmental organisations and leverage them to offset the high costs of developing new drugs.

JF: You arrived on AIM in March via a reverse takeover of 3Legs Resources. You also raised £1.95 million (before expenses) in conjunction with that. How will those funds be deployed?

IW: *These funds will cover operating expenses for iOx over the next 18 months and allow us to pursue the next transaction.*

JF: The conventional treatments for cancer of all types are disparag-



ingly labelled slash (surgery), poison (chemotherapy) and burn (radiotherapy). Given that cancers are essentially mutated cells that have evaded detection and destruction by the body's own immune system, immune-oncology would appear to be the Holy Grail of cancer treatment. What kinds of advances can we expect from this exciting area of research in future?

IW: *These drugs have been truly remarkable: the beauty of immunotherapy is that if we can teach your immune system*

to fight your cancer, it will keep fighting cancer not just on the day that you step out of the hospital but for the rest of your life. Immunotherapies also tend to be less toxic to normal tissues; letting cancer patients have a better quality of life not only during treatment but afterwards.

The two drugs that we helped develop at BMS are curing up to 35% of patients with certain tumour types, which is a great success; but 65% of patients haven't benefited from immunotherapy yet, including a friend of mine who recently died. We think of the checkpoint inhibitors as



“EVEN THOUGH PRICES FOR IMMUNOTHERAPIES ARE HIGH – >£100,000 PER PATIENT IN THE UNITED KINGDOM – NICE STILL FOUND YERVOY COST EFFECTIVE, AS AROUND 15% OF PATIENTS ARE EXPECTED TO LIVE OUT THE REST OF THEIR NATURAL LIVES.”

a foundation for combination therapy, and our strategy is to find compounds to complement the checkpoint inhibitors so that they can help more patients.

JF: The dramatic efficacy benefits of immunotherapies have reduced the traditional drug development timeline by two years, allowing for smaller, shorter and less expensive clinical trials. Does this mean we can expect new drugs to reach the market quicker, and at a lower initial price, in future?

IW: After years of reviewing products that added months to patients' lifespans without long-term cures, the FDA and other health authorities have worked very closely with pharmaceutical companies to get immunotherapies to patients who need them very quickly. For example, Merck's checkpoint inhibitor was approved and marketed only three years after starting human testing – other drugs might take up to ten! The results were so profound that FDA approved the drug based on one study of approximately 250 patients.

Drug pricing is a fraught issue because of the tension between a health authority or insurer's motivation to lower costs and the drug developer's need to satisfy investors' expectations. Drug companies usually employ a value-driven drug pricing strategy that examines what the alternative to care is – in this case usually end of life care and repeated hospitalisation that can be very costly. Even though prices for immunotherapies are high – >£100,000 per patient in the United Kingdom – NICE still found Yervoy cost effective, as around 15% of patients are expected to live out the rest of their natural lives.

While we do expect the prices of immunotherapies to be high while they are on patent, we expect the eventual entry of

biosimilars and generics to reduce prices of older drugs and relieve the burden on the healthcare system. High prices for new drugs and low prices for old drugs gives investors an incentive to deploy vast amounts of capital on a very risky endeavour rather than invest in lower-yielding but safer assets. This system of incentives is the engine behind innovation in medicine, and we can thank it for major improvements in our standard of health over the past decades, including cancer immunotherapy.

JF: With the pharmaceutical majors cutting back on their R&D activities, is now the time to be investing in early-stage drug developers like SalvaRx? Presumably, the majors can simply let the smaller companies do all the hard work and then simply scoop up the winners to bolster their pipelines. Why would investors want to bear the additional risk when they can simply invest in their favourite pharma majors, which are now leaner and meaner?

IW: You are right that major pharma companies have cut back on internal R&D: there have been layoffs of thousands of scientists in the past decade because of a perception that internal R&D is too risky or unproductive. At the same time, major pharma still have large sales forces and internal infrastructure that are useless without new drugs to sell. Pharma has transferred the risk of R&D to small biotech, but they have transferred much of the reward as well. At BMS, our budget for in-licensing new compounds was \$8 billion while I was working at their business development unit. Deals struck by small companies are at record highs, especially in cancer immunotherapy. If you look at the past few deals in this space, once the products had exciting human data, pricetags have climbed above \$1 billion.

Drug discovery is an inherently risky endeavour: a recent study has calculated that drugs that enter the clinic have roughly a 10% chance of approval. While the risks of drug development are great,



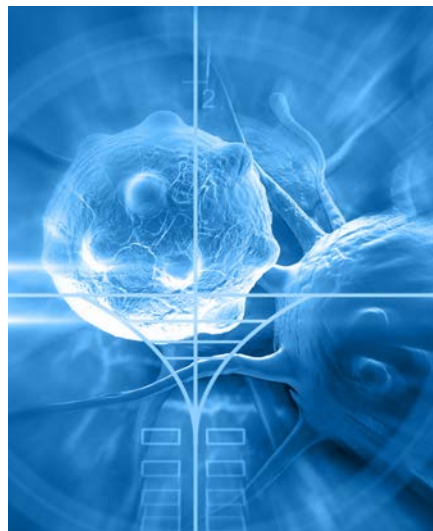
the rewards of a successful programme are greater. For example, a billion dollar licensing deal would be about a 50x multiple of our current market cap – that sort of return is usually only seen in venture-backed private companies. One of our theses in listing SalvaRx on AIM was that there are relatively few small similar public British biotechs and that there was demand from British investors for that return profile.

While we can't change the fundamental risks of drug development, we are building SalvaRx to mitigate as many risks to our investors as possible. We plan to add additional products to our pipeline with the goal of having one or two pivotal read-outs per year, diversifying compound specific risk. We have also chosen a field where there is a great deal of exciting science and proven therapeutic potential. In the event that one of our compounds is successful, our corporate structure will allow us to return significant capital to our shareholders without selling our entire pipeline.

JF: The biotech sector in general has suffered a setback on the markets of late. What's your take on the recent sell-off and how do you view the healthcare market in general? Are we currently in the middle of a healthcare super-cycle?

IW: Our impression is that generalist funds have largely moved out of pharma stocks as a result of other macro events like the slowdown in the Chinese econ-

omy and crash in the energy sector; discussions of drug pricing as part of the American election have also been a catalyst for the downward move. Most political analysts predict that political drug pricing discussions will remain as discussions and that there won't be changes to the drug pricing model that underlies Pharma and biotech. I have not seen any fundamental changes to the biotech and pharma companies, and I think that a large acquisition this year or next could bring generalists back into the sector. Pharma and Biotech are creating innovative drugs that are making real improvements in patients' lives, and I think that these breakthroughs will always be rewarded.



JF: SalvaRx is said to be "actively screening acquisitions and investments in cancer immunotherapy and complementary areas of oncol-

ogy." Other than the immunotherapy market, what areas of cancer research are you most excited about right now?

IW: I am confident that immunotherapy will be around for a long time. Cell therapies have been interesting. Your body and cells have remarkable abilities to grow, heal, adapt, and in the case of T-cells to ward off abnormal cells. Cell therapy has great potential because cells can do much more than a small molecule or biologic that hits one or two targets; but this complexity has made the field unattainable until very recently. Scientists have learned how to harvest useful cells, manipulate them, and re-infuse them back into the patient. Groups like Juno, Kite, and Novartis have been developing increasingly sophisticated ways to manipulate cells, including genetic manipulations that help the cells directly target tumours. Cell therapy has had some very promising results in some small subsets of liquid tumours; in some cancers, nearly every patient responds to therapy. Although cell therapy isn't our focus, I do find these results very exciting. There have been fundamental scientific and medical advances that are greatly improving our ability to treat cancer. That should be very exciting not only to investors but also to everyone who is affected by cancer or who has a loved one who is affected by cancer – in my mind that's close to everyone. Regardless of what the healthcare market does in the short term, I think that the future is bright.

