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WELCOME



Dear Reader,

Welcome back from the summer break!

That is, if you actually had a chance to take a break. For us at Master Investor, it has been a busy few months. There wasn't much of a break to be enjoyed on our end of things. We used this quiet period of the year to advance how we can best serve you in the future.

We have grown our team, in particular through hiring additional staff to build-out our digital platform. Over the coming months, you'll see rolling improvements to our website and to how we serve you as a reader of hard-hitting financial analysis and commentary.

In about a month's time, we will also uncover our revised and expanded events calendar for next year. Following the success of the Master Investor Show in April, we have decided that it's time to broaden our range of events. This means more events throughout the year, spread across the UK, with different thematic approaches. There is much to look forward to next year!

As we can see both from our website metrics and when speaking to delegates at our events, there is an ever-growing hunger amongst private investors to take charge of their financial destiny. We are living in a world of virtually zero (and sometimes negative) interest rates and heightened distrust of conventional financial institutions, but also unprecedented opportunities for investors who latch onto the right themes at the right times. Navigating this brave new world requires high quality information on which to base investment decisions.

At Master Investor, we are committed to bringing you top notch insight from investors, executives and entrepreneurs who have already proven that they have what it takes to beat the market.

On that note, in this month's issue I particularly recommend you read "Mellon on the Markets" (page 8), "It's a Mad, Mad, Mad, Mad World" (page 16), and "India's Fintech Revolution" (page 44). These articles offer insights that I guarantee would be difficult to find elsewhere!

Enjoy the latest issue, and please do not hesitate to drop us a line if you have any ideas about how we can improve our range of content further. You can reach me directly by emailing swen@masterinvestor.co.uk.

Best regards,

Swen Lorenz
Editor, Master Investor



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BY JIM MELLON

MELLON ON THE MARKETS

This month, I am composing my column on the train from Edinburgh to London, having just made my thirtieth visit to the Edinburgh Festival. Every year, the Fringe gets bigger and wackier, and every year the ticket prices go up – in fact, quite a lot!

This ticket price inflation contributes to a noticeable change in the demographics of the audience – i.e. they are getting older (as am I!). When I first started going, tickets were generally a pound or two, and now they are between ten and fifteen pounds. Young people simply can't afford them, so apart from being denied decent affordable housing and a free education, they are also denied culture. Ah well, there's always drink!

And this brings me to the point of this anecdote. Inflation may appear to be low, but if you are a consumer of services, or of housing, or of coffee shop time, or of public transport, you will not find it to be so. Sure, electronic goods and textiles have been falling in price (not any more though!) and this has masked the true rate of inflation, which is much higher than the official stats suggest.

This is why Mark Carney should be fired – at once, preferably. I talked about the plague and curse of academic/investment banking central bankers at the [@MasterInvestor](#) Show this year, and how they were manipulating economies into long-term stagnation with their ever run-

ning printing presses and distortion of the Wicksellian rules on the true rate of interest and allocation of capital.

Well, Mark Carney is at it again. He has stupidly *cut* interest rates and reinstated QE at a time when he should be *raising* interest rates and *selling* bonds. He left Canada in an almighty mess, and he's going to do it to the Brits unless Theresa May gets rid of him.

“MARK CARNEY SHOULD BE FIRED – AT ONCE.”

What the British government should be doing (and I know not all of our readers are British, so I'll be quick) is borrowing as much as they can – possibly as much as £1 trillion – at 1 per cent for a hundred years, then use the money to *cut* taxes (corporate tax to zero) and to kick-start infrastructure and really improve education.

And by education, I mean continuous education throughout life, because the modern [@FastForward](#) world demands it. We all need to embrace a process of updating our skills; otherwise those darn robots are going to turn us into redundant proles.

I am happy to write a short piece for Mrs May if she summons me (in my dreams!) on just how we can turn the UK into the world's fastest growing major economy, but the first thing she needs to do is to exile Mr Carney.

Now, to the broader world. August has been a quiet month, stock market, bond market and currency wise, but beneath the seemingly calm waters there has been some interesting activity – mostly, of course, involving our crazy squad of investment bankers. As I have said, Mrs Yellen seems to get it – the world needs interest rates to go back to "natural" levels. This needs to happen before savings are destroyed, productivity goes even further down the tank than it is, and capital stock erodes with old age. I'm pretty sure there will be another interest rate rise in the US this month.



“THERE IS A WINDOW OF OPPORTUNITY FOR THE BANKING BOZOS TO RIGHT THE WRONGS (AT LEAST IN PART) THAT THEY HAVE DONE TO US, BUT IT IS A NARROW ONE.”

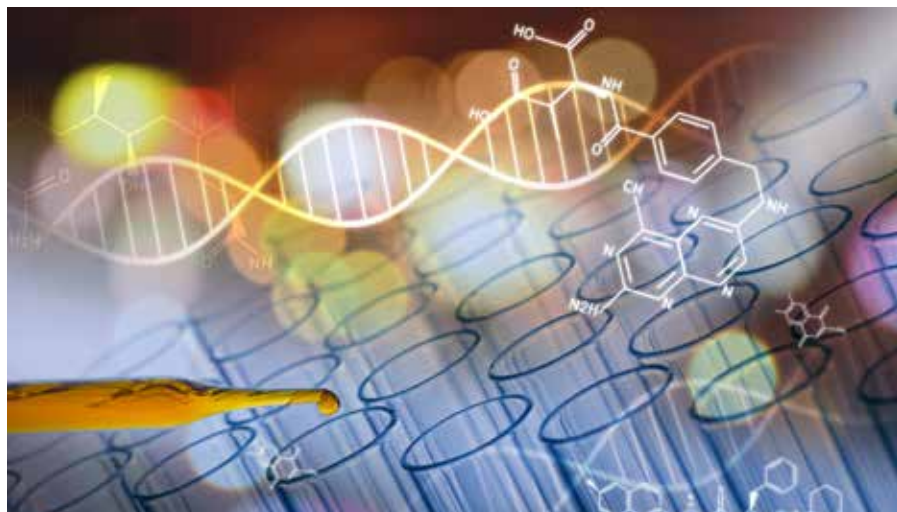
But Teflon Draghi, Mark Carnage and Kamikaze Kuroda really don't get it – and keep on pushing on the same bit of frayed string. In my opinion, only fiscal stimulus, taking advantage of ultra-low interest rates to get the necessary finance, will work. Don't worry if debt ratios blow out, ultimately inflation will erode the value of the debt. There is a limit beyond which growth isn't really possible though, but the UK, the US and even Europe haven't yet reached it.

It's probably 250% government debt relative to GDP, and so for Japan renewed growth maybe a forlorn hope. I do still believe that the Japanese market will outperform, and I would stick with it, especially Sony, which has been going well for us.

There is a window of opportunity for the Banking Bozos to right the wrongs (at least in part) that they have done to us, but it is a narrow one. Interest rates in bond markets are going to start going up soon, no matter how many bonds are bought by the central bankers. I can already see evidence of this, as JGB yields (a short recommendation [@MasterInvestor](#) Show) gently rise.



Inflation, returning to my earlier point, is coming back, and it could in the relatively near future really bite. The best counterbalances to this are of course gold and silver, and as my top rec-



ommendation of the year I would be actively adding to positions. You can buy physical gold (Britannias and Sovereigns are great being CGT free and VAT free), ETFs, miners (Condor is my favourite), or even proxies such as platinum. Gold has been drifting a bit recently, but it will go to 1500 an ounce in the next year, I believe.

Meantime, shorting bonds is a good ploy – if you can do it. 10 year Spanish bonds, 10 year bunds, 10 year US Treasuries and 10 year gilts, along with JGBs of any duration, are my picks.

It is also interesting to note that **Medivation (NASDAQ:MDVN)**, a strong buy at [@MasterInvestor](#) a few years ago, has been bought by **Pfizer (NYSE:PFE)** for \$14 billion in cash. One of the early founders of Medivation, Dr Greg Bailey, is my partner in **SalvaRx (LON:SALV)** and in **Portage Bio (OTC:PTGEF)**, both now listed, and both excellently run and exciting biotech opportunities.

But the takeout of Medivation suggests something else: Big Pharma really, really wants to get its hands on established drugs and cash flows (Xtandi, Medivation's drug for prostate cancer is selling about \$2 billion a year). This means that other deals will follow. I think **Gilead (NASDAQ:GILD)** (much

bigger) is a banker here. It's cheap (7x earnings), loaded up with cash (it has bought back \$25 billion worth of its own shares in the last year) and has some innovative stuff going on. A top recommendation now.

Next month, I'm going to get my colleagues to help me to do a piece on writing put options (or selling them, put another way) as a way of generating income in shares you like. It will be a bit technical, but I promise you it will be worth reading. You can use the same technique in FX and in metals, and I'll show you how to mitigate risk in this strategy as well.

As I said, life is about continuous learning, and this is a relatively recent strategy for us. We are doing our best to keep up with the times!

Happy hunting!

Jim Mellon



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BY FILIPE R. COSTA

THE MACRO INVESTOR

THE END OF AUSTERITY?

"Monetary policy has done as much as it really can and it needs to be complemented by fiscal policy and structural reforms,"

- Catherine Mann, chief economist at OECD

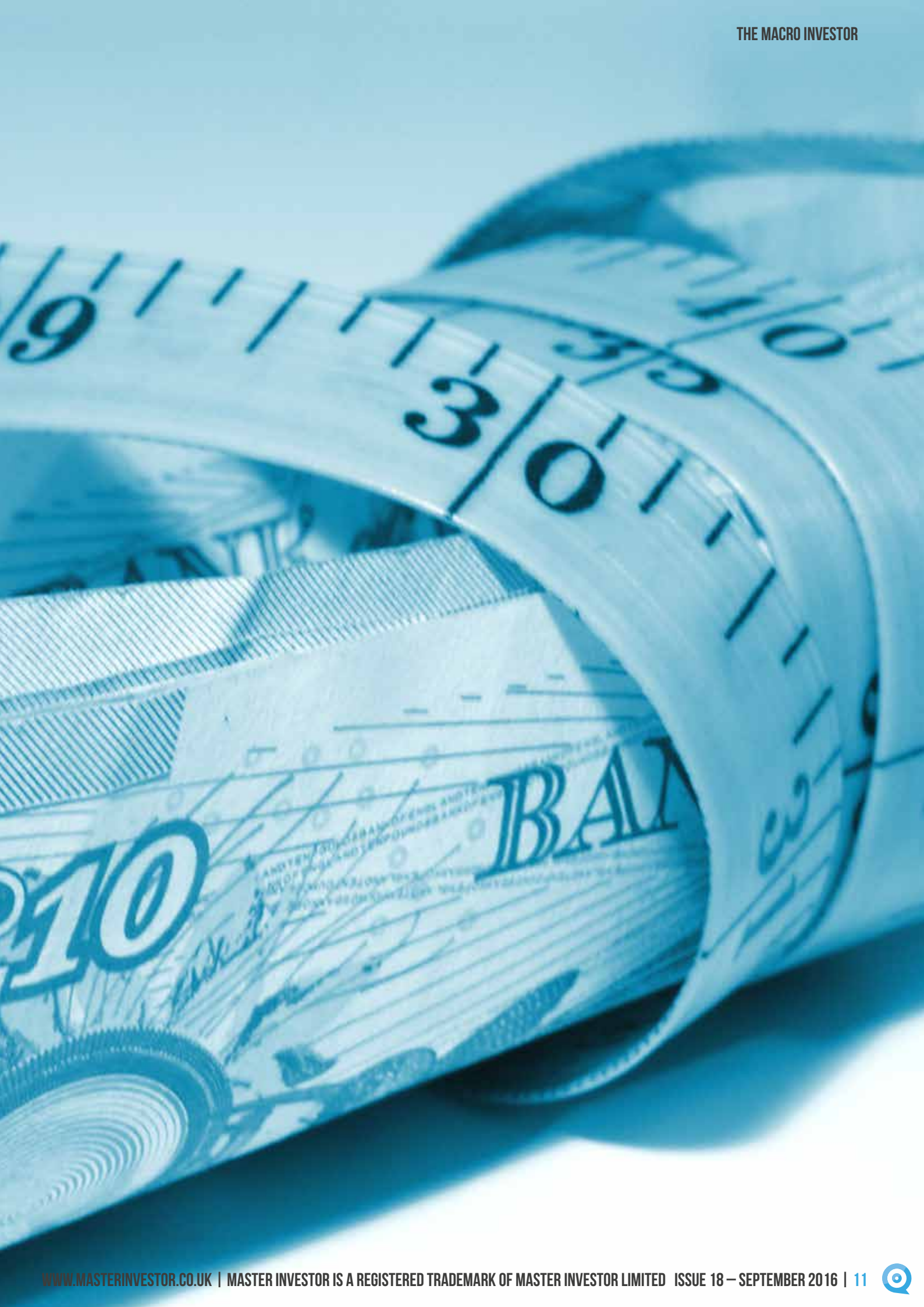
A new investment paradigm?

We're living in a year of extremes. Record high equity prices, record low oil prices, record low inflation levels, and even record low Olympic swimming times. But the biggest extreme is effectively the extent to which central banks have pushed their monetary policies, stretching their policy tools to the limits, setting record low interest rate levels and purchasing record amounts of financial assets. Activist monetary policy has become so entrenched in investors' minds that some now believe we're moving to a new investment paradigm, grounded in zero interest rates, very low real rates of return, and near-zero inflation levels, which appear to be here to stay for the foreseeable future.

For the last 30 years, central banks have been very effective at keeping inflation levels under their radar whilst leading interest rates to single digits. The independence of central banks from governments and the move from "monetary targeting" towards "inflation targeting" allowed central banks to increase their effectiveness. But during the last few years, we have also witnessed a progressive shift from fiscal policy towards monetary policy as the main economic adjustment tool.

Governments are still accountable for income redistribution matters and social policy, but they have gradually withdrawn from the responsibility of managing the business cycle, through the use of counter-cyclical policies, to rely on an ever more interventionist central

bank. The importance of monetary policy has grown to the point that the once non-existent (or at least largely ignored) press releases accompanying policy decisions have turned into big media events, where a single typo may lead to a market crash. In particular, since 2007-2008, monetary policy has regained life to the point that central banks have assigned themselves the task of managing financial markets, and in many cases have become the major equity market player (just look at the Japanese case, for example). Through direct intervention of central banks and new legislation approved after the 2007-2009 financial crisis, financial markets have been on a short leash and have more than fully recovered from the massive losses generated during the crisis.



But while it has become clear that central banks can keep asset prices inflated for however long they believe to be necessary, it has also become clear that the path that connects the financial and real economies is not straightforward and that the positive effects deriving from monetary policy are often unable to touch the real economy.

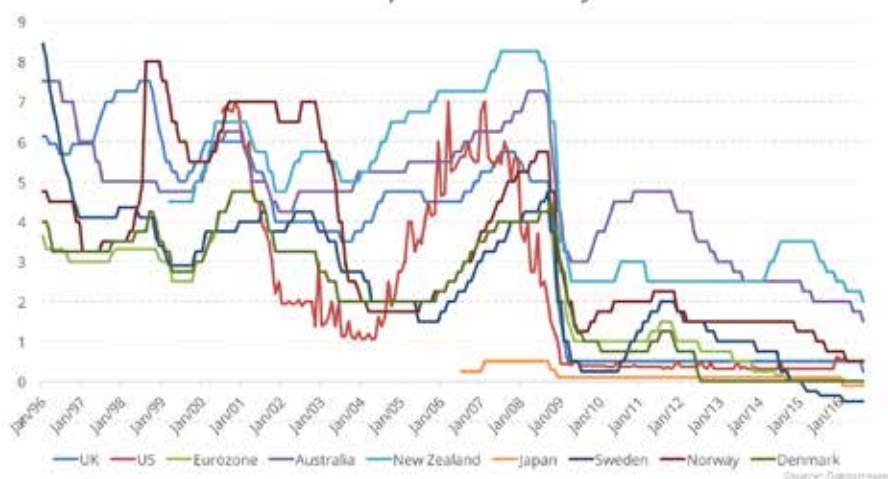
In 2007-2009, the bankruptcy of Lehman Brothers created a malfunction in the money market, where banks were unable to secure funding from one another. The Federal Reserve acted as a lender of last resort, providing the necessary liquidity to keep the banking sector oiled and thereby avoiding complete economic collapse. Meanwhile, in Europe things were complicated due to the lack of unity. The ECB acted too late and too little, creating a long-term expectation that there is indeed default risk inside the EU. Nevertheless, the liquidity squeeze was stabilised in both cases, as both the FED and the ECB ended up providing all necessary liquidity to their respective economies in order to keep the link between funding availability and borrowing necessities working properly.

