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MAGG

OUR GUIDE TO INVESTING IN THE SWEET SPOT OF THE MARKET

LITIGATION FINANCE

THE ULTIMATE IN PORTFOLIO DIVERSIFICATION?

THE OUESTIONS YOU SHOULD ASK BEFORE HANDING OVER YOUR CASH



IIM MELLONA





VIL KNIEVL



SATURDAY 23RD APRIL 2016 Masterinvestor Research • Analyse • Invest









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OWELCOME



Cyberspace is a great place to gather information – but it can also be a lonely place. So far at least, all futuristic predictions about tele-commuting, tele-conferences and other digital communication channels replacing the human urge to meet and mingle, have been proved utterly wrong. It seems that human beings are social animals, not social-media animals, after all...

You already know about our annual Master Investor gathering, which is now the biggest event of its kind in the UK. For 2016, we are planning an even bigger event for private investors — check page 2 for information about how to secure your ticket — and we'll be releasing more details over the coming months.

However, our yearly show is not the only event that we organise for investors. As part of our group, we also own Oilbarrel and Minesite, two boutique companies that are well known for organising oil and mining related events in the City of London. We will be relaunching these events with a bang in the month of September.

One aspect we feel strongly about is giving our readers access to people worthy of our brand name. The financial world is littered with folks who dispense advice and even charge for it. Yet many of these service providers have never actually made any money with their investments. Why is anyone even listening to them?

On that note, our relaunch event for Oilbarrel and Minesite – henceforth to be known as MI Commodities – will see an exciting keynote speaker – someone who has made a fortune in the resources sector and who can therefore speak both credibly and competently about how to make a buck in this sector. In addition, you will of course be able to meet the management of exciting companies, to hear first-hand about their plans and prospects. We will give you access to the people who matter, so that you can make better investment decisions and increase your chances of success in the markets.

In the meantime, we are continuing to improve the other backbone of our operation, our digital channels. Since last week, you will have noticed the commodities section on www.masterinvestormagazine. co.uk. With Alex Williams, we have signed up an outstanding analyst and a valuable contributor to this aspect of our reporting – make sure you follow his cutting-edge interviews and commentary about mining. Despite this sector currently being in the doldrums, there is still money to be made. Only last month, Savannah Resources soared by a staggering 98% in a single day, following the announcement of a partnership with Rio Rinto.

Stay tuned for more, and don't hesitate to send your feedback to swen@masterinvestor.co.uk

Until next month, Best regards,

Swen Lorenz, Editor



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MELLON ON THEMARKETS

BY JIM MELLON



The trickier the times, the greater the opportunities for profit (and loss!). And we are now firmly in tricky times. I have spoken and written before about the imperative of seeing through the fog of financial battle in order to achieve success.

By this I mean focusing on a few things where your level of certainty is greater than it is vis a vis the vast morass of financial instruments available for speculation, most of which will lose most people most of their money.

An example of this is call options. Unless you're an insider, call options are the equivalent of the National Lottery. Buyers of these are 99% certain to lose their money. That is because, although they may choose the correct stock, they are likely to be unaware of duration risk (the call option expiring before the stock goes up), or of the implied price of the volatility of the underlying stock, which is generally too high.

On the other hand, the writers of the call options, most of whom are institutions, almost always do better. And of course, the biggest winners are the brokers who trade them - they are the Camelot equivalent of this particular market. Quite often, chartist forecasters suggest using call options to add

leverage to stock recommendations, but the fact is, most chartists I have met have no money to speak of. So here is another tip: why would you follow the recommendations of a stock market or financial forecaster who is impoverished? The answer of course, is that you shouldn't. I always admire the forecasts of our very own Evil Knievil, and one of the reasons for so doing is that he is a made man - he trades in his own recommendations, and makes good money - not always, but way over half the time - and so his actions are worth following.

But perchance, if you did have call options in Synergy Pharma, one of my featured stocks in last month's magazine, you would have done pretty well. The share has moved from \$4 to \$9 in the last three weeks, on the back of great Phase 3 trial results for Plecanitide, its drug for chronic constipation.

I want to add a few words as to why I liked this company, and show a little of the methods I use in undertaking research. I have met the management and like them, and I knew that Phase

3 data was imminent (this was public knowledge). Of course, neither I nor the company knew what the data would look like, as it is blinded till it is released, but I had a pretty good guess. This is because the Plecanitide molecule is very similar to that of Linzess, which is a drug marketed by Ironwood, and which is running at \$400 million a year in US sales, after one year on the market.

Phase 2 data for Plecanitide indicated fewer side effects than for Ironwood's drug, notably less diarrhea, and I felt that those results would persist in Phase 3 data. Also positive for Synergy is that it owns 100% of the rights to Plecanitide, whereas Ironwood owns only 50% of the rights to Linzess. And Synergy has plenty of cash.

Synergy is now a sitting duck for a takeover – and it's a duck that wants to be caught. Its drug will be best in class, in a market that has been trail blazed by Ironwood, and where there is clear medical need.



At least 40 million Americans suffer from chronic constipation, partly the result of diet, but also because of high consumption of opioids, which induce the condition. The other piece of good news is that the drug is not highly priced; it is about \$6 per day, which means that it will be easily reimbursable by insurers and won't suffer from what I think is coming.

What's coming is much greater pricing pressure on exceptionally highly priced drugs in the US. Some of these drugs, for orphan diseases, or cancers, or Hepatitis C, are really expensive. Soliris for instance, from Alexion Pharmaceuticals (which has a market cap of about \$30 billion), is a biologic drug that can cost up to \$450,000 per person per year and it's not a cure, and has to be administered for the rest of the sufferer's life.

In Europe, national medical agencies rarely pay anywhere near US drug prices; I am watching carefully to see if European drug pricing practices come to the US – and will pounce on the short side – and let you know when the time is ripe.



That having been said, I still love the biosciences industry; it is a fact that prescription drugs make up about 10% of health spending in most developed countries, and that figure has been constant for 50 years. Moreover, those drugs tend to displace hospitalisation, which is by far the biggest expense. So I don't expect across the board carnage in manufacturers of high priced drugs -



"THE STOCK MARKET IN ATHENS IS **VALUED AT THE LOWEST PERCENT-**AGE OF GDP OF ANY MARKET IN THE WORLD, AND THAT'S AFTER A CRUSHING DEPRESSION."

just an appropriate adjustment.

I am writing my monthly missive in Ibiza, where I spend the summer. In order to avoid the temptations of the local taverns and dive clubs, I spend a large part of my days reading and trying to work out strategies for making me and hopefully, you - money.

Of course, the present news is dominated by Greece. I called for a sale of the Euro eighteen months ago, and then in April reversed that position, at least temporarily. I now think the Euro is range bound, and even if there is a Grexit, it won't move much. I also called at this year's Master Investor conference for short German Bunds - then yielding 0.21% on the ten year paper and now at 1.16%. Yields are probably going higher, but I would bank the profits - which by the way are substantial, if you followed my lead. Following my lead has not always been a good move, but this year's crop of recommendations has been very good, so maybe I'm on a roll. Long may it last!

Now the following suggestion is really contrarian, and is not for the weak ofheart. I don't know whether or not there will be a Euro fudge at the last minute to Save Greece. Either way, the holders of Greek debt are not going to be repaid any time soon, unless it's in Drachma Bonds, which would serve well as supplementary paper in the downstairs lavatory.

But Greek stocks are really cheap (I am not including the banks, which are cheap, but bankrupt). The stock market in Athens is valued at the lowest percentage of GDP of any market in the world, and that's after a crushing depression. If Greece exits the Euro, the new currency will plummet, but shares will soar. If there is a solution to the Greek tragedy, shares will soar. Buy Hellenic Telecommunications and Hellenic Petroleum. I'm in for the wild ride ahead - and I am guessing that plenty of Greeks with money outside the country will be also.

Happy Hunting! Iim Mellon

What Jim read this month...



Game of Drones: Drone Startup Funding Hits High. Have Raised More in 2015 than Last 3 Years Combined.

If you saw Jim at this year's Master Investor Show, then you'll know he's no stranger to drones. This article from CB Insights looks at the seemingly unstoppable success of drone start-ups, most notably a \$75M financing to DJI innovations, securing its place on the list of unicorn companies.\

https://www.cbinsights.com/blog/drone-startup-venture-capital/



In Busy Silicon Valley, Protein Powder Is In Demand

It seems the coders and software engineers of the world's booming tech trade are now too busy to process solids. The next stage will be to upload their consciousness onto MacBooks and flee the planet in search of an eternal energy source. But until then Silicon Valley's demand for meal replacement drinks is soaring, with waiting lists for first orders anywhere between 1-6 months. With names like People Chow, Schmilk and the suspiciously familiar Soylent (what's in that again?), meal replacement drinks could be set to hit our supermarket shelves within the next couple of years.

http://www.nytimes.com/2015/05/25/technology/in-busy-silicon-valley-protein-powder -is-in-demand.html? r=1



Making the Modern Farmer: The Precision Agriculture Revolution

This article by Jess Lowenberg-DeBoer for Foreign Affairs looks at the evolution of agriculture from the roots up. Starting millennia ago with the very first humans to sow and nurture plants to the Industrial Revolution that paved the way for modern farming, to the present day, where a fast growing population and depleting resources mean farmers now have to rethink traditional methods. Humanity is at an agricultural crossroads. Precision and efficiency is key, from the way crops are harvested to the very DNA of the plants themselves.

https://www.foreignaffairs.com/articles/united-states/2015-04-20/precision-agriculture-revolution



The Hottest Startups That Have Launched So Far This Year

Looking at factors like funding, growth and investor interest, Maya Kosoff compiles a who's who of this year's top start-ups with some surprising contenders. From the live streaming app Twitter bought before it was even launched to a start-up that mines bitcoins using a chip implanted in your phone, these are the promising start-ups to look out for.

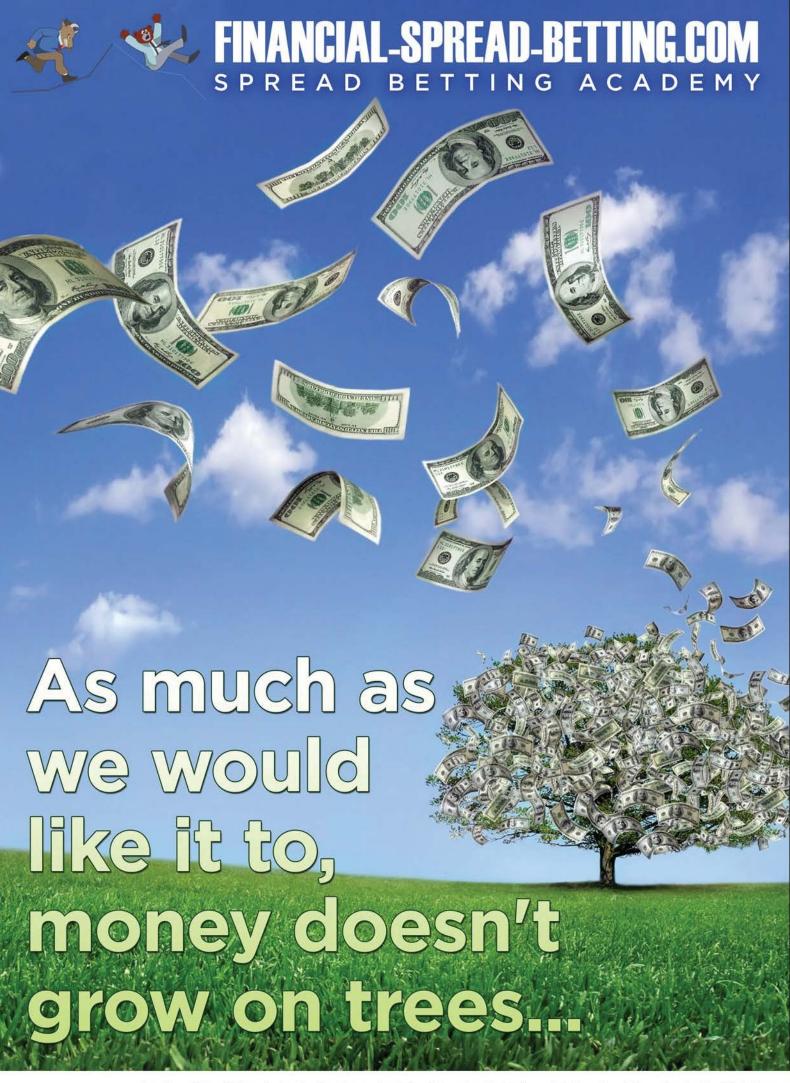
http://uk.businessinsider.com/best-startups-that-launched-so-far-in-2015-2015-5#ixzz3bRBPcms8



Survival Of The Fittest Means Men Are the Healthier Sex At 100

We all know women tend to live longer and it's true that there are far more lady centenarians out there than men, but a recent study published in the Journal of the American Geriatrics Society (a riveting read I'm sure) showed that the number of people living past 100 has risen considerably, with the rate of men rising by 30%. It also showed that men over 100 were less likely to suffer from chronic illness than their female counterparts, meaning overall centenarian men are the healthier sex.

http://www.thetimes.co.uk/tto/health/news/article4476464.ece?shareToken=39f7de9ab034333f7f0ef28



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

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

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

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

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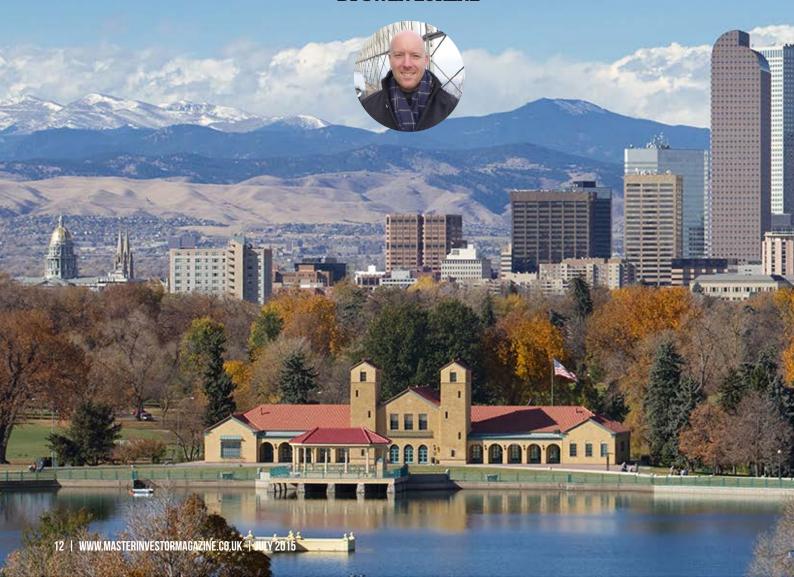
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AROUND THE WORLD IN A DOZEN PROPERTIES (PART 4)

YIELD AND CAPITAL GROWTH: DOES THE SOUTH AND SOUTH-WEST OF THE US OFFER INVESTORS THE BEST OF BOTH WORLDS?

BY SWEN LORENZ



From a European perspective, the US real estate market primarily consists of New York, Washington, Miami, San Francisco, and maybe LA. These are the cities that Europeans are most familiar with, not the least as they are also among the most popular travel destinations for folks from the old continent.

However, there exists an entire universe of second-tier US destinations that are overlooked, but which deserve a closer analysis because of their strong fundamentals.

On my most recent travels, I detoured to Colorado, staying in its capital city, Denver. Who'd have thought that last year, Colorado was the fourth fastest growing state in the US – for the second year in a row? It's not just New York where real estate prices are going through the roof. A population that increased by 1.6%, combined with a dearth of new housing being finished as a result of the aftermath of the 2008 financial crisis, led to house

prices in Denver becoming "red hot" during the past twelve months.

Denver is typical of a whole sub-section of US cities. There are a considerable number of large and medium-sized cities that are in the South and Southwestern US, with lower costs than more established metropolitan areas, an attractive quality of life, and increasingly strong economics.

Within Colorado, a leading example of this type of city is Boulder, a town of around 100,000 about an hour's drive north of Denver. What used to be a sleepy university town has recently seen Google open a new campus, which is now earmarked to see further investment to grow

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its staff by a factor of 4. Throw in stunning mountain scenery with lots of options for outdoor activities set in a mild climate, and it's easy to understand why house prices have shot up 30% in the last year alone.



Business is booming in many of these second-tier cities, but valuations for some parts of the real estate market have not yet fully caught up. That's particularly true for the office space market in these cities. There, bargains can still be had.

One way for investors to get access to this opportunity is to look at Real Estate Investment Trusts (REITs) that have specialised in office properties in such locations. One such trust is City Office REIT (Nasdaq: CIO), which is specialised in the entire gamut of second-tier cities of the US South and Southwest. Having gone public in mid 2014, the company is not yet well known among investors and can currently be invested in at an attractive valuation.

City Office has built up a portfolio of 2.4m square foot of office space in Texas, Colorado, Arizona, Utah, Oregon, Idaho, Washington State, and Florida. The company's focus is to buy properties worth between \$20m and \$50m, a section of the market with less competition and more opportunities to create value by bringing management expertise to the table.

All of its properties are within thriving markets of the kind described above, which exhibit growing population trends, diverse employment bases with national and international employers, educated workforces, and low-cost centres for businesses to operate, often with a university nearby.

At last count, its portfolio had an occupancy rate of 93.7%, its leases were for an average of 4.6 years, and 48.7% of its rental revenue was derived from government agencies. The average rent of the properties is lower than the rent from newly developed offices, leaving room for catch-up.

The \$72.5 million additional equity that the company raised through its IPO has been put to use already. The four properties that the company has acquired since going public are yielding an 8.2% rental return. Further acquisitions are in the pipeline.



"BUSINESS IS BOOMING IN MANY OF THESE SECOND-TIER CITIES, BUT VALU-ATIONS FOR SOME PARTS OF THE REAL ESTATE MARKET HAVE NOT YET FULLY CAUGHT UP."



With a market cap of just \$160 million, City Office is still a minnow among US REITs. Investing into smaller operators always carries a higher degree of risk. However, the directors of City Office are themselves major shareholders in the company. They own a combined 13%, thus aligning their interests with those of other shareholders. With their own money tied up in the company, the management team is unlikely to pursue an overly risky strategy. Their track record in the industry, where the team has done a combined \$2 billion in transactions, also speaks in their favour.

At the current rate, City Office is on course to pay an annualised dividend of more than 7%. Trading at \$12.50, analysts from Oppenheimer recently rated the share a "buy" based on the low val-

uation of its properties. The suggested target price of \$15, if reached, would add a spot of capital growth to the attractive yield.

Investing into smaller, slightly more exotic REITs may not be for everyone. Investors who buy into City Office should regularly check the company's fundamentals and ensure that the management sticks to its course as they further build the company's portfolio. However, it's with such smaller companies that "alpha" can be earned. City Office, and its investment focus on second-tier cities, is definitely worth a closer look.



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SOVEREIGN DEFAULT IS A FUNNY OLD BUSINESS

BY VICTOR HILL



In the long-term, as JM Keynes so sagely said, we are all dead. But sometimes one can only make sense of events in the realm of finance and economics with a long-term view.

We have been assailed by the news from Greece (and Brussels, where Greece's fate is being cooked) but it is often difficult to make sense of what is going on. For the last five years, dear old Robert Peston and hordes of his tribe have been accosting us with breathless speculation. Will they, won't they? Would they, could they? Should we panic, or should we party?

On 23 June, the French Commissioner for EU finance announced that a "comprehensive and enduring agreement" (please don't laugh) had just been spatchcocked together in the European corridors of power, which will keep Greece afloat for now - at least until the next financial cardiac arrest. Subsequently, negotiations have ground on behind closed doors. The voices in the air suggest the Greeks are still not home and dry.

Now, let me be clear. It's not my purpose to adjudicate on the putative deal or even to speculate on the next chapter

"THE VOIC-**ES IN THE AIR SUG-GEST THE GREEKS ARE STILL NOT HOME AND**

of the Greek tragedy or soap opera (depending on your point of view).

However, I do wish to ask: What does sovereign default really mean? What are the consequences when a country goes bust? And how common has it been historically? Also: why is the Greek situation today historically different?

First question: What does that horrible word default mean?

Actually, the technical definition differs from one country to another, and also depends on the exact provisions of the (loan) contract between the borrower and lender. In the USA, (where I cut my banking teeth) it used generally to be that, if a borrower was more than one day late with a payment of interest OR capital, then he would be ipso facto in default. Such rules are always subject to interpretation. (Was the payment stuck somewhere in the banking system? Did the lender calculate the debt service payment (repayment of capital plus interest due) correctly? And so on.)

In many jurisdictions, legal default occurs 30, 60 or 90 days after the due date (when payment is legally required). Moreover, in some countries legal default is only triggered if a payment of interest is in arrears, even if the full repayment of capital due is in arrears.



Are you still with me? If you want to explain this to your thirteen year old, tell her that default is a legal concept enforceable only in courts of a particular country as a special case of breach of contract, and that there is no universal definition...

On second thoughts, please don't bother. Just say that default is something that Uncle Robert is very worried about, but that it only happens when everyone agrees that it has happened, which in this case, they won't. (Your thirteenyear-old will then shrug and get back to playing Candy Crush).

In any rigorous sense of the word, Greece has been in default since 2012, when, under the terms of the second Greek bailout by the "troika" (the European Commission, the European Central Bank and the IMF), private bondholders were given a "haircut". That's international banker's language for a write-down on the value of their bonds. So if the Greeks don't pay up, that's a default; but if an international agency devalues the Greek bonds you hold, that's a haircut.

Second question: What happens when a country goes bankrupt?

I must confess to a personal memory here. I think it was in 1976, when James Callaghan and Denis Healy called in the IMF to stop our country going bankrupt.

I remember my Dad telling my Mum that the country was on the brink. She replied (good old South London common sense): So what's going to happen? Will our house fall down?

Countries don't go bankrupt like companies do, in the sense that they don't cease trading and cannot be liquidated. (Sorry to be partisan, but part of the Greek sub-text is that the Nazis did try to liquidate them, and there was no proper reparation package.) When countries default, the assets side of national balance sheets remains intact; but the liabilities side is cleansed of debt.



(Actually, unlike other corporate entities, even central banks, countries don't have balance sheets, only budgets, and therefore don't have a capital account.)

The consequence of sovereign default is that financiers become very reluctant to lend to the country again. At least until there is a credible new government. Countries have to repay debts in order to maintain their right to borrow in the future. And yet, bankers can be surprisingly forgiving.

The probability that a borrower will default is encapsulated by its rating, as determined by a credit rating agency. Statistically speaking, a credit rating of C or less means that the rating entity has about a one in four chance of going bust within the next twelve months.

Some of us who lived through the Credit Crunch of 2008 have become a bit sceptical of ratings; so it was more in amusement than sorrow that we observed, on 11 June, Greece's latest downgrade by Standard & Poor's from CCC+ to CCC with negative outlook. Surely, we have been here before. The fact is that Greece

can't pay; moreover, from here on in, it probably won't pay (unless it is given more leeway). S&P's ratings have always been more politically attuned than those of Moody's. (That's also why the UK's rating is also under threat from S&P but that's another discussion.)

Third question: Is sovereign default a freak event, or an occupational hazard?

Accountants amongst you please know how much I value your profession, but right now I need historians.

Herodotus tells us that as many as ten Greek cities defaulted on their loans in about 410 BC. (He doesn't say to whom they owed their money).