About Ian

Ian B. Walters, M.D., M.B.A., is the Entrepreneur in Residence at Mediqventures and is part-time CMO of Intensity Therapeutics, Inc. Over his 19 year career, he has demonstrated both leadership and expertise in drug development, including the advancement of multiple cancer compounds from research stages through approval.

Ian specialises in the evaluation, prioritization, and the innovative development of new therapies for the treatment of severe diseases. He has worked at PDL BioPharma, Inc., Millenium Pharmaceuticals, Inc., and Sorrento Therapeutics, Inc., leading corporate development, translational medicine, clinical development and medical affairs.

Ian spent seven years at Bristol-Myers Squibb, where he managed physicians overseeing the international development of more than eight oncology compounds (including Nivolumab (anti-PD-1), Ipilimumab (anti-CTLA-4), brivanib (anti VEGF/FGF), anti-IGF1R, VEGFR2 biologic, Elotuzimab (antiCS1), as well as biomarker and companion diagnostic work. He was a core member of Bristol-Myers Squibb's Strategic Transactions Group evaluating and executing licensing agreements, mergers and acquisitions, clinical collaborations, and the company's immuno-oncology strategy.

Before entering the private sector, Ian was a lead investigator at the Rockefeller University and initiated advanced immunology research to understand the mechanism of action of several compounds. Ian received his MD from the Albert Einstein College of Medicine and an MBA from the Wharton School of The University of Pennsylvania.





BY SAMUEL RAE

FORENSIC FOREX

BUCKLE UP FOR A VOLATILE SECOND HALF OF 2016

The first quarter of 2016 offered up a volatile start to the year in the foreign exchange markets, and with a host of potentially game-changing fundamental developments set to play out across the next few months, the chances are we will see far more volatility before things settle. The vote in the UK regarding a European Union Brexit could prove the medium- to long-term bias driver in the cable and other sterling associated pairs, and as the fiscal situation in the US unfolds against a backdrop of political uncertainty, how the dollar will play out against its major counterparts is anybody's guess.

Those familiar with my strategy will be aware that I bring some fundamental elements to what is essentially a technical charting approach – partly through

necessity and partly to make things a little more interesting. Charting can be profitable, but it's the underlying factors that make for interesting reading.

So, with this said, here is a look at how I'm approaching the majors as we head into the second half of this quarter, and beyond, into the latter half of the year.





271 km



Fasten
seat belt





First then, let's address the aforementioned Brexit. Sterling is down considerably against the US dollar on expectations that the UK public will vote to leave Europe come June. The primary driver behind the weakness is a concern over how an independent UK will maintain trade relations with Europe (and, of course, the rest the world) when it no longer benefits from the free trade that being part of an economic union affords a nation.

This is a valid concern, but why do its implications for UK growth warrant a devaluation of the nation's currency? The answer is rooted in the Bank of England's response to ailing UK trade. If the UK leaves Europe, and trade declines, ground-level manufacture and service offerings in the UK will suffer. Estimates put the impact at a 1% trimming of economic growth in the year that follows an exit. This doesn't seem too dramatic, but at a time when 2% growth is an optimistic estimate even if we remain a Eurozone member, it looks a little more serious.

As the economy suffers, the only real response from the Bank of England will be a reigniting of its quantitative easing programme – an unorthodox form of monetary policy intervention that central banks all over the globe have initiated across the last decade or so. Quantitative easing may go some way to stimulating the economy, and could well offset the missed growth that comes about as a result of the UK's inability to compete in the global trade arena. However, it will also devalue

“I’D WAGER THAT THE UK WILL REMAIN PART OF THE EU. THIS PRESENTS ME WITH AN INTERESTING OPPORTUNITY GOING FORWARD.”

sterling, and that's why we are seeing weakness in the GBP/USD, the EUR/GBP etc.

Of course, this all feeds into the assumption that the UK will leave Europe. If I was to fall onto one side of the fence or the other as far as predicting the outcome of the upcoming referendum is concerned, I'd wager that the UK will remain part of the EU. This presents me with an interesting opportunity going forward. That is, an opportunity to approach the next couple of quarters with a contrarian cable bias – leaving me on the lookout for upside entries that go against the grain of general market sentiment.

This doesn't mean I won't enter short if the charts throw out a signal. It does mean, however, that I can be that little bit more aggressive on my long entries, and, especially if the referendum keeps us part of the European Union, give myself some pretty wide risk scope on the positions I take.

One thing I will keep an eye on is the situation in the US. Chances are the Federal Reserve won't raise rates in the near term, but the US dollar is on a serious upside run, and I expect this to

continue in the coming months. If Janet Yellen pivots and hikes the base rate, it could debase my medium-term bullish cable bias.

All said, it's going to be an interesting few months. Uncertainty reigns supreme as things stand, and chances are sentiment will remain uncertain (and in turn, volatile) for the foreseeable future.

My strategy affords me the luxury of not being forced to form a preemptive bias (at least, that is, not having to rely entirely on said bias for entry signals). Having said this, when I do, its impact on my risk profile can be the difference between a small chop out and a real hit.

If there was ever a year to take a severe hit, it's one in which the UK leaves the EU, China's bid to become a global superpower collapses under its government's attempts to shift towards a retail economy, and a New York real estate mogul becomes a layman-supported, but establishment-despised leader of the free world.

Hold on tight!



	Oct 14	Spot	
\$ per €	1.239	1.234	€ per \$
\$ per £	1.797	1.793	£ per \$
£ per €	0.690	0.686	€ per £
¥ per \$	109.66	109.73	
¥ per £	196.6	196.1	
\$ per ¥	95.0		
¥ per £	1.543		



BY JAMIE REDBOND

LANDLORD SURVIVAL GUIDE

**HOW CAN LANDLORDS BEST DEAL WITH
THE NEW REGULATIONS BROUGHT IN
WITH THE BUDGET?**





125%), but since 1st April 2016, landlords and owners of second homes have had to find an additional 3% in Stamp Duty Land Tax (SDLT) across all bands.

Compounding their misery, wealthier buy-to-let landlords are also going to see the tax relief they're able to claim on mortgage interest payments cut to a flat rate of 20% from April 2017 – down from the 40% or 45% they currently enjoy.

This could have a huge impact on net profits and it seems the more interest you pay, the more you'll be affected. In fact, if you have a long-term fixed rate mortgage, you might be better off selling up and putting your money into a savings account, especially when you factor in the additional stamp duty.

It's a riskier option, but switching to a short-term fixed rate deal, with a lower interest rate, might be a viable alternative; or you might consider placing your portfolio into a limited company. This might limit your mortgage op-

tions, but your profits would be subject to corporation tax rather than income tax (which is higher).

Appointing a managing agent for your property portfolio is also a very worthwhile consideration, as you'll be able to offset those tax-deductible costs against your income.

“IF YOU HAVE A LONG-TERM FIXED RATE MORTGAGE, YOU MIGHT BE BETTER OFF SELLING UP AND PUTTING YOUR MONEY INTO A SAVINGS ACCOUNT.”