But it is exactly at this point that the limitations of monetary policy become obvious. While the liquidity squeeze was easily solved, the real economy was severely wounded. With governments discarding fiscal policy as an adjustment tool, central banks extended their initial liquidity policies by cutting interest rates down to zero while engaging in large-scale asset purchase programmes in order to propel real growth. The FED, the BoE, the BoJ and later the ECB allowed their balance sheets to expand significantly. But none of them has been able to rebuild the domestic economy. And, until today, none of them has been able to normalise its policy. A decade after the financial meltdown, monetary policy is still stretched to the limit all around the world. *Is this a new normal? Or, is it the result of governments relying on ineffective policy tools?*

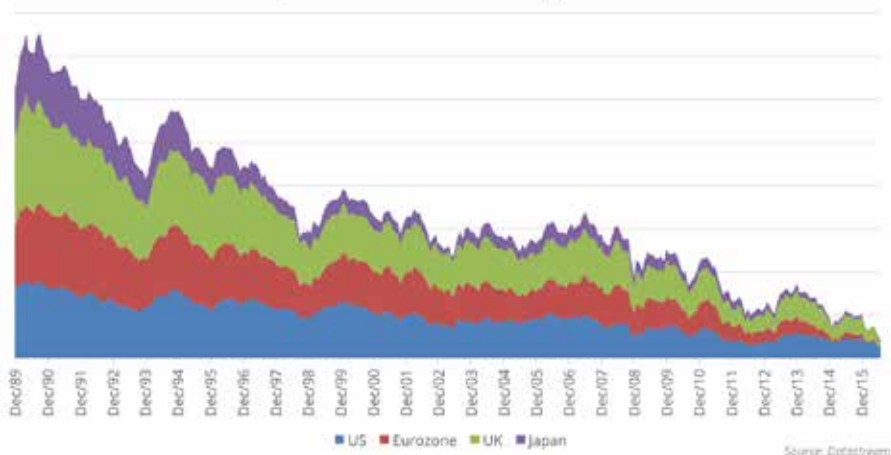
The link between policy and the real world

It's much easier to cut interest rates and purchase assets with electronic, intangible reserves than to increase

The Decline and Compression of Key Interest Rates



The Compression of Sovereign Debt Yields



“THE FED, THE BOE, THE BOJ AND LATER THE ECB ALLOWED THEIR BALANCE SHEETS TO EXPAND SIGNIFICANTLY. BUT NONE OF THEM HAS BEEN ABLE TO REBUILD THE DOMESTIC ECONOMY.”

spending. Indebted governments found comfort in monetary policy, adopting pro-cyclical fiscal measures while leaving the burden of boosting the growth to central banks. They thought that extremely dovish monetary policy could drive the economy to pre-crisis levels.

While there are quite a few policy channels behind monetary policy, the main adjustment process is relatively simple. Through depressing returns on savings and safer assets, low interest rates should encourage businesses and consumers to spend more and then create demand for goods that

would help lift inflation and boost economic growth. At the same time, from an international standpoint, the lower rates should depress currency values and also help boost the economy through improved external demand. But these features are both currently compromised.

Last month, the WSJ published an interesting article discussing the pernicious effects of interest rates, where theory often stands in contrast to reality ([“Are Negative Rates Backfiring? Here's Some Early Evidence”](#)). While some theorists continue to believe the solution lies in further cuts to interest



rates, sometimes all it takes is a visit to a real-life market to be convinced of the opposite. When asked about her opinion on interest rate cuts, a 54-year-old fruit and vegetable seller from Germany replied that she considered it to be "madness" and complained that she "now need(s) to save more than before to have enough to retire." In Japan, when questioned about borrowing, a barbecue pork seller explained, "I'm not interested in borrowing money to expand my business, whether the rate is lower or not. It is riskier." These two comments taken from real people living real lives carry important lessons that stand as evidence against the traditional wisdom of central banks.

Firstly, it is not clear that lower interest rates lead to an increase in consumption at the expense of savings. As I have been arguing in many past articles, under certain conditions households may increase their savings rate if they fear they are no longer able to achieve the same level of expected future savings. If central banks cut key rates and flatten the yield curve, and households are highly risk averse, the final result will most likely be an increase in savings rates, a decline in consumption levels and ultimately deflation and sluggish growth, and not the "expected" opposite.

Secondly, it is not clear that business investment is highly sensitive to interest rates. There's no doubt that, *ceteris paribus*, someone would prefer to borrow more at lower interest rates. But

business investment is much more sensitive to consumer demand and global risks. *Why expand a business if the installed capacity is enough and one doesn't expect demand to increase soon?* When economic conditions are weak and interest rates are already very low, borrowing becomes almost insensitive to the interest rate. At this point, what would drive borrowing higher would be improved expectations about consumer demand, which is something outside the remit of the central bank.

The aforementioned WSJ article points to a few recent studies which found that savings rates are increasing in Germany, Japan, Denmark, Switzerland and Sweden, as further evidence of policy failure. Under current conditions, it seems that interest rate cuts may be detrimental for the global economy.

One last point regarding the effectiveness of current monetary policy must be made here. Imagine a very simplified setting with a single street, two countries and two coffee shops. The street is divided between the two countries, each with its own coffee shop. At some point in time, country A believes that the economy should grow more. It then finds a way of cutting coffee prices, by depressing the value of its currency against that of country B, which acts similarly to a price cut. The coffee shop at country B would then lose some of its clients to the coffee shop at country A. As a result of it, country A should now grow faster and

“UNDER CURRENT CONDITIONS, IT SEEMS THAT INTEREST RATE CUTS MAY BE DETRIMENTAL FOR THE GLOBAL ECONOMY.”

at the expense of country B, right? Not really, because country B would most likely react in the same way and then should more or less neutralise the initial measure taken by country A.

The above example helps us to understand why trying to gain external market share through interest rate cuts might not work at a time when everyone is doing the same. This explains why the Reserve Bank of New Zealand cut interest rates in August while blaming its move on global easing. With its neighbours cutting rates, New Zealand experienced a rise in the domestic dollar, which was negatively impacting its external demand. With all major central banks around the world now following the same policy at the same time, can anyone reasonably expect much of an external boost through rate cuts? It becomes clear, then, that the exchange rate channel doesn't work as expected.



“A DECLINING RELIANCE ON CENTRAL BANKS SHOULD ALSO HELP COMMERCIAL BANKS, IN PARTICULAR IN EUROPE WHERE THESE BANKS MAKE THE MOST PART OF THEIR PROFITS FROM TRADITIONAL BANKING ACTIVITIES.”

A return to the old Keynesian fiscal policy

The above analysis of the current monetary policy framework highlights the ineffectiveness of monetary policy to boost real growth. At this point, the only solution lies in fiscal policy and in a return to the old Keynesian economics of adopting a counter-cyclical fiscal policy to manage the business cycle. In fact, apart from doing nothing and allowing a more free market adjustment, there is little option except for governments to reclaim the main policy role from central banks. That means gradually retreating from asset purchases and rate cuts while completely turning the current austerity agenda into a more counter-cyclical fiscal policy.

The financial crisis, and in particular the sovereign debt crisis, brought into Europe a new austerity view, which guided Greece into its own Great Depression, pushed Southern European economies into dire straights, led unemployment to record high levels and depressed economic growth for years. In the end, such policies didn't even

contribute to improving the debt positions of the sovereign states. The excess of austerity is also contributing to an anti-EU sentiment that has already led to Brexit and now threatens to destroy the EU completely.

But recent news holds out the possibility of a change in direction, as it becomes clear how unsuccessful austerity has been so far. In the UK, Brexit is pushing the country towards a different approach regarding government deficits. The priority now is to avoid a recession. With the BoE nearing the limits of intervention, the next round of stimulus will come from the government.

In Canada there has been a massive change in fiscal policy. The last Prime Minister, Stephen Harper, returned to budget surpluses last year after running six consecutive deficits. But the incumbent liberal government has adopted a more expansionary approach. Ottawa's view is shifting, and its liberal government, which was elected on the promise of balancing the budget, has approved a \$47 billion Canadian dollar fiscal stimulus to



spend over the next five years (around \$C120 billion for the next 10 years). After being forced to cut interest rates in 2015 due to the austerity of the past government, the Bank of Canada is now on hold, assuming a much less active role than before.

In Japan, Shinzo Abe has been betting on coordination between monetary policy and fiscal policy since being elected at the end of 2012. The prime minister has recently presented a new 28 trillion-yen stimulus package, which includes 13 trillion yen in fiscal measures, while the Bank of Japan seems to be retreating from the adoption of negative interest rates.

In continental Europe, and in particular inside the Eurozone, there's still much to do. But some core members are already abandoning austerity, as is the case with France, which is expanding its spending on security and defence. But as the ECB continues to fail at delivering the necessary results on growth, I believe that fiscal policy will become more flexible to deal with the economic cycle.

Preparing for the future

While debt yields are still declining everywhere, I believe this situation is nearing an end, as more and more governments become aware of the need for fiscal stimulus. As such, I feel that if there is any value in trading debt,

Euro Area GDP and Unemployment Rate





row. Long-term yields will start rising again, which will improve banks' balance sheets. I particularly like the **db x-trackers Stoxx Europe 600 Banks UCITS ETF (XS7R)** because it tracks European banks but is quoted in sterling.

Because inflation may come up higher than currently expected, gold looks appealing. One option is to buy the **SPDR Gold Shares ETF (GLD)**. For investors looking for a leveraged bet on gold, a good option is to buy gold miners. The **VanEck Vectors Gold Miners ETF (GDX)** and the **VanEck Vectors Junior Gold Miners ETF (GDXJ)** are good options for those who want to reduce the idiosyncratic risk that comes with picking individual equities. Regarding leverage, I must make a point here. I would prefer the leverage given by GDX and GDXJ than the leverage given by a 2x or 3x leveraged ETF on gold, because the 2x/3x leveraged ETFs suffer from the constant-leverage trap ([see my late August blogs on this matter for](#)

[more](#)). There is always a lot of volatility in commodities and precious metals markets such that these leveraged ETFs are usually weak options.

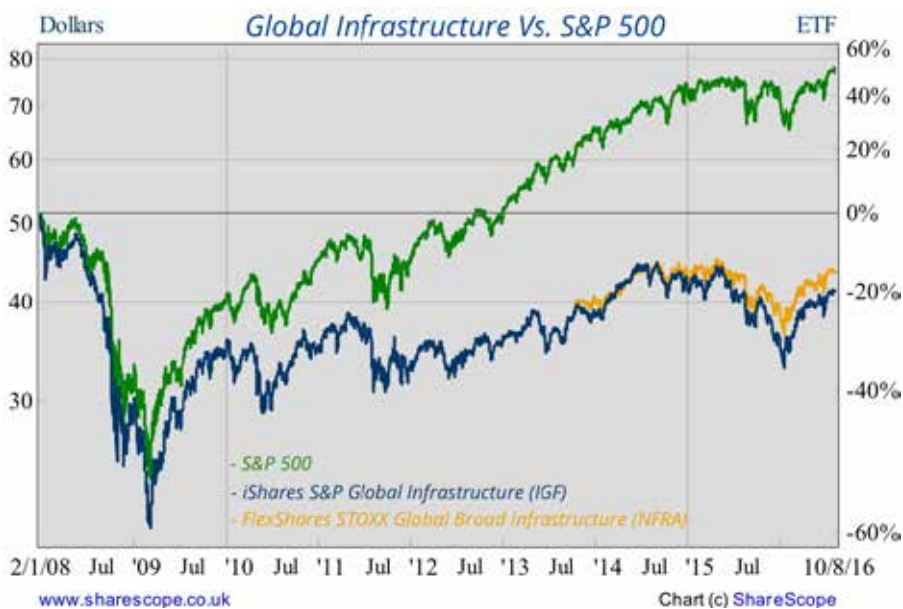
With a change of focus from monetary policy to fiscal policy, it is expected that governments will spend more on infrastructure. I like the option of buying the **iShares Global Infrastructure ETF (IGF)** as a way of getting exposure to the sector. The ETF owns shares in the transportation (40%), utilities (39%) and energy (29%) sectors, with particular exposure to the US (39%), Canada (10%), Australia (9%) and Spain (9%). An excellent alternative is the **FlexShares STOXX Global Broad Infrastructure Index Fund (NFRA)**, which provides exposure to the same three sectors as the IGF ETF but also includes two non-traditional sectors, Communication and Government Outsourcing/Social. In terms of geographical exposure, the top holdings are the US (40%), Japan (12%), Canada (11%), and the UK (8%).

it would be by means of shorting its long-term segment. I really don't see how current yields will cover future inflation. Historically, we have never had a long period of deflation and it is very unlikely that we will have one now. The population is certainly ageing in the developed world, but what brought sudden deflation to Europe was certainly not an abrupt ageing of the population. The explanation relies much more in the policies adopted in response to the crisis, rather than anything else.

While gilts are trading at record highs, I wouldn't rely on them as a store of value, as Brexit may lead to inflation coming sooner rather than later. Historically, gilts have underperformed the equity market. While risk is certainly higher for equities over short periods of time, it declines over longer periods. Holding gilts is counter-productive from a long-term investment perspective, particularly at this point.

With the current UK yield curve so flat, I believe the only reasonable option is to short gilts. A good option is to purchase the **db x-trackers UK Gilts Short Daily ETF (XUGS)**. A declining reliance on central banks should also help commercial banks, in particular in Europe where these banks make the most part of their profits from traditional banking activities. For them it is all about net interest income – the difference between the rate at which they lend and the rate at which they bor-

Accumulated Real Returns in the UK





BY BILL BLAIN

IT'S A MAD, MAD, MAD, MAD, MAD WORLD

If you want to figure out what's likely to happen in the next eight months, a good start is to try to understand what's been happening over the last eight years – since the collapse of Lehman and the beginning of the Global Financial Crisis. Understanding what a portfolio should look like to cope with whatever the next few months hold... well, that's a big question, deserving of a very big roundabout answer.

Unlike many market commentators, I'm not given to predicting the end of the world. One of the things I've noticed over my 30 years in markets is that they always over-react and over-anticipate. The trick is stripping out the noise to predict exactly when to play them. A good example was in the immediate wake of the Brexit vote when stocks tumbled. It was the perfect moment to step in and buy.

In fact, I am moderately positive. I even expect we might see some resurgence in global growth in the coming months, but I'm cautious as to how sustainable it can be. What the markets really need is normalisation – and as the recent Bank of England panicked rate cut highlights, there is little sign of that happening.

Meanwhile, there are a number of known and unknown threats out there – like Donald Trump, the Brexit situation, China's banking crisis, the European banking crisis and countless other boogie men. Markets will fret and agonise about them all. Predicting what will and won't create volatility is pretty much a guessing game,

but we can make some informed decisions on how markets are likely to function given the likely pressures. Remember, the sun usually comes up in the morning.

“AT SOME POINT WE HAVE TO PAY THE COSTS OF GLOBAL CENTRAL BANKING POLICIES SINCE 2008.”

What worries me most is the pernicious ongoing effects of market distortion caused by the last eight years of monetary policy distortion. At some point we have to pay the costs of global central banking policies since 2008 – they have created massive market imbalances and inefficiencies that need to be corrected.