Fast forward: England, 1340. King Edward III of England is unable to meet the interest payments on loans to two Florentine banks. He needs finance at short notice to fight a bunch of marauding Scots. (Funny how history often sounds

so familiar). The Florentine bankers are threatening to drag Edward's name (credit rating) through the mud.

As for the country that Edward nearly conquered, but his successors lost, the Kingdom of France, it became one of the dominant powers of early modern Europe, and yet defaulted between 1500 and 1800 about once every 30 years.

Since the beginning of the industrial revolution major sovereign defaults have been disarmingly regular. In a fascinating and magisterial study entitled This Time is Different, Harvard economists Carmen M Reinhart and Kenneth S Rogoff record an extraordinary litany of sovereign defaults*. (You guessed it, the title is ironic). Countries often run out of money.

Before World War I, Spain, Portugal, Turkey and many Latin-American countries defaulted numerous times. Russia defaulted in 1917, 1992 and again in 1998. And yet, until Mr Putin annexed the Crimea, Western banks were queuing up to lend to him.

The USA has never defaulted since the Founding Fathers convened. But the State of Pennsylvania has defaulted, as well as numerous counties, most famously Orange County, California in the 1990s.

Argentina, a serial defaulter, went bust in 2002 after ten years of the One to one Peso-Dollar Parity policy. (A kind of forced and ill-conceived currency union there are parallels). The default affected \$100 billion of debt. There are still hedge funds pressing lawsuits against Argentina on behalf of aggrieved bondholders (turn to page 64 to find out more).

There is no universal rule as to what level of national debt triggers default, as there are too many variables. Most defaults, according to Reinhart and Rogoff's research, occur with a debt to GDP ratio of below 60%. (Greece's is currently at about 180%.) Sovereign default can occur even if a country has relatively low levels of debt if it has a liquidity crisis

and runs out of cash to service that debt.

Yet the Harvard professors conclude that financial markets always do recover from sovereign defaults, after an initial crisis, despite the systemic risk associated with a thrombosis in the government bond market. A systemic banking crisis, such as the one that was narrowly averted in 2008, is more dangerous than a single government default.

Reinhart and Rogoff have an axe to grind - they are fiscal conservatives who believe that excessive government debt is corrosive. In May 2010 they published a highly influential academic paper entitled Growth in a Time of Debt. They argued that there is a statistically significant negative correlation between long term growth rates and a country's debt to GDP ratio.

They purported to show that debt to GDP ratios of more than 90% stifle long-term growth. That seems like a reasonable proposition; but they didn't actually prove it. In April 2013, a graduate student, one Thomas Hendon, demonstrated that there was a critical error in Reinhart and Rogoff's spreadsheet, sparking an academic firestorm.

As one who is inclined towards their viewpoint, I must admit that, even if Reinhart and Rogoff's spreadsheet had been without embarrassing formula

errors, they might have been confusing correlation with causation.

Well managed, disciplined but open economies, where government expenditure is rigorously controlled, might enjoy high growth rates because the conditions exist for economic success. Equally, feckless governments which luxuriously indulge their core constituencies at the expense of fiscal rigour (yes, I am thinking about Gordon Brown) will ultimately court financial crisis, and thus low growth. Yet that doesn't necessarily mean that there is a direct causal link between the growth rate and the national debt.

Back to the Greek tragedy.

Fourth question: Why is the Greek situation different?

If we go back to the first Greek bailout of May 2010, the problem for the European policymakers was not so much an imminent Greek default per se, but the effect that it would have on the European banking system. Outright default by Greece could have unleashed a Lehmanstyle systemic banking crisis. That was because European banks, especially French ones, held massive volumes of Greek government bonds.



In subsequent years the EU and the ECB worked assiduously to transfer Greek liabilities from the balance sheets of commercial banks to that of the ECB itself. With the advent of a massive programme of "quantitative easing" (QE) - money printing - in January this year, the ECB has a licence to hoover up as much government debt (including Greek government bonds) with invented money. Theoretically, the ECB could keep the Greeks in ouzo and moussaka for as long as they wished (with a few periodic "haircuts") - but there is a political problem.

That is of course that Greece is not just a debtor country making its way in the world, but a member of the European Monetary Union (EMU), with all the privileges and obligations that that entails.

Normally speaking, countries do not default on their national debt because they can always print more currency to pay off domestic currency bondholders. (True, Russia did default on its domestic Rouble obligations in 1998 given a simultaneous systemic banking collapse and hyperinflation). But governments generally only default on foreign currency obligations.

The problem for Eurozone countries is that they do not have the right to print their domestic currency, the Euro - for that is the preserve of the ECB.

Mrs Merkel has a dilemma. If she accedes to all of Mr Tsipras' demands, then EMU risks losing credibility. Why should the Irish have tightened their belts if the Greeks get off lightly? If Greece is abandoned and left to fend for itself, the currency union also loses credibility. People would say that it is not actually a currency union at all but a souped-up exchange rate mechanism which countries can join and leave at will.

Surveying the European scene, one is tempted to wish a plague on all their bond markets, and there is one investment manager who has devised an investment strategy to do this.

William Littlewood, manager of the Artemis Strategic Assets Fund, is betting that QE won't work. With European bond yields at ludicrously low levels, William takes the view that a tipping point for bond markets is not far away. As a result, Artemis Strategic Assets Fund holds government bond shorts to the tune of 100% of the fund's net asset value, effectively betting that quantitative easing - money printing - while it creates liquidity in the banking sector and stimulates asset prices, does nothing for underlying growth or productivHe believes that there will come a point where the markets wake up to this.

If Greece really does default, European government bond yields (maybe not Germany) will rise, and bond prices will fall. If the can is endlessly kicked further down the road, in time, the markets will realise that Eurozone government bonds look expensive. Either way, Artemis will clean up.

Be assured that this saga is likely to keep Pesto and co. in business for some time to come. In the meantime, William's strategy could make you money.

"MRS MERKEL HAS A DILEMMA. IF SHE ACCEDES TO ALL OF MR TSIPRAS' **DEMANDS, THEN EMU RISKS LOSING** CREDIBILITY. WHY SHOULD THE IRISH HAVE TIGHTENED THEIR BELTS IF THE GREEKS GET OFF LIGHTLY?"



Victor is a financial economist, consultant, trainer and writer, with extensive experience in commercial and investment banking and fund management. His career includes stints at JP Morgan, Argyll Investment Management and World Bank IFC.

^{*} This Time is Different, Eight Centuries of Financial Folly, Carmen M Reinhart and Kenneth S Rogoff, Princeton University Press, 2009.

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KIF KII



There's been a whole spate of bids for small cap shares in the last month. Anite (AIE) and Thorntons (THT), for example, and one I had only recently bought in the expectation of a bid - Aga (AGA). Aga bagged me a 50% profit, which was very nice. It looks like there is plenty of cash around for bigger companies to buy up the small fry on the cheap.

If you do get a cheap small cap share there's a decent chance it will eventually get bought out, and I usually manage to get 5-6 of these a year. Every time you get it right there's usually a 30% to 50% increase in the share price. I usually find it's a good idea to sell some, just in case the bid doesn't go through, and hold onto the rest.

The price of the share usually goes to somewhere near to where the market thinks the eventual bid price will be. Once the bid is guaranteed you can either sell the shares at a small discount to the price (I usually do that) or wait for the full payout. The whole process usually takes about 1-2 months.

Anyway what are the next small caps to fall prey?

I have a few ideas, and so here are five companies I have stakes in hopeful that one morning I wake up to the glad tidings. Really, there is no better feeling than seeing the news a company you have shares in is going to be swallowed up.

"IF YOU DO GET A CHEAP SMALL CAP SHARE THERE'S A DECENT CHANCE IT WILL EVENTUALLY GET BOUGHT OUT, AND I USUALLY MANAGE TO GET 5-6 OF THESE A YEAR."

Five potential bid targets:



1. Gulf Marine Services (GMS)

This is an under-the-radar oil services company with a share price that doesn't do a lot except sit between 115p and 130p most of the time. It's one of the world's leading providers of support vessels. Profits are up and it appears to be continuing to expand nicely. I would imagine this one to be a very handy fit with any number of oil services companies looking for acquisitions. Although its boss has said it isn't for sale, I reckon an offer of 200-220p would be successful, and it really wouldn't be a surprise.



2. Iomart (IOM)

This one already got bid for last year but an agreement wasn't reached at the 300p level. I think a bid at around 350p is on the cards here giving a 100p plus uplift to the price. This cloud computing outfit is putting out bullish statements with adjusted profit up nearly 15% in its last results. It's been buying up companies itself. But I reckon within the next 6-9 months it will fall to a predator as the "cloud space" will see a lot of bids and mergers. I got lucky getting a 215p to 270p uplift last time. This time I'm in between 170p and 210p.

Quartix

3. Quartix Holdings (QTX)

This one specialises in supplying vehicle tracking systems, a market where there is currently good growth. Pre-tax profit grew by nearly 10% in the last year and debt has been nearly wiped out. At the current price with a market cap of well under £100 million, there are loads of big companies for which this would be a nice buyout for small change. I've been in this since around 120p.



4. GB Group (GB.)

GB Group is one of my favourite companies ever. I've been in it for nearly five years, having bought initially at 20p. Now there is an extra nought in front of that as it trades around 200p now. It's been in the right space at the right time - Identity data intelligence. The chart is a thing of beauty, lovely rises, and then plateaus then rises again. I have a feeling the directors would be happy with a bid of 275p here. It's got such a lovely niche area that there might even be a bidding war over it.



5. Verona Pharma (VRP)

This one is an interesting penny tiddler that I picked up in the 3-4p area. It focuses on drugs to treat respiratory diseases. One of the drugs in its pipeline could treat cystic fibrosis. It's raised a decent amount of cash to keep going, and if any if the drugs get approval the share price will go bananas. But in the meantime there are a few big drugs companies out there that could take an interest and just buy up Verona. Vectura (VEC), for example, is a much bigger



company that also specialises in the same area. So I think if I were in charge of Vectura I might have a look.

Of course, all the above is pure speculation on my part; none of them may get bid for. But in any event all the companies mentioned seem to be doing well enough in their own right. Often patience is required in holding these types of companies, especially if they are non movers. But patience often pays!

I am away for the summer but should be back with a new column in the October edition. Have a lovely summer!

"GB GROUP IS ONE OF **MY FAVOURITE COM-**PANIES EVER, I'VE **BEEN IN IT FOR NEAR-**LY 5 YEARS, HAVING **BOUGHT INITIALLY AT 20P. NOW THERE IS** AN EXTRA NOUGHT IN FRONT OF THAT AS IT TRADES AROUND 200P NOW."

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MID-CAP MAGIC:

Y EVERYONE JLD INVEST IN THIS DILOCKS SECTOR



BY JAMES FAULKNER

Elephants don't gallop, as we're often told. But the gazelles of the investment world certainly can – and do – move rather quickly. Mid-caps can be looked upon as something of an investment sweet-spot, as they are generally small and nimble enough to grow fairly quickly, but also large enough in order to withstand adverse economic conditions during a market downturn.

This 'Goldilocks' effect is perhaps the most obvious attraction of mid-cap stocks, but their appeal doesn't end there.

One of the key problems with investing in the FTSE 100, home of the 'blue-chips', is that it is a very crowded market. There are literally thousands of analysts, brokers and fund managers poring over the fundamentals of blue-chip stock, day in, day out. This makes it very difficult for private investors to get a look in, to spot a bargain before the wider investment community jumps on board and arbitrages any profit opportunity out of existence. If the Efficient Market Hypothesis has a grain of truth in it, this is most likely to ring true in the FTSE 100.

The mid-cap, or FTSE 250 Index, is an altogether different kettle of fish. Whereas the lumbering giants of the FTSE 100 can count their market capitalisations in the tens to hundreds of billions of pounds, a market capitalisation of just over £600 million is currently sufficient to gain entry to the FTSE 250. To stand a chance of making it into the FTSE 100, a company would currently need a market capitalisation of c. £4 billion - almost seven times the threshold for the FTSE 250. Consequently, they don't attract the same degree of analyst attention as the blue-chips, thus providing a more fertile hunting ground for stock-pickers.

The attractions for stock-pickers are compounded by the fact that the mid-cap index is largely populated by what might be referred to as specialists.



Whereas the FTSE 100 is generally composed of multinational mega-caps who operate businesses with a very diverse range of activities, the companies in the FTSE 250 tend to be more focused in the range of activities they undertake. This makes it easier for stock pickers to nail down specific business areas or activities that they think are going to perform well.

For example, let's say you want to invest in online fashion. You could buy shares in FTSE 100 constituent Next (NXT), which would get you online exposure via its Next Directory business. However, if you have real conviction that online fashion is the way to go, you could invest in ASOS1 (ASC), which operates 100% online. It is mid-cap's more specialised approach that enables investors to assemble portfolios that more accurately reflect their investment outlook.

While many cite mid-cap's greater reliance on the domestic market as a source of weakness, the reality is much less cut and dry. Firstly, the extent of the gap between the FTSE 100 and FTSE 250 in terms of the internationalisation of earnings is overplayed. While the FTSE 100 generates around two thirds of its earnings from overseas markets, the equivalent figure for the FTSE 250 is roughly 50%. In addition to this, it is also worth remarking that a UK slant hasn't been all that bad in recent years, as the UK economy has done relatively well vis-a-vis its developed market peers. Housebuilding has been one particular mid-cap sector that has performed extremely well on the back of the upturn in the UK economy, with most stocks having seen price rises in the hundreds of percent in recent years.

But with global growth presenting a much more subdued backdrop for businesses, large multinationals are finding it ever harder to grow their top lines. With this in mind, it is likely that M&A (mergers & acquisitions) activity will continue to play an increasingly important role, as larger corporates look to acquire growth. In recent months, a slew of mid-caps have fallen prey to international predators. March saw challenger bank TSB Banking back a bid from Spain's Banco de Sabadell, while industrial inkjet printing specialist Domino Printing Sciences recommended an offer from Brother Industries of Japan in the same month; and more recently, set-top box maker Pace was snapped up by US rival Arris Group in April.

With corporate balance sheets still brimming with cash, there is plenty of scope for M&A activity to remain strong in 2015. That said, investors should be aware that the factors supporting midcap valuations could just as well turn against them in future. A rise in interest rates could take away a major incentive for M&A activity and also prompt a shift to less risky assets. A weakening of the UK economy would also have a disproportionate impact on many mid-caps given their greater reliance on domestic earnings. We are also conscious that mid-cap valuations are now back to where they were at the height of the last bull market. Although it does not follow that a crash is imminent, investors need to adopt a selective approach in such an environment.

One potentially lucrative approach might be to tap into those larger small caps that haven't quite yet made it into the FTSE 250 but whose growth prospects suggest that they might well do so in due course. This is the focus of my small cap piece on page 32. On page 27 Robert Sutherland-Smith puts his decades of experience to work in hunting down his favourite picks from the FTSE 250 index, all from the banks of the great Limpopo River. If you prefer to sit back and let the industry professionals do your stock picking for you, then Nick Sudbury serves up his top mid-cap funds and investment trusts on page 36. For an international slant, turn to page 40 where Matthias Kurzrock of Paladin Asset Management outlines some of his favourite German mid-cap picks.



"WITH CORPORATE BALANCE SHEETS STILL BRIMMING WITH CASH, THERE IS PLENTY OF **SCOPE FOR M&A ACTIVITY TO REMAIN STRONG**

1. Although ASOS is not currently a FTSE 250 constituent, its market capitalisation of over £3 billion qualifies it for inclusion in the index.

THE LIMPOPO DISPATCHES

BY ROBERT SUTHERLAND SMITH



Your correspondent ponders the fate of Lord Salisbury as Prime Minister in the recent UK general election, before finding a note from the editor, in a bottle, asking for views on mid cap companies. I happily, give my views on Close Brothers Group (attractive), N.Brown (attractive), Croda (only downside in my opinion) and Ladbrokes, which has been coming up nicely on the rails, as it heads for the finishing line...

Strange stories and rumours are spreading, through the undergrowth and across the veldt, that someone called Cameron has been elected Prime Minister of the old UK. The neighbourhood monkeys seem to be chattering in disbelief at the news that Lord Salisbury has been replaced as British PM. MacQuerkie, the Church of Scotland missionary, has heard from a maiden aunt in Aberdeen - the Lord knows how - that this Cameron is no true son of Caledonia, despite the name, and is strongly disapproved of by all true Robbie Burns loving Scots, because he is really a unkilted soft southerner (the best kind I always say), and an Old Etonian to boot (like the Duke of Wellington, who also invented the boot of that name so that he could beat Bonaparte), who did not take a commission in the Guards but instead went into television PR; in my opinion, a bit like a chap joining the catering corps of the French Foreign Legion, when he could have entered a decent regiment with proper chums.

Anyway, enough of this Cameron fellow! Salisbury will be missed. Men are now increasingly growing beards in recollection of him, they say.

"IT SEEMS THAT IN BLIGHTY THE ELEC-TION MAY BE OVER BUT THE THEATRE OF BRITISH POLITICS GOES ON LIKE AN OLD TIME MUSIC HALL OF PART PANTOMIME IN 2015."

It seems that in Blighty the election may be over but the theatre of British politics goes on like an old time music hall of part pantomime, part magician's performance, and part exhibition boxing – with recent cauliflowered ear, punch drunk, below the belt, election scrappers like 'Harry Houdini' Osborne, still throwing punches into empty air. "What about some real supply side government?" the citizens cry. "What about building some more houses? What do we want and when do we want them?" goes the cry. But they are not really listening. Politics is much greater fun than government; fortunately, the fat lady has not sung yet.

Parliament, in the true traditions of mime, is now putting on surreal legislative performances, like the government passing insubstantial Acts which have no true legislative significance to the real world of sovereign government and real people. First, there is the No Taxation Act, which is framed to deny Her Majesty's Government the right to raise tax revenue on behalf of Her Majesty, to do the thing it is elected to do - govern the country! Similarly, we are to also have the No Fiscal Deficits Act, which ignores the basic laws of national accounting, evidently requiring foreigners to get so bad at exporting to the UK, that

they will incur the compensating annual trade deficits to make the whole thing work. Confused? So are we!

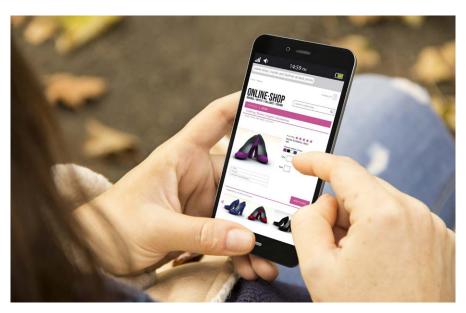
Meanwhile, according to recent Chiefs of Staff, our Armed Forces are reduced to beggarly proportions as IS runs riot in Mesopotamia and Mr Putin's Russia continues to cut alien corn circles in the wheat lands of the Ukraine. Some of us think he may be after George's Northern Power House. Our American ally looks on queasily.

Meanwhile, 'Scrapper Osborne' has found time to resurrect a Committee against public debt that was abandoned in 1864 – I remember it well – in which the Victorian Chancellor of the Exchequer, the Speaker of the House of Commons and the Lord Chief Justice - I kid you not - sit down to take port wine and discuss ways of cutting government spending. It was abandoned in 1864 in favour of Gilbert and Sullivan operettas at the Savoy Theatre, which were not a charge on the public purse and a good deal funnier. If Blighty is going to revive Gladstonian Committees, I think it should also revive D'oly Carte operetta. Has anyone got his telephone number? Savoy 1234 I think it was.

Anyway, here on the Limpopo the sun is going down over the yard arm. The witch doctor will be around soon for a snifter before a fine dinner of roast beef and Yorkshire pudding. He has just flown back from London on his own personal flying carpet; that hedge fund management course in Shepherd's Market seems to have worked a treat! Must go! I have just found a note in a bottle from the Editor asking for my views on mid cap stocks. With Polly the parrot on my shoulder, I stagger up the steps of my bungalow in a setting sun.

N.Brown (BWNG) at 344.5p

N.Brown is a Manchester (think "Osborne"; think "Northern Power House") catalogue and online retailer of men and women's clothing and footwear and household goods. Last year



to 31st March 2015 it had sales revenue of £818 million, after a steady rise from £718 million over the preceding four years; a compound rate of about 2.5% p.a. according to my arithmetic. So the top line of revenue growth has been healthy enough in a particularly tough period for retailing as well as the UK economy generally, in a clear signal that the company has things that people want to buy and an ability to sell them.

N Brown Group plc

As you may suppose, the earnings picture is less clear and less steadfast in its progress. Earnings per share on a comparable basis, year by year, fell 3% in 2013 and 1% in 2014; then by a whopping 26% in the year to last March 2015. One initially gets the impression of a management which had decided that, after a period of net earnings floating irresolutely in the doldrums, it was time to take action and forget about earnings per share for last year. That is pretty much what the accounts reveal.

Until a year or so ago, N.Brown was a darling of the stock exchange, when the share price peaked a short distance from 600p. From then on, the progression was downward; this time last year, June 2014, the share price was 468p. Last seen, it has shrunk to 342p; although that was some improvement on the lowest price this last year when it reached 282p sometime last October.

This is a good time to be looking at N.Brown again, because the company has only recently reported its results to last March and had its analysts and shareholder's meetings at the end of last April. It means the numbers are pretty up to date and the share price has revealed the market's perception of the results in the recent movement of the share price.

Very simply, as shown by the accounting figures, top line sales revenue was flat at £818.0 million versus sales revenue of £818.9 million the year before. More dramatically, regular statutory pre tax profit plunged a reported 21.2%, with adjusted earnings sliding from the 27.74p in the year before to a newly reported 20.49p - a descent of 16%. The yearly dividend was maintained at 14.23p on much reduced dividend cover.

Despite that, the cash flow account shows that the company needed to increase borrowing to pay for both the investment in the company and the cash outflow to shareholders by way of dividend payment. In the year to end February 2015, management increased capital spending by 185% and spending on dividends to shareholders by 2.5% in money terms. That was financed in part by deferring payments to creditors and by increasing borrowings; 97.5% was long term debt.

Nevertheless, it was raised by nearly 11% so that on balance sheet day the total debt to equity ratio was 58%; splendid if all goes to plan (particularly when interest rates are historically low) but onerous if they do not.

So what do the consensus estimates make of the prospects for N.Brown shares at this point? After last year's 26% drop in earnings per share, the market consensus is that they should jump 20% this year and 9% next year. That sounds attractive because the 'PEG' for this year is alluringly estimated at 0.7, indicating that the shares are conservatively priced in relation to that estimate for earnings growth. The dividend is also estimated to rise by 3.9% to a forecast estimated 14.78p a share. In short, the current market estimate is of a forward price to earnings ratio of 13.4 times and annual dividend yield of 4.4%.

Moreover, this is a company with shareholder net assets to take into consideration. Without goodwill, they are estimated to be worth around 178p of the 342p share price; knocking that attributable net asset number off the market price, gives a "pure" PER valuation of 6.5 times the 25.5p of earnings, estimated for this current year.

Finally, the board declares itself confident that it has the right strategy to drive sustained profitable growth. These shares look attractive to me.

Croda International (CRDA) at 2773p

As I wander the market shoreline looking for value amongst the middling sort of shares, my eye catches sight of the share Croda International, which I have not looked at since being keen on the shares last year. As it is selling at twenty one times (or thereabouts) last year's earnings and has a modest 2.3% dividend yield, it would seem reasonable to expect earnings to be growing by around 20% this year or next and dividends to be increased robustly in consequence.