Hiking up rents is a strategy that's unlikely to work as most tenants are already paying as much as they can afford, and the government's Help-to-Buy scheme is making it easier for them to get on the property ladder. With demand outstripping supply, and

The Budget on 16th March confirmed the announcement in last year's Autumn Statement that the residential buy-to-let property market was heading for a serious shake up.

Not only have important lenders within the sector – including Barclays – tightened their lending criteria (rental income must now exceed 135% of interest payments, instead of the previous





more costs to cover, it would be tempting to push rents up, but getting too greedy would be a very short-sighted approach.

Business as Usual?

Until now, landlords have been able to take their rental income then deduct their mortgage costs and only pay income tax on the balance – if there was a profit. That's no longer the case. We thought this would lead to a slow-down in the buy-to-let market while landlords adapted to the changes and waited for the dust to settle. However, we've actually seen very little change at the lower end of the market.



It's only been a month since the SDLT changes came in, but it seems people are still keen to invest in second properties, either for short-term capital growth or pension purposes. For the sub-£125,000 band, it's really been a case of business as usual, and the £125,000 to £250,000 band has hardly been affected either. It appears the 3% SDLT increase is being viewed as not particularly onerous at these levels.

Fewer purchases are being made of properties worth more than £250,000, but it's not until you get above £500,000 that any significant reductions are evident. Very few transactions are going through at £1 million and above as the stamp duty increase actually becomes quite oppressive at that level.

Property investors looking for more bang for their buck are increasingly being forced out of London, where £1 million properties are commonplace. This helps explain why the East and South East have become particularly desirable locations for buy-to-let landlords eager to take advantage of the capital's widening commuter belt, while staying within the lower SDLT thresholds.

Average house prices in the East are up by more than 10% on last year (the second highest growth area behind the South East) and Ipswich has just entered [emoov's UK property hotspot](#)

[index](#) as the fourth most sought-after place to live. This has contributed to the UK's average house price rising to almost £285,000 – up nearly 8% on February 2015, according to the [Office for National Statistics \(ONS\)](#).

“PROPERTY INVESTMENT STILL MAKES A LOT OF SENSE, PARTICULARLY IN BOOMING MARKETS OUTSIDE LONDON.”

These figures show why property investment still makes a lot of sense, particularly in booming markets outside London. If the economy remains fairly consistent and house prices continue to rise at a similar rate, why would an additional 3% in stamp duty put you off? You'd earn that back within six months.

The bottom line is, people still like to invest in property. They see it as safe

“THOSE LOOKING FOR MORE SIGNIFICANT GAINS MIGHT FIND COMMERCIAL PROPERTY A MORE ATTRACTIVE PROPOSITION.”

and secure – an investment they can physically see, rather than a virtual investment or something held on a piece of paper in a bank or stock exchange. While the banks are offering a frankly pathetic interest rate for savers, property still offers an excellent yield if you buy well.

What are the Alternatives?

Although we're not too involved in the world of commercial property, I've been told that some investors have decided to move away from residential and give commercial a look. The commercial property market is typically driven by pension funds and trusts rather than private investors, but it might become the preferred option for savvy investors undeterred by the long-term contracts and higher legal fees.

Private investors usually prefer residential because they understand it; however, it appears the new, lower Capital Gains Tax (CGT) rates – 10% for basic rate and 20% for higher rate taxpayers – will apply to commercial property (residential is exempt). There has also been a reduction in stamp duty on commercial properties worth up to £1 million, so this could be enough to tempt hardy investors to make a leap of faith.

The golden spell may be over, but low borrowing rates for the foreseeable future should mean landlords will continue to yield a good return from buy-to-let investments. The higher end of the market (properties worth in excess of £500,000) is likely to suffer, but it's business as usual at the lower end.

Smart buy-to-let landlords are already taking a step back and assessing their position with regards to their income tax exposure next year, but for others, it won't be until they complete their tax return in January that they realise the impact. This is likely to be when the property market will really feel the effect of these changes, as professional investors who have been pushed over their income tax threshold might decide to dump their portfolios and explore more tax-efficient special vehicles, like VCTs and EISs.

As a long-term capital growth tool, residential buy-to-let still makes sense, especially at the more affordable end of the market. Those looking for more significant gains might find commercial

property a more attractive proposition. Investors relying on income generated by residential property should approach the buy-to-let market with caution.

If you're in any doubt about the potential implications arising from the recent changes, seek professional advice from a financial adviser or an accountant specialising in tax matters.

Should the residential buy-to-let market start to level off or slow down, the everyday mortgage industry should experience growth due to the increased availability of properties. It's still very early days, but it's not looking like there'll be a glut of affordable property any time soon.



About Jamie Redbond, Managing Director, Nicholas Estates

Jamie is the managing director of Nicholas Estates (www.nicholasestates.co.uk) – one of the most recognised and trusted Estate Agents in Ipswich and surrounding areas. He has worked in the property market for many years, offering a wealth of knowledge to first-time buyers and seasoned property investors.