Ever since the Global Financial Crash I've been trying to fathom just how

dangerous this financial Gordian knot has become. We've seen markets swaddled in rules and regulations that might well yet prove a greater threat than half-a-dozen European banks collapsing. Central banks remain in the ascendant. Banks and markets have been muzzled. Since 2008 our financial markets have been cosseted in multiple levels of regulatory cotton wool, monetary accommodation, and promises to do "whatever it takes".

Yet, has any of it made society better?

Across the globe, until very recently, the post-crisis global economy has felt weaker than ever. It's only in the last few weeks we've started again to hear and see hints of recovery in the US and UK. I'd even argue cheap money and regulations have held back real growth by focusing investment towards the instruments affected by policy.

Much of the slightly stronger sentiment in recent days follows the surprisingly benign aftermath of the Brexit vote. Many pundits and central bankers warned us a "vote-leave" financial tsunami would flatten global trade and



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“I COULD SHOW YOU LITERALLY THOUSANDS OF CORPORATES THAT HAVE BORROWED CHEAP MONEY AND USED IT TO FINANCE STOCK BUYBACKS AND EXECUTIVE INCENTIVE SCHEMES. BUT NEW REAL ASSETS? THAT’S A TOUGH ONE.”

growth. But instead, the UK's decision to exit Europe has proved a damp squib. Despite the fears, the sun still came up the next morning.

The distortion problems of the last eight years are becoming increasingly apparent. The real beneficiaries of the last seven years of monetary experimentation by the Bank of Japan, the Fed, the Bank of England, the European Central Bank and others have been investors sitting on assets that have seen value inflation as a result of the massive distortions and inefficiencies engendered over the last few years. Investors know in their hearts that some markets are profoundly overvalued as a result of distortion – but because it's ongoing they keep buying!

I recently read a fascinating piece by a US mega-investor pointing out the S&P Sales/Price ratio is at an absurdly unbalanced level – the kind of level that prefigured the dot.com bust. Yet despite it being one of the most closely correlated data sets to market moves,

the same investor is maintaining his very high equity exposures because he sees no end to the current rally in the face of distortion.

Financial asset price inflation is no substitute for real growth, but judging on the current equity valuations, markets act like it is. As long as central banks keep distorting markets – well, keep buying. The cumulative results are massive investment imbalances that will need to be rectified at some point.

The theory of monetary intervention was simple: after the crash central banks sought to make themselves relevant by enforcing "safer" markets, encouraging broken banks to lend, and by stimulating growth through lower interest rates and buying back government bonds to push money into the economy. Theoretically, all that money would quickly flow into stimulating recovery. It didn't. It created financial asset inflation. Show me a single new factory creating jobs, or growth-nurturing infrastructure projects that have

sprung into existence as a direct result of the years of Quantitative Easing and Zero Interest Rates.

I could show you literally thousands of corporates that have borrowed cheap money and used it to finance stock buybacks and executive incentive schemes. But new real assets? That's a tough one.

Things may be changing. Recently we've been getting the sense US growth is on the rebound. Global GDP expectations are edging upwards again. That's partly a result of lower interest rates driving up short-term growth. At the same time, oil prices remain low – again a positive for producers. On the other hand, a stronger dollar immediately raises commodity prices for non-dollar economies. It's a fine balance.

If there is one fundamental difference between the US and Europe (let's not worry about the UK at this point), it's banks. US banks were quickly and efficiently fixed following the crisis. They were forced to recapitalise and have subsequently thrived. European banks were not, and are still effectively broken. On top of all that, banks have been forced to stop trading, making markets less and less efficient.

Banks are important. They are the transmission mechanism between lenders and borrowers. Banks don't lend based on their expertise any more – they lend according to rules set by regulators. "Evolving" regulations have effectively ended bank lending to SMEs, long-term borrowers and a host of "risk" assets.

The problem of financial asset inflation is exacerbated in today's financial environment because banks no longer operate as the distributor of efficiently allocated capital as determined by the invisible hand of markets. Capital is allocated on the basis of banks optimising the capital rules.

The result is further massive ongoing distortion across markets and assets. Bond yields – negative across much of the government and even corporate bond sector – are so low investors are forced to partake in "yield tourism" to garner real returns. That means taking more, not less, risk. In Japan, for exam-





ple, investors are coat-tailing the BoJ, which has embarked on a massive programme of equity purchases.

One primary reason stock indices remain so high is the effect of bond money seeking higher returns. In such an environment it's easy to believe high equity prices can be sustained for ever – or at least as long as the distortion continues. Don't believe it. When it looks like the distortion is going to be exposed – that moment when the little boy shouts out "The King is Naked" – then the market gyrations could be extraordinary.

Yet, despite the increasing dangers posed by monetary distortion (and the number of senior policy makers who admit it needs to be addressed), much to no one's surprise the Bank of England embarked on a bit of post-Brexit monetary Health & Safety overkill back in August. As the economy teetered on the edge of meltdown following Brexit, Mark Carney saved the day and the UK by slashing interest rates by 0.25%. More than one commentator has pointed out that seven years of QE et al have not boosted growth.

Please. There was no risk of meltdown. The economy had a minor hiccup post Brexit. The BoE's intervention was utterly unnecessary and pointless. It was a bit embarrassing. Mr Carney had told us a Brexit vote would destroy the UK and that therefore his intervention was required. No it wasn't. With hindsight,

“IT COULD BE YEARS BEFORE REAL GROWTH JUSTIFIES CURRENT VALUATIONS.”





the impossibly tight gilt yields that have followed might ultimately get Mr Carney a one-way flight home to Ottawa. Who benefits? Borrowers? Not really. Savers are stuffed.

So what's likely to happen in the coming months?

There are three big "known" threats: i) bonds, ii) equities, and iii) Donald Trump. (There are lots of little issues as well, but if anyone can explain to me why oil prices should spike higher, I'd love to know. Forget all the usual panics about China and wherever.)

Let's start with Trump. The "Stupid Voter" thesis suggests the anti-establishment loners like Trump can get elected because of rising distrust in the system by otherwise disinterested citizens. It's much the same game as the Brexit vote. I'm reliably informed by some US friends that Trump is the greatest threat to the US and global economy since Bunker Hill.

Yeah. Sure he is. Get over it. If – and it's still a big if – he gets the job, he won't have a free hand. Some folk even suggest that past his awful manner, appalling manners and dreadful rhetoric,

polices like lower taxes will help the US economy. Longer term, a really bad president might just remind Americans just how important it is to elect really good ones.

I suspect that come November we'll see markets extremely nervous on the US election. They will panic and it will all quickly subside when the sun inevitably comes up the next morning.

Bonds are an interesting case for concern. Many pundits believe they are set for a massive sell off and dump – especially as the US may be on track to raise bond yields by a whole percentage point over the next two or three years. Ouch. Rising rates would certainly suggest that a repricing of bond assets is likely – but we're not so sure it will be catastrophic.

Money has to go somewhere and a rising dollar will attract investment – which is most likely to go into the highest yielding quality bond market – US Treasuries. How sustainable the ultra-low rates elsewhere are is open to question. I suspect a sell off is a high probability, but not the degree of 'bondfire' some commentators predict.

And any sell off will be slowed because many market participants will continue to believe central banks will step in with yet more distortion if things were to get out of hand. And therein lies another unpalatable consequence of the policies followed since the Global Crash of 2008: moral hazard. Due to the moral hazard aspects of taxpayer-funded bailouts, bank regulators have declared that banks should no longer be Too Big to Fail, but the last eight years have established a false confidence among investors that central banks will step in to back stop markets. That's a really bad precedent to establish.

As for equities, why all the excitement? If the global economy is in recovery mode, then that's a positive. But the truth is it will remain in the recovery room for many years yet. Interest rates will remain low and that should support the market. But what room for upside? It could be years before real growth justifies current valuations.

However, perhaps a more sensible approach would be a back to basics market reset. Or how about real returns from real risk assets? We're seeing a rise in the number of institutional investors participating in real assets: financing aircraft, shipping, infrastructure, trade finance etc. – all the risk investment sectors that banks no longer care to get involved in. These produce exactly the real risk-weighted returns real investors are looking for. The problem for retail investors is how to share the rewards. Investing in lending platforms or buying alternative investment funds, maybe?

Whatever happens over the next few months, it's going to remain interesting. Cheap fuel and low interest rates bode well for growth, but the creation of real jobs that create consumption (as opposed to low wage Mc-Jobs) remains an issue. That means slow growth and the risk of markets remaining addicted to the teat of central bank monetary distortion.

Has anyone in the central banking community heard of fiscal policy?

About Bill

Bill Blain is Head of Capital Markets at Mint Partners, and a regular market commentator.

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BY JOHN KINGHAM

THE DIVIDEND HUNTER

CAN LEGAL & GENERAL'S MARKET-BUSTING YIELD BE TRUSTED?

Most of the time, when a stock has a dividend yield which is significantly higher than the market average there's a good chance the dividend is about to be cut or suspended. It happened recently to BHP Billiton and Rio Tinto, although perhaps that is understandable since both are highly cyclical companies. It can also happen to more defensive "blue chip" stocks, with Tesco being a good example. Like Tesco a few years ago, Legal & General (LON:L&G) is a relatively defensive company offering investors a very high yield (6.5% as I write). As a dividend-focused investor my interest is certainly peaked, but will L&G just turn out to be another Tesco?

Investors in L&G have been here before

This isn't the first time L&G has offered investors an enticing dividend yield. The most recent and extreme example came during the financial crisis. As a financial company in a world undergoing a financial crisis, it's not surprising that the company's shares were clobbered. Between 2007 and 2009 the share price declined by more than 80% from almost 160p to less than 30p. For several weeks in early 2009 L&G's shares offered a dividend yield of more than 20%, and no, that isn't a typo.

But that spectacular yield didn't last. A dividend cut of more than 30% was announced in March 2009 and so – at least in some respects – the market was right to have pushed the share price down. In retrospect though, the price decline was massively overdone.

The dividend was only reduced to around 4p, and so a sub-30p share price still made L&G one of the great bargains of the financial crisis. By 2015 the share price had rallied over 1,000% to almost 300p, so buying L&G with a double digit yield in 2009 turned out to be a very smart (or very lucky) thing to have done.

A successful track record provides some degree of comfort

Other than cutting the dividend in its 2008 and 2009 results, what has L&G done in the past? The answer is quite a lot. Purely in terms of financial results the last ten years have mostly been very successful, as Chart 1 shows.

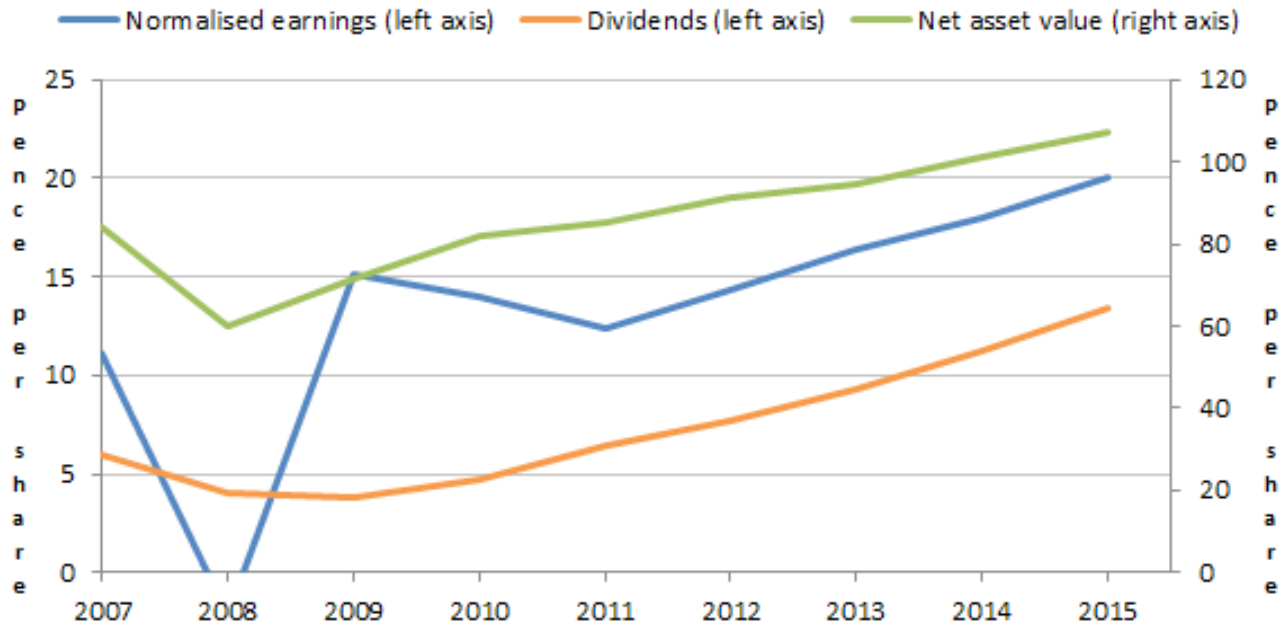
Of course, the period covered in the chart starts out badly thanks to the financial crisis, but even allowing for that, the company's post-crisis recovery has been very impressive. Dividends have been growing



**“THIS ISN’T
THE FIRST
TIME L&G
HAS OFFERED
INVESTORS
AN ENTICING
DIVIDEND
YIELD.”**



Chart 1: L&G's Recent Financial Results



by around 20% per year, earnings by just over 10% and net assets (or book value) by about 6% per year.

“HIGH RETURNS ON EQUITY ARE TYPICALLY THE RESULT OF EITHER COMPETITIVE ADVANTAGES OR AN AGGRESSIVE USE OF LEVERAGE.”

What's also obvious from that chart is the consistency of the recovery, with net assets and dividends growing in every post-crisis year and earnings in almost every year. If you're looking for a high yield stock from a company with a track record of consistently growing its dividend (bar the occasional crisis-induced cut) then L&G certainly fits that bill.

Another positive aspect of L&G is its consistently high profitability – i.e. its return on shareholder equity. On aver-

age this has been close to 19%, which is better than most companies and better than most life insurers as well. High returns on equity are typically the result of either competitive advantages or an aggressive use of leverage.

Since high levels of leverage can be dangerous it's worth taking a look at how much debt and other forms of leverage L&G has used to produce its impressive growth rate. If its use of leverage is not excessive then perhaps its high levels of profitability are driven instead by competitive advantages.

L&G's use of leverage appears to be relatively prudent

Taking interest-bearing debts first, the company has £411m of operational borrowings. My usual approach to measuring the appropriateness of a company's debts is to compare them to its recent profits. In this case L&G's post-tax normalised profits have averaged £966m over the past five years, so the ratio between its operational borrowings and its recent profits (which I call the debt ratio) is 0.4.

That's actually quite low as most companies have a debt ratio between one and five, and as long as the ratio is below four I'm not usually worried. L&G's ratio of 0.4 means its operational borrowings are unlikely to be a cause of

major problems when the next inevitable bump in the road comes along.

Another form of leverage, or "borrowed money", which insurance companies use is the insurance premiums paid in by customers. As insurance premiums are paid in they effectively go into one big pot which is then used to pay out claims as they arise. This "insurance float" sits on the balance sheet as an asset and most life insurance companies invest it in things like equities, bonds and property in order to generate an additional investment return.

On the other side of the balance sheet sits the value of expected future claims, which is a liability to the insurance company. It is of course a good idea to make sure that there are more than enough premium assets to cover all of the expected claim liabilities; in other words there should be a surplus of premiums over expected claims.

How big should this surplus be?