Mystifyingly, encouragement towards such an expectation is found neither

in the actual historic record, nor in the market's consensus estimates of future prospects. In the consensus of market estimates of past and future progress, earnings per share grew a modest 2% in the year to 31 December 2012 and 8% the following year. This represents a good improvement, but not enough to justify the current estimated price to earnings ratio for this year.

CRODA

So, does the market expect a big spurt in earnings per share this year or next? Evidently not! The latest market consensus estimate is for earnings growth of a mere 7% this year and an equally mere 7% next year.

Nothing I see in the past record or the forecasts supports Croda's prospective estimated 21 times earnings valuation. Perhaps it's a share with sizeable attributable balance sheet assets which, once taken into account, make the actual valuation of earnings themselves look reasonable.

However, reported balance sheet assets attributable to ordinary shares are worth an estimated 356p, which is not enough to make a significant difference to earnings per share when the share price was 2858p last seen. Subtracting the 356p net asset value per share from the share price still leaves a "pure" earnings per share estimated valuation at 20 times earnings, which looks dear on the traditional PEG check of 2.8 (the rule of thumb is that it needs to be below 1 to makes the shares look good value.)

As you might imagine, on that basis, the dividend growth prospects are limited. The consensus estimated annual dividend growth for this year and next, is limited to around 5% p.a. Combined with an estimated prospective annual dividend payout of only 2.4%%, such estimated dividend growth looks insufficient. I would have thought that even a bid, if such a thing were to happen, is wholly or largely discounted on a current market valuation of 21 times earnings. It leaves little room for a premium to be offered.

This share has "overvalued" emblazoned all over it. The company has good margins. But unless top line sales revenue grows, the benefit of such margins to growth prospects is limited.

This is a company with a market cap of just under £4 billion and ten significant institutional shareholders. It would need only one or two of them to look at the valuation and conclude "it is all in the price" to see this share price lower.



"NOTHING I SEE IN THE PAST RECORD OR THE FORECASTS SUPPORTS CRODA'S PROSPECTIVE **ESTIMATED 21 TIMES EARNINGS."**

Close Brothers Group (CBG) at 1560p

The useful diversity of the London market is well illustrated by the profitable existence of Close Brothers, the financial services group headquartered in the City of London. It comprises a deposit and lending bank, a small company market making business - Winterflood - and an asset management business.

It is the bank subsidiary that I find particularly interesting as a valuable mini-dynamo for generating investor equity value and wealth. It is a bank on a human scale. It is a "not too big to fail". As other banks grew larger, more complex and less manageable in their universality and conflicts of interest, Close Brothers Bank stuck to a micro mission of providing loans for smaller British companies.

The Winterflood small company stock jobbing business, apart from requiring working capital of its own (I remember the day when all stock jobbers, even the biggest, financed their activities mainly with bank overdraft), is a separate subsidiary and not a department of Close Brothers Bank.

Close Brothers Group provides UK investors with an opportunity to buy bank shares, geared to UK economic recovery, without all those other snags and pitfalls of the big banks. Because it is a bank that is small enough to fail, it has historically been very well capitalised and managed.





Over five years, Close Brothers Group has outperformed the FTSE 100 Index by 90%. Over the last year, its shares have risen by 18% whilst the FTSE 100 Index fell by just under 1%. It has also had a better capital gains record than the record of the big FTSE 100 banks. Consequently, I am very well disposed to Close Brothers Group as a proven, above average provider of rising shareholder value and capital gains.

However, after such a run, is it a share to still add to a portfolio at this stage



"CLOSE BROTHERS GROUP PROVIDES UK IN-**VESTORS WITH AN OPPORTUNITY TO BUY** BANK SHARES, GEARED TO UK ECONOMIC RE-COVERY, WITHOUT ALL THOSE OTHER SNAGS AND PITFALLS OF THE BIG BANKS."

and share price?

The company reported its Q3 results - to 30th April 2015 - late last month. They were solid looking. The loan book of the bank grew 2.7% in the three months and 6.1% over the year. Market conditions for the Winterflood jobbing business were reported as 'improved' and the asset management company saw funds under management rise by 9% to £10.6 billion. In its statement of prospects, the company told us the following:

"Overall, the group remains well positioned for the remainder of the current financial year. In Banking we expect to deliver continued loan book growth at good returns. Winterflood has benefited from the improved trading environment but remains sensitive to market conditions. We continue to see steady growth in asset management."

In consequence, the immediate prospects look solid enough as we await

publication of the results for the year that ends 31 July 2015. The latest consensus of market expectations for this year include an estimated 3.3% rise in group sales revenue; a 12% increase in earnings per share to an estimated 117p; and a 10% rise in the annual dividend, to an estimated 54p.

At a share price of 1565p (last seen), that produces a valuation of 13.3 times estimated earnings and an estimated annual dividend yield of just under 3.5%. For the following year, the consensus forecast is for a 9.6% increase in earnings to an estimated 129p and an 8.3% increase in the annual dividend payout to 58.5p putting the shares on a forward PER and dividend yield of 12 times and 3.7%.

Technically, the share price pattern looks enticing; it currently hovers just above what looks like a trend support level. Have a look!

The dividend is attractive and the PER not too demanding. All in all, a stock that continues to offer decent value, prospects and income.

Ladbrokes (LAD) at 137p

Ladbrokes is a share I have recently looked at on the Master Investor website, so here I bring you up to date with a quick comment and review on the latest news and events.

Ladbrokes is a speculation as it lacks net asset support and its dividend looks vulnerable, not least because it is money going out of the business when it could finance and hasten the recovery plans of the newly appoint CEO, Jim Mullen, a cheerful looking man who has valuable experience elsewhere in the industry.



Whereas the share price has moved up 33%, from the 103p it was at the time of my last note in April, to 137p now (last seen), it has also outperformed the FTSE 100 Index over the last six months. By way of contrast, the share price over a year fell 3% but over the last six months it has actually risen by 24%. Last month, there was news that the company was in talks with the private equity owners of Coral Betting. As a result, the share price rose to 147p.

The historic dividend yield remains untrustworthily high and handsome at 7.3%. This is no classic dividend yield stock but one for a speculative capital gain, which should follow recovery in its business. The really unaffordable annual dividend payout hangs by the thread of the promise of the previous CEO to keep paying it. The new CEO clearly has a free hand to cut it.

A merger with Coral could bring sudden new doubt to that likelihood. The idea of such a merger would mean reduced costs, a bigger collective market share and the scales of economy and financial efficiency enjoyed by larger operations.

However, there are caveats. It is thought more probable than possible that the UK competition authorities would have something to say about such a significant consolidation of the gambling market. Also, the private equity interests that own Coral should be expected to drive a hard bargain on behalf of their own interests. They will know that Ladbrokes needs a deal like this and will negotiate on that basis.

Ladbroke shares are still a long way below the peak share price of a year or so ago. I still think they are a hold on the basis that recovery is still on the agenda with or without a merger with Coral.





"THIS IS NO CLASSIC DIVIDEND YIELD STOCK BUT ONE FOR A SPECULATIVE CAPITAL GAIN, WHICH SHOULD FOL-LOW RECOVERY IN ITS BUSINESS."

SMALL CAP CORNER

THE CONTENDERS

BY JAMES FAULKNER



This month's small caps – if they can be referred to as such – have been selected from the higher echelons of the FTSE Small Cap and AIM indices, with a view to one day seeing them make their way into the FTSE 250. The beauty of selecting stocks that look likely to one day make it into the larger indices lies in the fact that many fund managers are restricted to buying stocks in the FTSE 100 and FTSE 250, so such companies can often be carried higher as they meet new sources of liquidity.

Vectura* (VEC) - A breath of fresh air

Shareholders in Vectura* (VEC), of which I am one, should breathe easy following last month's results from the inhaled medicines specialist. Vectura reported a maiden profit after tax of £3.7 million on the back of revenues up by 59% to £58 million. However, this is just the beginning, as Vectura is now a company that truly is coming into its own. An inflection point is approaching in terms of profitability, and Vectura is already large enough to enter the FTSE 250 in the next reshuffle.



Vectura is a UK-based speciality pharmaceuticals company focused on the development of inhaled drugs mainly for respiratory diseases - a market which is estimated to be worth \$32.4 billion in 2013 and is expected to grow to \$43.9 billion in 2018, with a compound annual growth rate (CAGR) of 6.2% (source: BCC Research). The group currently has eight products marketed by its partners

including GSK, Novartis and Baxter International and a portfolio of drugs in clinical and pre-clinical development, some of which have been licensed to major pharmaceutical companies.

The headline figures from the results include a 55% increase in royalty revenues to £25.2 million as new products come on-stream. For example, sales of Seebri and Ultibro (both used to treat COPD), from which Vectura receives mid single digit royalties from Novartis, grew rapidly and amounted to \$309 million in FY15. There is scope for further growth during the current year, as Ultibro has been launched in 21 countries (including Germany, Japan and Canada) but has been approved for use in over 60 countries including countries within the EU, Japan, Latin America, Canada, Switzerland and Australia. Meanwhile, Vectura expects FDA action on both QVA149 (Ultibro) and NVA237 (Seebri) by Q4 2015, and the launch of these products in the US is anticipated to generate significant additional milestone and royalty income for Vectura. Of course, there are risks with bringing these products to market, but given that they are already approved in many other jurisdictions around the globe it appears unlikely that the FDA will take a different view.

Vectura has also been busy gaining the necessary European marketing authorisations for AirFluSal Forspiro (formerly known as VR315). AirFluSal has been launched in 12 European countries and also in South Korea and Mexico. It has been approved in approximately 30 countries. VR315 is a generic copy of GlaxoSmithKline's \$8 billion-a-year inhaled lung drug Advair, a real blockbuster. Analysts at Berenberg had been assuming 2017 sales of around \$250 million, or roughly 10% of Advair's current European sales, but this could prove conservative given the cost advantages. Vectura is also partnered with "a US division of a leading international pharmaceutical company" for bringing VR315 to market in the States, which could be a source of further upside over the medium term.

In any case, Vectura has now made the transition from loss-making R&D outfit to profitable pharmaceuticals business. There is also cash of £90 million on the balance sheet, and the company has no debt. With this in mind, we could be nearing an inflection point, both in terms of the firm's financial performance and its share price.

"AN INFLECTION POINT IS APPROACHING IN TERMS
OF PROFITABILITY, AND VECTURA IS ALREADY
LARGE ENOUGH TO ENTER THE FTSE 250 IN THE
NEXT RESHUFFLE."



The imminent ramp-up of royalties from various avenues means that a multiples-based valuation for Vectura will be possible in future, which makes the stock much easier to value. For example, broker Stifel notes that Vectura trades on an estimated FY16 P/E in the high twenties, but a FY17 estimated P/E of around 10x. It notes that this looks "unwarranted" given the strong growth.

Elsewhere, last year's acquisition of German pharmaceuticals company Activaero packs out the company's development pipeline into the foreseeable future and represents a focus for the reinvestment of the royalty income from the aforementioned products. With the caveat that Vectura carries risks traditionally associated with the pharmaceutical sector (e.g. product development failure, regulatory risk etc), it appears to be building what could ultimately become a valuable franchise, and I believe the shares are worth a look for the more adventurous investor. What's more, Novartis has been very open about its ambitions in the inhaled medicines arena, and has not ruled out the prospect of acquisitions. Vectura would be an obvious target given its existing working relationship with Novartis.

CVS Group (CVSG) – Can't put a paw wrong

CVS Group is one of the UK's leading vetinary service providers, currently operating 276 vetinary surgeries, including five diagnostic laboratories and three crematoria. The group is primarily focused on the small animal market and operates under a number of well established brands. Despite the firm's market leading position, it only accounts for an 11% share of what remains a highly fragmented marketplace. Therefore, CVS sees its role as one of a national consolidator, typically through buying into practices operated by vets in their 50s who wish to carry on working whilst crystallising the capital in their business.

The majority of CVS's surgeries are based in England with good representation in the Home Counties, Midlands and the North-East. A typical CVS site will be situated in an urban area and will form part of a practice of several sites in the locality. Services include consultations, annual vaccinations, dentistry, surgical procedures, ECG monitoring, hospitalisation, home visits and emergency services. The surgeries also stock pharmaceutical products for use by the vets and pet owners. In addition many offer over-the-counter products such as pet food, grooming, vitamins, shampoos and pet accessories. The laboratories and crematoria businesses complete the offering and ensure that CVS is able to offer the full gamut of services.



The UK pet market is currently highly fragmented, thus providing plenty of opportunities for CVS to grow through acquisitions - the five largest corporate operators, of which CVS is the largest, own just under a quarter of small animal surgeries (out of a total UK market of c.4,000 surgeries). Moreover, trends in the UK pet market are positive, with advances in medical interventions and the growing popularity of pet insurance increasing the average spend per visit and the requirement for medical care. The long-term growth of the market is also underpinned by an ageing population leading to a higher demand for animal companionship. With pet ownership levels currently standing at around 50% of UK households, there is plenty for CVS to get its teeth into.

Given that CVS is now the leading vetinary operator in the country, there is little scope for it to come under pressure from another corporate - especially



following its acquisition of Pet Doctor in 2010, which would have been a logical first step for a competitor looking to challenge CVS. Rather, the main threat to the business comes from online retailers of pet pharmaceuticals, because whilst many medicines require a prescription there is nothing to stop customers from taking their prescription and using it elsewhere. In order to meet this challenge and capture a share of what will inevitably be a growing market for some time to come, CVS has established its own online offering, Animed direct.

Having gone live in July 2010, the website has performed beyond the company's expectations, having seen revenues increase from a standing start to £8.5 million by December 2014. Animed Direct benefits from the significant buying power of the CVS group, giving it a competitive edge over its online competitors, whilst the wider group also benefits from the additional volumegenerated efficiencies. Meanwhile, the Healthy Pet Club loyalty scheme also complements the rest of the business through bolstering recurring revenues through bonding pet owners to their local surgery by offering discounted products and perks. Take-up has so far been promising, with a 45% increase in the last year alone, bringing total numbers to 162,000 pets. This trend is encouraging given that scheme members spend 15% more per visit on average.

"ACCORDING TO RE-**SEARCH FROM MCA-**FEE, CYBERCRIME **COSTS THE GLOBAL ECONOMY \$445 BIL-**LION A YEAR, A FIG-**URE WHICH INCLUDES BOTH THE GAINS TO CRIMINALS AND THE** COSTS TO COMPANIES FOR RECOVERY AND DEFENCE."

Results for the year to June 2014 saw revenue climb 19% to £142.9 million, driving pre-tax profits 18% higher to £14.3 million. The key strength of the business is the highly cash generative nature of veterinary practices, which provide plenty of internally generated funds for further acquisitions. Acquired businesses benefit from the CVS Group infrastructure and back office, thus enabling cost reductions and further reinvestment in what is clearly a virtuous circle for CVS. With the fragmented nature of the market and the strong market backdrop, CVS looks like it has many years of growth ahead of it, which could see it achieve the necessary scale to take it into the FTSE 250 in due course. However, the rating is currently a tad too punchy for my liking and prospective investors should therefore be looking to buy on any significant dips.

NCC Group (NCC) - Policing the web

Demand for cyber-security in all its forms is growing every year as firms wake up to the myriad threats they face from cyber criminals. According to research from McAfee, cybercrime costs the global economy \$445 billion a year, a figure which includes both the gains to criminals and the costs to companies for recovery and defence. However, many companies are still ill equipped to tackle this growing threat. In a Q4 2013 survey

of FTSE 350 companies, less than 50% of Chairs thought their boards had a clear understanding of the impact of a cyber attack on their businesses; 40% did not receive regular threat intelligence from their CIOs; and 25% didn't know who shared their key data.



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

Of particular note for the future is the firm's investment in .trust, a generic top level domain (gTLD) which aims to create a universal environment for end users to operate and navigate the internet

with complete safety and security. The group established a new wholly owned subsidiary, Artemis Internet Inc. in San Francisco, to develop the critical infrastructure and know-how to deliver this project. The Board expects this Division to be close to break even in financial year 2015/16, as it achieves a critical mass of customers buying different services as well as joining the .trust community. The ultimate goal is to offer a unique and secure gated community for companies to offer improved security enabling their end users and customers to interact with them safely and securely over the Internet.

Growth in both revenue and profitability has been fairly consistent over the years, and the most recent trading update flagged organic revenue growth of 14%. Management are confident of "double digit organic growth and strong cash generation for future years to come," and with over 50% of the Group's revenues now outside the UK - with the majority in North America - the firm's ascent will not have gone unnoticed in the industry. I believe NCC will become a takeover target before long (if it isn't already) and the shares currently look reasonable value on a PEG basis, with a current rating of 17.2x and an earnings growth estimate of 31% for FY2016 (at time of writing).

* James Faulkner owns shares in Vectura



FUND CORNER

THE INBETWEENERS

BY NICK SUDBURY



The mid-cap stocks of the FTSE 250 sit between their larger rivals in the FTSE 100 and the minnows of the FTSE Small Cap index, but over the last 10 years it is these middle ranking companies that have delivered the strongest performance. Respective cumulative returns of 144%, 34% and 63% represent a staggering difference and indicate the sort of growth potential that these sorts of businesses can offer.

A mid-cap company is more likely to be geared in to the UK economy than one of the multi-nationals of the FTSE 100 with operations all around the world. This has been a major advantage in the last few years as other regions have lagged behind, including the EU which accounts for around 40% of the country's exports.

The FTSE 250 is a much more dynamic and diversified part of the market than the main blue chip index with the companies ranging in size from £4.4 billion down to £169 million. It also has a radically different balance in terms of the sectors with Financials making up about 33%, followed by Industrials at 22% then Consumer Services at 18%.

Over the last 10 years the mid-cap index has provided better risk-adjusted returns than the FTSE 100 and the FTSE Small Cap. The Sharpe

Ratio, which measures the excess return per unit of risk, is 0.7 compared to 0.5 for each of the others, although its maximum drawdown (the biggest peak to trough loss) sits in the middle at 47.4%. This came about after the 2008 financial crisis.

Straight down the middle

Most of the 260 or so open-ended funds in the UK All Companies Sector have the scope to invest in FTSE 250 stocks, but there are just a handful that focus exclusively on this part of the market.

According to data from Morningstar, there are 11 mid-cap funds and they have all comfortably outperformed the wider sector average over the last one, three and five years. The most consistent of them has been **Neptune UK Mid Cap** with a five year annualised return of over 23%.

Mark Martin, the manager, can invest in

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any of the stocks in the FTSE 250 as well as the 50 largest small caps. He has put together a highly concentrated portfolio with the top 10 holdings making up more than half of the fund. The largest of them is the flooring and beds retailer, Carpetright, with a weighting of over 9%.

The portfolio has been designed to benefit from three main themes: corporate turnarounds, structural growth, and the economic recovery.





Martin invests at least 20% in each area with the aim of delivering strong riskadjusted returns across the business cycle while minimising the downside risk.

Another strong performer and the largest of these specialist vehicles with £1.8 billion in assets under management is Old Mutual UK Mid Cap, which invests at least 80% of its capital in members of the FTSE 250. The 48 stock portfolio provides a more diversified exposure than the Neptune fund with the top 10 holdings including house builders such as Barratt and Taylor Wimpey, as well as the online takeaway intermediary Just Eat.

Paul Spencer, who runs the Franklin UK Mid Cap fund, aims to outperform the FTSE 250 on a three to five year time horizon. In order to do this he has put together a highly concentrated portfolio of 38 holdings with the top 10 making up 37.5% of the allocation. The manager is predominantly a stock picker and looks for companies that are sustainable, attractively valued and with strong management. His current selections include: Unite Group, Micro Focus International and Bodycote.

If you prefer the passive approach there is a mid-cap tracker fund from Black-Rock that is benchmarked against the FTSE 250. It was created in June 2012 and has generated a one year return of 15.85%, although the ongoing charges of 0.52% make it slightly more expensive than most of the ETFs linked to the same index.

Special situations

Another option is to invest in one of the special situations funds within the UK All Companies sector. These focus on stocks with particular attributes and will normally have some mid-cap exposure, although they don't concentrate solely on this part of the market like those that are benchmarked against the FTSE 250.

A good example is **AXA Framlington UK** Select Opportunities, which is run by Nigel Thomas, who is one of the most highly regarded managers operating in the sector.

"ACCORDING TO DATA FROM MORNINGSTAR, THERE ARE 11 MID-CAP FUNDS AND THEY HAVE ALL COMFORTABLY **OUTPERFORMED THE WIDER** SECTOR AVERAGE OVER THE LAST ONE, THREE AND FIVE YEARS."

The fund is a top quartile performer over five years with a cumulative return of 94.9% and currently has 35% in mid caps with 51% in the blue chips of the FTSE 100.

One of the main themes in the portfolio is to invest in online companies that can replace the existing leaders in the industry with a new way of doing things. There are two of these stocks in the top 10 holdings and they are both mid caps.

The first with a 3.3% weighting is the property website, Rightmove. Thomas holds 5% of the issued share capital and believes that the stake has the potential to make huge gains over the medium term. Rightmove has almost 20,000 registered estate agents and house developers who each pay to list their properties on the website for would-be buyers to come and view.

The other holding is the online betting company Betfair, which makes up a further 3.1% of the fund. There are lots of these sorts of businesses operating in the UK, but Betfair has the biggest betting exchange and has an innovative approach in terms of the products and odds that it offers. Thomas thinks that it has great potential and has acquired 6.5% of the issued share capital.

Another top performing fund is Artemis UK Special Situations, which is up 468.4% since it was launched in March 2000, comfortably outpacing the 100.9% total return from the FTSE All-Share index. The manager has a value bias and looks for out-of-favour stocks with the potential to be re-rated. He currently has 41.4% invested in mid caps and a similar proportion in the FTSE 100.

The defence company QinetiQ is a good example of the sort of undervalued midcap business that the fund invests in. It has recently announced a strong set of results and has some interesting technologies as well as a £200m cash pile for the new chief executive to work with.

Anthony Cross and Julian Fosh, who co-manage the Liontrust Special Situations fund, take a rather different approach. They look for UK companies with distinctive, intangible strengths that competitors will struggle to reproduce, as this should allow them to increase market share while protecting their margins. It is a strategy that has generated impressive returns, although only about a third of the portfolio is currently invested in mid caps.

Investment trusts

Those who prefer closed-ended funds have three mid-cap investment trusts to choose from: Schroder UK Mid-Cap (SCP), JPMorgan Mid-Cap (JMF) and Mercantile (MRC). Over the last ten years they have been the strongest performing members of the AIC's UK All Companies Sector with cumulative returns of 439.5%, 363% and 356.3% respectively.

Schroder UK Mid-Cap was launched in May 1983 and is benchmarked against the FTSE 250. It has net assets of £191 million and is trading on a 9% discount to NAV. The manager, Andy Bough, invests in companies with strong balance sheets with little or no debt. He also runs Schroder's equivalent open-ended fund, which is almost eight times bigger, although the investment trust that has been the better performer.

SCP provides exposure to a 58 stock portfolio with the top 10 positions accounting for 25.79% of the fund. These include property related businesses such as Kennedy Wilson Europe Real Estate, Redrow and the Grainger Trust, as well as financial stocks in the form of Investec, Brewin Dolphin and IG. It is yielding 1.88% with the dividends paid twice a year.