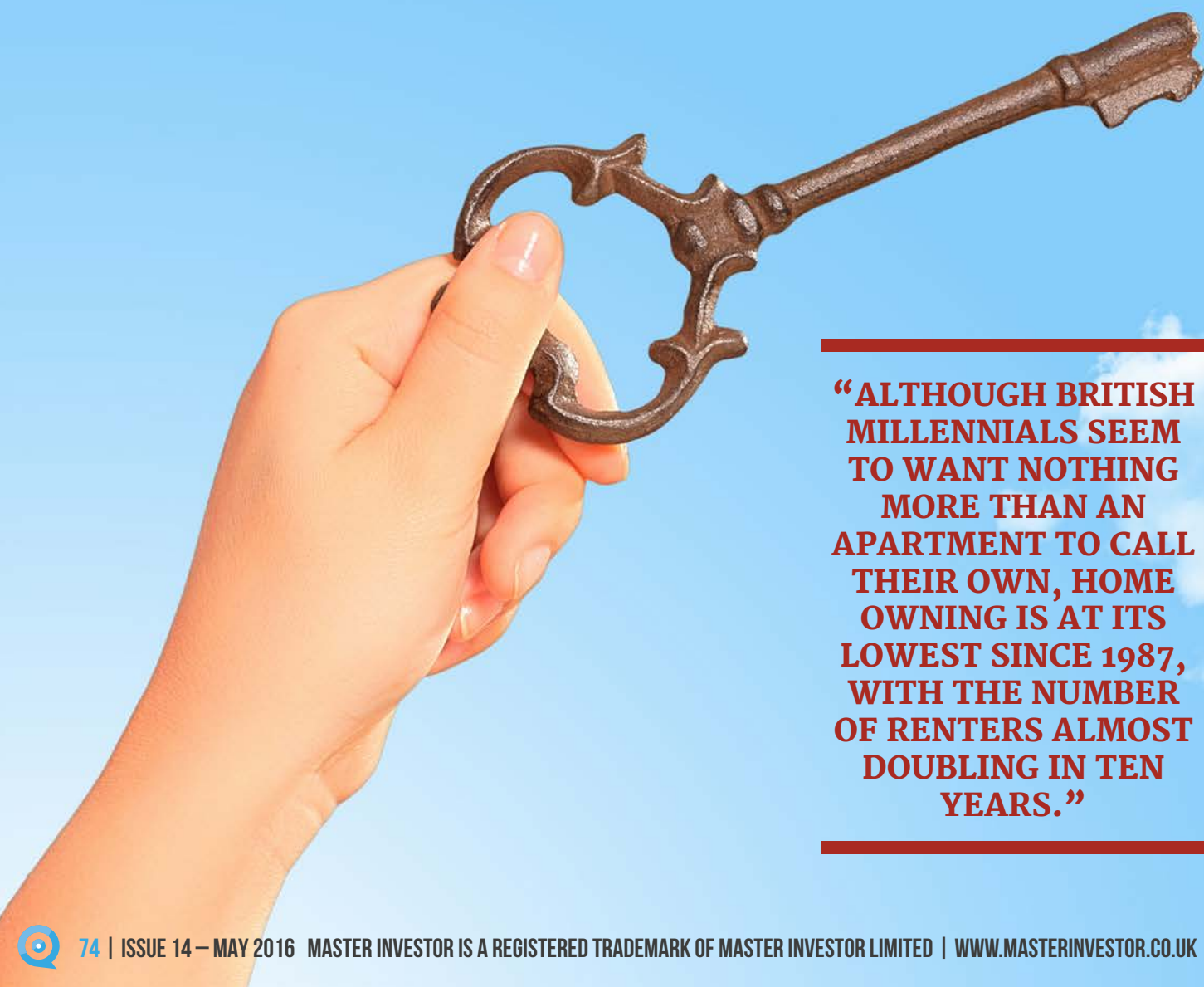




BY CAROLINE DREWETT

MILLENNIALS AND PROPERTY

HAVE RECENT CHANGES IN THE HELP
TO BUY SCHEME ACTUALLY HELPED
ANYONE BUT THE MIDDLE CLASSES?



**“ALTHOUGH BRITISH
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Someone recently asked me if growing up as a Millennial was depressing because of the financial hardships we have to endure. Well, when growing up, the internet was dial-up, and we had no colour television until my teens, but other than that, it wasn't too bad. After all, two generations ago, my grandparents grew up in a World War. As did the generation before that. All with no public health system, internet, or free education. In fact, all in all, we Millennials have it pretty swimmingly. So why do we feel so hard done by?

The property market within Britain is like very few other places in the world. Given the UK's population density, every square foot is in high demand, and as the population continues to rise, so do prices. Although British Millennials seem to want nothing more than an apartment to call their own, home owning is at its lowest since 1987, with the number of renters almost doubling in ten years, from 2.2 million in 2003 to 3.9 million in 2013. And to add uncertainty to an already huge number of Millennials at the hands of landlords, these figures come at a time

when renting from private landlords now outweighs housing association and council renters for the first time. This means that fewer rent controls are in place, with the result being that the baby-boomers have spent the last two decades cashing in on the buy-to-let market whilst tending to their own bank balances at the expense of the eternally-renting generation.

Of course, whilst Millennials' troubles might seem cataclysmic in our eyes, we should remember that we have the power to sway the country's fig-





ures given our sheer numbers, not to mention an unprecedented amount of wealth about to be transferred to us within the next two decades. We need to focus on the positives of living in this time, rather than the negatives. Of course, the negatives aren't hard to find. According to Country Life's "Who Owns Britain?" in 2010, 0.6% of the population owns over 50% of rural land in Britain, but this has been the case for centuries, and convincing ourselves that we are the only ones on the receiving end of such hardship only serves to stop all sympathy and makes us seem ungrateful whingers.

The main problem is the Millennial lifestyle. We want everything, and we want it now. Whilst home owning was more common for the baby boomer generation, they also bought a house and stuck with it. These days, we want a house purely for the cash value to re-sell in a few years, as well as the social status of showing off that we've 'made it' by our 30s. If we truly cared about financial security, we wouldn't have store credit card debts coming out of our ears or feel pressured to get a new phone every six months. As I have argued previously, everything is in our reach, and getting on the prop-

erty ladder is possible; but it takes a lot of work. Hard work. If you are willing to approach the challenge with a positive mindset, there are increasing possibilities.

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How to get on the ladder

The government's 'Help to Buy' scheme has had a successful run in the past two years. Intended for those who can't stump up the full 25% de-

posit, the government loans 20% of the house value, interest-free for five years, so that you only need to save 5% to get a decent mortgage rate of 75% loan-to-value. Given that that average UK home is now worth £284,000, that means that a household (traditionally a couple or individual, but increasingly two friends who club together) require a joint income of just under £41,000 to buy somewhere, along with their £14,500 joint deposit. All of a sudden, owning a home isn't quite so far out of reach. Unless you live in London, of course. Living in London has the draw of increased employment prospects, often with a London salary weighting allowance, but the increase in salary doesn't always match up to the increase in property prices.

The average London home has now exceeded £520,000, so even with Help to Buy deposits out the way, a household would need a minimum income of £90,000 to get a mortgage, which, given the average UK salary is nearer £26,000, would mean most couples fall short by almost £40,000. However, having bowed to pressure in the latest budget, Osborne has separated the Help to Buy scheme into two different regions – London, and the rest of the

UK. This means that Londoners finally have a chance to access the Holy Grail of savings – buying a house. Having increased the interest-free loan to 40% rather than 20%, borrowers only need to find a mortgage provider willing to lend them 55%. The outlook is much rosier.

The downsides

But should we all rejoice in a spontaneous gesture of thanks to the government? Perhaps not. One of the biggest criticisms of the Help to Buy Scheme has been that it has helped everyone except the hard-done by Millennials, and some commentators have even suggested that it has made buying a home harder due to the increased competition. With many first-time buyers being virtually fully funded by the Bank of Mum and Dad, the government – ergo the taxpayers' – interest-free loans have not ended up helping low-income Millennials, but rather have just been used as a way for wealthy Gen X parents to offload some of their savings to their children. With a ceiling of £600,000-purchases available under the scheme, in all likelihood, it is those who already boast a financial head-start in life that are making the most of the scheme. Their ability to snap up bargains chain-free is only serving to increase competition in the market whilst low-income couples who have slowly moved up the property ladder over the years are being edged out of the market once they reach the half a million value mark.

The middle classes have been rushing to help their children out of the endless renting spiral by giving them huge deposits which have enabled them to buy 2-3 bed London homes, whilst dodging any risk of inheritance tax on the way, all on the government's interest-free loans. This has meant that London homes, as well as those in popular university towns like up and coming Newcastle or trendy Bristol, are now in demand as soon as anything comes on the market. In recent years, bidding wars have been everywhere, yet how many of the Millennials are out-bidding each other on £600,000 two beds with all their own money? It leaves those from low-income families well and truly out of the homeowners club: the result of a well-intentioned scheme.



“THE MIDDLE CLASSES HAVE BEEN RUSHING TO HELP THEIR CHILDREN OUT OF THE ENDLESS RENTING SPIRAL BY GIVING THEM HUGE DEPOSITS.”



Alternatives

As written in last month's Master Investor Magazine, the new Lifetime ISA is a great alternative, and it holds no disadvantages to those without a trust fund behind them. If you can't wait until 2017 to get started, there is also a government Help to Buy ISA. It allows you to save up to £200 a month in the scheme so that when you are ready to buy a home, the government will contribute an extra 25% (up to a maximum bonus of £3,000). On top of the 4% interest rates available, one of its most attractive aspects is that it is of course, like all ISAs, tax-free. Where else could you put in £2,400 during a year, and get an additional £600 from the government for doing nothing? Within five

years you'll have an extra £3,000 from nowhere. All it takes is a little consistent saving.