On the one hand a bigger surplus means a bigger margin of safety against the risk that actual future claims turn out to be larger than expected or that investment returns turn out to be negative. But a larger premium surplus typically means higher premium prices which may not be price competitive

“THERE ARE AROUND \$9 TRILLION OF DEFINED BENEFIT PENSION LIABILITIES GLOBALLY, AND A GROWING NUMBER OF COMPANIES ARE LOOKING TO OFFLOAD THOSE LIABILITIES ONTO COMPANIES – SUCH AS L&G – WHO HAVE THE RIGHT EXPERTISE TO DEAL WITH THEM.”

against other insurers. That in turn means the overall amount of insurance written and premiums invested could be smaller, which could mean less insurance and investment profit will be generated.

On the other hand, a smaller premium surplus typically means lower premium prices, which leads to more insurance being written and a larger pot of premiums to invest. That of course can lead to more insurance and investment profits. In fact this model is sometimes taken to extremes where insurance is written at an expected loss (i.e. premiums are too low to cover expected claims) in order to write more policies and gather more premiums. The hope is that those additional premiums can produce investment returns that more than offset the expected insurance loss. This low premium surplus model is, as you might expect, much more risky and in the long run most insurance companies aim for a surplus which is somewhere in the middle.



There are various ways of measuring the appropriateness of a company's premium surplus, but my preferred approach is to use the premium/surplus ratio, which compares how much premium an insurance company has earned to its premium surplus. To calculate the ratio I use net earned premium from the income statement and tangible shareholder equity from the balance sheet. If the ratio between them is more than two then the com-



pany's premium surplus may be dangerously thin.

In L&G's case it reported net earned premiums of £4.7bn in the latest annual results along with tangible shareholder equity of £6.0bn, giving the company a premium/surplus ratio of 0.8. Taking a longer view, over the past five years the average premium/surplus ratio has been 1.2.

On the face of it that looks fairly prudent, but the picture is clouded somewhat by L&G's business model, which involves running several closely related but largely separate businesses (which I'll outline in a moment). Having looked at the accounts in a bit more detail I can't see any obvious reason why this prudent-seeming premium/surplus ratio would be hugely misleading, so I'll assume it isn't.

Having said that, the company's past isn't an unending picture of low-risk

bliss. In the crisis years of 2008 and 2009 the premium/surplus ratio grew to 4.3 and 2.3 respectively, indicating the stress the company's balance sheet was under as equity markets collapsed.

The company's predictable response to the crisis was to "de-risk" its investments by lowering their equity allocation, which is the opposite of what modern portfolio theory tells us to do (it says to buy assets that have fallen in value rather than sell them as L&G did). L&G's position as a forced seller in the crisis is a good example of why markets are not price efficient, as many investors large and small buy or sell for reasons other than price and value alone.

So after all that number-gazing where does that leave L&G? As far as I can see it's a highly profitable, prudently managed company that has produced consistent and successful results since its





(arguably impressively small) stumble during the financial crisis.

That's good to know, but I also like to know a little bit about what a company actually does to produce its financial results, and also what it might do in the future. So let's have a look at that now.

Transitioning from life insurer to asset manager

L&G's primary purpose is to "help people achieve financial security and [to] invest in the future of society". Its strategy for achieving this goal is to run several complementary businesses in order to take advantage of the various synergies and cross-selling opportunities which they provide.

Today those businesses are: Retirement, which deals with pensions for individuals and corporate pension schemes (through annuities and related products); Insurance, which is mostly life but also general (or non-life) insurance; Savings and Investment Management, which manufacture low-cost savings and investment products; Capital, which invests "slow money" from annuity premium generated by the Retirement business (it's called "slow money" because unlike life insurance premiums, annuity premiums don't have to be held in liquid assets as they will never be paid out to cover a claim. As a result annuity premiums can be invested in illiquid real assets such as buildings and infrastructure).

Putting it another way, the company consists primarily of asset management businesses (Investment Management, Capital and Savings) and businesses which funnel assets into those asset managers (Retirement and Insurance). That puts asset management, rather than life insurance, at the heart of the business, and that trend is expected to continue into the future.

However, perhaps a more important and certainly more impressive trend is the rapid growth of the company's Retirement business, which focuses on de-risking defined benefit pension schemes. The problem of underfunded pension schemes is becoming a mainstream issue thanks largely to the mess that is British Home Stores, but it is also a global issue. There are around \$9 trillion of defined benefit

pension liabilities globally, and a growing number of companies are looking to offload those liabilities onto companies – such as L&G – who have the right expertise to deal with them.

2011 marked a watershed year with L&G taking on its first £1 billion bulk-annuity scheme as well as writing its first longevity swap transaction (longevity swaps help pension schemes hedge their exposure to the risk of pensioners living longer than expected). In 2012 the Retirement business unit was spun out from the previous Risk unit (which covered both retirement annuities and life insurance) and since then Retirement's operating profits have soared from £281m to £639m, driving much of L&G's recent growth.

Although the UK pension risk transfer



market is expected to continue to grow at a healthy rate, L&G is also looking abroad – and especially to the US – for additional deals and faster growth. This is perhaps the most interesting aspect of the company: its access to a leading position in what could potentially be a high growth market over the next ten or twenty years.

A value trap? Perhaps, but I don't think it's likely

As always there is a chance that it could all go horribly wrong. After all, life insurance is a cyclical industry and the company's profits and dividends could take a hammering in the next inevitable bear market. But at a share price of 207p and with a dividend yield of 6.5%, I think that sort of cyclical and non-life threatening risk is already factored into the price.

I'm more concerned about structural risks that could permanently damage the company, such as excessive leverage or a market which is in permanent decline. As far as I can tell, the company is not obviously exposed to that sort of structural risk, although of course that could change in the future.

As things stand then, L&G has an extensive list of attractive features, from its long and largely successful track record to its high profitability, (seem-

ingly) prudent use of leverage, its leading position in a global growth market and its progressive dividend policy.

So with an impressively high dividend yield of 6.5%, do I think L&G is a potential bargain or the next Tesco? The

answer by now should be obvious. Clearly there are no sure-fire bets in the stock market, but I wouldn't be the least bit surprised if by the end of the year Legal & General made up three or four percent of my portfolio.



“L&G HAS AN EXTENSIVE LIST OF ATTRACTIVE FEATURES, FROM ITS LONG AND LARGELY SUCCESSFUL TRACK RECORD TO ITS HIGH PROFITABILITY, (SEEMINGLY) PRUDENT USE OF LEVERAGE, ITS LEADING POSITION IN A GLOBAL GROWTH MARKET AND ITS PROGRESSIVE DIVIDEND POLICY.”

About John

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

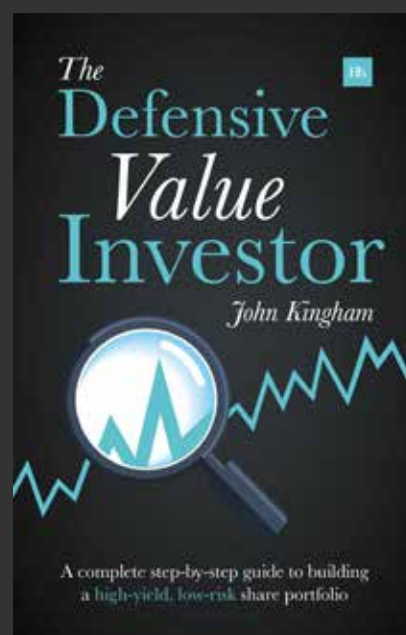
John is also the author of *The Defensive Value Investor: A Complete Step-By-Step Guide to Building a High Yield, Low Risk Share Portfolio*.

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BY NICK SUDBURY

FUNDS IN FOCUS

50 SHADES OF GREY: THE FUNDS TRYING TO DO NO EVIL



It is hard to think of an area that divides opinion more strongly than Socially Responsible Investing (SRI). Those who believe in it think that companies that follow these principles will outperform and by actively engaging with those that don't they can change the world for the better, whereas sceptics dismiss it as nothing more than emotive advertising. There is also the more practical problem of finding a fund that reflects your own personal point of view, which makes it less black and white and more like 50 shades of grey (but without the erotica).

The first ethical funds in the UK were created in 1984 when Friends Life launched its Stewardship range. Many other providers have since followed their example and it is thought that there are now around 100 of these products available. Yet it remains a niche area accounting for £10.7bn or 1% of total assets under man-

“ONE PERSON’S VIEW OF WHAT IS ETHICAL CAN BE VERY DIFFERENT FROM THAT OF SOMEONE ELSE, SO THEY NEED TO CAREFULLY RESEARCH THE REMIT TO MAKE SURE THAT THEY ARE COMFORTABLE WITH WHAT THE FUND IS DOING.”

agement according to the Investment Association.

Traditionally these funds used a form of negative screening to eliminate undesirable businesses from their investible universe. The problem with this approach is that it can knock out large areas of the market, which is why some firms have developed a 'best-in-class' strategy that enables them to invest in the most socially responsible companies even if they are operating in unethical industries.

Many of the more recent mandates use positive screening to identify those businesses that are making a beneficial contribution to society or the environment. They will usually have the words SRI, sustainable or environmental in their title and will normally engage with the directors of the companies they invest in to try to improve their policies.

Grey area

The problem for investors is that one person's view of what is ethical can be very different from that of someone else, so they need to carefully research the remit to make sure that they are comfortable with what the fund is doing.

They also need to be mindful of the fact that positive and negative screening will reduce



the number of stocks that the manager can choose from and the more extreme the process, the smaller the resulting universe. This means that their stock selection skills are likely to be absolutely critical to the final performance.

Another point to be aware of is that the screening process can lead to systematic biases that can result in periods when they significantly out- or under-perform the wider market because they don't invest in a particular area.

For example, in 2015 many of the more generalist ethical funds benefited from the weak commodity prices because of their low exposure to oil companies and natural resources stocks. The collapse in the oil price also made many alternative sources of energy less competitive, which had a negative effect on clean energy funds like **Guinness Alternative Energy**, **BlackRock Global Funds New Energy** and **Pictet Clean Energy**.

Brexit has had an impact as well. The stricter – or dark green – ethical funds that avoid anything even slightly 'bad' will have missed out on the sharp rally in the Pharmaceutical and Tobacco sectors. From the date of the referendum to 19 August these segments of the FTSE 350 were up 22% and 13% respectively because of their significant dollar denominated earnings.

UK All Companies

The majority of ethical funds operate in the UK All Companies sector where



the likes of **Premier Ethical**, **Kames Ethical Equity** and **F&C Responsible UK Equity Growth** all appear high in the list of strongest performers with five-year returns in excess of 96%.

The £119m Premier Ethical fund invests in companies whose business is based on ethical principles, especially those that contribute to the requirements of a sustainable civilised society and whose products or services are of widespread benefit to the community. It aims to support firms that are improving their ethical behaviour, while avoiding those in harmful areas such as tobacco.

Chris Wright, the manager, has put together a relatively concentrated portfolio of 68 holdings with the main sector exposures being Financials 31.3%, Consumer Discretionary 15.4% and Information Technology 14.7%. It has returned 74.7% over the five years to the end of July, which is considerably better than the 48.5% achieved by its FTSE4Good UK benchmark.

The £523m Kames Ethical Equity fund uses a 'dark green' screen that is aimed at investors with a strict ethical philosophy. This is designed to capture a range of environmental, social and governance issues, while weeding out companies that engage in certain unacceptable activities such as mining and tobacco.

Audrey Ryan, the manager, has a significant overweight position in mid-cap stocks that make up 37.7% of the fund compared to just 15.5% in the



FTSE All-Share benchmark. Her main sector overweights are Consumer Services and Technology, with the biggest underweights being Consumer Goods and Oil & Gas.

The Kames fund is one of the first to operate in this area, having been launched in April 1989, and has a decent record over the last five years compared to the UK All Companies sector. Over the longer term it has lagged behind the FTSE All-Share with an annualised return since launch of 7.86% compared to the 8.33% achieved by the index.

The £359.7m F&C Responsible UK Equity Growth fund has been around even longer having been created in June 1984. It has a slightly different approach to the others as it invests in UK companies whose products and operations are considered of long-term benefit to the community at home and abroad.

Some people may find it surprising that its top 10 holdings include the likes of GlaxoSmithKline and AstraZeneca, but it just goes to show that there is no universally accepted definition of an ethical investment. Those who are comfortable with these sorts of stocks will have done pretty well out of it as the fund has returned 63.3% in the five years to the end of July compared to the 44.1% increase in the FTSE All-Share.



“ONE OF THE MAIN DIFFICULTIES IS THE SYSTEMATIC BIAS CREATED BY SCREENING OUT ‘BAD’ PARTS OF THE MARKET LIKE MINING STOCKS, AS THIS CAN WORK FOR OR AGAINST YOU.”

Other areas of the market

Ethical investors who want to add an element of global diversification to their portfolio might be interested in the £476m **Jupiter Ecology** fund. This is a mid sector performer with a five-year return of 86.4%.

The Jupiter fund invests in international companies that demonstrate a positive commitment to the long-term protection of the environment. Charlie Thomas, its manager, has put together a relatively concentrated portfolio of 66 stocks that range from \$10bn mega caps down to \$500m small caps.

Most of the fund is invested in the US, Europe and the UK with the largest holdings including the likes of Cran-swick, a British supplier of premium foods; LKQ, a US provider of alternative collision care parts; Vestas Wind Systems, a manufacturer of wind turbines; and A.O. Smith, an American supplier of hot water heaters.

It is normally quite difficult to compare the performance of an ethical mandate with a directly equivalent mainstream alternative, but that is not the case with the **Stewart Asia Pacific** fund and the firm's **Asia Pacific Sustainability** fund. Both operate in the same geographic region, although the latter will only invest in companies which are positioned to benefit from, and contribute to, the sustainable devel-

opment of the countries in which they operate.

The two funds are near the top of the Asia Pacific ex Japan sector with the SRI mandate leading the way with a five-year return of 111.4%, pushing its unconstrained equivalent into third place with its gain of 94.1%. They are not completely analogous as they have different managers, but they are pretty close and both have had to bring in an initial charge of 4% to limit further investment.

There are also less volatile options such as the £558m **Kames Ethical Cautious Managed** fund, which operates in the Mixed Investment 20% to 60% Shares sector. This is one of the best performers and is ranked second in its peer group with a five-year return of 68.2%.

It has the same manager and uses the same ethical criteria as the firm's UK All Companies fund, but is a lot more diversified with 238 equity and bond holdings. The list of the top 10 positions is virtually identical except that the weightings are smaller.

Income investors may prefer a fixed income fund like **Rathbone Ethical Bond**. This screens out securities in areas such as armaments, animal testing and tobacco, and screens them in where the issuers have good human rights records and manage their environmental impact.

Bryn Jones, the manager, looks for investment grade bonds with a high yield, while paying close attention to the underlying cash flow and strength of the balance sheet to minimise the risk of a default or downgrade. The £460m fund is spread across 172 holdings and has a historical distribution yield of 4.7%, which is one of the

highest in the Sterling Corporate Bond sector.

Does it pay to be good?

It is impossible to say if ethical investing is more or less profitable than an unconstrained approach as you can't directly compare the performance of the different funds. One of the main difficulties is the systematic bias created by screening out 'bad' parts of the market like mining stocks, as this can work for or against you.

Having a smaller investible universe means that the fund manager will need exceptional stock picking skills to make up for the fact that some of the best performers may not be available to them. The problem is that you can only really assess this by looking at the performance relative to an appropriate benchmark, but most of the UK All Companies funds seem to use the FTSE All-Share, which doesn't reflect the list of stocks that they can choose from.

Critics of SRI say that it is just a case of emotive advertising and doesn't make any real difference, but fund managers who actively engage with the directors of the companies they invest in are in a great position to argue their case.

The more optimistic believe that ethical or socially responsible companies should experience strong long-term outperformance, especially as the world moves towards more sustainable technologies and better corporate practices.

Anyone with this sort of outlook is likely to keep investing in this area as long as the fund does what they want it to and the performance is acceptable, but it is likely to remain a niche part of the market.





BY FILIPE R. COSTA

HOW TO INVEST LIKE...