JPMorgan Mid-Cap is slightly larger with total assets of £270 million and is trading on a wider discount of almost 13%. It is a slightly more diversified portfolio with 76 holdings, although the top 10 account for 28.71% of the fund. The largest of these is the hardware store owner, Howden Joinery, which is a long-term holding and one that the

Mid Cap Funds	1 Yr Return	3 Yr Return Annualised	5 Yr Return Annualised	Current Fund Size (£m)
Neptune UK Mid Cap A Acc	23.34	26.83	23.28	580
Old Mutual UK Mid Cap Acc	26.76	27.19	20.36	1,863
F&C UK Mid Cap Acc	23.20	24.96	20.02	30
Franklin UK Mid Cap A Inc	21.83	23.46	19.74	1,068
Royal London UK Mid-Cap Growth Ret A	17.49	22.82	19.25	349
Threadneedle UK Mid 250 A Acc	20.94	22.22	17.38	119
Schroder UK Mid 250 A Acc	10.52	24.85	16.99	1,533
Aberdeen UK Mid-Cap Equity A Inc	9.98	18.46	15.60	70
A ll ianz UK Mid Cap A	18.35	20.47	15.19	57
AXA Framlington UK Mid Cap R Acc	17.20	24.72	N/A	106
BlackRock Mid Cap UK Eq Tracker A	15.85	N/A	N/A	251
Average	18.68	23.60	18.65	548
UK All Companies Sector Average	8.561	15.98	12.15	

Source: Morningstar, data to 11/6/15



"THOSE WHO PREFER CLOSED-ENDED FUNDS HAVE THREE MID-CAP INVESTMENT TRUSTS TO CHOOSE FROM: SCHRODER UK MID-CAP (SCP), JPMORGAN MID-CAP (JMF) AND MERCANTILE (MRC). OVER THE LAST TEN YEARS THEY HAVE BEEN THE STRONGEST PERFORMING MEMBERS OF THE AIC'S UK ALL COM-PANIES SECTOR WITH CUMULATIVE RETURNS OF 439.5%, 363% AND 356.3% RESPECTIVELY."

manager thinks will benefit from the improving strength of the UK consumer.

Mercantile is the largest and most liquid of the three with total assets of just over £2 billion. It also has the broadest remit as it can invest in both mid and small cap companies. The fund has a healthy 2.81% yield and highly competitive ongoing charges of 0.5%.

MRC holds a diversified portfolio of 130 stocks with about two-thirds of the capital invested in the mid-cap section

of the market. It is managed by a team from JPMorgan who look for attractively valued companies with sustainable competitive advantages, as well as turnaround situations. A major theme that it shares with many of the other mid-cap funds is the strength of the UK consumer, hence the large holdings in stocks like Howden Joinery and Dixons Carphone.

GERMAN MID-CAPS

FASHON IN FACUS

BY MATTHIAS KURZROCK AND DREW BURNS





Why Germany, why fashion, why now?

At Master Investor, we believe in picking the brains of the best and brightest. Over the coming months, you'll see a recurring theme in this publication: to become a contributor, it takes proven, concrete evidence of having been successful in the markets. Master Investor is all about, well, master investors!

That's why I am delighted that we have signed up the management team of Paladin Asset Management, the family office and fund managers of one of Germany's best-known self-made billionaires and investors. Carsten Maschmeyer built one of the country's largest IFA businesses (not quite unlike Hargreaves Landsdown in the UK), sold it for a fortune (and with

near-perfect timing), and since then has been a real force in the markets. When he decides to invest, other investors are advised to take notice!

Master Investor gives you exclusive access to some of the research carried out by Maschmeyer's private team of analysts. What's more, having such contributors in other parts of Europe will help you strengthen your portfolio and provide unique insight.

As for German equities, readers should bear the following points in mind:

- Germany has much less of an equity culture than the UK, which is why valuations are often more attractive.
- Being a member of the Euro, you can use German equities to gain exposure to another major currency, which can help you to both diversify as well as maximise your investment success (at times when

the Euro rises versus the Pound Sterling).

• Last but not least, a resolution of the Greek crisis may spark a re-rating of European (including German) equities and help lift European M&A activity towards US levels. After all, Europe is a single market, and companies can take advantage of this by building scale throughout the continent.

Despite our love for the UK, history shows again and again that investors are well advised to look beyond their usual horizons, which are often restricted by "home bias". With Paladin among our contributors, we can now offer you cutting edge research from Europe's largest economy. I couldn't be happier to have them onboard.

Swen Lorenz, Editor



The German stock market has had a roller coaster ride since the beginning of the year, as was to be expected. After an unbelievable 26% run from the beginning of the year until mid-April, the DAX Index turned around and rapidly retreated 11%. We at Paladin were well-prepared for this development, losing a mere 2% in the drop, and we now are systematically combing through small and midcaps in the German-speaking universe for the best ideas where we can put our significant liquidity to work.

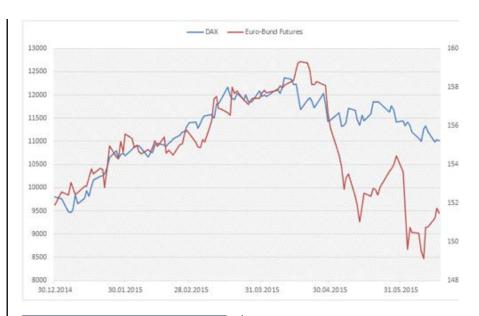
Interest Rates Drive Prices - Upwards and Downwards

What's noteworthy about the developments of the past couple of months is that corporate performance is only partially responsible for driving the rally, and that interest rates played a greater role. The yield on 10-year German government bonds fell to practically 0% early in the year, and shorter duration yields were negative for a while. It was as though investors were paying for the privilege of loaning their money to the German government.

Equities become naturally much more attractive in such an environment. On one hand, this is due to dividend yields becoming more attractive. On the other hand, in most valuation models lower interest rates lead to higher corporate valuations.

This illustration shows the pronounced early-year correlation between the falling interest rates for government bonds - shown in rising bond futures - and the rise in the DAX. The apex on each chart is only seven days apart from that of the other - April 10 for the DAX and April 17 for bond futures. Since then both have fallen significantly.

At Paladin we did not allow ourselves to become tied to short-term interest rate developments. Quite the contrary, we use a rather high risk-free rate in our valuation process, thereby really hammering the companies we value. The good in this is that when we determine high upside with this method it comes with a certain margin of safety, which serves to protect us in volatile markets.



"QUITE BEAT UP, AND THEREFORE **WORTH A LOOK, ARE** GERMAN FASHION **COMPANIES SUCH AS GERRY WEBER, TOM** TAILOR AND ADLER -**TYPICAL COMPANIES** IN THE CONSUMER **SPACE THAT ARE** GENERALLY ASSOCI-ATED WITH STABLE RESULTS."

A volatile and rate-driven market environment is a challenge for any investor. At the same time, increased volatility is exactly what brings opportunity for investors. This has happened particularly in the small and mid cap space, where numerous shares have retreated sharply from their highs.

Chances with the Biggest Losers: Fashion in Focus

Quite beat up, and therefore worth a look, are German fashion companies such as Gerry Weber, Tom Tailor and Adler - typical companies in the consumer space that are generally associated with stable results.

In reality this branch is anything but simple. One must be aware of changes in consumer behavior that might very well represent a sustained trend change as opposed to a temporary aberration. A study of the retail market by GfK shows that European consumers had approximately 2.5% more purchasing power compared to the previous year. However, the share of private consumption in the retail sector declined over the course of the year, from 31.2% to 30.9%.

In Germany in particular, bricks-andmortar stores have come under pressure on the back of the rise in the popularity of online shopping. Enormous growth

at Zalando, which saw revenue grow 25.7% in 2014 to €2.2 Billion, as well as others, is something traditional retailers can no longer afford to overlook, as the latter saw their revenues decline by 1% during 2014. Retailers describe this euphemistically as "declining activity in city centres."

Q1 2015 was again unfriendly to German retailers. The sector was again hit by a market decline - albeit from a high basis of 5%. This brought about weak quarterly figures, which served to drag down share prices.

Shares of Gerry Weber (-44%), Adler (-26%) and Tom Tailor (-17%) have managed to take a hearty dive despite the positive market direction over the first half of the year. If we assume that clothing sales in traditional stores are unlikely to be entirely eradicated, and we accept this less than adventurous premise, the shares mentioned above are certainly worth a look at these prices.

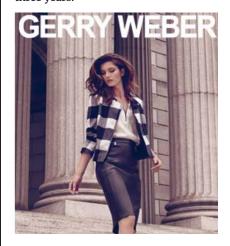
Gerry Weber: Transition to Retailer

Our attention was drawn to the sector in February due to developments at Gerry Weber, when the company published its full year guidance, which called for acquisition-driven revenue growth from €852 million to between €970 million and €1 billion. At the same time, the guidance called for underwhelming EBIT growth from €109 million to between €118 million and €126 million, proportionally far lower than revenue growth. For interested market watchers, this guidance was far from surprising, but the market reacted nonetheless with a solid hit to Gerry Weber's share price.

Gerry Weber is located in the quiet town of Halle in Westphalia, but has a worldwide presence through the four brands under its umbrella: Gerry Weber, Taifun, Samoon and Hallhuber, the latter of which was only recently acquired at the end of last year. The company has nearly 1,000 of its own specialty stores, 2,800 in-store locations, 281 franchise locations and branded online stores.

The company's two business segments are wholesale and retail, which have developed in starkly contrasting directions over the past few years.

Gerry Weber's wholesale business has been the company's primary distribution channel since it was founded in 1973. This business centres on sales spaces that are operated by franchisees based on a "shop-in-shop" model or multi-label retail. In Europe there has been a clear trend in this space over the past couple years toward an overall reduction in wholesale retail space, which has threatened both vertically integrated fashion enterprises as well as smaller 'Mom and Pop' shops. Thus Gerry Weber has seen headwinds in this space for years, which can be seen in their segment reporting, where one sees zero growth in the segment over the past three years.



Gerry Weber has addressed this trend in a manner similar to many of its peers, by broadening its own retail presence and continually opening new stores. It was thereby able to increase its revenue in this segment over the past five years from €174 million to €400 million.

On the other side of things the share of total revenue for the retail segment increased from 28% to 47% over the past five years, which brought about a definitive shift in Gerry Weber's business. In the wholesale business goods are sold to other merchants at low margins, while on the retail side gross margin is generally higher, before considering costs for renting floor space, sales personnel and increased logistical needs.

Overall Gerry Weber has been able to grow its operating profit (EBIT) proportionally in sync with revenue over the past five years. EBIT margin last year was an adequate 12.8%, which with revenue of €852 million meant an EBIT of nearly €109 million.

"IT WAS THEREBY ABLE TO INCREASE ITS REVENUE IN THIS SEGMENT **OVER THE PAST FIVE YEARS FROM** €174 MILLION TO €400 MILLION."

Cashflow: Not much left after CAPEX

When examining the cashflow statement one must realise that the aforementioned growth came with a price. Over the past years, the organisation consistently achieved an operating cashflow of approximately €70 million which was, however, almost completely wiped out by investments. Even after adjusting minor investments, the average investment level remains at about €40 million for the past few years.

This high level of investment evinces itself in a corresponding rise in the capital intensity ratio, which is a measure of how much capital is tied up in generating €1 in revenue. For Gerry Weber, this ratio has nearly doubled over the past five years, going from €0.20 to €0.37. The transition from wholesaler to retailer has been less evident in the company's profitability and much more salient in its increased level of investment and accompanying balance sheet expansion.

Hindered by high CAPEX, Gerry Weber's free cash flow is approximately €30 million, far too low to justify a market capitalisation of €1.5 billion, which is where the company was valued when we first started looking at it earlier this year.

It was clear that there was a lot of fantasy about the company's future priced into the €34 share price at that time. Company statements supported this rosy picture, as the company stated it expected retail store space to grow by 10%, that the retail segment should account for 60% of total revenue by the year 2020 and the EBIT margin should expand to 15%. Even though the company was able to explain how these goals should be achieved, one thing was clear: if anything were to go wrong in this process, there stood the potential for a significant loss. For us at Paladin the ice was too thin with this potential investment for us to consider walking on it.

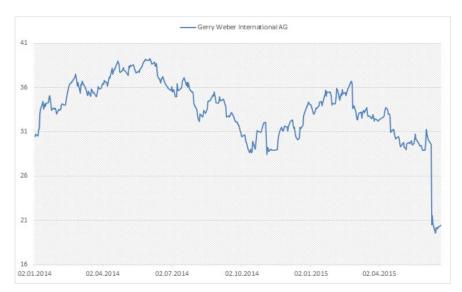
Post-Profit Warning Price Drop Excessive

At the beginning of June the ice cracked when the company put out weak quarterly numbers accompanied by a profit warning. Revenue only met guidance due to growth via acquisition, on comparable basis revenue actually declined by 7%.

The wholesale segment was particularly weak, with a revenue drop of over 10%. Increased inventories among core clients led to lower order volumes. The fall of the Russian Rouble put further pressure on earnings, as revenue in Russia fell by almost 15%.

The retail segment saw a decline as well, though its 4.6% fall can be almost entirely attributed to an overall market decline of 5% for the period. Operating profit fell by almost 40% for the quarter, and the EBIT margin was halved to 7.8%.

With this report the share lost 30% of its value in a single day, falling all the way to €20. The overly-optimistic expectations that were previously priced into the share quickly evaporated; moreover, our valuation models show that today's market valuation implies an expectation that the company will never again be in a position to sustain an EBIT margin over 10%.

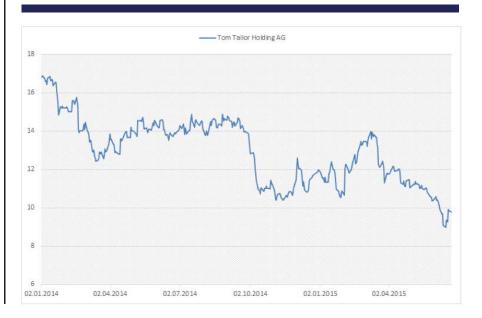


Given that Gerry Weber has regularly achieved an EBIT margin over 12% over the past few years, the market reaction to the profit warning appears to be overdone. Regardless, our opinion is that further caution is necessary, since as a general rule a hit like the one Gerry Weber is currently taking seldom resolves itself within one quarter. But one thing is clear: Gerry Weber has made a significant jump to near the top of our funds' watchlist.

Tailor's Valley of Tom **Tears**

Compared to the short-term hit that Gerry Weber has taken, another wellknown fashion retailer, Tom Tailor, has been slogging through the valley of tears for a number of years. Both companies earn similar revenues. But while Gerry Weber sacrificed €900 million worth of market cap at the market's alter during its recent swoon, Tom Tailor currently has a total market cap of only €250 million.

"GIVEN THAT GERRY WEBER HAS REGULARLY ACHIEVED AN EBIT MARGIN OVER 12% OVER THE PAST FEW YEARS, THE MARKET REACTION TO THE PROFIT WARNING APPEARS TO BE OVERDONE.



The reason for this is a deep-seated profitability problem at Tom Tailor. The company consistently achieves operating profit far below that of Gerry Weber, as was the case last year when Tom Tailor earned only €33 million, compared to Gerry Weber's robust EBIT of €109 million. As stated above, this happened with both companies earning approximately the same revenue.

While Gerry Weber earns about €76 million more EBIT on the same revenue as Tom Tailor, it is interesting to note that Gerry Weber's superior profitability comes not from superior branding. Thereby Gerry Weber's gross profit (revenue less production costs) of €531 million is only about €25 more than that of Tom Tailor.

Thus there remains a further difference of €50 million between the two companies' operating profit, which is accounted for by Tom Tailor's problems in controlling costs. Tom Tailor needs more personnel compared to its peers and has higher rental costs, both of which serve to put pressure on margins. Put another way, Tom Tailor earns less per square metre of retail space, resulting in substandard productivity.

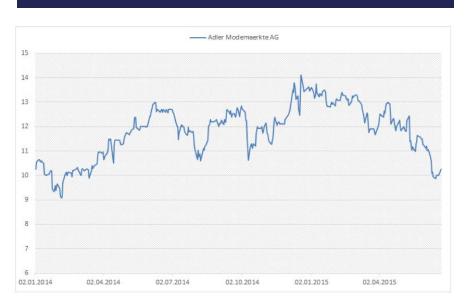
In the past few years, Tom Tailor has had an average EBIT margin of only about 3%, compared to a margin of 12% in a normal year for Gerry Weber. The market is thus wary of Tom Tailor, which naturally weighs on the company's valuation.

Weakness Offers Great **Opportunity**

Depending on one's perspective, this weakness can also be seen as an opportunity. If it is possible for the company to sustainably improve its productivity per metre of retail space, it will reflect almost immediately in operating profit due to a high fixed cost base.

In the past quarter, despite adverse overall market developments, Tom Tailor grew revenue at 4.2% (adjusted for store space), though this growth was helped by a low basis for comparison on

"THE CURRENT VALUATION OFFERS SIGNIFICANT **UPSIDE POTENTIAL IN THE EVENT THAT TOM TAI-**LOR IS ABLE TO GET ITS REVENUE PER STORE SPACE MOVING IN THE RIGHT DIRECTION.





the part of Bonita. Regardless, one should not underestimate this development. The current valuation offers significant upside potential in the event that Tom Tailor is able to get its revenue

per store space moving in the right direction. We remain cautious with this investment, as there are still too many "ifs" and "whens" tied to it to allow us to feel comfortable.

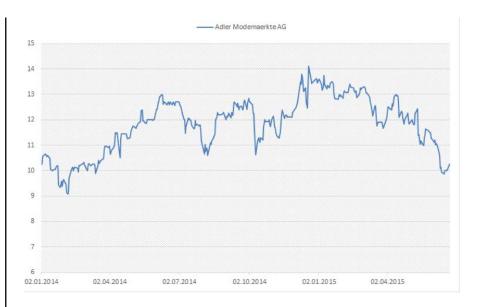
Adler is Boring... and Attractive

The situation at Adler is entirely different. The company operates in one of the most boring segments of the fashion industry: low-price, low-fashion, low-trend. The target demographic is consumers 45 years old and above. Adler sells its products not in modern shopping malls, but rather in large, simple stores located in industrial parks on the outskirts of large cities. The company follows this approach diligently and successfully.

What makes Adler special is that it enjoys an incredibly loyal customer base, with more than 90% of revenues coming via the Adler Client-Card. The typical Adler shopper is a repeat visitor over many years. Further, the company knows each client and his/her shopping habits and preferences so well, that it is able to engage in very precisely targeted marketing campaigns.

Adler currently has about 170 stores and plans to open about five new stores each year. This is moderate, organic growth that can be well managed and is lowrisk. Furnishing a new store is surprisingly low-cost given store size, which serves to keep Adler's level of investment relatively low.

Adler's acquisition strategy is also more predictable than that of its competition. Whereas Gerry Weber recently acquired Hallhuber (Revenue > € 100million) and Tom Tailor still needs to digest its acquisition of Bonita (Revenue > €150million), Adler recently acquired clothing



provider Kressner with an estimated €20 million revenue.

Compared to the other two companies, Adler has achieved average free cashflow of close to €26 million over the past few years, which is consistent with the company's current market capitalisation of €185 million and enterprise value of €240 million. Thus, the company's net cash position increases every year, and a steady dividend yield of 5% makes the company all the more attractive.

Conclusion

High risk with huge potential for Tom Tailor, the chance for a speedy recovery from its lows with Gerry Weber, or simply solid consistent cash generation on the part of Adler? One can find a reason to buy any of the companies we covered above. At Paladin, capital protection and growth are our overarching aims. Even in markets such as these, which have

made steady gains since the beginning of the year, we prefer to be defensively positioned. For this reason we tend to favor boring old Adler compared to Tom Tailor or Gerry Weber, since companies that can generate cash at an attractive level in comparison with their market valuation have proven over time that they seldom wind up worth nothing.

"WHAT MAKES ADLER **SPECIAL IS THAT IT ENJOYS AN INCRED-**IBLY LOYAL CUSTOMER **BASE, WITH MORE** THAN 90% OF REVE-**NUES COMING VIA THE** ADLER CLIENT-CARD. THE TYPICAL ADLER SHOPPER IS A REPEAT VISITOR OVER MANY YEARS."

About Paladin

Paladin Asset Management originated as the family office for the Maschmeyer family. Based in Hanover, the company began offering public funds in 2013 in order to allow outside investors access to the investment methodology previously only available to the family. Rooted in traditional value investing philosophy, Paladin's approach relies on proprietary techniques and a conservative approach to achieve steady long-term capital appreciation, making use of expertise in special capital markets situations such as take-overs and spin-offs, among others, to augment returns.

Led by two management board members, Dr. Peter Schömig and Matthias Kurzrock, who boast a combined 40 years of investing experience, the company currently manages its first fund, Paladin ONE, which applies the company's value investing approach to small and mid cap equities in the German, Austrian and Swiss markets.



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ARE LITIGATION FINANCE INVESTMENTS DIVERSIFICATION TOOL?

BY FILIPE R. COSTA



"To reduce risk it is necessary to avoid a portfolio whose securities are all highly correlated with each other. One hundred securities whose returns rise and fall in near unison afford little protection than the uncertain return of a single security." - Harry Markowitz, 1968

Early Days of Modern **Portfolio Theory**

The year was 1952. Three years before receiving his PhD in Economics, Harry Markowitz developed an asset allocation model that would revolutionise our perception of the importance of risk. Up to that day, investors only cared about returns. But within the new HM framework (the Mean-Variance model as it became known), assets would be chosen depending on their risk-reward characteristics. The introduction of standard deviation (or variance) into the decision process allowed Markowitz to prove that it is possible to diversify risk by adding assets together in a portfolio, as long as they are not perfectly correlated. The rationale is relatively straightforward: if you have two assets and mix them together, the expected return on your portfolio is a linear combination of the individual returns; but, as long as they

aren't perfectly correlated, portfolio risk is a less than perfect combination of individual assets' risk. That means you have just reduced risk.

Markowitz gave risk a key role in portfolio management. Even a naive strategy of adding assets for the sake of it would be enough to completely (or, at least, significantly) reduce the specific risk that is related to each individual asset. When the portfolio is well diversified an investor ends with just systematic risk, which, until now, no one could find a solution to eliminate. Then the Capital Asset Pricing Model (CAPM) was developed and for many years it was believed that the return on any security is a linear function of the market return. The only reason why the expected return on a given security (or portfolio) is higher than the market is because its beta is higher than one. A higher return is only achievable though higher beta, which means higher risk.

The results given by the Markowitz Mean-Variance theory and the CAPM are frustrating for portfolio managers. Any fund manager achieving higher than market returns is incurring higher risk; the riskadjusted returns are not any better. So, instead of spending money in a 2-20 fee structure, an investor would be better off just splitting money between a market portfolio (like the SPY ETF) and Treasury Bonds. He could buy the ETF on borrowed money (shorting the Treasuries) and achieve the same kind of returns hedge funds do, with less risk...

In fact, theory is based on many unrealistic assumptions and markets are not always efficient, such that there is a way to beat the CAPM. But it is also true that most of the time active portfolio managers don't beat the market. As an example, look at what happened during the financial crisis. Almost all hedge funds, no matter how selective they were, ended losing money along with the wider market.



"THE RESULTS GIVEN BY THE MARKOWITZ MEAN-VARIANCE THEORY AND THE CAPM ARE FRUSTRATING FOR PORTFOLIO MANAGERS. ANY FUND MANAGER ACHIEVING HIGHER THAN MARKET RETURNS IS INCURRING HIGHER RISK."

Then they recovered with the market. This in fact gives credit to the CAPM: most hedge funds are leveraged bets on the market. All they get is Beta, not Alpha.