Although we Millennials like to think that properties should fall into our lap, the key is saving and restraint. The concept of getting onto the ladder without any form of savings is unheard of for any past generation, so why should we be any different? There are practical schemes out there to help, and although a few evenings out here and there might need to be sacrificed, the government is under pressure to help Millennials, and through taking advantage of these, the potential of being a home owner by 35 is in everyone's reach.





APRIL 2016

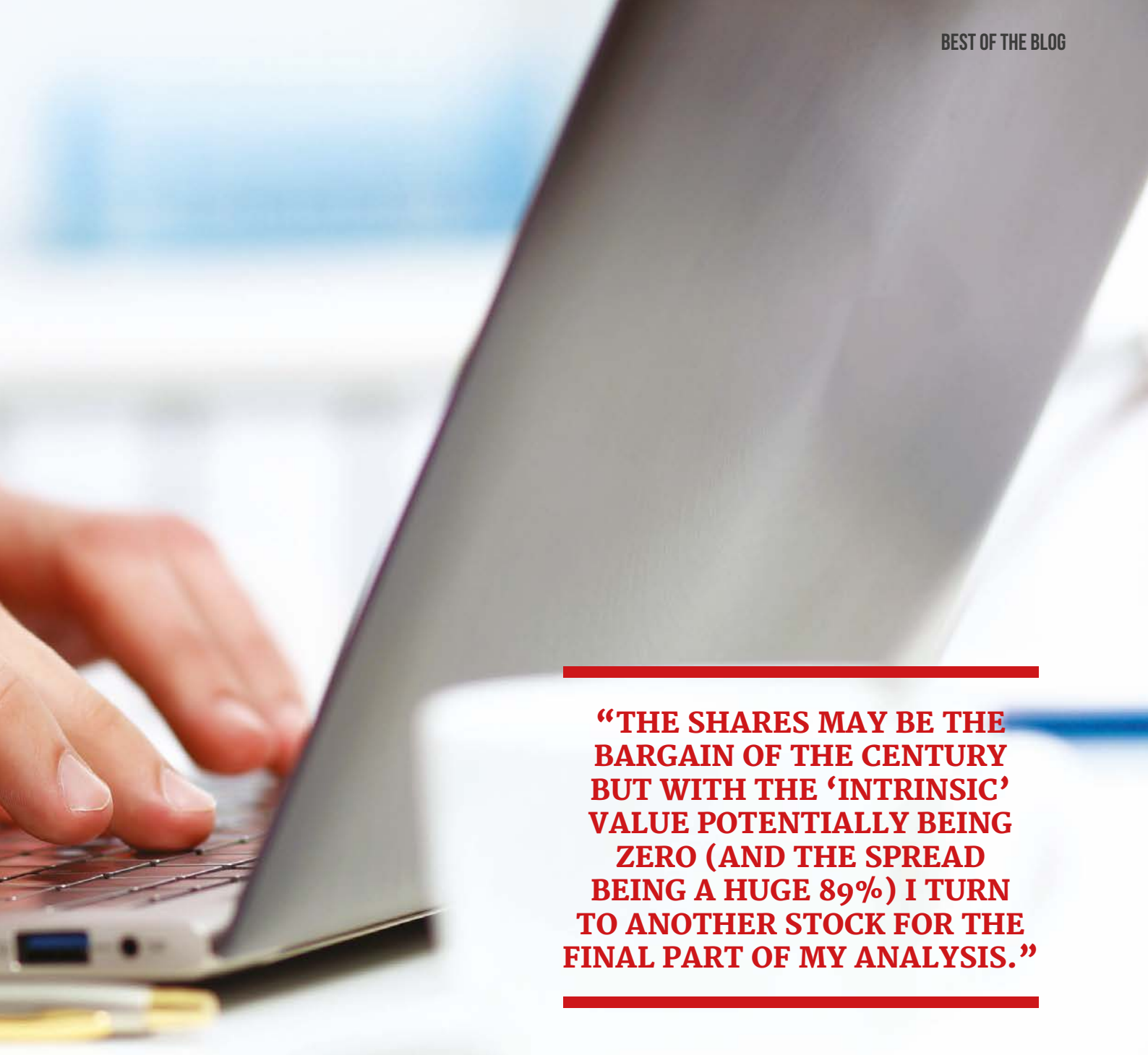
BEST OF THE BLOG

Are These the Cheapest Stocks in London (Part 3)?

Having done a scan of all the stocks in London for this three part feature one stood out as being the cheapest, by far, in valuation terms. Chinese seafood seller Aquatic Foods Group (AFG) is trading on a PE of 0.7 times, yields 15% and has net cash of c. £40 million against a market cap of £10 million. A bonkers valuation if ever there was one.

The problem is that, with the company being based in China, the markets simply do not believe the numbers. This is given the raft of China based scandals and company suspensions which have hit AIM in recent years. The shares may be the bargain of the century but with the "intrinsic" value potentially being zero (and the spread being a huge 89%) I turn to another stock for the final part of my analysis.

Listing on AIM in October 2014 **entu (UK)** is a provider of energy efficiency products and services to UK homes. The firm owns a portfolio of ten companies which provide offerings including home improvement products – mainly doors and windows, the sale of energy generation and energy saving products, the sale of insulation products, and repairs and renewals service agreement programmes. These are supported by installation services business Job



“THE SHARES MAY BE THE BARGAIN OF THE CENTURY BUT WITH THE ‘INTRINSIC’ VALUE POTENTIALLY BEING ZERO (AND THE SPREAD BEING A HUGE 89%) I TURN TO ANOTHER STOCK FOR THE FINAL PART OF MY ANALYSIS.”

Worth Doing, which provides the nationwide installation of Entu products. The firm also earns commissions on finance packages offered to customers via third-party providers.

Entu shares plunged after a profits warning in September last year caused by problems in the company's Solar division, which provided and installed solar panels to homes. An expected upturn in trading did not materialise and the business

made a loss of over £2 million for the year to October 2015 against a budgeted contribution of £1.6 million. Along with a planned reduction in feed-in tariffs by the government the decision was made to close the business. Then, just before the year-end, Entu completed the disposal of its loss making kitchen retail operation, Norwood Interiors, for a nominal £1.

By Richard Gill, CFA



**Click here
to read the
full article**





What the Film 'The Big Short' Teaches Us about Value Investing

Spoiler Alert – Read this article after watching the movie.

It's reasonable to wonder what a movie about the housing crisis and ensuing financial meltdown could teach regular people in the market about investing. But within *The Big Short* there are nuggets of wisdom that pertain to value investing. There's also Margot Robbie in a bathtub, so something for everyone.

“WITHIN THE BIG SHORT THERE ARE NUGGETS OF WISDOM THAT PERTAIN TO VALUE INVESTING. THERE’S ALSO MARGOT ROBBIE IN A BATHTUB, SO SOMETHING FOR EVERYONE.”

The movie is set in the 2000s and follows the events and characters involved in the housing market bubble (Spoiler Alert: that bubble burst). The characters were all prescient, and saw that the housing market was decidedly overvalued, and they realised that they stood to gain by shorting it. Most of the characters in the film, and their real life counterparts, profited immensely from those trades.

While the movie focuses on hedge fund managers, big time stock traders, and bond salesmen – not your typical lot to learn from for personal investing – there are truths in the movie that extend to all levels of value investors. If you're in London, join us at [London Value Investing Club](#) where we as a group of value investor discuss various value investment opportunities.