JOHN BOGLE

"The reality of the investment business is that we investors (as a group) not only don't get what we pay for (the returns earned by our corporations), we get precisely what we don't pay for. So the less we pay (as a group), the more we get. And if we pay nothing (or almost nothing, as in an all-stock-market index fund), we get everything (the market return)."

— John Bogle in *Journal of Portfolio Management* (2011)

Are investors rational and markets efficient?

In past editions of this column, we have invited the reader to travel through the world of value investment. Jesse Livermore, Peter Lynch, John Templeton, Warren Buffett and Benjamin Graham are some of the most respected value investors. They all see investment as a long-term activity, consisting of in-depth research to uncover opportunities arising from erratic short-term price movements, to then open positions and wait for the long-term to replace sentiment with rationality. Value investors ignore the premise on which portfolio theory is grounded, replacing the rational investor with a sentimental trader and the efficient market with a market exposed to herds that lead to over- and under-reaction to events

and thus producing the disconnection of prices from fundamental values.



In the last edition, we reviewed one of the greatest investors of our time – George Soros. Unlike the others, Soros is not even sure about the long-term conversion of prices to fundamentals. He believes that *"man fails at predicting the future because knowledge is incomplete, biased and inconsistent. But, such skewness influences the way people act,*

changing the reality in which they participate. Human action is then much better characterised by fallibility and reflexivity than by rationality." Like Soros, none of the above investors believe in the traditional scientific approach that created an unemotional, rational, fully-capable individual who always makes the best decisions. Soros, in particular, criticises the fact that most theoretical models depart from the idea of equilibrium, when in fact the most common situation seems to be disequilibrium, resulting in a complete failure to explain reality.

But today we're going to look at the other side of the argument. If some believe in psychology as an important price driver, others believe in the power of mathematics and exact science. If they're right, and the human



Antonio Scorza / Shutterstock.com



being is indeed rational and markets are efficient, then investors shouldn't spend time and valuable resources researching the market. The best course of action would be to buy and hold the market portfolio, as predicated by the Modern Portfolio Theory, the Capital Asset Pricing Model and their subsequent developments. Any excess returns would just be compensation for the higher risk taken.

John Bogle is on the side of rationality and efficiency and in this vein he created (or at least gave life to) what is today known as passive investment strategies. If investors can today invest in equity indices like the S&P 500 or the FTSE 100, in specific sectors, in global portfolios and in groups of commodities, that should be mainly credited to Bogle and his efforts to create an investment vehicle that would maximise the returns of an investor that can't beat the market. Bogle's contribution is not only in adding evidence to the long-running dispute between active and passive investment strategies, but in making it possible for the retail investor to hold a well-diversified portfolio at a very low cost.

From the Great Depression to Vanguard

If George Soros owes much of his success to World War II, John Bogle owes much of his to the Great Depression. While this may sound weird, the truth is that both men were heavily influenced by these unfortunate episodes. In Soros's case, escaping from the war planted the seeds for his risk awareness that helped him place fearless trades when he had the best opportunities to do so. An example of this would be the trade that "broke the Bank of England" in 1992. In Bogle's case, the misery in which the Great Depression left his family sharpened his abilities such that he fought hard to get full scholarships that led him in the direction of the best schools and ultimately Princeton University. While at Princeton, Bogle met Paul Samuelson, who played a key role in encouraging him to launch the first ever index fund.

John "Jack" Bogle is now 87 years old, having retired from The Vanguard Group in 1999. He was born in New Jersey in 1929, at the peak of the Great

“BOGLE’S CONTRIBUTION IS NOT ONLY IN ADDING EVIDENCE TO THE LONG-RUNNING DISPUTE BETWEEN ACTIVE AND PASSIVE INVESTMENT STRATEGIES, BUT IN MAKING IT POSSIBLE FOR THE RETAIL INVESTOR TO HOLD A WELL-DIVERSIFIED PORTFOLIO AT A VERY LOW COST.”



Depression. His family lost their inheritance and had to sell their home during this period, which led his father to fall into alcoholism, and to the subsequent divorce of his parents. But his family miseries led him to become a skilful student who got a full scholarship, which enabled him to graduate from the prestigious Princeton University. At Princeton he studied finance and economics and he was determined to examine the subject of the mutual fund industry. The research would become crucial in his professional life, as he would found The Vanguard Group 25 years later and create the first passive mutual fund, borrowing much from the findings of his research. Such achievement would later earn him an honorary doctorate from Princeton.

Just after graduating in 1951, Bogle landed a job at the Wellington Fund, where he showed great talent. He was able to rise through the ranks until becoming chairman of the fund. He later got fired, as he made a huge mis-

take when approving a merger during the Go-go era. But the most positive achievements always come from disruption. Bogle learned an important investment lesson from this mistake and ended founding Vanguard, in 1974. Influenced by the efficient market hypothesis of Fama and the encouragement of Samuelson, Bogle created the Vanguard 500 Index Fund in 1975, the first index mutual fund available to the general public.

Success is born from failure

The main idea behind the *Vanguard 500 index Fund* (at that time named *First Index Investment Trust*) was to create a passive equity management entity that would be able to outpace actively managed funds and mirror the performance of the market. During his research using the data on the performance of mutual funds, Bogle found that it couldn't be said that they outperformed the market. Over a

long period of time, actively managed funds couldn't consistently beat passive funds after accounting for the fees charged by active funds.

While Bogle was convinced of the strength of his theories, his passive management strategy was derided by the investment industry, which often referred to his index fund as "Bogle's Folly". The official underwriting of the *First Index Trust* occurred on 31 August 1976 and came in at \$11.3 million, 93% short of the expected \$150 million. It was such a failure that the underwriters suggested calling off the whole deal. Fortunately, Bogle wasn't deterred and was able to progressively grow this fund and turn Vanguard into a \$2 trillion asset manager, holding more than 170 funds.

“FOR BOGLE, LONG-TERM INVESTMENT ‘REFLECTS THE CULTURE OF THE INTELLECTUAL, THE PHILOSOPHER, AND THE HISTORIAN’. SHORT-TERM INVESTMENT, ON THE OTHER HAND, REFLECTS ‘THE CULTURE OF THE STATISTICIAN, THE TECHNOCRAT, AND THE ALCHEMIST’.”

Recent data shown on the *Lipper Performance Report*, ranks the *Vanguard 500 Index* as the second largest US mutual fund, with assets under management of \$163.5 billion, just \$15 billion shy of the SPDR S&P 500 ETF. Vanguard has seven funds in the top 10, which is living proof of the success achieved by Bogle's passive management strategy. Had he been deterred after his initial failure, we would today miss the op-

LARGEST US MUTUAL FUNDS

Rank	Ticker	Fund Name	Assets (millions of USD)
1	SPY	SPDR S&P 500 (ETF)	178,790.0
2	VFIAX	Vanguard 500 Index Adm	163,456.4
3	VTSAX	Vanguard Total Stock Mkt Idx Adm	136,131.8
4	VINIX	Vanguard Institutional Index	110,407.9
5	VTSMX	Vanguard Total Stock Mkt Idx Investor	98,869.4
6	VIIIX	Vanguard Institutional Index Plus	93,192.4
7	VGTSX	Vanguard Total Intl Stock Mkt Idx Investor	81,937.0
8	FCNTX	Fidelity Contrafund	75,239.1
9	VITPX	Vanguard Total Stock Mkt Idx Inst Plus	74,044.0
10	AMECX	American Funds Inc Fund of Amer A	74,044.0

Source: Lipper Performance Report, 28/Jul/16

portunity to gain exposure to a broad-based index at a low cost.

Investment vs. speculation

Starting his career in the 1950s, Bogle contributed to the fast improvements in technology that led to the obsolescence of the market "tape" and made it possible for investors in Spain to purchase stocks in Asia with just a few mouse clicks and within a few seconds. The average human being was declared a "retail investor" and a whole financial services industry was born. At the beginning, Wall Street was about facilitating capital formation. Initial public offerings (and secondary offerings) allowed companies to finance their projects and savers to become investors. But Wall Street is no longer the place where entrepreneurs meet investors, as market turnover is now more than 200x the total amount of primary and secondary offerings. This fact makes it very important to distinguish investment from speculation, which is something that has been keeping Bogle busy for the last few years. He wrote several papers where he expresses his opinion and concerns on the subject. For Bogle, long-term investment "reflects the culture of the intellectual, the philosopher, and the historian". Short-term investment, on

the other hand, reflects "the culture of the statistician, the technocrat, and the alchemist". Speculation is the result of the society increasing its focus on today, rather than on *tomorrow*. We today "*look to speculation – even at long odds – to lift us out of the everydayness of our lives*". Bogle believes that speculation has its own role, but has largely surpassed what would be desirable.

The nascent financial industry, fed by brokers, advisors, fund managers, investment bankers, lawyers, accountants, record-keepers, and marketers, turned a zero-sum game into a negative-sum game. All these new jobs and tasks earn their fees from the individual investor, who on average was turned into a loser. With this in mind, Bogle believes that, more than ever, passive investment is the key to performing in the long-run. It's not a matter of getting alpha but rather of getting beta in full.

In his paper *The Clash of Cultures* published in 2011 in the *Journal of Portfolio Management*, he details his concerns with the growth of speculation. With the help of a simple example he shows how important it is to reduce trading costs to a minimum. Someone passively investing in the market portfolio for 50 years and getting a



Vanguard 500 Index Vs. S&P500 Index



return of 7% per year would earn a total return of 2,800%. If, instead, the option had been to put the money in an actively managed fund, giving away 2% of the annual performance in fees and borrowing costs, the total return would be reduced to 1,000%. The impact of even a small cost may be huge because of compounding. Thus, the best route is to invest in an all-equity-market index fund that keeps costs to a minimum, paying nothing away (or almost nothing).

When Bogle created the *First Index Trust*, he followed six main principles suggested by Samuelson. He created a fund that (1) would be available for investors with small means; (2) would match the broad-based S&P 500 index (the market); (3) would carry an extremely small annual expense; (4) would require an extremely low portfolio turnover; (5) would offer broad diversification in order to maximise return with minimum variance and volatility; and (only achieved at a later date) (6) would be a no-load fund.

Investment strategy

As a passive investor, Bogle doesn't need to spend much time analysing individual equities. Bogle's strategy is in fact the simplest of all. Just consider the facts: on average the equity market

is a negative-sum game mainly due to the costs the average investor incurs in trying to beat the market. Thus, for the average investor the best course of action is to just buy the market and mimic its returns.

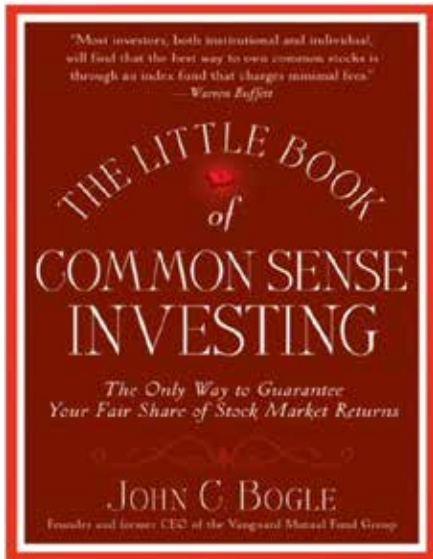
“IT’S NOT A MATTER OF GETTING ALPHA BUT RATHER OF GETTING BETA IN FULL.”

Bogle's strategy can then be summarised in a few key principles. Before anything, investors should (1) start investing early and often. We all know the effects of compounding. If you decide to cut £1,000 from your annual investment goals today, and considering an annual market return of 7%, you would lose out on £70 at the end of the year. At the end of the next year you would lose out on £74.90, then and £80.14 at the end of the following year. Over a lifetime, the opportunity cost may be huge. Thus, the key is to start early and to save the maximum possible at the beginning.

Investors should also (2) never bear too much or too little risk. While all investors should buy the market portfolio, there is still one decision left to each individual investor; that is, his exact allocation between the risky asset (equities) and the riskless asset (bonds). Each investor should evaluate his specific conditions and risk tolerance before splitting his money.

A point that is of maximum importance is (3) diversification. Instead of trying to pick specific equities and sectors, the best option for an investor is to seek out a broad-based index. Such index should offer him beta, something that isn't always achieved when the costs of active management are taken into consideration. This raises another important point that is (4) do not overrate past performance. According to Bogle's study on mutual fund performance, funds can't consistently beat the market. In Bogle's mind, any funds outperforming the market will likely soon underperform it.

Of crucial importance is a principle stating that individual investors should (5) never try to time the market. The market follows a random walk and can't be predicted. Trying to time it, would just result in over-trading and, consequently, in larger trading costs. Investors should instead (6) use index funds



when possible while keeping all costs at a minimum. Index funds provide the lowest costs in the fund industry, while offering exposure to the broad market. But that isn't enough. When investing for a long period of time, investors should also look at the smallest differences that may exist across funds. Over a period of 30 years, £10,000 invested every year at a 7% market return would be worth £944,608. If there was a small annual expense ratio of 0.15%, the accumulated value would decrease by just £25,100. But, if the expense ratio was raised to 1.00% or

2.00%, the final value would decrease by £154,206 or £280,219 respectively. This is exactly what Bogle believes investors should avoid.

Last, (7) spend the saved time with family and friends. Passive investment doesn't require more than just a few hours every year to rebalance portfolios. On the contrary, active investment strategies are time-consuming, as they require investors to watch the markets and read financial news in order to make a subjective judgement about the future.

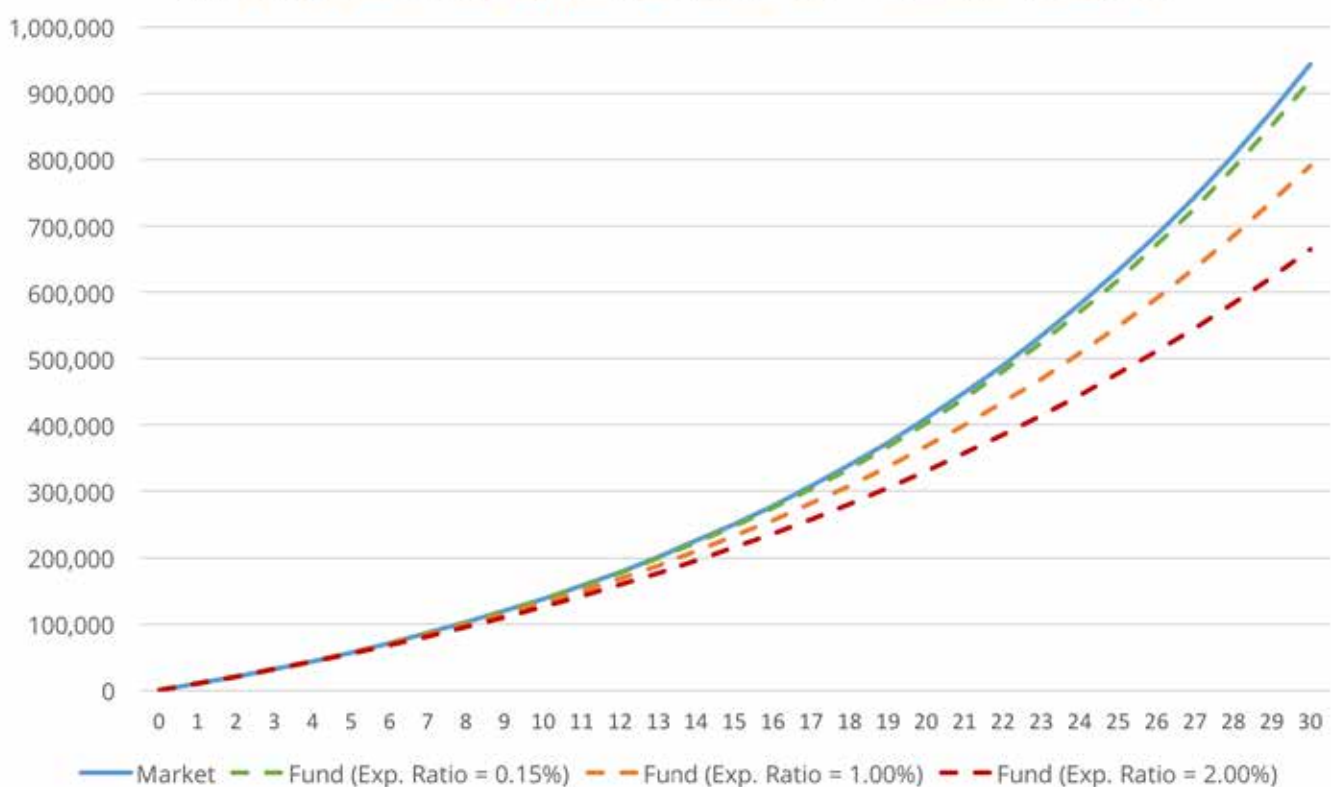
Final remarks

Recent evidence shows that the efficient market hypothesis on which the Modern Portfolio Theory is grounded doesn't hold. The models that are often used to build the optimum portfolio allocation and which usually dictate that investors should split money between the market portfolio and a riskless asset are deficient and hardly explain reality. There is evidence of market anomalies that result in trading strategies that deliver profits over the long run in excess of the market. At the same time, because the individual investor is on average a loser, some must be winners. The ability to

pick individual equities and to avoid short-term irrationality has resulted in huge consistent profits for value investors like Warren Buffett, Benjamin Graham and Peter Lynch, as pointed out in past magazine editions. If fund out-performance is mean reverting, such that past fund outperformers would most likely turn into underperformers, one could also argue that purchasing underperforming funds and selling outperforming funds would be a profitable strategy.