Seeking Truly Uncorrelated Assets

A leveraged bet on the market is not magic but rather financial engineering. What we really need is to find some uncorrelated assets. Sharpe, Mossin, Lintner and Treynor were all credited with the development of CAPM, but none of them said you must stick with the S&P 500 or the FTSE 350. You can also invest in real estate and land, or in government bonds. And for those that want to go the extra mile, why not invest in life settlements or catastrophe bonds. There is also the world of water rights in Australia, and museum art, and pottery elsewhere. Oh, and why not adding the finest French wine (turn to page 58) and Scottish single malt, or even some high-end violins. Unlike the time of Markowitz, when just two asset classes were known (stocks and bonds), we now have so many other asset classes, to the extent that sticking with bonds and stocks is like driving an Aston Martin in first gear. If you have a 6-speed gearbox, why not use it? In finance, as long as there are varying cash flow outcomes and a distribution of probabilities can be assigned to them to quantify the upside potential and the downside risk, there is a trading/investment opportunity.

A key concept in diversification is correlation. In a globalised world it is ever more difficult to find assets with beta around zero. The latest financial crisis showed how risky a diversified portfolio in fact is and how difficult it is to avoid the market downtrend. This suggests a need for assets that are uncorrelated with the market and that are not heavily exposed to the business cycle, to interest rates, and to general turmoil. All assets mentioned above may offer a reduced exposure to such risk.

Litigation Finance as an Asset

What about if a legal claim could be treated as an asset, an investment asset? Wine, scotch, pottery: all seem a little correlated with the business cycle. But a legal claim doesn't sound likely to bear much market risk.

The world of litigation finance is not new. There are many companies and specialty investors that from long ago finance plaintiffs in exchange for a return. They're not exactly lending money as their activity involves bankrolling plaintiffs (or plaintiffs' lawyers) in exchange for a slice of the lawsuit's potential winnings. They may advance money to pay for legal fees and then collect a return if the court decision is favourable. Litigation finance treats legal claims as financeable assets. These assets aren't much different from real estate and receivables.

Third party litigation finance, as it is often referred to, originated in Australia. The main idea is very simple: an investor puts money into a third party's litigation for a return. If the case is won or settled, the investor receives a return on his money. If the case is lost, then an investor loses his money.

However, some argue that this procedure increases conflicts and increases the number of lawsuits. They additionally claim that it expands the average number of years to solve cases, as investors push for big settlements. They finally add that there is no added value to plaintiffs, as they have easy access to justice and can always hire an attorney on a contingency fee basis.

There are many lawsuits that oppose unequal sides. The latest John Grisham novel, Gray Mountain, explains very well why many meritorious claims are left unresolved or prematurely settled when there is an abysmal financial difference between the plaintiff and the defendant. In Grisham's fictional world, plaintiffs are coal miners who acquired black lungs after a prolonged exposure to coal dust; while the defendants are multi-million dollar coal companies able to hire a dozen of the highest paid specialised litigators and pay them uninterruptedly for years if needed. It is hard to believe that a coal miner could pay the legal fees under these conditions. Many litigators wouldn't accept working on a contingency fee either, as such prolonged cases are a huge drag on funds for many years. The risk is that they would be bankrupt before the case is settled.

With the above in mind, one could say that litigation finance has a strong favourable impact, as it is a kind of insurance. It solves the problem of unequal financial resources providing funding for the weakest part, whenever theclaim is meritorious. In doing so, it removes the unfair advantage money gives to the wealthy defendants. Regarding additional issues, in general, the financiers do not interfere with the case. They usually have a team of law experts and investment bankers to carefully select the cases they believe are worth financing, but they don't interfere with the counsellor. They of course require this to be someone experienced within that particular field and with an exceptional track record, as this is key for the success of the case (and indirectly for the return investors make), but they don't interfere with the rest.

While litigation finance offers new opportunities to plaintiffs, it can also provide the diversification an investor is seeking for. The best companies working on litigation finance are able to carefully choose the cases with the highest probability of success, thereby providing high returns for investors at very low betas. In other words, this asset class can provide investors with the much envied alpha.

How to Play the Game

One of the first companies to specialise in litigation finance is the ASX-listed IMF Bentham. The company has generated more than £185 million in net income and £813 million in total income since inception, while spending only a total of £111 million. From the 169 cases in its portfolio, 113 (67%) were settled without the need for a judgement and the company won 15 of the 21 cases that ended with a judgement. These data clearly show that cases are very carefully chosen to maximise the winning probability and add to the idea that the leverage applied via litigation finance in fact speeds up the resolution process (against the claims of the naysayers). The average funding duration for its entire portfolio is 2.3 years, which isn't much for investors seeking medium to long term returns.

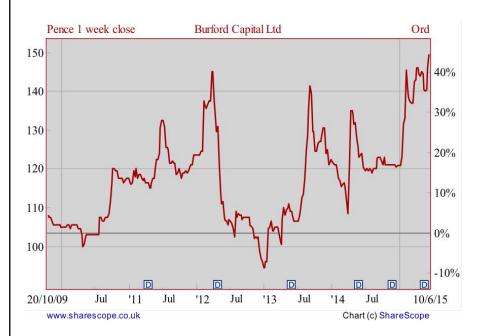
In the UK, investors looking to diversify into litigation finance may wish to take a look at Burford Capital. The company was founded by Chris Bogart and Jon Molot in 2009 and is listed on the London AIM market. Burford pays dividends and currently has a very respectable dividend yield of 3.6% on a P/E of just 10.5x. For those seeking a mix of capital appreciation with income, this equity offers a good opportunity.

While all of the above represent good ways of diversifying a portfolio, my favourite asset is Juridica Investments. This is an AIM listed close-ended investment company that invests in claims across three different groups: antitrust and competition, patents and intellectual property, and commercial. The fund was admitted to AIM in December 2007 at a price of 100p. Until today the fund has already paid out 58.6p in dividends. For the period between December 2007 and June 2015, the fund shows an annualised total return (price plus dividends) of 7.5% on a 14.4% standard deviation. This compares with 4.9% return and 20.9% standard deviation for the FTSE 100. Unlike the FTSE components, the exposure to the business cycle is very low for Juridica, which allows for the steady payment of dividends while providing capital appreciation over the long-term.

Another option to invest in litigation finance is through committing funds to specific cases through the platform Lexshares. The website presents investors with a set of lawsuits that need to raise funding. The cases are pre-selected by a specialty team but the last word regard ing which cases to invest in comes from the investor, who may choose from the portfolio of possibilities. This may be

IMF BENTHAM	- COMPLETED CASES	(OCT 2001 TO DEC 2014)
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Outcome	Nr. Of Cases	% of Total	Total Income Generated (M£)	Total Expenditure (M£)	Income Attributtable to Funded Clients (M£)	Income Attributtable to IMF (M£)	Net Income	Average Funding Duration
Settled	113	67%	731.91	86.17	473.05	258.9	172.69	2.61
Judgements - Won	15	9%	81.10	14.19	43.58	37.5	23.33	2.57
Judgements - Lost	6	4%	0.00	8.31	0.00	0.0	-8.31	2.55
Withdrawn	35	21%	0.12	2.44	0.00	0.1	-2.32	1.32
Total Portfolio	169	100%	813.13	111.11	516.63	296.50	185.38	2.34
COLLDCE: IME BENTHAM I	IMITED							



Juridica Vs FTSE 100 20-Dec-07 to 11-Jun-15

	Total Return	Annualised Volatility
Juridica	7.53%	14.48%
FTSE 100	4.86%	20.93%

a good option for investors with better knowledge of legal matters and with a more diversified portfolio. Others would probably be better served through buying a fund like Juridica and allowing it to select a portfolio of cases, instead of looking at cases on a one-by-one basis.

Final Remarks

As Markowitz puts it, "One hundred securities whose returns rise and fall in

near unison afford little more protection than the uncertain return of a single security". Now more than ever, investors need alternative ways to diversify; simply adding equities from the S&P 500 in varying proportions is not enough anymore. In that case, you're really better off buying the SPY ETF and spending the spare time with family instead of trying to outsmart the market.

IS ALL PUBLICITY GOOD PUBLICITY?

BY ADRIAN KEMPTON-CUMBER



They say all publicity is good publicity. So was it the smug lyrics of "The One and Only" that killed Chesney Hawkes' barely started career? The only person I knew at the time who didn't think Hawkes was a dick was also in the cast of Buddy's Song, the movie the song came from, starring Hawkes.

Perhaps now the None and Only, Hawkes is still gigging. Playing circuit venues like the Half Moon in Putney and Pizza Express' Pheasantry in Chelsea. Decent enough gigs, but not where you'd expect to find the artist who held the number 1 slot in 1991 for no less than five weeks. I bet he wishes he'd written the song, but that was Nik Kershaw. In any case it's taking a long, long time to get back in the spotlight.

While Chesney was riding high with his song at number 1, and Buddy's Song was in cinemas and doing quite well, there was another debacle about to take place in a much more explosive manner. At the Royal Albert Hall on April 23rd Gerald Ratner addressed the Institute of Directors. He was to utter a phrase that would wipe £500m off the share value of his eponymous company, Ratners. This in turn would lead to his dismissal as a director and the company to change its name to Signet.

For those of you too young to remember, Ratners was a cheap jewellers. They sold incredibly cheap stuff and people lapped it up. At the RAH Ratner said in his address:

"We also do cut-glasssherry decanters complete with six glasses on a silverplated tray that your butler can serve you drinks on, all for £4.95. People say, "How can you sell this for such a low price?" I say, "Because it's total crap."

"IT REMINDS ME HOW **MUCH I ENJOYED THE RECESSION OF 1991. IT** WAS LIKE A CHANCE TO CATCH UP A LITTLE WITH THE BABY BOOM-**ERS FOR THOSE OF US** YOUNGER THAN THAT **DEMOGRAPHIC."**

You can see the whole speech - and do watch it because it's brilliant: https:// youtu.be/Nj9BZz71yQE. It reminds me how much I enjoyed the recession of 1991. It was like a chance to catch up a little with the Baby Boomers for those of us younger than that demographic. A proper recession is great unless you're lazy, with more opportunities than you can poke a stick at.

Signet still exists but it's nothing like

the household name it once was. It does have High St brands though, like H Samuel and Ernest Jones. As you can see from the chart it took until 2009 for it to really take off. The share chart looks pretty good, with the last few years almost entirely above the Ichimoku cloud (i.e. bullish). There is a rather toppy MACD, and it has become a little volatile. It took years to produce decent share price growth though.

Signet is presently registered in Bermuda by the way. I presume that's for tax purposes, although I should add that the company has paid over £100m in tax in each of the last three years. Companies are of course obliged to keep a lid on their tax bills. In turn they appoint accountants who are obliged to mitigate their clients' tax liabilities, using any legal methods available. In other words tax loopholes are a failure in government policy, and reducing a corporate tax bill by using them is not some sort of abuse, it's sound business practise, and companies ultimately have a fiduciary responsibility to shareholders to exploit these loopholes where they exist.

I was disgusted to hear comedian Jimmy



Carr's name mentioned in the House of Commons, criticising his perfectly legal tax affairs. He was literally mentioned for NOT breaking the law. He's on a British tour for the rest of the year and seems to have fared better than Chesney. Sadly, you can't buy shares in Jimmy Carr, so how about Starbucks then?

Starbucks hasn't paid any UK tax since, well, more or less ever it seems. They basically export their profits to a more favourable tax regime. A bit like when you get a friend to bring back duty free stuff for you. In their Annual Reports they refer to the number of stores in different territories in some detail, but with the financial numbers they are less specific. Non-US business is 64% made up from the UK, Canada and China. Using the number of stores as a metric we can determine that the UK is probably around 7%-8% of Starbucks' total revenue. So whether a problem here in the UK could significantly affect the parent company, and thus the share price, is debatable.

Thinking that our government - indeed any and all governments - don't negotiate large corporate tax bills behind closed doors in order to keep companies sweet, and above all, keep them providing jobs in domestic markets, is naïve. It's a competitive world out there. The unstoppable rise of unemployment is not going to be stemmed. In a generation from now, my off the cuff guess is about 25%-30% permanent unemploy-



"REDUCING A CORPORATE TAX BILL BY US-ING THEM IS NOT SOME SORT OF ABUSE, IT'S SOUND BUSINESS PRACTISE, AND COMPANIES **ULTIMATELY HAVE A FIDUĆIARY RESPONSI-**BILITY TO SHAREHOLDERS TO EXPLOIT THESE LOOPHOLES WHERE THEY EXIST."

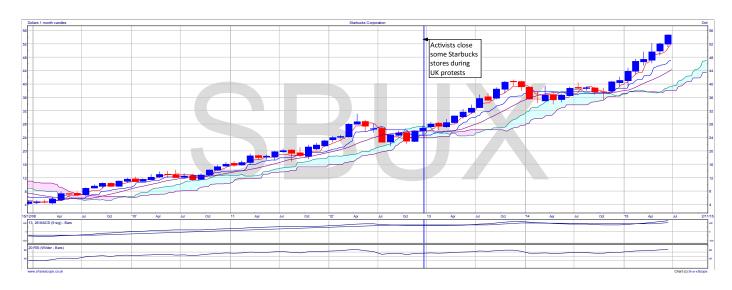
ment in all developed economies due to jobs being done by machines/robots. For the time being I'm willing to bet most governments think jobs are of more value politically than corporation tax. You've only to look at Ireland where their low

rate of corporation tax continues to attract lots of companies, i.e. jobs, and how hard they fought to keep it when they were negotiating rescue packages with Germany... err... I mean the EU.

A quick look at the Starbucks chart shows that the protests in the UK, whist they may have affected the UK revenues somewhat, have certainly had little or no impact on the share price. The same is true for Vodafone. In each case I've marked the month in which the protest took place, regarding that as the 'highlight' of any dissent.



"FOR THE TIME BEING I'M WILLING TO BET MOST GOVERN-MENTS THINK JOBS ARE OF MORE VALUE POLITICALLY THAN **CORPORATION TAX."**



What about the 'News of the World' phone tapping scandal then? I mean people actually went to jail over that. And at the heart of it all was Murdoch's News Corporation. This did have at least short-term negative effects on the company. The NOTW was removed from publication, and in 2012 the company was split up, presumably to make it hard for me to write about them in this article.

One thing we do know about News Corp in terms of CT is that they paid \$202m four fiscal years ago, but have since paid none, instead claiming hundreds of millions in so-called 'tax benefits'. There are all manner of items which may or may not be a bit accounting 'art'. Their Financial Report is a hard read too more notes than the Flight of the Bumblebee.

I have to conclude I don't know how much the scandal has affected News Corp (and Fox, which was the other spin-off from News Corporation after the scandal). It's hard to see anything at a glance. We can look at the two share charts though. News Corp has retraced from its highs to a support level at 14.25 and is knocking on the door of a further fall. It's quite a trending stock so if it fails here I'd expect a decent drop.

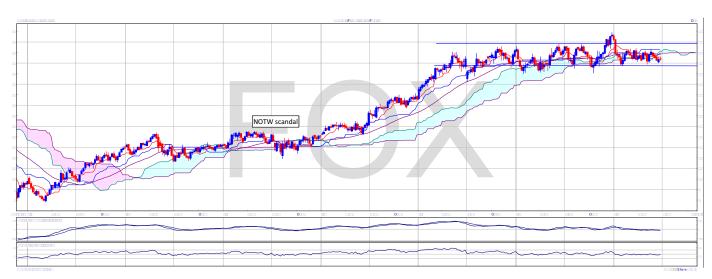
NEWS THE WORLD

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Certainly to the 50% retracement level of around 13.50 and probably a lot further. Just looking quickly at the Fox share chart, it looks very interesting. For about two years now it's been flat-lining in a range, following a one year move up. I would expect to see a measured move here when and if it does break upwards, so that would give a target of \$52. A move down should be significant too – say \$25. One to watch...







McDonalds have hardly seen a decline following the release of Supersize Me, the movie that showed how unhealthy you would be if you just ate at McDonalds 'restaurants' and followed their suggestions. Another interesting chart – similar to Fox, and much as I hate breakouts, this could produce a big move whichever direction it breaks out of this almost three year congestion.



Associated British Foods, owner of Primark, don't seem to have been affected by either positive or negative news, with the possible exception of the Penneys hoax 'SOS note' story, Penneys being the Irish Primark. I've marked the stories on the chart's timeline.



I wish I could say buy on bad news, like you can with property and blood running in the streets, which remains a winner by the way. Instead it's probably irrelevant. Yet another reason to regard the news as noise!



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THE FINE WINE MARKET

EVIDENCE OF STABILITY AND REASONS FOR GROWTH

BY MILES DAVIS



In my last article for this publication in February I outlined the journey the fine wine market has been on historically, but most importantly where it has travelled in the last ten years, the most extraordinary period of time this market has ever witnessed. In this piece I suggest where it may be off to next.

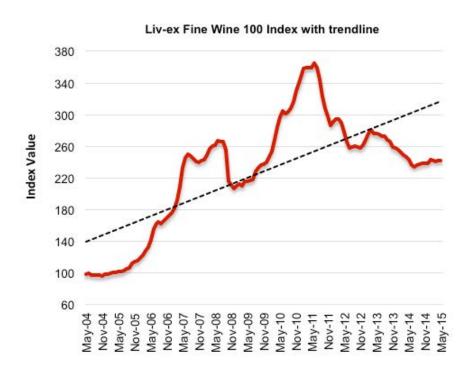


The chart to the right maps the industry benchmark index, the Liv-ex 100. Livex, standing for London International Vintners Exchange, is an independent fine wine exchange for professional wine traders and the only truly independent source of quality fine wine data. The 100 index represents the price movement of 100 of the most sought-after fine wines on the secondary market. It is easy to see how far below the long-term trend line the market is currently trading. Obviously the trend line guarantees nothing, but following a 36% correction from mid-2011 and mid-2014 and a year of price stability since then, there appears to be little downside to this investment case.

"THE BEST PERFORM-ING WINES WERE ACTU-ALLY THE LOWER QUALITY, SECOND WINES PRODUCED BY THE TOP CHATEAUX, AS THESE ALLOWED ACCESS TO THE GREATEST BRAND NAMES AT A FRACTION OF THE PRICE OF THE FIRST WINES, "

Following the rise and fall brought about by 'The Red Obsession' (this was actually the title of a documentary film on the subject!) in China, prices are behaving more along the lines of what we would expect and indeed how they used to behave.

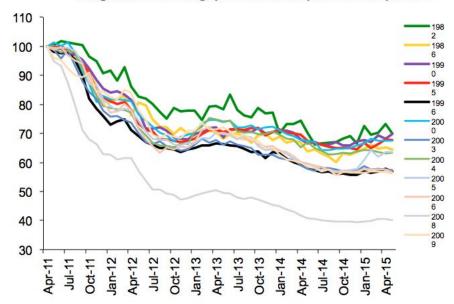
During the boom, old fashioned principles of wine buying went out the window. The list of criteria for wine selection changed from the quality of each wine, the brand, the vintage and how old it was (and therefore the assumed rarity) to purely the brand and the lowest possible price for which the brand was attainable. Larger volume was also preferred, again reversing previous logic. Probably the first consideration any connoisseur would make would be the quality of the vintage, but this did not matter one jot to the new breed of wine buyer.



The best performing wines were actually the lower quality, second wines produced by the top Chateaux, as these allowed access to the greatest brand names at a fraction of the price of the first wines. Carruades de Lafite, the second wine of Chateau Lafite, outstripped all others. I am glad to say this period of history is closed and there are good early indications of the old order returning.

On this theme, it is interesting to note that during the correction the best performing vintages amongst the first growths were 1982 and 1990 - the most mature of the very best vintages from the last thirty years. (See chart below. Some of the lesser quality vintages have been stripped out.)

First growth claret vintage performance comparison since April 2011



As part of the capital market discipline we employ in our research we look at the 'Vintage Curve', which functions rather like the yield curve but with Bordeaux vintages of similar quality rather than bonds. For the Vintage Curve for the outstanding vintage category we looked at the average price of first growths from 1982, 2000, 2005, 2009 and 2010. Older vintages are more scarce and therefore one would expect a downward sloping chart where older vintages feature first, as below. Over time we expect to see a shift upwards in the curve as prices increase, as evinced in the chart to the right.

We singled out 2005 as the best value vintage in this category, evident in its position on the Vintage Curve as well as for other reasons, explained below. Since the summer of 2014 the older vintages have started to shift upwards, notably 2005. The youngest vintages (2009 and 2010) have not moved as there is still ample supply. 2010 in particular, which is a powerful, tannic vintage will take longer to mature than 2009, and remains relatively over-priced. Again, this would indicate a semblance of normality has appeared in the market.

If we assume this analysis is correct and with all else being equal, it is safe to assume the long-term fundamentals of decreasing supply of highly sought after wines will start to play out and prices will begin to gradually increase once more. If western economies continue to improve and there is a reversal of fortunes in the emerging markets, marginal demand will be created. This would test the supply side of the equation and it would be interesting to see how inelastic it may become; after all, the boom sucked a lot of stock out of the market at a much faster rate than we have ever witnessed before.

In the past, wine prices have benefited from the first release of a superior vintage. This creates a focus which brings wine back onto the radar for consumers and speculators. The market reacts positively, phones start ringing and emails

First Growth Vintage Curve - "outstanding" vintages

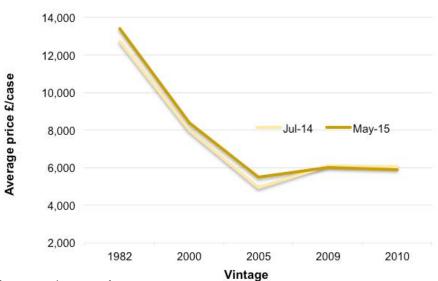


Chart sources: Liv-ex.com and WAM LLP.

start flying around. People get involved because people like a taste of the best and enjoy the hype. As en primeur is largely dead, at least for now, owing to the over-pricing of young wine, a new focal point is needed. Inadvertently the all-powerful 'Nose of Baltimore', Robert Parker, the world's most influential wine critic, may be about to provide one. Mr Parker recently announced his retirement form tasting en primeur but will continue to score in bottle wines, at age 3, and has stated he will revisit the 2005 vintage, now aged 10. For whatever reason - and this is universally accepted - Parker originally underscored the outstanding 2005 vintage and will very soon be posting his updated scores. Given a recent re-rating of Chateau Mouton Rothschild 2005 from 96 points to 99+ and his attached comment "the greatness of this vintage is increasingly apparent as the wines throw off their cloaks of tannin", we would not be surprised to see a broad-based re-rating and much adulation. Incidentally, the price of Mouton '05 increased by 20% in short order.

In summary, there is enough evidence to suggest the wine market will return to its time honoured fashion of steady returns, set against low volatility. Older quality vintages from 2000 and beyond look set to outperform over the longer

term while it would come as no surprise if there was a short term jump in some 2005 prices.



"AS EN PRIMEUR IS LARGELY DEAD, AT LEAST FOR NOW, OWING TO THE OVER-PRIC-ING OF YOUNG WINE, A NEW FOCAL POINT IS NEEDED. **INADVERTENTLY THE ALL-**POWERFUL 'NOSE OF BALTI-MORE', ROBERT PARKER, THE WORLD'S MOST INFLUENTIAL WINE CRITIC, MAY BE ABOUT TO PROVIDE ONE. "

CURRENCY CORNER

BY SAMUEL J. RAE



Those of you reading this that are familiar with my trading, and those who follow along with my blog at Diary of a Currency Trader (www.diaryofacurrencytrader.com) will be all too aware that over the last few weeks - a number of us in the community have had some difficulty with a particular brokerage.