The market doesn't always make sense

“Markets can remain irrational for longer than you can remain solvent”

– John Maynard Keynes

The quote from Keynes illustrates a truth from the movie, though it's not directly evident without thinking about it a little. Part of the problem with following the type of people in the film is that they were all in situations where they had millions of dollars at their disposal. At a few points in the movie, characters were down nearly 40%, and considering whether or not to cut their positions. But they were all certain about the impending burst, so they held on for the massive pay day in the end. But what if the bubble took longer to burst? How long would they have held on, and what level of losses were they willing to tolerate?

By Ruzbeh Bacha



**Click here
to read the
full article**

The UK Market is Toxic

Lefties are constantly on about how trickle-down economics doesn't work. You introduce money into the economy and the idea is that it works its way down to the man in the street. Sounds a lot like Keynes' Multiplier Effect to me. A lefty policy to introduce money into the economy which creates economic activity. You can't have your cake and eat it though. You first have to actually buy the cake. At least not on the black market. The problem here is we have no economy, only the illusion of one because of all the money that came from PIGS countries to park itself in London after the financial crisis. We have avoided a full blown noticeable recession here in the South East precisely because of trickle-down economics.

Austin Reed followed BHS into administration this week. The retail landscape out there is not bleak. The companies must have been really making a balls-up of things. Completely misreading the market place and committing to a succession of poor decisions (if at all).

The sector charts are a good place to check the pulse of British Retail. **General Retailers (NMX5370)** is no longer bullish, but if we've already seen two failures this week then there are lots more to come. I understand Philip Green is to be hauled before MPs to answer questions as to why MPs didn't see this coming. One simple reason: they evidently don't read my articles. The biggest threat to us all is not these





businesses going under. That's just a bit of inevitable unemployment, which is inevitably on an incline anyway. It's the fact that these pensions black holes are being underwritten by us, and they exist in part because companies have been allowed to borrow against them and can get their greasy little hands on the money.

By Adrian Kempton-Cumber



**Click here
to read the
full article**

Where Now for the Oil Price?

The Hydro Carbon gnomes in Switzerland! Have we seen the bottom of the oil market and how strong should we expect it to get from here?

Only madmen (and mad women, of course), charlatans and economists believe that they can forecast oil prices. If they could, it would be a perfect (as in 'perfect market' – a state of existence not created by God but dreamt up by economists as an aid to teaching the subject) oil sector, which it is not.

If they could even fairly reliably forecast the future price of oil, you would not have a top analyst, of a top investment bank, at the top of the oil market in 2014 – earning, no doubt, top dollars – pronounce that the price of oil would keep on rising up to, I seem to recall, an estimated \$200 a barrel, just before it started its big slide downwards. Big salaries guarantee neither correct forecasts of oil prices by analysts nor goals by Premier League footballers. Foretelling oil prices is the highly democratic game of informed guesswork – just like backing horses. Being informed does not make it a science.

I write these cautionary observations because we have just had reports from the great jamboree of crude oil specialists in Lausanne, whose observations sent equity markets into cartwheels of happy bullishness. **BP (BP.)** was up

2.6% in a few hours to 366.25p. One can almost feel through the very ether, misery, pessimism and gloom lifting off into ecstasy, optimism and joy. For more than one reason, we are all in the mood for good news from somewhere. This is the rich soil in which giant beanstalks and magic mushrooms grow. So keep the feet on the ground (not up the bean stalk) and the head clear of magic mushroom hallucinations (as required by the law).



The basic rule about crude oil prices is that they are volatile and thus often unpredictable. We have all had enough recent evidence of commodity volatility.

By Robert Sutherland-Smith



**Click here
to read the
full article**





BY VICTOR HILL

READ TO SUCCEED

AND THE WEAK SUFFER WHAT THEY MUST?

EUROPE, AUSTERITY AND THE THREAT TO GLOBAL STABILITY

BY YANIS VAROUFAKIS, BODLEY HEAD, LONDON, 2016

Ode to a Grecian Bailout

Yanis Varoufakis, as readers will know, is the Greek motorbike-riding superstar Marxist economist who served as Greek Finance Minister from January to June 2015 – until, that is, his mate Alexis Tsipras fired him for continually upsetting the Germans. And, oh boy, has he now got his revenge.

MI regulars will know that I am not exactly a Marxist: but I still do have a soft spot for Marxist intellectuals who challenge the prevailing inane orthodoxies of the lame and failing status quo. I find myself, not only impressed by the acuity of Yanis's analysis (I feel compelled to refer to him by his first name – and surely he would approve) of what has gone wrong in Europe (more specifically in the Eurozone), but also cheering the guy on in his rigorous denunciation of the Franco-German elites who have led Europe to the edge of the abyss. And yet his conclusions are so wide of the mark as to make me despair. There is quite a lot to unpack, here; but let me have a go.

This book is a sequel to *The Global Miotaur* which was Yanis's take on the Credit Crunch. In that book, America took the key role; but in this one Europe is the main protagonist. One of the themes of the book is that the on-going crisis in the Eurozone is intimately connected with the *American regulation of global capitalism* and will only ultimately be resolved through reforms initiated in America.



Ververidis Vasilis / Shutterstock.com

When, as Greek Finance Minister in a leftist government, Yanis first went to see the German Finance Minister, Dr Wolfgang Schäuble in Berlin, Schäuble refused to shake his hand. Germany was Greece's major creditor and the Greeks had messed up. Why should Yanis be treated as an equal? You can see where this is going... there is a lot of resentment, both personal and national, in play. But as you travel with Yanis on his personal and intellectual journey you realise that he has a lot to be resentful about. The Germans, at the end of the War, thanks to American pressure, had their debts wiped clean, and paid only minor reparations to the Greeks for the Nazi occupation of the country. They have not reciprocated this generosity.

What we call the European Sovereign Debt crisis goes back to President Nixon's abandonment of the Dollar Standard (based on the Bretton Woods Agreement of July 1944) in August 1971 – which of course in Yanis-world was done in a particularly brutal and imperialistic way. The Europeans had to create a new monetary system which

A hand is holding a black tablet. The tablet screen shows a book cover with a thick orange border. Inside the border is a black rectangle with a thin blue border. The text on the cover is as follows:

YANIS
VAROUFAKIS

AND
THE
WEAK
SUFFER
WHAT
THEY
MUST?

EUROPE, AUSTERITY AND THE
THREAT TO GLOBAL STABILITY

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Kostas Koutsaftikis / Shutterstock.com

falteringly – the "Snake" of the early 1970s, the European Monetary System (EMS) of the 1980s, the Exchange Rate Mechanism (ERM) of the 1990s, and then full-on European Monetary Union (EMU) – they achieved.

Yanis sees the goal of Valéry Giscard d'Estaing and Helmut Schmidt and then François Mitterrand and Helmut Kohl to achieve EMU as a belated response to the *Nixon Shock* – a sustainable solution to the essential monetary problem, or as the French would say, a new global financial order. But – as I have written before – it was conceived by politicians, not economists¹. The basic design flaw in EMU was the absence of any shock-absorbers in the mechanism. It should have been foreseen that some countries (Germany and The Netherlands) would run persistent trade surpluses while others would run deficits on their current accounts. After the financial crisis of 2008 the inherent disequilibrium of the system, and the huge debt mountains it had generated for deficit countries, became unsustainable. And yet the French and the Germans have never really seriously contemplated solving the problem with what Yanis regards as the obvious solution. Namely, to forgive the Greeks and Portuguese (and the rest)

their debts, as the Germans were forgiven theirs in the late 1940s. Instead, they have determined to impose more austerity on Greece, a country which will never be able to repay its debts anyway.