Nevertheless, Bogle makes an important point about the market. The rise of the investment industry led to the creation of a whole army of new jobs that must be paid for by someone – the individual investor – thus reducing average returns and turning the equity market into a negative-sum game. These new players have an incentive to incite overtrading, from which they extract their income. The individual investor should carefully evaluate whether the transaction costs, advisory costs, sales loads, administrative costs, and the opportunity cost of the lost time with family and friends involved in active management do compensate in the form of excess returns over passive management. Bogle thinks they do not.

The Impact of the Expense Ratio on Portfolio Returns





BY RICHARD GILL, CFA

FROM ACORNS TO OAK TREES

THREE SMALL CAP IPOS TO BRIGHTEN UP A QUIET SUMMER

No long introduction from me this month. Instead let's get straight on with looking at three interesting small cap companies which have recently listed on the markets during these (Brexit aside) quiet summer months.

SEC SpA

Small cap companies with operations in Italy haven't always had the best of luck delivering value for their shareholders. Whether it be the investment firm Clear Leisure (down over 99% since 2011) or oil explorer Northern Petroleum, those UK listed firms with assets in the land of vino and Versace don't often have the best of reputations amongst investors. But that might be about to change.

SEC (SECG) is a public relations and advocacy business which is based in Milan. Its main operations are located in Italy, with other income coming from Belgium, Germany and Spain following expansion via acquisition in the past few years. Showing that our European neighbours still hold us Brits in good regard, the business became one of the first to list in London following the recent Brexit vote. The firm joined AIM

on 26th July, raising a total of £3.4 million in order to accelerate its acquisition strategy.

The company was founded by current CEO Fiorenzo Tagliabue in 1989 and following a period of strong growth within major Italian cities it began to expand internationally via acquisition in 2013. SEC now acts as a holding company for nine subsidiaries in which it has controlling stakes ranging between 51% and 75%. These currently have over 500 clients which typically pay a periodic retainer for services rendered.

At the core of the business are traditional **public relations** services, which include activities such as brand management, financial PR, reputation management, media relations and others. This area of the business made up almost half of revenues in the last financial year.

Next up, at c.30% of revenues, are **advocacy** activities. In this area the company provides services which help clients to deal with government agencies, public affairs, community relations – anything which helps to promote support for a cause. Services are also provided to political parties to help them with election campaigns.

Finally, the so called **integrated services** business makes up the remainder of group revenues and provides offerings such as social media management, event management and other communications work.

Growing the dough

One of the main reasons for obtaining an AIM listing was to help the company with its strategy to grow via the acquisition of complementary businesses. The focus will be on smaller firms, typically with revenues of between €1-3



“TALKS WITH A UK BUSINESS, WHICH MADE REVENUES OF £3.2 MILLION IN THE LAST FINANCIAL YEAR, ARE SAID TO BE AT AN ADVANCED STAGE.”



million, although larger deals aren't being ruled out should they be compelling enough. Of course PR is all about people, so owners of target companies will be expected to continue running the operations while retaining a minority interest.

While no deals have been done during the first month of SEC's time on the market, the company is in discussions with some potential targets in the UK, France and Poland. Talks with a UK business, which made revenues of £3.2 million in the last financial year, are said to be at an advanced stage. Further down the line, SEC will be looking to the US, Latin America and then Asia in order to spread its presence worldwide.

Grab a pizza the action?

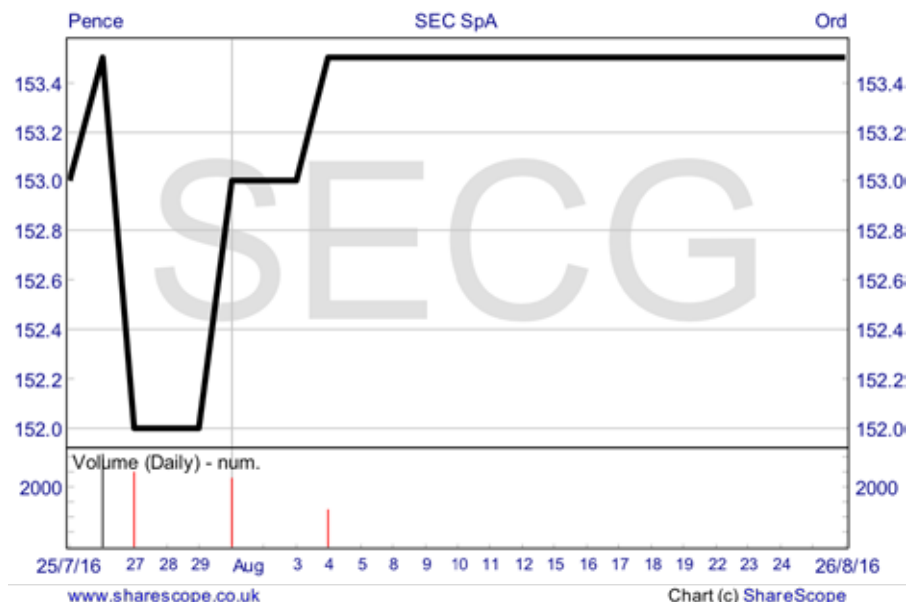
Shares in SEC have been thinly traded since their AIM debut but have edged up from the IPO price of 151p to the current 153.5p. This gives a current market capitalisation of £18.76 million.



All looks good with the numbers provided in the admission document, with revenues having more than doubled to €21.2 million over the two financial years to December 2015 after four businesses were acquired by the group during this time. The strong operational gearing inherent in the business model meant that net profits increased almost nine fold between 2013 and 2015 to €2.05 million. However, with €0.67 million of these profits attributable to non-controlling interests SEC shareholders earned just €1.37 million.

The balance sheet is solid, showing net cash of €2.1 million as at 31st December, since boosted by the net placing proceeds of £2.18 million. And cash flow is very good, with the net inflow from operations of €2.54 million in 2015 representing 124% of net profits.

In terms of the valuation the historic figures, excluding earnings due to minority interests, put the shares on a multiple of 16 times earnings at cur-



rent exchange rates. Given the growth seen over the past two years, combined with the strong cash position, this does not look too unreasonable in my view. There is also the prospect of income with SEC, with the company saying it intends to pay a "modest" annual dividend and expected to commence in spring 2017.

Of course, there are large risks involved in an investment in SEC, not least the acquisition-led growth strategy and the fact that the PR business is all about people, who can easily be poached by competitors or set up business on their own. Investors should also be aware that CEO Fiorenzo Tagliabue is the company's controlling shareholder with a 74.57% stake.

So SEC is a high risk, illiquid share. But if the growth strategy comes to fruition it looks like a modest investment could be worth significantly more in a few years' time.

COMPTOIR GROUP

We head to the other side of the Mediterranean now.

Founded by chef and current Creative Director Tony Kitous in 2008, **Comptoir Group (COM)** runs and owns a range of Lebanese and Eastern Mediterranean style restaurants in London and Manchester. The flagship brand is Comptoir Libanais (meaning Lebanese counter), a mid-range, all day casual dining restaurant with a Middle Eastern cafe culture feel. There are

currently nine such venues run by the company, with most located in central London in addition to one in the Bluewater Shopping Centre in Kent and the most recently opened restaurant in Manchester. The restaurants have an average of 128 covers each, with the average customer spending £14 per head.

Two further Lebanese and Eastern Mediterranean outlets are operated by the company under the Shawa brand, a smaller offering which serves traditional Lebanese shawarmas – a small meal similar to a kebab. These are complemented by two standalone high end restaurants, Levant and Kenza, located in the West End and City of London, which are well known for their nightly exotic belly dancing entertainment.

Revenues are also earned via franchising the brand to other operators. So far the company has given the rights to franchise two Comptoir Libanais outlets at airport locations to FTSE 250 business The Restaurant Group. This side of the business looks set to grow further, with an agreement recently signed with transport location food specialist HMS Host to expand into Middle Eastern airports. Comptoir is also in discussions with other potential franchise partners with the prospect of further international expansion.

Growth strategy

With a previous incarnation of the business having been put into a company voluntary arrangement (CVA) in April 2010 Comptoir Group has recov-



ered well and is now clearly set up for further growth. In 2015 it moved into a 15,300 square foot Central Production Unit (CPU) in Hendon, London, which produces food for its restaurants. A recruitment programme to hire senior staff has also been undertaken in preparation for an increased level of restaurant rollout in future years.

“IN THE NEXT FIVE YEARS THE COMPANY EXPECTS TO HAVE OVER 50 RESTAURANTS TO ITS NAME.”

The AIM IPO on 21st June saw the company raise £8 million for itself at a price of 50p per share, as well as raising the same amount for Tony Kitous and CEO Chaker Hanna who cashed in some of their stake in the company (they retain a combined 66.7%). After expenses a net £7.3 million is set to be used on expanding the restaurant portfolio.

At least eight new Comptoir Libanais restaurants are expected to be opened during the next 18 months, and with no presence in most cities around the UK this looks like a reasonable target. The pipeline of openings for this year

includes new Comptoir Libanais openings in London, Leeds and Exeter, as well as a Shawa in Haymarket, London. In the next five years the company expects to have over 50 restaurants to its name.

Worth dipping into?

Shares in Comptoir Group currently trade markedly higher than the IPO price of 50p. Currently 33% ahead at 66.5p the company is capitalised at a tasty £63.8 million. Looking at the historical numbers that valuation looks a bit racy.

While revenues grew by 63% to £17.73 million over the two financial years to

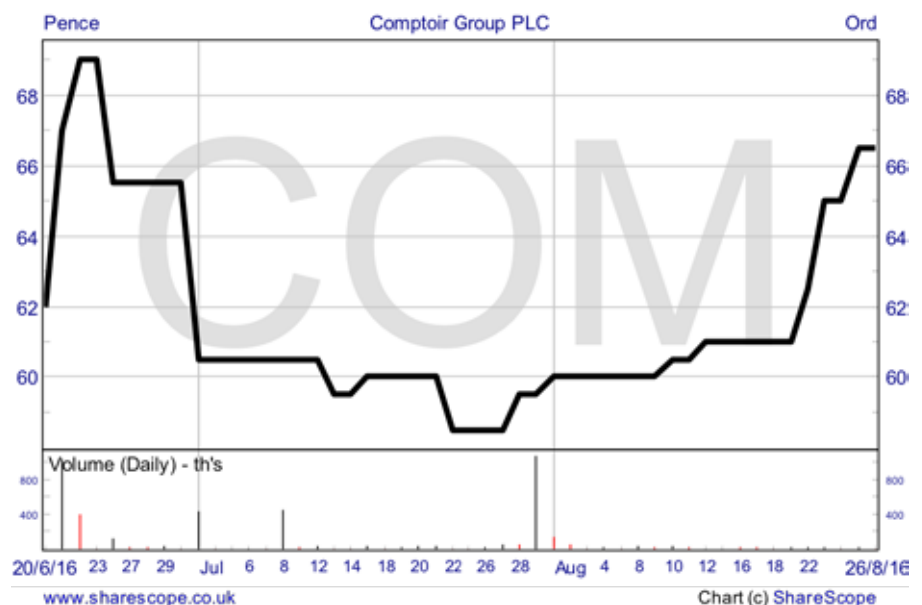
December 2015, net profits only grew by 45% to £1.02 million, actually falling between 2014 and 2015 due to soaring admin expenses. So the historic price earnings multiple is 62.5 times. And with pro-forma net assets of £10.47 million as at 31st December (assuming the IPO placing was completed then) there is little in the way of asset backing.

The net cash from operations was strong in 2015 at £1.68 million, but at this stage a lot is being spent on expanding the restaurant portfolio. With £3 million spent on capex in 2015 there was an overall cash outflow from the business of £1.1 million. Again assuming the placing was completed on 31st December 2015 net cash would have been £5.55 million. There will be no dividend here in the foreseeable future, with all earnings expected to be used to finance expansion.

So why is the market putting such a high valuation on the company?

There is a lot to like about the business itself. Of course there are many competitors in the restaurant sector but Comptoir has its own unique offering, with no rival national restaurant chains having a focus on Lebanese and Eastern Mediterranean food.

And let's say entrepreneurial spirit is in abundance at Comptoir Libanais. Founder Tony Kitous apparently arrived in London in 1988 with just £70 in his pocket and now has a stake in Comptoir worth more than £33 million. For reasons of balance however





it must be said that he was a director of three companies which entered into company voluntary arrangements and one which went into liquidation. Also on the board of Comptoir, as a Non-Executive Director, is Jonathan Kaye. Kaye was founder and CEO of restaurant business Prezzo which was sold in 2015 for £304 million to TPG Capital after being listed 13 years earlier with a market cap of £9.1 million.

Even if a fraction of that success can be repeated here then the shares could offer good value. But I would prefer that they came down to at least the IPO price of 50p again before taking a nibble.

TIME OUT GROUP

Best known for publishing its city focussed lifestyle magazines, Time Out Group, perhaps bravely, listed on AIM on 14th June, just over a week before the EU referendum. Raising £90 million at a price of 150p per share the company has £58 million left over to spend on its growth strategy after paying debt and listing expenses.

Time Out was founded in 1968 by current non-exec Tony Elliot as a London culture and entertainment magazine – funnily enough he started the business with £70, exactly the same amount of

“WITH SUCH A WIDE RANGE OF ACTIVITIES TIME OUT DERIVES REVENUES FROM A NUMBER OF DIFFERENT SOURCES.”

money that Tony Kitous of Comptoir Group came to the UK with. The business has grown over the years to become a global media and e-commerce business comprising print operations, online, mobile apps and live events. The firm's objective is to help people to experience the best of a city by using its informative content which covers a range of subjects such as food, drink, music, theatre, art, style, travel and entertainment. From small beginnings the company now has a presence in 107 cities in 39 countries around the world, with an estimated monthly global digital audience reach of 111 million.



With such a wide range of activities Time Out derives revenues from a

number of different sources. The majority of income comes from the sale of advertising across the print and digital platforms, with e-commerce commissions generated via online bookings and transactions being made through the company's websites. A "premium profile" offering in London and New York allows businesses to increase their exposure by purchasing additional advertising features for a monthly subscription. Time Out also earns fee and royalty income from selling international licences to use the Time Out brand.