While I won't mention the name of the brokerage in question or of anybody who is involved with the company, I will say that it was run by someone I considered a close friend and the core team that made up the operational side of the brokerage I knew very well as both traders and on a personal level. To cut a long story short, the brokerage was recently delisted and a number of its clients lost capital, me notwithstanding.

Well, for me, luckily, the loss was far from terminal, as I mitigate the risk across a number of brokerages to shield against exactly this sort of thing. There are a number of individuals however that will not be able to recover, and will have to start again from scratch, if at all. So, with that said, I thought it a perfect

opportunity to run through a few of the key elements I'm looking for as I hunt for a new brokerage - and hopefully in doing so, I can help readers avoid a similar experience.

As a quick aside, you may be saying, well, if Samuel found himself in this situation, who is he to be giving us advice on how to avoid it? Well, as I mentioned, the individuals involved have been close friends of mine for a number of years and I assumed this allowed me to overlook some of the inherent risks that come with a young brokerage. I now know that was wrong, but I hope it offers you some insight into how and why I find myself on the wrong end of a bad situation. So, anyway, let's get to it.

First up, and most importantly, is regulation. This should go without saying, but you would be surprised how many people either overlook or do not delve deep enough into whether, or where, the brokerage they are looking at is regulated. Different geo-locations offer regulatory services on different terms, and some are much more lax than others when it comes to foreign exchange. There are two things to consider here. The first is the reputation of the regulatory authority in question. Does it have a tight grip on the industry? Is it easy for a new brokerage to receive regulatory approval, or is it something that must wait months or years to receive?



"A NUMBER OF BROKERAGES WILL REGISTER SHELL COMPANIES IN THE JURISDICTION OF THEIR REGULATORY AUTHORITY, WHILE OPERATING FROM ANOTHER COUNTRY ALTOGETHER. THIS IS A RED FLAG AND SHOULD TURN YOU OFF TO ANY POTENTIAL ACCOUNT OPENING."

As an example, two of the top global authorities are the Financial Conduct Authority (FCA) in the UK and the Australian Securities & Investments Commission (ASIC). There have been numerous occasions on which both of these authorities (or the FSA in the UK, as the FCA was previously known) have pressed charges against fraudulent behavior in the foreign exchange industry. This is what we should be looking for.

The second key point is that you want to make sure that the broker is headquartered (and is actively operating out of) the country in which its regulatory authority has jurisdiction. You must look closely. A number of brokerages will register shell companies in the jurisdiction of their regulatory authority, while operating from another country altogether. This is a red flag and should turn you off to any potential account opening.

The next thing I'm looking for is a smooth deposit and withdrawal process. Fully compliant brokers will always

segregate funds. This means that the deposits received from clients are placed and stored securely in a completely separate account from that which the brokerage in question operates on a daily basis. This ensures that when it comes to depositing and withdrawing, there are always enough funds to pay out what is owed. All too often the demise of younger and less reputable brokerages comes about as a result of funding daily operations with deposits. It's hard to believe, but it happens. Don't be fooled.

Deposits – depending on method, obviously – should be quick; instant for electronic methods such as credit card or PayPal and no longer than three or four days for wire transfer. Similarly, withdrawal speeds should match deposit speeds. This is important. The delaying of withdrawals in any brokerage is, once again, a serious red flag. Even if a client has abused his or her position – i.e. through swap abuse or scalping a brokerage that does not allow scalping – a reputable brokerage will close down his or her account and return the full

initial deposit with a warning. They can withhold profits, but not deposits.

Finally, don't be duped by bonuses and the promise of razor tight spreads. Large reputable brokerages do not have to offer percentage deposit bonuses or no deposit bonuses in order to gain clients. Further, if they offer low commissions they cannot afford to offer razor tight spreads, at least not sustainably. A combination of low commissions and razor tight spreads should always be a warning sign. If an incumbent is unable to offer these conditions despite the economies of scale that comes from being a large operation, an upstart brokerage certainly cannot.

Really, and as a final note, it all just comes down to common sense. We have the luxury of a huge resource of reviews and recommendations online, and serious consideration should be given to this resource before handing over hard earned capital, especially in the forex markets.

FUND MANAGER IN FOCUS

BY FILIPE R. COSTA



"We like to create value rather than merely identify it...if we just identify value, we can't make money unless the market moves the security in the predicted direction."

- Paul Singer

A Non-consensual Man

This month's hedge fund manager in focus has some peculiar characteristics that make him a tenacious eagle for some and a hateful vulture for others. Paul Elliott Singer likes to be known as an activist that creates value where it doesn't exist. Thirty-seven years of a stellar track record indeed corroborate his value-added claim. But, while creating value for his investors, Singer also leaves a trail of enemies along the way. Singer has been often criticised for his investment strategy and named as "the inventor of vulture funds" and a "financial terrorist", as he often buys junk debt in order to squeeze the juice from it in judicial battles against bankrupt issuers. At one extreme we have those who invest in Singer's funds, who have been

enjoying the peace of mind of higher than average returns at lower than average volatility over the long and short runs. At the other extreme we have the governments of Argentina, Peru and Congo-Brazzaville (just to name a few) who take Singer as "persona non grata" and most likely have his photo distributed across their borders for him to be kicked out as soon as he puts a foot inside their borders.

In a world where asset classes are highly correlated and where it is ever more difficult to beat the market portfolio, hedge funds are refining their tactics to attain the much sought-after alpha. Like central banks, hedge funds are using ever more unconventional strategies to achieve their targets.

Learning the Hard Way is **Always the Best**

Paul Elliott Singer was born in 1944 in New York. His father was a pharmacist and his mother a homemaker. He attended the University of Rochester, where he obtained a Bachelor degree in Psychology. Later, in 1969, he also obtained a JD from Harvard Law School. In 1979, he accepted a job as attorney in the real estate division of the investment bank Donaldson, Lufkin & Jenrette. By that time, Singer had already developed an interest in financial markets. He read many books on investment and in his spare time he tried a few different strategies with his own money. But, unfortunately for him, between 1968 and 1974 financial markets were affected by a few



odd events ranging from assassinations and riots, to political scandals, inflation, and the oil embargo; which culminated with bear markets in 1968-70 and 1973-74. None of his strategies really worked as desired and the money was lost.

While losing money is always unwelcome, it sometimes is a necessary step towards success. Only when an investor loses money does he realise that markets are a game where expected return is exchanged for risk. The unfortunate loss Singer took was eventually one of the most important ingredients for him to take a very conservative approach towards investment, one that is really market neutral.

Some of the actions taken by Singer during the 1970s were revolutionary and must be credited to him. At that time, almost no one knew what a marketneutral strategy was. But after taking the losses during the aforementioned period, Singer's attitude was all about risk management and being market neutral. At the same time, he revolutionised the short-selling trade. By that time, when a share was borrowed and sold short, the bank kept the proceeds as collateral while keeping any existing interest. This didn't allow for arbitrage and risk-neutral strategies. Singer and his first big client from the hedge fund he created in 1977 were able to persuade banks to act differently, such that it was possible for them to sell short shares while buying convertible bonds on the same share's issuer.

Elliott Fund Management

From his past lesson regarding risk management, and after seducing banks to allow for his arbitrage trade, Singer founded a fund management business. He created the Elliott Associates LP fund, which takes its name from Singer's middle name. He started with \$1.3 million from family and friends trading in the most conservative way possible via adopting a market-neutral convertible arbitrage strategy. The idea was to profit from price differences without incurring market risk. While a convertible bond is a portfolio of a non-convertible



bond plus a call option on the issuer's equity, it frequently traded below the value of these two separate instruments. In general, the embedded equity option was under-priced. With the correct ratio, it would be possible to keep a market-neutral strategy buying the convertible while selling the shares at the same time. Such a strategy is expected to achieve just moderate returns, but it hedges against the market risk. In fact, Singer achieved positive returns during 10 years and was even able to surpass the 20% mark in four of those years.

When we talk about markets we generally like to reference two separate things: one is the theoretical price for an instrument, the other is its market price. Both can deviate for long periods depending on the prevailing animal spirits that we simply don't control. In 1987 the market crashed. When that happens, investors quickly herd into the panic button, selling whatever they can. As Singer was short the shares while long the bonds, he was expected to be insured against just such a movement. But the liquidity in the convertible bond market is just a fraction of the same in the equity market, which interferes with the hedge trade. Under these circumstances, the price decline observed in the convertible market was more pronounced than expected and as a direct consequence, the loss in the convertible bond outpaced the gain in the equity short. Despite the unfavourable conditions, Singer was able to cut losses and end the year with a profit, but something changed inside his mind...

The 1987 crash along with the early 1990s crash made Singer rethink about how market neutral he really was. He decided it was time to move on and instead of waiting for the market to drive a profit to his portfolio he would create value by himself. "We like to create value rather than merely identify it" he stated, "if we just identify value, we can't make money unless the market moves the security in the predicted direction". The new strategy was to build value instead of waiting for it, which eventually would convert the fund into an activist one.

Activism or "Vulturism"?

Many hedge funds start with the least risky of all strategies - arbitrage. That was not only the case with Singer but also with John Paulson, just to give one example. Before Pellegrini joined Paulson for the "best trade ever" on the MBS market, he was investing in event arbitrage and merger arbitrage. But then, when money grows, greed always outpaces fear and fund strategies depart from arbitrage in the direction of real alpha (or leveraged beta). But unlike Paulson, Singer is very conservative. He never takes a leveraged bet and he always hedges everything. In the words of Lawrence Simon, founder of the New York-based Ivy Asset Management, Singer "is in the pantheon of risk-adjusted investment managers", which means that when departing from arbitrage towards a multi-strategy approach, Singer certainly has a plan to keep risks under control.

During the 1990s, Singer adopted a more activist strategy. He started investing in distressed companies and sovereigns, buying large chunks of debt on the cheap and then selling at a profit or suing the issuer for full payment. From that point on, his enemies grew in number as he was seen more as a vulture fund than a real activist.

An activist fund usually buys enough shares of a company to take some control and force management replacements or changes such that it can interfere with firm operations to unlock shareholder value. It may then ask for special dividend payment, share repurchases, liquidation of assets, sale of the company or capital structure changes. An example of this type of hedge fund is Bill Ackman's Pershing Square Capital. But what Singer and Elliot Management (the holding company that aggregates the whole business) were doing was not exactly unlocking value for shareholders, but rather extracting value from bankrupt companies after other bondholders had already lost their money and agreed on a renegotiation of bond terms. Singer was mixing his recently acquired financial knowledge with his law experience, to buy distressed debt at a few cents and then recover as much as possible, through a judicial battle if necessary.

In 1996 he spent \$11.4 million on defaulted debt from Peru, only to successfully sue the sovereign and extract \$58 million on his stake in 2000. Another successful episode occurred with the Congo-Brazzaville default. He bought a stake worth \$30 million and was paid more than \$100 million in interest in 2002 and 2003. In 2002, Argentina defaulted on its outstanding bonds. The country was in a bankrupt state. Singer bought the bonds for 6c on the dollar, spending around \$49 million for bonds with face value around \$830 million. Argentina offered to pay near 30c on the dollar for the defaulted debt but he didn't accept. He was seeking full payment for a profit of more than 1,500%. But this has been a tough litigation extending for many years, resulting in several delays not only between Singer and Argentina but between Argentina

and all other creditors. Singer led Argentina to a second default as he claimed he should be paid pari passu with other creditors owning the new debt resulting from the renegotiation, which prevented Argentina from paying the accrued interest. Argentina ended up being ordered to pay Elliott Management for its holdings but the country has been delaying the process. So far Elliott has been unsuccessful at collecting, despite having won the case in court. Argentina has condemned the attitude and claims that Elliott has harmed the prior bondholders only for the sake of extracting money through extortion. Argentina's

strategy is one of waiting for the majority of bondholders to renegotiate debt and accept a deal to then move and sue the country or company for full payment. When the dissenters are just a small percentage, the company or sovereign may decide on terms that are more favourable for this holdout group than for former bondholders. One can only consider such strategy as activist with a grain of salt.

Real Activism

More recently Elliott Management has expanded its business to take stakes



"IN 1996 HE SPENT \$11.4 MILLION ON DEFAULTED DEBT FROM PERU, ONLY TO SUCCESSFULLY SUE THE **SOVEREIGN AND EXTRACT \$58** MILLION ON HIS STAKE IN 2000."

president Cristina Fernandez de Kirchner recently even referred to Elliott and its fellow plaintiffs in the on-going litigation as "financial terrorists". This case was so extreme that in 2012, Elliott persuaded a judge in Ghana to hold the Argentine Navy ship "Libertad" in port until Elliot was paid the outstanding amount owed by Argentina. The ship was later released, without payment.

In general, if there is a debt renegotiation, then Elliot Management is most likely involved, as it was in the cases of Chrysler and Delphi. As always, the

in equities instead of distressed debt. It purchases shares in order to acquire sufficient capital to suggest changes to a company's operations. That has been the case with Interpublic, where Elliott was able to nominate two members to the board and push for a sale of the advertising giant. It has also been the case with EMC, where Elliott is forcing the company to spin off its VMware software virtualisation unit.

Another example of activism occurred with Juniper Networks, where Elliott was able to force the company to add a

few directors it nominated. It is also seeking for a few board seats on Family Dollar, an acquisition target which Elliott wants to force to reconsider a rebuffed buyout bid in order to drive more value to current shareholders. In June, Elliott acquired a stake worth 7.1% on Citrix and has been forcing the company to adopt several operational changes. In an open letter to the management, Elliott claimed that the multinational software provider could double its share value through operational changes. The company has been struggling over the last four years, having been clearly outperformed by its peers.

A Clear Outperformer

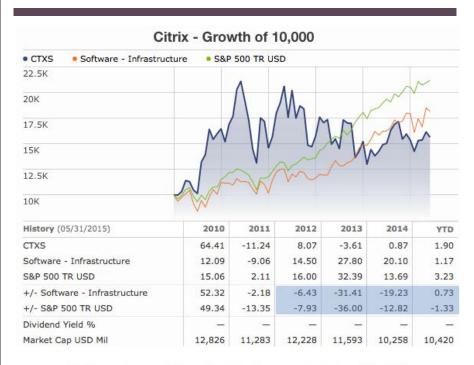
A hedge fund that lives on disputes with sovereigns and companies is certainly not the kind of business that everybody loves. In my own personal opinion, buying distressed debt at a few cents on the dollar just to force full payment thereafter is not exactly the activism that we usually know and love. When you wait for other bondholders to renegotiate, only to then force the issuer to pay you in full just to get rid of you, this does not exactly correspond to value creation; it's more the kind of opportunistic behaviour that extracts value from creating severe delays. But regarding the latest stakes Elliott has been taking in companies, these are aimed at creating value for the company's shareholders.

In any case, from the point of view of risk-adjusted returns, Elliott Management has a stellar record that is not easily attainable. Since inception, the net compound annual return for Elliott has been around 14.6% while the same for the S&P 500 has been 10.9%. At the same time, risk on the Elliott portfolio has been one third of the risk incurred by the benchmark, which is a clear outperformance in risk-adjusted terms. Starting with just \$1.3 million from family and friends, Singer has paved a long and successful path towards the current \$21 billion he has under management.

The Elliott Associates LP fund is the company's flagship fund created in 1977, which makes it one of the oldest

hedge funds. Later, in 1994 the company created an additional fund, Elliott International Limited.

"STARTING WITH JUST \$1.3 **MILLION FROM FAMILY AND** FRIENDS, SINGER HAS PAVED A LONG AND SUCCESSFUL PATH TOWARDS THE CUR-**RENT \$21 BILLION HE HAS UNDER MANAGEMENT."**



How Much Is £1M Invested in 1977 Worth Today?





It is rare to find a hedge fund with such a long track record of consistently outperforming the market on a risk-adjusted basis and with almost no negative year (only two years). That is the result of a very tight risk management in which the company waits for only the most favourable conditions to open positions and adopts a conservative approach whenever the situation is less clear. Elliott is driving real alpha to investors and protecting their money against the market. It is not a coincidence that Singer and his family have a large part of their wealth tied to Elliott Management.

Next Trade

"Bondholders continue to think that it is perfectly safe to own 30-year German bonds at a yield of 0.6 percent per year, or a 20-year Japanese bond (issued by the most thoroughly long-term-insolvent of the major countries) at a little over 1 percent per year, or an American 30-year bond at scarcely above 2 percent per year", Singer states. He believes that the next big opportunity is in shorting long-term paper claims - that is selling bonds which are trading at artificially low yields because of massive central bank experimentation.

ELLIOTT MANAGEMENT TOP 10 PORTFOLIO HOLDINGS

Security	Ticker	Value (x\$1000)	% Port.
Hess Corp	HES	\$1,208,086	14.86%
Juniper Networks Inc	JNPR	\$886,062	10.90%
EMC Corp Ma	EMC	\$856,260	10.53%
Family Dollar Stores Inc	FDO	\$652,682	8.03%
Twenty-First Century Fox Inc	FOX	\$489,765	6.02%
Interpublic Group Cps Inc	IPG	\$435,373	5.35%
Anadarko Petroleum Corp	APC	\$352,218	4.33%
Sector SPDR Trust Put	_	\$351,825	4.33%
Riverbed Technology	RVBD	\$312,948	3.85%
iShares Trust Put	_	\$310,925	3.82%

"ELLIOTT IS DRIVING REAL ALPHA TO **INVESTORS AND PROTECTING THEIR** MONEY AGAINST THE MARKET. IT IS NOT A COINCIDENCE THAT SINGER AND HIS FAMILY HAVE A LARGE PART OF THEIR WEALTH TIED TO ELLIOTT MANAGEMENT."

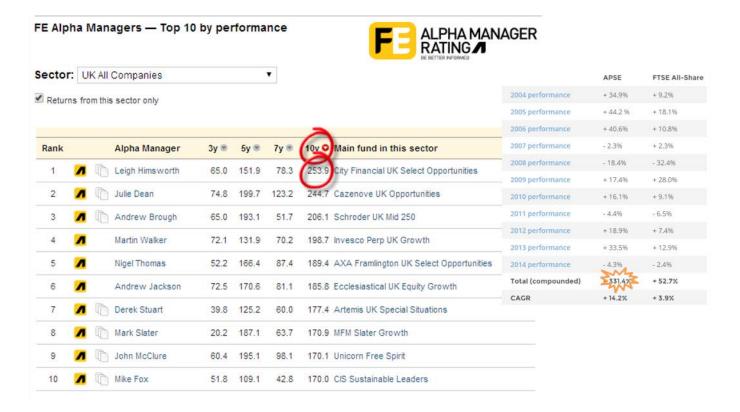
POWERLISTS FOR SPREADBETTING TO BEING BRITA BEST FUND MANAGF

BY ALPESH PATEL



Surely with the power of computers we can pick winning stocks faster and more accurately than the traditional way? When I started my hedge fund, I employed fund managers and it quickly proved expensive. They were good, and that's why they cost money. So I looked to replace them with computers – my little unpaid slaves. And it worked.

One algorithm ('APSE') has for the past ten years outperformed Warren Buffett and every other UK company fund manager too. (See image below).







(I put this into Sharescope to create my own little Fintech Venture - 'Alpesh Patel Special Edition of Sharescope'.)

So what's the secret sauce? What's the Piri Piri of stock-picking, the secret KFC herbs of my stock selection methodology?

Step one: Know what's important – a little help from the Financial Times

In picking winning stocks, I had to first look at all the stock picking criteria from PE to ROCE and the more esoteric ones like price/cash flow. But what works?

This is where writing a weekly column on trading for the Financial Times came in handy. Every week I would spend about 12 hours researching developments over the past century to the present day in stock picking. You should not be surprised there is a heck of a lot of academic research on the subject. Five years of that, plus my own experience of investing from age 12, and I had a good idea of what worked.

Step two: Have a strategy - help from Bloomberg TV

"SOME FUND MANAGERS **CLAIMED TO BE 'GROWTH'** AND OTHERS 'VALUE' AND OTHERS STILL 'INCOME'. SO I THOUGHT, 'WHY NOT ALL IN ONE'?"

What's the strategy? To hold for a day, a week, a month? A year? My strategy, or rather one of them, was to pick for a year. So I came up with the idea of looking for undervalued growth stocks generating good dividends.

From my years co-hosting on Bloomberg TV and interviewing and grilling fund managers I recalled how some fund managers claimed to be 'growth' and others 'value' and others still 'income'. So I thought, 'why not all in one'?

Step three: know the importance of what is important - a little help from the Bar

As a trained Barrister, the two most important things you learn are that evidence is needed for everything and secondly, you only base your case on one, two or three key arguments - not every single argument you could make (i.e. you learn the importance of what is important!).

So you realise that PE has been more important than ROCE in stock predictions. But how important? My next stage was to weigh the importance of each criteria. PE, revenue growth, earnings growth, cash flows; all of these things you know are important but not equally so.

So like a lab professor I crunched numbers and worked many late nights to discover the DNA of stock outperformance.

Step four: after complexity, simplicity - help from **Oxford University**

When I was a Visiting Fellow in Business & Industry at Oxford University, lecturing on finance, one of my research topics was how to convey financial education more simply. After all we want to make it easy for people to learn and then

So I scored each of the stocks out of 10, based on the weightings of the various factors my research showed was important. You sort of see why my performance outdid Warren and every UK company fund manager don't you!

So here is my UK PowerList - I've picked from the FTSE 350 in the first list and Small Caps in the second. They as a basket outperform over a 12 month period. Should any ever fall by 25% (in the case of a market crash, you don't just sit there, you go to cash). I've only listed the ones which are 9 out of 10 (none were 10).

No.	Name	Alpesh value/ growth rating
1	Barratt Developments PLC	9
2	Bellway PLC	9
3	Bovis Homes Group PLC	9
4	Carillion PLC	9
5	Crest Nicholson Holdings L	9
6	Galliford Try PLC	9
7	PayPoint PLC	9
8	Persimmon PLC	9
9	Redrow PLC	9

No.	Name	Alpesh value/ growth rating
1	Morgan Sindall PLC	9
2	Norcros PLC	9
3	S & U PLC	9
4	Trifast PLC	9
5	Vp PLC	9

Step 5: teach!

I love to teach, not just trade and manage money, so I then went on to create what are the best online bite-size courses on learning not just this, but

"FOR THE FIRST 30 READ-**ERS THERE IS A 50% OFF MY MOST POPULAR COURSE, WHICH HAPPENS** TO BE ON FX TRADING."



more active trading too. For the first 30 readers there is a 50% off my most popular course, which happens to be on FX trading. Just visit www.trading-champions.com and enter the coupon

'spreadbet' or just go direct to this link: (http://bit.ly/spreadbetfx). Enjoy!

Alpesh Patel

Alpesh is a hedge fund manager who set up his asset management company in 2004. His Sharescope Special Edition has outperformed every UK company's fund manager over the past decade, as well as Warren Buffett. He has written over 200 columns for the Financial Times and presented his own investment show on Bloomberg TV for three years. He is a former Visiting Fellow in Business & Industry at Oxford University and the author of 18 books on investing. Find out more at http://www.investingbetter.com and http://www.inter.tradermind.com

SCHOOL CORNER

INGFOR INGERALL

BY MARIA PSARRA



Now ladies and gentlemen, following the completion of "Maria's Golden Rules for Trading CFDs", it is time to continue with our previous educational articles series, a subject that we last discussed in Master investor Magazine's April edition. This is the seventh in the series of these educational articles, all of which are focussed on the best habits of winning traders and investors, the most common mistakes traders make and the best ways to avoid them.