“THE FRENCH AND THE GERMANS HAVE NEVER REALLY SERIOUSLY CONTEMPLATED SOLVING THE PROBLEM WITH WHAT YANIS REGARDS AS THE OBVIOUS SOLUTION. NAMELY, TO FORGIVE THE GREEKS AND PORTUGUESE (AND THE REST) THEIR DEBTS.”

For EMU to work, as is now clear, it should have had a unified system of bank regulation and a high degree of

fiscal harmonisation from inception. The first seems relatively straightforward to resolve but is trickier than it seems – you cannot have a banking union without a universal deposit insurance scheme and common insolvency regimes (one of the reasons why the Italian banks are currently racking up huge levels of non-performing loans or NPLs). Fiscal harmonisation implies not just common tax codes but a high degree of coordination of state spending. In other words an unprecedented level of political union which even the ultra-communitarian French have resisted – they have told the Bundestag to keep its nose out of the preparation of the French national budget.

Historians of the left tend to see historical processes as conspiracies pursued by the privileged (and especially by the Americans), whereas I see them more as cock-ups – of which EMU is a splendid example. It is clear, however, that the key drivers of the project have always been the French, who sought, as far back as de Gaulle, to tame the mighty Deutsche Mark by adopting it as their currency. De Gaulle talked about a German coach driven by a French coachman. Whereas currently, the Eurozone is a *Deux Chevaux* driven by an Italian stuntman.

And in the fat years it was the big German (and also French) banks which were ordered from on high to lend to the Eurozone periphery like crazy: superficially, with currency risk removed, lending to Thessaloniki was the same risk as lending to Stuttgart. For years, the swanky hotels of Athens pullulated with Northern European bankers on generous expense accounts. It took a crisis – which was of course in Yanis-world exacerbated by the excesses of the Anglo-Saxons – before the rottenness of the system became apparent.

Yanis is devoted – as I am not – to a set of French-inspired principles around the *European Project* and its ideals. He simply cannot understand how or why those who fashioned and impelled those ideals could strangle a small, noble country like Greece with their unwavering insistence that money borrowed should be paid back. Personally, I am grateful to him for sharpening for me the insight that, as European integration proceeds, small European nations will be crushed by large ones like intransigent nuts. It's a project that, if only they understood what is really going on, the overwhelming majority of fair-minded British people would oppose.

For people like me, and no doubt many readers, the obvious solution would be for countries like Greece to exit the currency union and to re-launch their national currencies which would then devalue against the Euro (or whatever currency Germany ends up with) thus reducing the trade imbalance. (Of course that would result in immediate default as Greece could never service its Euro-denominated liabilities.) But no, says Yanis; that would be to go backwards and would just create a new generation of poorer client states on the European periphery. And true, the process of creating a new currency would cause huge dislocation, not least for the worse off who do not have deposits of Euros outside the country. For Yanis, the Eurozone is Hotel California: *you can check out, but you can never*



Ververidis Vasilis / Shutterstock.com

“FOR YANIS, THE EUROZONE IS HOTEL CALIFORNIA: YOU CAN CHECK OUT, BUT YOU CAN NEVER LEAVE.”

leave. Austerity is a false discipline, as it drains the economy of essential new investment. (Mind you, where is the investment happening anywhere in a continent pursuing a Zero Interest Rate Policy?)

What he wants is the formal adoption of a policy of huge fiscal transfers from the surplus-generators to the deficit-holders. So the Germans are supposed, not just to sell their wonderful cars to the Greeks, but to pay for them as well. That is just not going to happen as long as the Germans are ruled by stern right-of-centre Protestants who regard the Greeks as a bunch of misbehaving teenagers who have maxed out their credit cards. If they were to wipe the slate clean, in any case, the entire cycle would repeat itself within a few short years.

Yanis has taught economics from Essex to Bondi Beach, and I must say I was expecting a work of rigorous economic analysis. What I actually got

was a financial historical melodrama, though a highly interesting and entertaining one.

It is the strong who always regard the suffering of the weak as inevitable. The book's title is a quotation from Book V of the *History of the Peloponnesian War* by Thucydidesⁱ. Yanis found a copy (in ancient Greek) while going through JM Keynes' papers at King's College Cambridge. He says that the great economist had underlined the passage. At last, a tiny drop of mild Anglophilia in a sea of Anti-American bile. (America is referred to throughout, in perfect Greek, as *the hegemon*.)

One can't help but like him, despite the chip. And I'm almost looking forward to 2020, in a weird kind of way, when he takes a cabinet post under the Corbyn-McDonnell *junta*, as Lord Yanis of Colchester, *Minister for the New Global Financial Order*. It'll be fun to see him un-charming the Germans.

- i See: *The Secret History of the Euro's Birth* by Victor Hill, available at: <http://masterinvestor.co.uk/brexit/the-secret-history-of-the-euros-birth>
- ii "Since you know as well as we do that right, as the world goes, is only in question between equals in power, while the strong do what they can and the weak suffer what they must."



BY ADRIAN KEMPTON-CUMBER

THE FINAL WORD

COMPLIANCE IS CREATING A SHORTING OPPORTUNITY FOR BANKS AND INSURANCE



Particularly since the financial crisis, regulatory policy has been based on a witch hunt style vigilante approach. As a society we find cohesion in picking on one subset, and then marginalise the hell out of them. For some time now it's been bankers. Well, bankers and the 1%, with an exemption for sports people and celebrities, the part of the 1% that actually don't create jobs or contribute anything tangible. So new regulation has been very much a gerrymandering and playing to the crowd exercise. And most people like regulation being based on jealousy. If it could be shown that taxing a flat rate of 10% across the board would yield more tax revenues than a progressive tax system, the great undoshed would say "No! Rich people should pay more." Why? "Because it's not fair that they're rich and we're not." In large part be-

cause they don't want to work hard enough to do well for themselves and they don't like it when others do. Petty jealousy as a policy model.

This country has a sorry track record on compliance and regulation. Part of the issue is that governments and regulators work against problems instead of with them. Bizarrely a good example of how to work with the problem exists on the London Underground. For years they tried moving buskers on. It was illegal to busk, but then they couldn't spare the employees to constantly prowl the tunnels in search of the musical miscreants. Eventually they realised that they could get a sponsor, pay buskers, and maintain at least some standards. To be fair most of the buskers I see playing at these official busking spots are simply getting paid to practise, especially the flashy lead guitarists. Most use backing tracks which

is of course cheating. I'm against it. I love music, and it's always been part of my life and livelihood, but I could do with reflective silence when I'm travelling. What is the point of hearing a snatch of a verse as you walk by? How is that any less annoying than someone's just slightly too audible tinny earbuds near you on your journey? However, the point is they worked with the problem instead of against.

The financial regulatory approach until 2008 was to wait until a problem presents itself and then deal with it. I've said many times that in the case of derivative markets you can't even do that, because they are exponential in their nature and the effect failures have.