A recent successful development has been Time Out Market. Launched in May 2014 Mercado da Ribeira operates from a former food market hall in Lisbon, Portugal. The venue brings together a selection of the city's best restaurants, food shops and cultural events, with visitor numbers having risen to two million a year since launch, making it the number one tourist attraction in the city. The concept is intended to be rolled out internationally, with the company being in advanced

discussions for new venues in London, New York, Miami, Berlin and Porto.

Time to get out?

The timing of the Time Out IPO was a little unfortunate. Following the result of the EU referendum shares in the company plunged from the IPO price of 150p to a low of 126.5p. They have since recovered to 141p, with a trading statement at the end of July helping to restore market confidence. The update commented that trading had been in line with expectations for the six months to June, with total group revenues expected to show growth of 16% for the period. Digital revenues were up by 33%, offset by a 2% fall in print revenues. Time Out Market meanwhile grew revenues by 106%.

So with growing revenues, a trusted international brand and cash in the bank for expansion, surely this looks a great company to invest in? Think again because Time Out's accounts are absolutely dire.

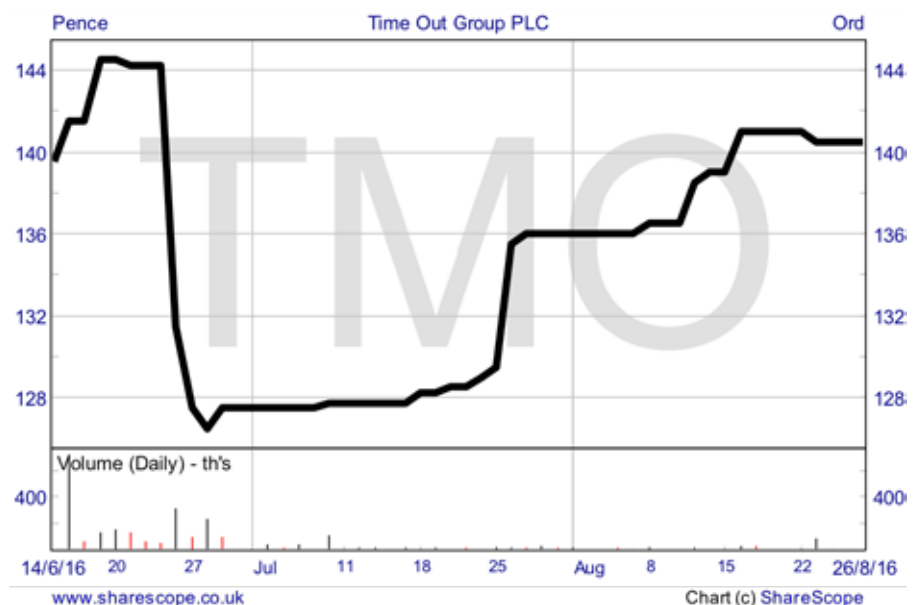
In the year to December 2015, while revenues grew by a modest 6% to £28.5 million the company's net loss soared by 59% to £20.3 million. Yes, a £20.3 million loss for a company being valued by the market at £183 million. The total accumulated losses stood at £54.3 million as at 31st December.

The main reason for the increased loss was higher administration expenses, which surged by 31% in the year, well ahead of revenue growth. Expenses are expected to grow further, with the company's admission document stating, *"The Group expects its operating expenses to continue to increase as its operations are expanded and, therefore, to be profitable the Group will need to increase its revenue sufficiently to offset higher expenses."*

So with no earnings – and certainly no dividend – for the foreseeable future, I am struggling to come up with even a small reason to consider buying shares in Time Out. Instead, maybe it would be wise to follow the lead of Tony Elliot, who in 2010 sold his 50% stake in the company to Oakley Capital for a reported c.£10 million.



“TIME OUT’S ACCOUNTS ARE ABSOLUTELY DIRE.”





BY VICTOR HILL

OPPORTUNITIES IN FOCUS

INDIA'S FINTECH REVOLUTION

It was bound to happen – and now it has. India's love affair with technology and e-commerce has spawned an explosion in "fintech". We can define fintech as digital technology businesses that compete against (and disrupt) – or sometimes support – the activities of established financial institutions. Businesses in the fintech space serve both customers who already have bank accounts and, in the case of India, the many who do not. Opportunities abound for wily investors in start-ups; but for non-specialist investors there are established players who are poised to profit handsomely from India's fintech revolution.

A New Indian Financial Services Sector Emerges from the Chrysalis of the Old

Old India was a conservative country where nothing much happened in a hurry and anything that did happen had to be approved and rubber stamped by several layers of bureaucracy. Banks in Old India were shuffling beasts that behaved more like bureaucracies than facilitators. They were largely state-owned – in fact there were no privately owned banks in India until the 1990s. And they were often under-capitalised and carried large portfolios of non-performing loans (NPLs).

Well, things are changing. New India is a country with a can-do finance sector and where fintech start-ups are mushrooming. And Nahendra

Modi's Government is on-side. Many investors are aware that Fintech has been driven in technology hubs in California's Silicon Valley, London's "Silicon Roundabout", Tel Aviv, Sydney, Singapore and Hong Kong, often with important input from leading universities in the host countries. They may not be aware, however, that Bengaluru, Mumbai and Gurgaon¹ are emerging fintech hubs developing services for a huge market of over 1.2 billion people who share a voracious appetite for technology.

Over the last year India's central bank, the Reserve Bank of India (RBI), has granted banking licences to a range of tech-savvy non-bank companies, including telecoms network providers, e-commerce platforms and microfinance companies – even the notoriously lugubrious Indian postal service. In addition,

there have been a myriad of new fintech start-ups. These new players are often serving customers that traditional banks cannot reach.

The RBI has two main goals. The first is to boost the lumbering state-owned banks. The second is an audacious programme to promote *financial inclusion* in a country where hundreds of millions of poor people have never had a bank account, let alone a credit card.

According to a recent report published by KPMG India², there have been an estimated 12,000 new start-ups in the Fintech space worldwide since the beginning of 2015 attracting a staggering US\$19 billion worth of investment. The proportion of this accounted by Indian start-ups is relatively small, though in India, where operating costs are lower than in

“INDIA IS A COUNTRY WITH A CAN-DO FINANCE SECTOR AND WHERE FINTECH START-UPS ARE MUSHROOMING.”



the UK, a modest investment can go a long way. In Bengaluru in 2015 there were 11 venture capital-backed Fintech start-ups, raising US\$56 million. In Mumbai there were nine such deals and in Gurgaon six.

One of India's key strengths here is that there seems to be an unlimited supply of new inexpensive technical talent emerging from its universities. In addition, there is no shortage of capital to finance new start-ups. The *Start-Up India* initiative launched by the Government of India in January 2016 includes a US\$1.5 billion fund to provide seed capital for technology start-ups. The Indian tax regime is also favourable to start-ups. Against this, however, we must weigh the negative fact that too many people in India still cannot get access to broadband internet.

Seven Fintech "Themes"

KPMG identified seven key "fintech themes" in the roll-out of new digital services in India's financial services sector. The first is a new generation of payments systems. The second theme is in P2P lending. Theme number three is what they call the "Bank in a Box" – the ability of non-finance companies such as telecoms providers to offer financial services on smartphones. The fourth theme is the government-backed drive towards financial inclusion. (*Vision 2020* is the programme that aims to ensure that 90% of India's adult pop-

ulation have bank accounts within the next four years.) The development of blockchain technology is the fifth theme. The sixth theme is the advent of *robo-advisory* services. Lastly there is cyber-security, which involves biometric verification and voice recognition systems.

Just looking at the nine largest start-ups of the last year in terms of funding raised there are also clear themes. **Paytm**, **Freecharge** and **Mobiqwik** are digital wallets that permit ordinary people to make purchases from pre-paid accounts. **Billdesk** is a payment aggregator, or what is often termed in the UK a consolidator. **Policybazaar** is essentially an insurance broker. **Financial Planning & Systems** offers financial planning software.

Blockchain Has No Borders

Blockchain technology, which has been around since 2009, is a way of initiating and verifying transactions which are conducted on the internet by distributing different component pieces of information to different places around the internet. Famously Bitcoin, the digital currency, uses blockchain technology and one could say that blockchain has made possible the brave new world of digital currencies. An estimated 700 other digital currencies so far have tried to imitate Bitcoin. Yet there is still no industry standard for blockchain technology, which is likely

to be endorsed any time soon by the world's major central banks, though one contender – called Distributed Ledger Technology (DLT) – is already used by NASDAQ for the settlement of share sales.

“KPMG RECKONS THAT INVESTMENT IN BLOCKCHAIN IS LIKELY TO INCREASE FOUR-FOLD BY 2019, GROWING AT A COMPOUND ANNUAL RATE OF 250 PER CENT.”

By decentralising – or as the software engineers have it, *distributing* – data, users can reduce costs, eliminate fraud and increase transaction speeds. With initiatives such as R3CEV (a consortium of 42 global financial institutions) leading banks are developing blockchain applications. Global investment in blockchain technology has exceeded US\$1 billion, with over a thousand start-ups in this space. KPMG reckons that investment in blockchain is likely to increase four-fold by 2019, growing at a compound annual rate of 250 per cent. A notable example is the funding received by **Coinbase** and **Circle** exceeding US\$240 million in 2015.



“CONTACTLESS CREDIT AND DEBIT CARD PAYMENTS ARE NOW STANDARD IN INDIA, AS ARE REAL-TIME PAYMENTS EFFECTED, FOR EXAMPLE, VIA INTERNET BANKING.”

In India the central bank, RBI, has set up a committee to determine how blockchain technology can best be implemented and regulated in the country. A "hackathon" was even organised recently by Block Chain University on the Mumbai Stock Exchange in order to stress-test computer security in a controlled environment. One Indian player, **Zebpay**, based in Ahmedabad, has set up a blockchain laboratory to develop blockchain technology. The company has already received about US\$1 million in equity funding. **Uno-coin** (Bengaluru) enables users to buy Bitcoins with Indian rupees.

Payment Systems are Evolving

In terms of payment technologies, a number of innovations are now underway in India. Contactless credit and debit card payments are now standard in India, as are real-time payments effected, for example, via internet banking. Many start-ups have entered the digital payments space to simplify mobile money transfer, such as **Chillr**, which provides peer-to-peer money transfer without using any bank account details.

Several leading Indian banks are launching their own digital wallets leveraging **National Payment Corporation of India** (NPCI)'s Immediate Payment Service (IMPS) platform. These digital wallets are integrated with social media features. One example is **Buddy** backed by **State Bank of India**.

One regulatory problem is that payments platforms have to invest 75 per cent of their deposits in treasury bills which are very low-yielding. This is currently inhibiting profitability.

Robo-Advisory – Indian Style

Robo-advisors have been billed as the next revolution in wealth manage-



ment. The idea is that an individual with funds to invest and in need of ideas no longer needs to make an appointment at an office with a man (or woman) in a suit but instead can subscribe to an online robot wealth manager at a fraction of the cost. As a general guide, wealth managers typically charge one percent per annum or more of funds under management whereas robo-advisors charge one quarter of one percent or less.

Here in the UK, it has had numerous exemplars, most recently **Munnypot PLC**, founded by Andrew Fay and Simon Redgrove, ex-directors of Cavanagh Group PLC. Munnypot aspires to offer clear advice and five tracker products which suit investors' particular risk-reward parameters. Once they invest, Munnypot will then keep clients informed about performance and advise on possible alternatives if market conditions changeⁱⁱⁱ. It's the investment advisory analogue of what I described recently in the context of [robot doctors](#). And if you trust your health to a robot, why not your wealth as well?

Fidelity, Blackrock, Schrodgers and Charles Schwab are already in this



space. In May this year, **Betterment**, a leading robo-advisor in the US with assets under management of over US\$3 billion, was valued at US\$700 million. In Australia regulatory authorities have set up the Digital Financial Advisory Committee to collaborate with start-ups on developing regulations given that various banks are planning to launch robo-advisory platforms in the near future.





paul prescott / Shutterstock.com

Robo-advisors in India are mushrooming. Many new entrants and traditional broking firms have launched robo-advisor services in India such as **Aditya Birla Money (BOM:532974)** with *MyUniverse*. Other start-ups include *BigDecision*, *ScripBox*, *Arthayantra*, *FundsIndia* and *5nance*. Demographics and access to technology have made new business models possible and have a strong take-up with young early adopters. Robo-advisors can recommend mutual funds and portfolio allocation strategies. They can also select optimal insurance policies and pension funds for each individual client. **FundsIndia**, has already garnered 80,000 customers with an assets under management reportedly of INR15 billion. And Robo-advisory firm **ArthaYantra** which offers analytical tools to customized financial advice is already serving 75,000 users with a target of one million users by mid-2018.

Smartphones in India: The Bank in a Box

The Unique Identification Authority of India (UIDAI) is a central government agency of the Indian state. Its objective is to collect the biometric and demographic data of all Indian residents, store them in a centralised database, and issue a 12-digit unique identity number called an **Aadhaar** for every Indian. It has been described as the

world's largest national identification number project. This project is now being used to facilitate the "Bank in a Box" model, which has received wide acceptance by small co-operative and Regional Rural Banks (RRBs) across India. However, India's Supreme Court still disallows Aadhaar numbers as proof of identity by banks and it is still not mandatory.

By way of example, **IDFC Ltd (BOM:532659)**, the infrastructure finance company, partnered with a local provider to facilitate *Aadhaar*-authenticated payments by smartphone for citizens who do not have a bank account. **Shivalik Cooperative Bank** has adopted the Bank in a Box solution from FIS Global Business Solutions India. Recently, **Yes Bank Limited (BOM:532648)** in India came up with distinctive "Bank in a Box" for corporate clients in sectors like retail, healthcare, banking and aviation which has helped these corporate clients to automate cash management.

P2P Finance

P2P is normally understood to be a means by which ordinary folk and financial institutions can lend surplus funds to small and medium sized enterprises (SMEs) at mutually advantageous rates. The global market for P2P lending is expected to grow at a com-

“THE GROWTH POTENTIAL OF THE P2P MARKET IN INDIA IS HUGE: KPMG ESTIMATES THERE ARE 57.7 MILLION MICROBUSINESSES IN THE COUNTRY.”

pound annual 60 percent to US\$1 trillion by 2025 from US\$9 billion in 2014. The leading P2P markets currently are the USA, the UK, Australia and China. One of the key issues in this space is the transparency of the credit risk assessment process. But regulation is still fragmented and heterogeneous. In some countries, as in the UK where the Peer-to-Peer Finance Association (P2PFA) operates as a trade association, a degree of standard practice has been achieved. In the US regulation is effected by both the SEC and at State level. Texas has actually banned P2P lending while California restricts the type of investors getting access to the lending platforms.

In India, P2P lenders focus on three categories: micro finance, consumer loans and commercial loans. For example, 30 per cent of **Faircent's** loans are taken by microbusinesses and SMEs, often small family-run stores. The rest are taken by individuals for private purposes such as weddings (a major expense in Indian culture), medical emergencies and home improvements. Some of the other leading P2P lenders in India are *i2ifunding*, *Loanmeet*, *i-lend*, *LendenClub*, *Milaap*, *MicroGraam*, *InstaPaisaand* and *Vote4Cash*. The growth potential of the P2P market in India is huge: KPMG estimates there are 57.7 million microbusinesses in the country.

Currently, in the absence of a regulatory framework, Indian P2P start-ups are registered under the Companies Act and must adhere the Negotiable Instruments Act. The RBI recently released a consultation paper on P2P lending covering registration, permitted activity, reporting, prudential and

5%



ACTION

The established private Indian banks **Canara Bank (BOM:532483)** and **ICICI Bank Ltd (BOM:532174)** will benefit from India's Fintech revolution because the entire industry is raising its game in this fast-changing environment.

As for the new entrants to the Indian banking sector, investors should check out **Infrastructure Development Finance Company (IDFC) (BOM:532659)**, which is investing, not least, in fintech start-ups. IDFC was set up in 1997 as part of the liberalisation of India's economy under the *Janata Dal* (United Front) government. Its project finance division finances infrastructure projects in sectors as diverse as energy, telecommunication, transportation, commercial and industrial projects, hospitals, education, tourism and hotels. **IDFC** is also active in asset management, investment banking, and institutional broking and advisory.