Our subject today is the ever famous search for the "Holy Grail" in trading and the financial markets.

So what do I mean by "Holy Grail"? Please allow me to clarify. The "Holy Grail" is this one single trade whose successful conclusion will make you richer than your wildest dreams. It will produce a return of, for example, 300% in the space of a few days.

For example, you buy stock x today, it goes up by 300% by next week. Now don't get me wrong, I am not saying that this can never happen; up to a certain extent, it can, and it does. In fact, this is what often happens when a junior oil explorer discovers oil in one of its exploration fields, or when a junior miner secures permission to explore a likely gold-rich geographic area of the world. What I am saying however is that forever looking for and investing all of your available funds in this one junior

explorer that if successful in its efforts will make you filthy rich is by no means a fool proof trading strategy, nor is it a prudent way to achieve consistent returns over the years.

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Obviously when saying this, I assume that one's investments involve no element of market manipulation, use of inside information or any other related form of financial crime that both I and the FCA would clearly advise you to abstain from.

You see, what I am about to share may sound a little mean, but I am convinced that there is a very specific reason that occasional financial press celebrities who claim they consistently make 300% (and above) returns on their trades in very short periods of time cannot "sell" to professional traders like me. The reason is that I have seen enough of the markets to realise that they are either lying or are actually guilty of some form of market manipulation, insider trading or some other offence. In either case, I would rather keep as far away from these types of people and situations as possible.

I believe that trading and investing are a business, and should be approached as such. As some of you will know from running your own business, or simply ensuring that your daily work contributes towards your employer's success, businesses need to be consistently performing and profitable in order to

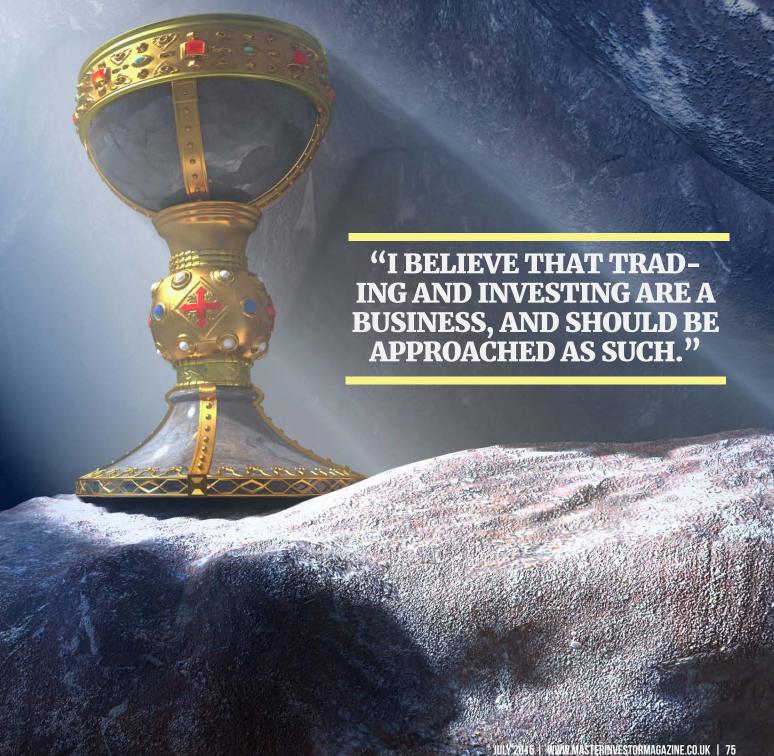
survive and prosper. The exact same principles apply to investing and trading.

As any honest professional investor will tell you, the way to make money in the markets is to be consistently profitable over a period of time. This period is not a few months or years, rather it is many years or even a lifetime. In order to achieve this, one needs many small winning and losing trades, a few big winners, and no big losers.

One is bound to have big winners over time, though not necessarily by design or because one is focussed on this. Let me give you an example that I often come across in my own trading and when advising my clients. Many of my clients as well as myself like trading companies' annual or semi-annual results announcements, by buying into a company's stock a few days or even the previous day before the announcement when looking for good results, or alternatively selling short the company's stock when we believe the results are

going to be bad.

One of the most recent trades of this type I advised clients on, and discussed on TV was a Buy in **Workspace Group** (WKP.L). On 6th March 2015, the company reported annual results which beat analyst expectations and the stock closed 6.52% up on the day. In money terms, this means that if you had bought £10,000 worth of Workspace shares during the last days preceding the announcement, you would have made a profit of £652 at market close on 3rd March.



If you had used leverage - i.e. CFD products for this £10,000 trade - you would have made five times that given that the CFD margin for Workspace is 20% with most UK clearing brokers. A £10,000 initial deposit would have given you exposure to £50,000 worth of the underlying shares, so a gross profit of £3,260. This is a 32.6 % return on your initial investment in the space of a few days.



So yes, quick high returns ARE possible even in liquid FTSE 100 and FTSE 250 stocks. The point I made earlier though, is that they are neither the actual trading strategy nor the "Holy Grail"; rather they are the result of adopting a wellresearched trading strategy. In this particular case, the strategy involves buying into companies that have been doing well, and selling short companies that have been doing badly prior to their results' announcements.

Although making such trades obviously entails a higher level of risk than just buying and holding blue chip shares for the long-term, it is (or at least should be) based on thorough analysis of the company's past financial performance, competition, related news flow, and other factors. In other words, it involves

taking a calculated risk, and is neither gambling, nor hoping and wishing for this one single trade that will make you rich. Furthermore, it is not every time a company reports good results that you see its stock price rise by 6.5% on the day. More often than not, even if results announcements are good, liquid stocks tend to move by a 1-2% threshold instead. You will have to learn to be happy with achieving these small successes, because the truth of the matter is that as long as you manage your risks properly, these will ensure you make consistent money over time.

I repeat this to the clients and traders I train: The financial markets are NOT where you should derive all of your life's excitement from. Taking this one step further, the markets are also not a place

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where you should expect to "win the lottery" or meet your "one true love", the quest for both of which closely resembles investors' ongoing quest for the "Holy Grail". Yes, you may get lucky enough to actually win the lottery or meet your one true love on any day. After all, "who am I to disagree" when, as an old song goes, "I travelled the world and the seven seas, and everybody is looking for something"? But until you find either, how about you focus on consistently growing your trading capital in a more consistent way? Hopefully, after reading my article you are at least more open to the idea.

Until next month, Happy trading everyone!

Maria is Head of Trading at ZAI Capital Markets. In her role at ZAI, Maria determines the company's trading strategy, supervises a team of experienced brokers, and advises highnet-worth individuals on suitable investment strategies. Maria employs different investment styles in order to construct personalised portfolios best suited to the risk and return preferences of ZAI's clients. Typical portfolios primarily comprise of UK and European equities and equity indices, and, to a lesser extent, commodities and fixed income exposure.

Maria appears on Tip TV on a weekly basis providing investment tips and market commentary, writes for a number of financial publications, and is often invited to present her views during conferences such as the London Master Investor Show, the London Trading Show, and the ETFs Europe conderence.







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EVIL KNIEVIL (AKA SIMON CAWKWELL)

THE BEST OF THE EVILLENCES



A big man with a bigger reputation, Evil Knievil famously made £1 million by short selling shares in Northern Rock during its collapse. He also uses his knowledge and experience to buy shares, often resulting in the same devastating effect.

At least three times a week, Evil provides his thoughts and musings on the markets. Now writing EXCLUSIVELY for Master Investor Magazine at http://www.masterinvestormagazine.co.uk/category/evil-diaries/.

He doesn't just pontificate on the financial markets in The Evil Diaries; he also comments on politics, current affairs, his favourite horses/sports bets, and the occasional film and book review thrown in for good measure. Here we take a look back on the highlights of Evil's diaries in the month of June.

1st June

Late on Friday last, **GCM (GCM)** offered two RNSs. The first was the advice that GCM had borrowed £3m for two years with no interest payable. However, the lender "has the right to convert the outstanding balance at a subscription price of 11p". Shares thus derived are locked up for two years running from the date of the conversion. GCM has reserved the right to "settle" the loan if GCM elects to do so. I am unclear as to how that election might emerge. After all,

the funds to enable repayment would have to be raised from current shareholders who, presumably, would only feel thus minded if the share price were better than it is or GCM's prospect could be reckoned to be worth the candle – by which point one rather imagines that the unsecured lender would have converted.

Anyway, this RNS was succeeded by another RNS advising that the management had awarded itself options over a further 2,150,000 shares at 11p and favourably amended (from the point of view of the management) the terms of already extant management options. I only mention the order of the RNSs since the awards considered in the latter RNS would have attracted some management enthusiasm had they known of the loan being completed. I am not being pernickety but one does wonder.

The effect of all this is that whereas GCM now has 63m shares in issue this figure will rise in effect by c. 37m to c. 100m shares and there will be enough betting money for at least two years. Even so, the capitalisation at 14p will be just c. £14m. And it will all swing round pressing ahead or not at the coal prospect. I myself cannot begin to imagine how the Bangladeshi government can avoid opening up Phulbari. But it would be a foresightful bunny who claims that it will happen in the next two years - if past conduct of the Bangladeshi government is any sort of guide. Anyway, I bought 100,000 GCM at 13.25p just to keep my hand in. Greed compels this since these shares could be many, many times the 13.25p if Phulbari succeeds financially. Others who are more cautious might merely hold on tight to Polo (POL) which holds a chunk of GCM and is in any event, at 6p, very cheap.



"THE TROUBLE WAS THAT BLAIRISM HAD BY THEN REALLY TAKEN HOLD ACROSS THE LAND AND SYSTEMATIC PROMOTION OF LIES HAD BECOME CENTRAL TO POLICY-MAKING."

8th June

About thirteen years ago, there was a tiny company, quoted on AIM, called Room Service, which was in serious trouble with its business and more than a few entirely reasonable people reckoned that not merely did it need to raise cash quickly but there wasn't much point since it was a useless, shortly to be insolvent, company. A young market maker, whom I encountered over lunch shortly after the denouement, recounted to me that, being a bold bunny (a requirement of any market maker either then or now), he used his position at Evolution to keep selling Room Service short. As it happened he sold short more capital than was in issue, let alone capital that might have been regarded as in free float. The buyers were half-witted private investors who, unsurprisingly (these guys are mad), claimed that had they been able to take delivery of stock they would have been able to do something (it was never specified as to what) to save the company. Needless to add, the young market maker sat back waiting for either a hugely dilutive placing or insolvency - at which point he would on behalf of his firm, Evolution, harvest the fruits of his good judgement.

Here squalid populism stepped in and the shares were of course suspended and an FSA (now FCA) enquiry followed. Also, a rabble rouser, of the squirtiest variety, corralled an action group which managed to get hold of yet another bent lawyer (there is no shortage of them) to pipe up down at the FSA. So the FSA duly decided to lick the bottoms of the undeserving and there was some sort of compensation paid to holders. Evolution was fined £500,000 and no doubt had to pay yet more of me learned friends a substantial sum. The head market maker at Evolution, Chris Potts, lost his job and has since forged another career.

Looking back, the wise and honest approach on the part of the FSA would have been to identify that there had never been any limits on a market maker's conduct of his book in force (either within Evolution or, more importantly, the LSE) and that a "delivered stock basis" should have been compelled. Such a basis would surely have caused a stunning squeeze which would have resolved everything.

The trouble was that Blairism had by then really taken hold across the land and systematic promotion of lies had become central to policy-making. Therefore an injustice was done.

Moving swiftly along, I take the reader to current affairs in the form of another tiddler, New World Oil and Gas (NEW) which has got an appreciable unsettled position in play. It is not clear what happens when it is settled or what is being done to settle it. However, unsurprisingly, another posse of protesters seeks delivered stock to enable its voting plans to be given effect in company law. The posse seeks to use the Room Service affair as a precedent. I do not know what happens now but I suggest that some bright spark at the LSE arranges a "delivered stock" market where buyers can compel delivery. That'll do the trick. As for engaging the FCA, the posse should not bother. The FCA's past endeavours indicate nothing other than that the incompetence the FCA showed thirteen years ago cannot constitute a precedent.

10th June

If it were not so sad it would be hugely comical. But HM Treasury decided to grab the money and run when it imposed the banking levy on HSBC (HSBA). The effect however has proved to be that HSBC has decided to run. There will be substantial job losses.



It should be borne in mind that HSBC never got into the financial trouble that all the others bar Barclays did. For this good housekeeping on its part HSBC found that the levy on banking assets would be applied not merely to UK advances but HSBC's advances worldwide. This is entirely irrational and, given that it was costing HSBC perhaps £250m p.a. HSBC have entirely understandably decided to up sticks and go. You can bet that the moron in HMG who devised this result will get his knighthood in due course.

As it happens I think HSBC, as represented by my local branch in the Fulham Road, is simply silly and I record that my wife took weeks to open a bank account for my younger daughter's tiny company simply because HSBC doubted whether my younger daughter exists. HSBC have had my younger daughter's puny banking affairs for about twenty years and rising. HSBC have encountered my ever polite wife for getting on for eighteen years on a personal and face to face basis.

I doubt if the staff are inherently that stupid. It is simply that they have been driven to despair. They have had their confidence entirely neutered by regulation. I have time and again said that the



sheer weight of this regulation in practice will be the death of us all. This headline event at HSBC is a solid example.

12th June

I saw that KKR had chucked out perhaps 25% of the equity of Pets At Home (PETS) a few days ago. I thought no more about it. But I have now had a chance to skim the figures. They are astonishing. The market capitalisation at 280p is of the order of £1.4bn and if Merrill are to be believed EPS for the year to March 2016 should be around 15.6p. Tangible net asset value per share is minus 30p. Inspection of the website reveals nothing patented and a bull dog pup trying to mount the left ear of, presumably, its mother. Talk about hope value.

It's just a thought but Private and Commercial Finance (PCF) is about to receive a banking licence (which is the right to take deposits from the public - it being ruled that the public should never be allowed to decide for itself so to make sure that regulators can be paid to go on pretending to do worthwhile work). This licensing might cost PCF a million or two on compliance. But one wonders what is the value of the licence? Tungsten (TUNG) is said by its supporters to value its banking licence at £40m. Even if these chaps are all on magic mushrooms there is the clear hint that PCF has hidden value - it is only capitalised at 20p at £11m with tangible net asset value exceeding this figure. Added to which the business is bonging along.

Here's a comment from China, reported by CNBC and attributed to a villager: "....it is easier for a villager to make money in the stock market than in farming." An author goes on to mention that this is in contrast to the observation under Communism "why should farmers grow rice when the State provides it free?" The Chinese are often curiously fatalistic and prone to gambling. So, to many ordinary Chinese, it must seem entirely sensible to fling money at a lunatically overvalued stock market. However, before we here go all hoity-toity, when the Chinese market and thus its economy tanks (as both surely will) we should bear in mind that we are also going to get a real shock.

17th June

Sherlock may have been instructed not to offer s**t but the fact is that dogs do not understand this basic order and, instead, deposit their doings all over the place. As a result, dog owners - in London at any rate – are obliged to scoop up the deposit and get rid of it appropriately. I do not envy them even though they are suffering from a self-inflicted obligation. And the point is that five or so years ago the deposits in question would tend to be liquid since, as a general rule, dogs were given canned food which gives rise to this result. Then the scoop laws in practice became stiffer and, as a result, dog owners found that they prefer to feed their dogs a dry food which tends to give distinctly more readily handled turds. The margin on dry dog food is 50% of sales whereas canned dog food is 5%. So one can see why Pets At Home (PETS) could be prepared for flo-

I would prefer to get over the problem

by summarily executing all dogs but accept that many fellow citizens will just go on buying dry dog food. As a result margins will come down as competition heats up. It's another reason for shorting PETS.

pets at home

Also, the balance sheet of PETS is thin air. Once one writes off intangibles, it adds up to minus £160m and debt stands at £315m. This is a bankers' creation capitalised at 277p at an astounding £1.37bn. It stinks.

"THE BALANCE SHEET OF PETS IS THIN AIR. ONCE ONE WRITES OFF **INTANGIBLES, IT ADDS UP TO MINUS £160M** AND DEBT STANDS AT £315M. THIS IS A BANK-**ERS' CREATION CAPI-TALISED AT 277P AT AN ASTOUNDING £1.37BN.** IT STINKS."

24th June

For some extraordinary (as a few will complain) reason Gate (GATE) remains suspended and its Nomad Beaumont Cornish has resigned with the immediate difficulty that no one has yet agreed to take on the hopeless case. I am still amazed that it was ever allowed to float.

That noted, Gate declares that it has £8.5m to hand in a solicitor's account pending the issue of convertible loan notes although the terms as regards interest, repayment or conversion have not been settled. In any event, these loan notes will not be taken up in the absence of a quotation since the whole point of a fraudulent promotion is to be free to sell the garbage. I tried to telephone the executive chairman, one Geoff Morrow, on 020 7887 6347, as shown on yesterday's RNS but this line proved to be dead - rather like Gate.

JUNE 2015

Things Are Looking up for **Insurers**

I recently received an email from a genealogy website called Ancestry.co.uk offering me a DNA test for just £79 (reduced from £99).

"Our DNA matching combines groundbreaking science with traditional research to give you the most accurate family history results available. The technology pinpoints relatives you never knew existed; you can then work with your new-found cousins to

discover your shared history..."

All I had to do to meet the cousins that I never knew existed (a curiously unappealing thought) was to take a swab of saliva and post it off to them.

Being of a suspicious mind set, my first thought was that Ancestry.co.uk might be a front for MI6. Once they've got our DNA profile on their infernal databases they can no doubt track us every where we go, cross-referencing our move ments with our Google searches.

Dismissing that thought, my second was that if it is really now so cheap and simple to profile an individual's DNA, then why isn't the National Health Service doing it already? The cost has fallen to less than that of a single doctor's appointment.

I predict that within five years - the lifetime of the new parliament - most of us will have had our DNA profile tested to some degree and it will be stored on somebody's computer database, hopefully our GPs' in the first instance. But



the biggest of these databases will be maintained by insurance companies.

Insurers are going to harness DNA and other technologies which are already facilitating data-driven underwriting.

Not only does this enable insurers toWhat is new for the insurance sector is that, thanks to technology, insurers can quantify the risks that each policy involves much more precisely. Car insurers in the USA have begun to set premiums based on observed driver behaviour. They can do this because they are installing tracking devices in people's cars which record if and when drivers exceed the speed limit, how heavy they are on the brakes, and so forth.

Not only does this enable insurers to distinguish bad drivers from good, but by offering feedback it also incentivises bad drivers to improve. That reduces accidents and hence claims. It also means that safe drivers can be charged lower premiums than dangerous ones.

By Victor Hill

To read the full article visit...

http://www.masterinvestormagazine. co.uk/latest/thingsare-looking-up-forinsurers/

Apple Vs Spotify

"Innovation distinguishes between a leader and a follower." - Steve Jobs

"Welcome to the most exciting and important frontier since the digital music revolution began 16 years ago", said Rdio's CEO in mockery of Apple after the company unveiled a series of new products that were mere copies and redesigns of existing products and services marketed by other companies. One of those was a subscription-based music streaming service, something which Rdio and Spotify had already been offering long before Apple.



"ITS ITUNES SERVICE LOOKS LIKE THE OLD-**FASHIONED CD PRODUCT** THEY DESTROYED AND IS PACKED WITH UNINTER-**ESTING FUNCTIONALI-**TIES THAT MAKE THE WHOLE PRODUCT ONE OF THE MOST COMPLEX AND UNFRIENDLY EVER **CREATED BY APPLE."**

While Apple was concentrating on ending the age of the physical CD, seducing its users to download their music instead of buying old-fashioned CDs, Spotify was concentrating on destroying that very same Apple business by offering its users the opportunity to listen to the entire CD catalogue at a monthly fee that was comparable to the price Apple was charging for a single CD download. Apple was ahead of the curve when it launched its iTunes service in the early 2000s, but it is now well behind it more than a decade after. Its iTunes service

looks like the old-fashioned CD product they destroyed and is packed with uninteresting functionalities that make the whole product one of the most complex and unfriendly ever created by Apple.

Apple thought that the destruction of the physical CD would bring the iTunes music store into the spotlight, where it would be the centre of the digital music scene. But by the time Apple got the job done regarding the physical CD, users already wanted something different from what the company had to offer. Why own a CD and build a music library piece by piece when you can have access to all music whenever you want? Users are now looking for streaming services like Spotify, Rdio and Deezer. They don't care about ownership but about having the music readily available whenever they want to listen to it.

The music industry was severely hit during the 1990s and the early 2000s due to the improvement of Internet connections and technology. The number of illegal downloads using programs like Napster (the early Napster) grew immensely. Businesses selling music, being it physical or digital, were somewhat reliant on the capacity of regulators and prosecutors to limit this shadow market. But the streaming services are different. Many of the users that were illegally downloading music to skip a fee payment are willing to pay for a streaming service. Streaming offers the possibility of listening to everything one could imagine for a small flat price. These services substantially limit the shadow market by removing the economic advantages of it. Just because of this, the music industry owes much to these streaming services.

By Filipe. R. Costa

To read the full article vis-

http://www.masterinvestormagazine.co.uk/latest/ apple-vs-spotify/

Is the M&A Machine Right to Be Intoxicated by Diageo?

On Monday the M&A rumour mill, which has been in overdrive since the year began, spat out reports, based on a 40 word Brazilian blog, that three of the Brazilian backers of Anheuser-Busch InBev were considering a bid for Diageo. Of course, such reports sent Diageo's stock jumping by just shy of 7%, with continued gains on Tuesday prompted by the news that 3G Capital had hired lawyers to look into the deal, pushing the stock to just shy of £19. Whether this deal would be from 3G itself or Anheuser supported by 3G is unclear; however this is just the latest in a long line of Diageo takeover rumours with the beverage giant obviously a hot property.

So what kind of health is Diageo in? Does it still have its fizz, or has it gone flat?

Firstly, it should be noted that 3G Capital likely wouldn't be considering the stock if it didn't think something special lurked at its centre. The company has played a role in the recent successes of Burger King, Kraft and Heinz, be it on its own or in partnership with another company like Berkshire Hathaway, and this past form implicitly points to worth in Diageo.

Of course, you just need to take a look at Diageo's own brand list to see the megaassets it has on its books. Look at your average spirits aisle at the supermarket and it will be dominated by Diageo. Johnnie Walker Scotch sees its top 10 countries comprise less than half of the brand's sales, whilst Smirnoff Vodka has begun to return to growth after a disappointing 2014 in the USA. Ciroc has a lot of room to grow beyond the USA, which makes up 86% of its sales but sees half of its profits handed over to rapper Sean Combs based on a 2009 promotional deal. Baileys is the top liqueur in the world and sees a strong 37% of its sales outside the major territories, whilst Gordon's Gin has benefited from a renewed popularity in certain areas of Europe.

For all the strength of its spirits, which cannot be underestimated, one of the

"CONTRARY TO WHAT MANY WOULD THINK GUINNESS SEES 35% OF ITS VOLUME IN AFRICA, OUTSHINING THE 25% IT SEES IN THE UK, THE BRAND'S SECOND LARGEST TERRITORY."

biggest attractions Diageo has is its African presence. This presence largely comes from Guinness which contributes nearly 60% of the company's beer sales, a sector that in turn provides 20% of the group's sales as a whole. Contrary to what many would think Guinness sees 35% of its volume in Africa, outshining the 25% it sees in the UK, the brand's second largest territory. Given that Anheuser-Busch InBev not only lacks this kind of presence in Africa, but any presence in the region at all, it would make sense that the world's largest brewer would want a quick and profitable entry into the territory.