LIBOR is a classic case of failed regulation, or a failure to regulate at all. It was obvious to anyone that LIBOR was open to abuse. Watch the regulator close the



gate once the horse has bolted. What I found astonishing about LIBOR was that it was all so secretive. This number that all our mortgages were based on was virtually a national secret. When I looked in 2007 you could see three weeks of data then not the next three, as I recall. Some cockamamie arrangement like that. Why did the regulator allow that lack of transparency in the first place?

Most of the regulatory failures were to do with elements that contributed to the financial collapse of the last decade. And plenty of fines have been issued to banks over the intervening years, which was not only highly predictable, but also why I've kept the Banking Sector in my Damaged Sectors list this whole time.

However, compliance is something that hasn't come under my scrutiny, but it's going to now. The first problem with compliance is one that Gregory House identified as a problem in medicine: everybody lies. Clients certainly do. Some time ago I was a mortgage advisor and a Harley Street dentist came in and enquired about a mortgage. There was some fixed rate deal he seemed vaguely interested in. I didn't follow it up because you get used to reading signals, and I didn't think he was a realistic prospect: there was something wrong with the picture. The deal expired and he complained to compliance that I hadn't contacted him and he'd missed the boat as a result. On examination compliance discovered he'd lied throughout the questions on his financial situation. What a waste of time though, complaining that



he hadn't been sold something! Compliance is a Moaning Minnie's charter.

There should be a more level playing field between the company and the client when it comes to the selling process of financial products. As things stand there is such a lot of vagueness about the sales process involved in most financial products. All a client has to say is that the sales person didn't tell them one key feature of the product and they will be believed. To do compliance properly there needs to be a sound recording, if not video, of the sales process itself.

What use is a compliance officer in a company when pretty much every PPI policy seems to have been mis-sold under their very noses?! Seriously, that's uber pathetic. Every compliance officer in Britain's finance houses didn't notice, and failed to stop the rot for years. Another question is that if we

“WATCH THE REGULATOR CLOSE THE GATE ONCE THE HORSE HAS BOLTED.”

know that most PPIs were mis-sold – and while we're at it, that certain energy companies have been playing fast and loose with their customer bills and overcharging them all over the shop – then why is the onus on the customer to contest it? They have the records and the regulator knows there's a problem. Maybe some of these palpably inert compliance officers could busy themselves organising the refunds to the public that wouldn't have been necessary had they done their jobs properly in the first place!

Compliance has to move away from relying on some unwelcome outsider inside the company, and on to recorded media of the sales process. In fact I suggest all interactions between the public and any government or sales organisation are recorded, where a contractual relationship exists (which will always be the case with local government and public services). Video all interactions and let's stop all this 'he said, she said' nonsense.

So how can we make money out of this is the question. This sort of compliance is going to result in ever more red tape for companies selling finan-



cial products to the public. That's going to hit the bottom line. So there is a negative effect which we can take advantage of. My prediction is that all these companies will be facing more and more costs. If they are to protect themselves against lying customers then they'll have to go the way insurance companies went and record the sales process, which itself means an up-front investment.

The ones to watch are the companies that deal principally with the public. In terms of banks, the ones who are setting aside provisions for more fines are: Barclays, HSBC, Lloyds, RBS and Santander UK. Most of these charts look abysmal. **Lloyds (LON:LLOY)** and **RBS (LON:RBS)** in particular. There

could be a swing trading short opportunity here if you're into that sort of thing. There's an important support level on RBS at 200p. Don't forget this was a £60 stock in 2007. Not so much a Royal Bank as a Royal Cock Up. Lloyds has been stuck below 100p since 2008. If it fails at 100p (or even below) then that could be a nice short signal. A failure at the cloud, around 75p, would be very encouraging. At these low prices it says something that there has been no

M&A activity. Obviously they're toxic or they'd have been fighting them off.

We've gone past the point where people are doing jobs that don't need doing, to the point where they're not even doing jobs that don't need doing, and creating even more work in the process. I'm not sure even Ayn Rand saw that coming! Compliance needs completely reforming. This time with machines, not people.

“COMPLIANCE NEEDS COMPLETELY REFORMING. THIS TIME WITH MACHINES, NOT PEOPLE.”



MARKETS IN FOCUS

APR 2016

GLOBAL EQUITIES

Index	Last Month %	YTD %	Proximity to 52w High*
Russian Trading System	8.1	25.3	
Bovespa	7.7	23.6	
IBEX 35	3.5	-5.5	
S&P/ASX 200	3.3	1.1	
Hang Seng	1.4	-5.7	
FTSE 100	1.1	0.0	
CAC 40	1.0	-4.2	
DAX Xetra	0.7	-5.8	
Euronext 100	0.6	-3.7	
Dow Jones	0.5	2.7	
S&P 500	0.3	1.8	
Nikkei 225	-0.6	-15.2	
NASDAQ 100	-3.2	-4.6	

COMMODITIES

Commodity	Last Month %	YTD %	Proximity to 52w High*
Crude oil (Light Sweet)	20.4	20.6	
Iron Ore	18.4	50.8	
Crude oil (Brent)	17.8	22.7	
Silver	15.8	27.2	
Soybean	13.2	20.9	
Platinum	10.6	20.9	
Palladium	10.0	10.1	
Cocoa	9.1	-0.4	
Natural Gas	8.7	-12.7	
Sugar (No. 11)	6.7	4.8	
Gold	5.0	21.8	
Copper	2.0	6.4	
Coffee	-4.0	-4.9	

FOREX

Pair/Cross	Last Month %	YTD %	Proximity to 52w High*
GBP/AUD	2.4	-5.1	
GBP/USD	1.7	-0.5	
EUR/USD	0.6	6.1	
EUR/CHF	0.4	1.2	
USD/CHF	-0.2	-4.6	
AUD/USD	-0.8	5.1	
EUR/GBP	-1.0	6.6	
USD/CAD	-3.4	-9.4	
EUR/JPY	-4.9	-6.1	
USD/JPY	-5.5	-11.5	

CENTRAL BANKS - RATES & MEETINGS

Central Bank	Key Rate	Next	After
BOE	0.50%	May 12	Jun 16
ECB	0.00%	Jun 02	Jul 21
FED	0.50%	Jun 15	Jul 27
BOJ	-0.10%	Jun 16	Jul 29
SNB	-0.75%	Jun 16	Sep 15
BOC	0.50%	May 25	Jul 13
RBA	1.75%	Jun 07	Jul 05
RBNZ	2.25%	Jun 09	Aug 11
BOS	-0.50%	Jul 05	Sep 06
BON	0.50%	May 12	Jun 23

FTSE 350 TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Evraz PLC	57.8	93.9	
Tullow Oil PLC	42.1	68.8	
Anglo American PLC	38.3	154.9	
Centamin PLC	36.8	87.7	
Acacia Mining PLC	25.1	95.4	

FTSE 350 BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Restaurant Group	-29.9	-59.9	
Cobham PLC	-29.1	-45.6	
Allied Minds PLC	-18.8	-4.0	
Brown (N) Group PLC	-17.8	-13.2	
Victrex PLC	-15.0	-22.4	

FTSE 350 SECTORS TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Industrial Metals	57.8	93.9	
Mining	15.3	41.3	
Oil & Gas Producers	6.2	14.7	
Banks	5.3	-14.2	
Pharma & Biotech	3.0	-4.2	

FTSE 350 SECTORS BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Tech Hardware & Equip	-7.6	-9.3	
Food & Drug Retailers	-6.2	10.4	
Food Producers	-5.8	-5.6	
Aerospace & Defense	-5.0	-1.4	
Media	-4.6	-3.3	



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