By Connor Campbell

To read the full article visit...

http://www.masterinvestormagazine.co.uk/ latest/is-the-ma-machine-right-to-be-intoxicated-by-diageo/

The SAGA of the Baby **Boomers**

I'm in Ireland this week travelling round on steam trains, seeing the sights, indulging in the famous culinary delights (that's not potatoes any longer, for anyone under that outdated impression), and of course supping the occasional Guinness.

The company that runs these excellent excursions is called Steam Dreams. It organises many trips around the UK and occasionally overseas - this is the first time they've done the Emerald Isle. For a variety of reasons most of the people who do these longer trips (this



one's around a week) are Baby Boomers. They have the time, inclination and the money. If you didn't know, Baby Boomers are loaded! 80% of Britain's net personal wealth is owned by the over 50s.

To some extent it's axiomatic, all other things being equal, older people should have more wealth, after all they had longer to accumulate it. But the Baby Boomers here have been particularly lucky with a number of things. Decades of a burgeoning residential house market, several economic booms, jobs for life, investments that paid off their mortgages, and final salary pensions that those of us a way off retirement can only dream of. The new paradigm of low interest rates may mean servicing a loan is not too much of a hardship, but making a passive investment to pay that loan off is now next to impossible.

Businesses like Steam Dreams have seemingly grown up without really consciously targeting the Baby Boomers. I was talking to Marcus Robertson (Chairman of Steam Dreams) yesterday. A Baby Boomer himself, he hadn't really thought about how much his business related to this economic phenomenon that undoubtedly underpins their success (these trips are very well subscribed if not sold out in my experience).

On many of their steam day trips they do get a younger demographic travelling too - and why not - we don't remember steam! But the predominant age group on the week-long trips is certainly those for whom steam is nostalgia, and perhaps a reminder of what now seem like they were better times.

By Adrian Kempton-Cumber



To read the full article visit...

http://www.masterinvestormagazine.co.uk/latest/ the-saga-of-the-babyboomers/

READ TO SUCCEED

THE INSIDE STORY O

BY NATHANIEL POPPER

A BOOK REVIEW BY SWEN LORENZ

Harper Collins Publishers, £16.59 on Amazon (Hardback)

Most people would agree that now doesn't seem like a good moment in time to publish another book about Bitcoins. The so-called crypto-currency has been reported on at length, it has had its fair share of scandals and negative headlines, and anyone actually owning Bitcoins will have had to withstand its 80% decline in value since peaking at \$1,240 in December 2013.

Why another book? Why now?

I am glad I asked myself this question, because after having read Digital Gold, both my understanding of how cryptocurrencies work as well as my perspective on their possible future has broadened immensely. Add to this the fact that I tremendously enjoyed reading this New York Times reporter's new book in a rare instance, I devoured it in a single sitting during a four hour flight! As you can guess, no emails were replied to during that flight.

Nathaniel Popper's book deals with a phenomenon that entered mainstream media a mere three years ago. Cryptocurrencies such as Bitcoin are new payment systems that, according to some,

"are the most important invention since the Internet itself. They will change the way the entire world does business."

"CRYPTO-CUR-**RENCIES SUCH AS BITCOIN ARE NEW** PAYMENT SYSTEMS THAT, ACCORDING TO SOME, "ARE THE MOST IMPORTANT **INVENTION SINCE** THE INTERNET ITSELF."

Bitcoin is supposed to be a currency that is universally accepted, outside the control of any government, and not beset by the inflationary policies of central banks. It's also supposed to be entirely safe against theft and fraud, offer extremely low transaction costs, and keep its users' identity private. Many of these aspects gained additional prominence in the aftermath of the 2008 financial crisis, and the current issues surrounding Greece and the Euro only add to that.

Just how such crypto-currencies work is something Popper's book sets out in a way that is both fascinating to read as well as entirely comprehensible to the layman. Anyone who ever fancied knowing more about the subject but only has one hour to spare should read the book's first 50 pages and then stop. The entire 400 pages are a recommended read for anyone who wants to delve into the characters and companies that shaped the first few years of Bitcoin's existence, and for anyone who wants to understand how the entire phenomenon of crypto-currencies arose in the first place.

On that note, the timing of the book's publication couldn't be better. The recent conviction of one of the earliest and heaviest users of Bitcoin, a 31-year-old Internet entrepreneur who set up an online marketplace for trading illegal substances, was in its very own way an important landmark in the history of crypto-currencies. With the US Government having drawn a line under the use of Bitcoins for illegal purposes, will the currency now move on to become a currency for less controversial transactions? Your author recently spotted a

"WITH SEVERAL TOP-NOTCH SILICON VALLEY PLAYERS CONTINUING TO BET THAT BITCOIN IS HERE TO STAY, ALL BETS ARE OFF."

Bitcoin ATM on the campus of Google in London (see photo), which may just be a sign that times are changing.

What "Digital Gold" doesn't provide is an outlook on the future of crypto-currencies. Our very own Jim Mellon has delivered one in his own book, Fast Forward, and his summary was not one of great enthusiasm (you can order the book on www.fastforwardbook.com). Still, at 80% below its peak value, and with several top-notch Silicon Valley players continuing to bet that Bitcoin

is here to stay, all bets are off. At last count, Bitcoins were changing hands at \$250, and some say they have the potential to one day rise to \$10m (in case you were wondering that would be a 40,000 times investment gain).

Some of the most successful new developments on the Internet started out against great scepticism. I experienced the IPO of Amazon in 1997, but was among those who never expected it to succeed. Wikipedia, the online encyclopedia, was not expected to become a

success, but today is one of the world's biggest websites. Will Bitcoin eventually do to conventional money what the Internet has done to the postal service and to media?

Master Investor Rating: If you'd like to follow the development of crypto-currencies in more detail, this new book will provide you with an easy, entertaining start.



TECHNOLOGY CORNER



BY SIMON CARTER

There's nothing more mysterious and enticing than 'the future'. It's a magical place full of hope, ventures, ideas that haven't failed yet and investments that are yet to tank. And technology. Ah yes, the technology of the future has stoked the imagination of playwrights, novelists, filmmakers and dreamers for years. From The Jetsons to Back to the Future we've been promised a future of unimaginable luxury, all thanks to technology. But wait, isn't 2015 technically the future?

999

999

Well of course any old day is the future when compared to the past, but for the sake of this argument, let's all agree, that yes, we live in the future. After all, Marty McFly was propelled to 2015 (albeit October 2015) in the

second instalment of his time travelling trilogy. And if we're living in the future, doesn't that mean we can experience a life of unimaginable luxury? Well, close but not quite.

So tell your robot butler to go and stick the kettle on while you read about the gadgets and gizmos you can rush out and buy today.



iKettle (£99.99)

In fact, call off your robot butler (probably called iJeeves) and pick up your smartphone because now you can, for less than the cost of a wet weekend in Blackpool, control your kettle from anywhere in your house. It can even be programmed to boil as your alarm goes off of in the morning. The question of how to get water in the kettle without actually visiting it, or whether somebody who is too lazy to turn on the kettle will be able to muster the motivation to actually go and make a brew seems not to have troubled the inventors.

"FOR LESS THAN THE COST OF A WET WEEK-END IN BLACKPOOL, **CONTROL YOUR KET-**TLE FROM ANYWHERE IN YOUR HOUSE."

iShower (£679)

Because nothing but nothing can be truly technologically advanced without a little 'i' preceeding it – an iNternet rebrand is surely on the cards - the iShower is surely the future of cleanliness. Joking aside, as well as looking really cool (ambient lighting also helps) this has some really useful features. Of course you can turn on the shower and set your temperature using your phone, but you can also store different users' preferences, luxuriate in the 12 water outlets (each can be set to a different temperature) and up to eight dispensers for shampoo, conditioner, body wash, face wash and... actually surely four would be enough.





WhyCry (£35)

According to its makers, the WhyCry can determine why a baby is crying with up to 90% accuracy. Split into five categories - hunger, boredom, discomfort, tiredness and stress - the device aims to help teach parents to instinctively know why their child is crying. Now if they can make a device that turns parents' talk into something a baby could understand, we'd be really cooking.

Dyson 360 Eye Robot (£750)

Disappointingly priced at more than double the aesthetically pleasing £360 they could have sold this for, you might also be disappointed that a robot vacuum has made it into your future home. After all, aren't they old news? But this is Dyson, and it's been in development for more than 15 years. So you know it's going to be good. And you also know that your deep-pile shag will never have been so clean.





Egg Minder (£30)

This is more like it! You know that feeling when you're near a supermarket and that feeling of dread washes over you: "Have I got enough eggs?" No? Well even if you've never experienced that sinking feeling, the Egg Minder is here to make sure you never fall fowl (ahem) of it. The Egg Minder keeps track of how many eggs are in your fridge and just how fresh they all are, even sending notifications to your phone. The future is here, and it's egg shaped.



Avegant Glyph (£320)

Available to pre-order, the Glyph is a set of high-end noise cancelling headphones... that is until you flip it down over your eyes. Then it turns into a high definition display which uses two million micro mirrors (just the million for each eye) to project streaming media directly onto your retina. The aim is to mimic the way our eyes see light, and the experience is breath taking. No better way to watch Game of Thrones on the throne.



"THE CONCEPT OF A 'WINE ACCESS SYSTEM' IS PERHAPS THE MOST EXCITING THING ON THIS LIST, AND THANK GOODNESS SOMEBODY IS PUTTÍNG MONEY INTO ALCOHOL RESEARCH."



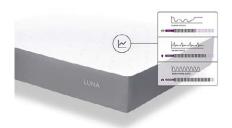


Coravin Wine Access System (£185)

The concept of a 'wine access system' is perhaps the most exciting thing on this list, and thank goodness somebody is putting money into alcohol research. This device transfers wine from bottle to glass without ever disturbing the cork, meaning that no air can get to the wine left in the bottle. Of course this will come in very handy for those who wish to save the rest of the bottle for another time. Seems like a niche market.

ReST **Smart Mattress** (\$500)

Unfortunately you'll have to ship this in from the USA, but a true future home should also look after you while you sleep, and the Smart Mattress does that with a constantly shifting, sleep optimising, surface that automatically responds to your body to give you the ultimate night's sleep.



So from a refreshing sleep, only briefly disturbed by your crying baby, to your morning cup of tea and shower, to the chores such as cleaning and shopping and finally to relaxing with a glass of wine and your favourite movie, you really can live in the home we've been promised for decades.

THE FINAL WORD

15: 1HE FRST

BY ADRIAN KEMPTON-CUMBER



Not being a twenty-something any longer you may be forgiven for thinking that all my Olympic hopes are dashed. But they're not! One particular sport remains where medal winners can often be quite advanced in years: shooting.

I first went to a shooting range in Oklahoma. It turned out I was quite good. Not a big surprise: I've been doing handheld photography at music gigs without using a flash for years. That was with a Glock .22 - but of course we're not allowed hand guns here in England. Apparently they're so dangerous that only trained professionals and criminals get to have them. Not sure if I'll ever make it to the Olympics, but certainly being in the UK on the one hand probably doesn't help my shooting, but there is perhaps less competition in selection.

There's a general disdain of fire arms in England. I say England because the rules aren't consistent all over the UK, and more correctly I mean England & Wales. In Northern Ireland, for example, the rules are less restrictive. Of course everyone immediately goes for the worst possible comparison when guns are mentioned: the US. The US is rarely a useful metric in any economic or social study. They are outliers on almost any bell curve, so America is perhaps best

"THE US IS RARELY A **USEFUL METRIC IN ANY** ECONOMIC OR SOCIAL STUDY. THEY ARE OUT-LIERS ON ALMOST ANY **BELL CURVE, SO AMER-**ICA IS PERHAPS BEST REPRESENTED AS A BELL END."

represented as a bell end.

The history of America is quite different to other places we might recognise. The right to bear arms came about in an environment of pioneers, who were constantly under attack from the really unreasonable people who already lived in America, and clearly should have just said, "Alright, it's a fair cop, here's our country without a fight". I can tell you, when the London riots of a few years ago reached a few hundred metres from my door, and I was watching aerial

coverage on the BBC, I wished I'd had the right to bear arms and a firearm at my disposal - not least because we all know the police don't, but also because I'm trained and accurate. To give you an idea, I can consistently shoot with an accuracy of a few square centimetres over a distance of 25 metres. Had the rioters reached my door I would have quite reasonably feared for my life.

In any case, for the most part they weren't riots; on the one hand, they were organised crime taking advantage of the civil unrest to clear out warehouses on a wholesale basis; while on the other hand, the police were being distracted by rampaging youths on a destructive jolly through many town centres. It's nice to know many of the 'rioters' are rotting in jail, or at least have been. And these riots were quite different from the riots of the '80s, where there were genuine social reasons behind them. And in typical English half-way house fashion, we've gone for Tasers rather than arming the police properly.



The police are there to protect us; their job should be made easier, not be used to make some faux-noble point about guns, whilst making us less secure.

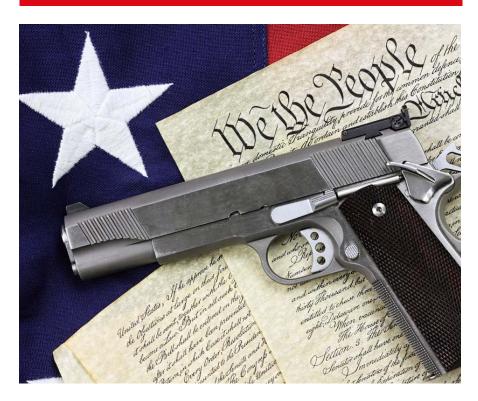
We've gone mad with regulation here, to the extent that our own Olympic shooting team practise overseas. Ok, you could argue the weather means plenty of other sports have to, fair enough. So the question is whether or not the fear of fire arms is justified, and whether our regulation is actually working well. As I said earlier, the US is no help when examining this.

I was quite shocked at the statistics I found. There are countries with worse death rates than the US for starters. Brazil has six times more deaths caused by guns than the US (per capita). That's a statistic you never hear, and Brazil is certainly not the worst. Well that doesn't suit the English position does it? On the other hand I was equally shocked to find there are places like Norway, which sits around 10th in the world for gun ownership with 31.3 guns owned per 100 people. And yet Norway has slightly lower per capita deaths from guns than we have in the UK. Well that isn't the accepted view is it? Could it be we're doing it wrong? What is it that makes a country like Norway apparently much more mature and sensible than England when it comes to guns? Norway's figures for gun ownership are not dissimilar to other European countries, like Germany and France, by the way.

I moved on to thinking that a per capita approach might not be the way forward. How about 'guns per death per annum'. This is much more illustrative of how well regulation is working. So what I'm talking about here is the actual number of guns divided by the actual number of gun deaths (excluding suicide) per annum. You can see my Excel chart here, with some countries highlighted in red or black, and it makes some interesting reading!

There are a couple of things that stand out. Using this metric, Norway is by far the best regulated place in the world.

"WE HAVE MORE DEATHS PER CAPITA THAN NORWAY AND FRANCE, YET THEY HAVE A MAGNITUDE MORE GUNS IN CI-VILIAN CIRCLES THAN WE DO."

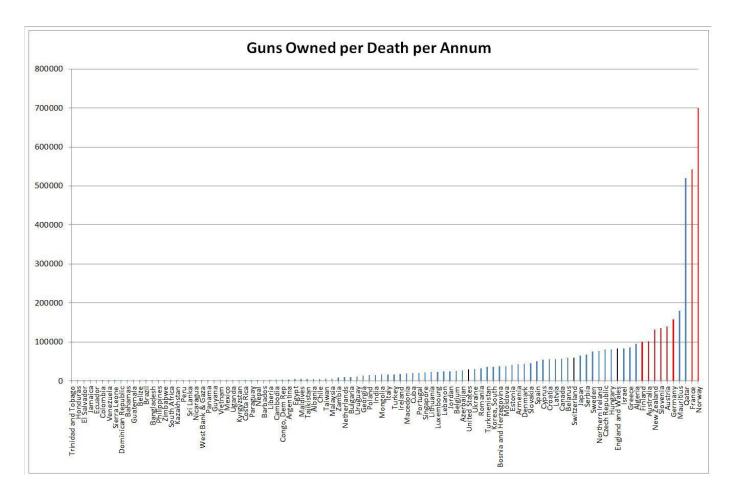


There are 700,000 guns for each annual death. That's a really good statistic. Closely followed by France, where there's over half a million guns for each gun death. That's quite stunning isn't it? In the UK it's just under 83,000. To put that into context, it means we have slightly less effective regulation than Israel and Algeria. Of course the US is lower down, but not by any means the worst in the world. Actually they are in the top half of this list, and have just under 30,000 guns for each death. All this doesn't make the UK look so good does it? Incidentally, the figures I've based these numbers on are from the Guardian newspaper and represent total civilian fire arms.

A lot of people think that guns are illegal in England. They're not. They're heavily regulated and controlled. But we can see from these figures, and in fact the usual stats like deaths per capita, that regulation is not the governing factor. In other words we have more deaths per capita than Norway and France, yet they have a magnitude more guns in civilian circles than we do. Meanwhile, the Americans will let practically anyone have a gun with very little due diligence - they're really no better than us because they're getting it wrong too. So it must be training and screening that gives Norway and France such effective gun controls. In other words it's not just about regulation. It's about successful regulation.

I can't see our attitude changing here, but we've got it pretty wrong. Of course there are all sorts of local factors, and in a proper national debate these should be considered. As it stands though, most people are deluded that our way is the best way. In reality it's not even that successful, and it certainly doesn't make us safe.

Just a quick note on suicide... There are countries where lots of suicides are done



using guns. I've excluded those statistics because they don't really relate to a crime, and because the guns aren't the reason people commit suicide, they are a symptom at most. Add to that, suicide is a right and a choice, whereas being gunned down by someone else isn't.

I started looking at gun death statistics because there are lots of critical posts on Facebook every time there's a killing spree in the US, as well as American anti-gun memes, posted by Brits. The US is a mature democracy, where citizens have a mechanism to change the laws that affect them, and they don't need our help to decide how to control guns, any more than we'd welcome Americans telling us we should abolish the NHS. I note all the bleeding heart do-gooders that post these memes rarely - if ever - seem to mention that figures suggest around 1 million civilians in Africa are shot each year. For the most part they don't have any democracy, let alone a say in how their own gun controls work. They just get shot. Schools there also

have killing sprees, carried out by military and para-military groups - including one recent case where the military group was supposed to be on their side!

"THE US IS A MA-TURE DEMOCRACY, WHERE CITIZENS HAVE A MECHA-NISM TO CHANGE THE LAWS THAT AFFECT THEM, AND THEY DON'T NEED OUR HELP TO DE-CIDE HOW TO CON-TROL GUNS, ANY **MORE THAN WE'D** WELCOME AMERI-**CANS TELLING US** WE SHOULD ABOL-ISH THE NHS."

What is going to push the issue of guns here though, is the advent of 3-D gun printing. It's not a myth, it's a reality. The printed firearms aren't necessarily safe, but why would a suicide bomber give a monkeys about that? We will have to have a public debate on the issue of gun controls in every developed nation soon. I'll be doing all I can to ensure it's based on facts and not popular prejudice. Incidentally, the NRA (National Rifle Association) here was founded 12 years before the NRA in the US, and is still alive and well and living in Bisley, Surrey with around 23,000 members.

Related article: my blog on guns stocks: http://www.masterinvestormagazine. co.uk/latest/are-you-feeling-lucky/

MARKETS IN FOCUS

JUNE 2015

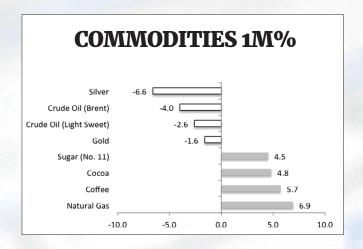
FOREX Forex Jun % YTD % GBP/USD 2.6 0.7 GBP/AUD 1.9 6.9 EUR/USD 1.3 -8.0 AUD/USD 0.7 -5.8 EUR/CHF -13.4 0.7 USD/CAD 0.2 7.4 EUR/JPY -0.1 -5.9 USD/CHF -0.6 -5.9 EUR/GBP -1.3 -8.6 USD/JPY -1.4 2.3

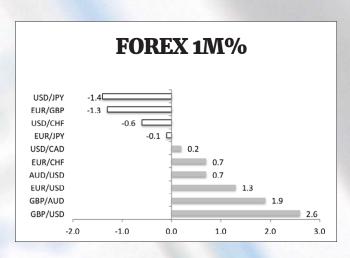
GEODIE INDERES			
Index	Jun %	YTD %	
Bovespa	0.6	6.2	
Nikkei 225	-1.6	16.0	
S&P 500	-2.1	0.2	
Dow Jones	-2.2	-1.1	
NASDAQ 100	-2.5	3.8	
IBEX 35	-4.0	4.8	
DAX (Xetra)	-4.1	11.6	
CAC 40	-4.3	12.1	
Hang Seng	-4.3	11.2	
Euronext 100	-4.4	12.0	
FTSE MIB	-4.4	18.1	
Russian Trading System	-5.5	18.8	
S&P/ASX 200	-5.5	0.9	
FTSE 100	-6.6	-0.7	

GLOBAL INDEXES

INTEREST RATES			
ntral Bank	Key Rate	Next Meeting	
	0.50%	Jul 9	
	0.05%	Jul 16	
	0.25%	Jul 29	
	0.10%	Jul 23	
	-0.75%	Sep 17	
	0.75%	Jul 15	
	2.00%	Jul 7	
	3.25%	Jul 22	
	-0.25%	Jul 2	
	1.00%	Sep 24	
	IIN/IIA	ntral Bank 0.50% 0.05% 0.25% 0.10% -0.75% 2.00% 3.25% -0.25%	

COMMODITIES			
Commodity	Jun %	YTD %	
Natural Gas	6.9	-3.1	
Coffee	5.7	-19.7	
Cocoa	4.8	9.7	
Sugar (No. 11)	4.5	-14.2	
Gold	-1.6	-1.1	
Crude Oil (Light Sweet)	-2.6	9.3	
Crude Oil (Brent)	-4.0	9.2	
Silver	-6.6	-0.3	
36"		-	





FTSE 350 BOTTOM

Castan	Jan. 0/	VTD 0/
Sector	Jun %	YTD %
Evraz PLC	-26.9	-20.3
Lonmin PLC	-20.6	-37.1
KAZ Minerals PLC	-19.2	-21.1
AO World PLC	-16.7	-48.4
Foxtons Group PLC	-16.4	47.8

FTSE 350 SECTORS BOTTOM

Sector	Jun %	YTD %
Industrial Metals	-26.9	-20.3
Aerospace & Defense	-11.6	-3.3
Chemicals	-10.3	-2.6
Mobile Telecommunications	-9.9	3.8
Mining	-9.8	-11.7

FTSE 350 TOP

Sector	Jun %	YTD %
COLT Group SA	26.2	41.0
Ocado Group PLC	22.3	11.5
Telecom plus PLC	21.6	-21.6
Aldermore Group PLC	15.3	48.3
Clarkson PLC	12.0	44.4

FTSE 350 SECTORS TOP

Sector	Jun %	YTD %
Food & Drug Retailers	2.0	10.2
Fixed Line Telecommunications	1.0	13.2
General Industrials	0.3	13.7
Industrial Transportation	-1.5	8.4
Beverages	-1.6	-0.4



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