On 01 October 2015 IDFC acquired a banking licence and de-merged the commercial banking arm as a separate entity. **IDFC Bank Ltd (BOM:539437)** can raise finance by taking deposits, thus lowering its cost of capital. It already has plans to roll out a retail banking subsidiary which will focus on rural India, using technology to keep fixed costs low, with minimal bricks-and-mortar branches. The strategy is to offer low cost transactions-based services but in mind-boggling volumes.

IDFC does not suffer from the shortcomings of India's state-owned banks. Its Tier 1 capital ratio is reportedly more than 20 percent. Be aware that when the de-merger took place last October the mother company share price suffered a spectacular fall from INR140 to INR61 and has since flat lined.

There are numerous funds allocating to India's burgeoning microfinance sector managed by the state-run Small Industrial Development Bank India

(SIDBI) but they are unlisted and are therefore only for the specialist investor. In June, **State Bank of India (BOM:500112)** set up an INR2 billion fund to finance fintech start-ups. State Bank of India is of course largely government owned but like **Bank of Baroda (BOM:532134)** and **Punjab National Bank (BOM:532461)** a portion of its shares is traded on the Mumbai stock exchange. The State Bank of India chart shows a consistent upward trend since February this year.

The **Neptune India Fund^v**, which I have referenced before, managed out of London by Kunal Desai is 24 percent allocated to Indian financial stocks of which a 3.7 percent position is in **SKS Microfinance (BOM:533228)**. It also has an 18.3 percent exposure to information technology stocks. The fund is up nearly 25 percent year to date.

governance requirements, business continuity planning and customer interface. The idea is to bring the P2P lending platforms within the scope of regulations and laws relating to non-bank financial companies (NBFCs).

Technology convergence is likely to make P2P lending safer and faster. Universal Personal Identification (UPI) and blockchain are two big technology revolutions that are projected to have a favourable impact on the expansion of P2P lending in India. The government of India has resolved to address certain key areas for P2P lenders such as capital structure, lender protection, transfer of funds and infrastructure needs.

Financial Inclusion – Banking Services for All

Globally, 38 percent of adults do not use any formal financial services and 73 percent of the world's poor do not have a bank account. This is attributed primarily to the onerous requirements involved in opening a bank account and lack of awareness. The United

Nations together with the World Bank has launched *Universal Financial Access* – a programme with a delivery date of 2020. This will cover 25 countries including India.

Universal mobile telephony has been revolutionary in creating a new paradigm for the spread of financial services in unbanked areas. An outstanding example of achieving true financial inclusion is M-PESA in Kenya (*pesa* is the Swahili word for money). Launched in 2007 by **Vodafone (LON:VOD)** for Safaricom and Vodacom, the largest mobile network operators in Kenya and Tanzania, it has since expanded to Afghanistan, South Africa, and India. In 2014 it was rolled out in Romania and in 2015 in Albania. M-PESA allows users to deposit, withdraw, transfer money and pay for goods and services easily with a mobile device. It is now used by over two-thirds of Kenya's population of 45 million people.

Financial inclusion in India is still unsatisfactory but improving – 145 million households do not have access to banking services. According to PWC,

however, the number of unbanked individuals has fallen from 557 million in 2011 to 233 million as of October 2015^v. But the rapid growth of smartphones and internet penetration has led to the emergence of multiple technologies for replacing cash and purchasing financial products digitally. The recent granting of bank licences by the RBI is likely to stimulate this digital trend. RBI has also given licences to 10 microfinance firms which are now called *Small Finance Banks*. Their objective is to lend to even the poorest villagers.

The RBI has a financial inclusion target of 90 percent of the adult population by 2021. This means that virtually everyone will get access to a bank account with an overdraft facility. Every Indian will have a unique identifier in the form of the Aadhaar card, an ATM-capable debit card and accident insurance cover of up to INR100,000 (approximately £1,125).

According to the Telecom Regulatory Authority of India, there were 1.03 billion mobile phone subscribers in India

in October 2015 – a number that is only eclipsed by China's 1.29 billion. Even the remotest village in the poorest parts of India will have mobile phone kiosk – though the nearest bank branch might require a day's journey.

There have also been numerous private sector initiatives to promote financial inclusion. **Ezetap's** low cost point of sale devices help local stores and villagers transfer funds and make payments. **Instarem's** international money transfer service charges as little as one percent. **Milaap's** customised credit programme for underprivileged sections of society has led to more *social lending*. **Budipay** has developed innovative solutions around workers' remittances and direct state benefit transfers in India.

Advances in Banking Security and Biometrics

As consumer acceptance of biometric authentication increases, fingerprint recognition has the potential to become the most commonly used technology for customer interactions in India. **Kotak Mahindra Bank Ltd (BOM:500247)** is promoting fintech start-ups by organising "Hackathons" to develop innovative applications in the field of computer security and e-commerce. KM Bank has started offering voice recognition technology to authenticate customers rapidly, based on speech patterns. These systems can then apply the customer's *Aadhaar* details for credit profiling. Indian bankers believe that India's unique Aadhaar identity number system will be a boon to cyber-security.

Similarly, its "Smart Vault" service offers an automated locker facility in a secure lounge with biometric authentication. Banks in India are also lever-



“ACCORDING TO THE TELECOM REGULATORY AUTHORITY OF INDIA, THERE WERE 1.03 BILLION MOBILE PHONE SUBSCRIBERS IN INDIA IN OCTOBER 2015 – A NUMBER THAT IS ONLY ECLIPSED BY CHINA’S 1.29 BILLION.”

aging biometric technology for faster loan approvals.

Win-win: Established Players Gain Too

75 percent of India's bank assets reside with state-owned institutions, whose asset quality is generally poor and profitability low. Bank consolidation has proved politically controversial. Prime Minister Modi's government is set to inject about INR250 billion (about £3 billion) annually into India's state-owned banks in 2016 and 2017, and INR100 billion in fiscal 2018 and 2019 in an effort to revive the flagging sector.

The 23 banking licences that the RBI has granted to non-bank financial institutions is designed to stimulate more specialised forms of banking serving every customer niche. Of the 23 new licences, only two were universal

banking licences (allowing institutions to take deposits *and* to lend money). These were given to Kolkata-based microfinance house **Bandhan Bank** and to **IDFC Ltd** in Mumbai.

Mobile commerce platform **Paytm** (still private, but a probable floatation within three years) has grown from a mobile phone top-up service to an e-commerce platform to a bill payment service and then to a digital wallet in just six years. Founder CEO Vijay Sharma expects that Paytm wallet users will reach 500 million by 2018 from today's 120 million. Interestingly, **Uber** launched in India with Paytm's wallet as its sole digital payments service. Even rickshaw drivers in Delhi accept payment by Paytm. Paytm also lends money to Uber drivers (apparently mostly ex-military men) to get loans to buy their vehicles. It's a case of the digital economy in symbiosis: what analysts call an *ecosystem*.

- i **Gurgaon is a "new" Indian city just outside Delhi in Haryana State – but with unrivalled transport links, being closer than central Delhi to Indira Gandhi Airport and on the A8 highway to Mumbai.**
- ii **Fintech in India – A Global Growth Story, KPMG India, June 2016. Download at: <https://assets.kpmg.com/content/dam/kpmg/pdf/2016/06/Fintech-new.pdf>**
- iii **See: <http://www.international-adviser.com/news/1031034/uk-fintech-start-launch-straightforward-robo-adviser>**
- iv **See: *The new age of Indian Banking* by Stefania Palma, *The Banker*, April 2016, page 20.**
- v **August factsheet available at: http://www.neptunefunds.com/Private-Investor/1/Funds/India-Fund?gclid=CjwKEAjwrvq9BRD5gLyruftqg0YSJACcuF813YRTfK5kZBE6g_QGoqmAXKL2QNba3DGjhw_5D1157BoC1Wfw_wcB&usertype=privateinvestor&mock_country=GB&cm_mmc=Consumer-_-Google-_-PPC-_-India**





BY ADRIAN KEMPTON-CUMBER

CHART NAVIGATOR

DON'T LET YOUR CHARTS CONTROL YOU

We take cheap, or even free, real time data and charting for granted nowadays. It wasn't always so. And you'd be forgiven for thinking that we are better placed now than ever to make use of the data, and especially to apply TA on charts. We certainly have the technology and tools at our fingertips. But are we controlling it, or do our charts control us? Are we suffering from analysis paralysis, or perhaps worse, prescriptive analysis?

I use ShareScope, which is probably the UK's leading chart package. It's fairly priced and very controllable. Their support is exemplary, and it can be a fantastic tool in analysing stocks. But most people don't want to control their workspace much and tend to use standard settings, which takes away any edge you might otherwise have. First off, if you're looking at exactly the same visualisations as everyone else, you'll tend to conclude the same things they do and act in the same way. As much as we look for variance in stock prices and charts, we have to apply variance in our behaviour. Do the same as everyone else and the same fate awaits you. For the vast majority of private investors that is unremarkable gains and big losses.

How then should we set up our work area? First of all, don't have things on your chart that you don't use. A cluttered chart is harder to read. If you don't use volume as a tool to trade then take it off your charts, making the bit you do use bigger and clearer. We are all limited by screen size so maximise what you do want to see.

We all use different time frames to scale in and out. You may use the monthly chart to get a bigger picture, and then move to weekly or daily, for example. A monthly chart is probably a long enough time frame such that scaling doesn't matter too much. But to understand the lower time frames in context, I like to use a scale that covers the price levels I'm actually interested in.

By default, chart scaling generally allows for the highest and lowest prices in a time series. If you have live charts, the y axis (price) will be changing each time the highest or lowest visible price drops off the left side of the chart. This gives a false impression of where the boundaries of possibility lie. For instance, we can see here in the first example that we have an upper limit on the price axis of 7,000 for the **FTSE 100 (LON:UKX)**. Is it helpful? Well we will be tempted to think that because it's a round number it's significant. So let's zoom out a bit. In the second chart we can see further back in time. The resistance is clearly not at 7,000 but around 7,100. So in the third example we have the chart in its helpful form with the resistance

“IF YOU’RE LOOKING AT EXACTLY THE SAME VISUALISATIONS AS EVERYONE ELSE, YOU’LL TEND TO CONCLUDE THE SAME THINGS THEY DO AND ACT IN THE SAME WAY.”



around 7,100 clearly shown. You can't use automated settings to do this, you have to get your hands dirty and examine what you want for each individual chart. Think outside the box – in this case literally!

“IT’S A GOOD IDEA TO HAVE A NUMBER OF SAVED SETTINGS WHICH YOU CAN USE IN DIFFERENT CIRCUMSTANCES.”

It's a good idea to have a number of saved settings which you can use in different circumstances. For example, you might be looking for variance against a longer term moving average to suggest that a price is stretched. One of the cool features on ShareScope is the ability to choose the time frame for indicators. Example four is a daily chart showing a big variance on the FTSE 100 back in '09. It's a little obscured by the resistance level line, which obviously I don't want to move, but the variance to this Moving Average (MA) is over 39%. Clearly a variance like that cannot persist. Either the MA goes to the price, or the price snaps back to the MA. Being an index, and having fallen almost 50%, it's more likely that it's going to recover. So we need a way to get an early entry. We could go with simple Dow Theory and take the higher low just before the big blue arrow. But let's say for argument's sake you take a half position there, or none at all. After all, it did fail to recover twice before. The Ichimoku chart here is based on the weekly data. It gives a nice 200 point advanced nod that it's going to hit 4900/5000. How? Generally, when a price enters the cloud it crosses it. Where the blue arrow is you can get a 200 point lead on the majority of the retail market participants (i.e. the public) who are waiting for a breakout at 4,650. You're in, even if you're really conservative, on that pullback bounce on the cloud bottom at around 4,500. Now you've got early entry to the breakout and a nice clear stop for a scratch trade at worst. It's a very good way to anchor your analysis when changing timeframes.

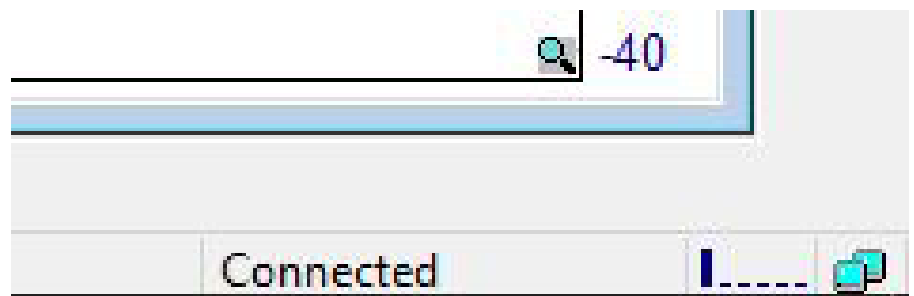




Avoid duplicating indicators on your charts. If you have loads of oscillators on, they are all telling you the same thing: you only really need one. So make a choice and pick the one you find most useful. Having multiple indicators which are essentially the same may encourage you to think you are getting more confirmation than you would from just the one. There may be a case for changing them in different situations, they may offer subtlety, but don't let them influence you by duplicate reinforcement of your trading ideas. In example five I've magnified two oscillators to show that they are almost identical. The top indicator is the Williams' %R and the lower Stochastic. Look closely and you'll see they're almost the same. These are telling you precisely the same thing. One is not reinforcing the other. So it's best to use just one of these in order to avoid creating a false sense of security and unhelpful, if not dangerous and costly, bias.



If you do have the luxury of space, then have a useful set of charts and data visible. I have a 21:9 screen for analysis, that's the aspect ratio of a cinema screen, on which, it's true, I see movies broadcast here in letterbox while other countries actually broadcast this standard (like Sweden for example). It's very wide so I can either get loads



“HAVING MULTIPLE INDICATORS WHICH ARE ESSENTIALLY THE SAME MAY ENCOURAGE YOU TO THINK YOU ARE GETTING MORE CONFIRMATION THAN YOU WOULD FROM JUST THE ONE.”

of data points on horizontally, or use the width for different representations. Now I know what the next question is: "Adrian, why don't you show us what you use?" Do you remember that scene from Life of Brian, "he's not the messiah, he's a very naughty boy"? It also has the bit where Brian tells them not to follow him: "You don't need to follow anybody. You've got to think for yourselves. You're all individuals." To which the horde replies in unison, "Yes. We're all individuals". I wrote about this in a very early Master Investor piece called [Own Your Own Trades](#), which appeared in the very first Master Investor magazine (April 2015). Don't follow other people, own your decisions, develop your own strategies and methodology.

To conclude I want to make one final point about free charting. Most spreadbetting platforms offer free charting. Be careful, it's offered 'as is'. If you subscribe to a product like

ShareScope they have a responsibility to provide reliable data and keep it live etc. On ShareScope there's a little graphic which flashes on and off accompanied by the word 'Connected', as you can see in the image from my own screen. It is clear you're connected and if there's a data issue they'll message you in real time. The problem with free charting is that it can often freeze up and if you're looking at a 15 minute chart how long do you think it will be before you notice? Long enough to lose money I can assure you!

I can think of hundreds of ways charting packages could be more bespoke and controllable. But it begins with making use of what space you've got. And try to be realistic about what you're doing. Managing a trade on a mobile device is one thing. Trying to do your analysis on it I should imagine is impossible. Spend the time to get familiar with the possibilities on the package you use. Don't let it control you.





BY SAMUEL RAE

FORENSIC FOREX

HERE'S WHERE THE FED IS GETTING THINGS WRONG

The US interest rate is the hottest topic in global finance right now, and as a forex trader, however tedious it has become to continuously read seemingly ill advised predictions, it has become impossible to avoid. Everybody is at it. From [bookmakers](#) to [Greenspan](#). Interestingly, everyone seems to have a different opinion. There are arguments on both sides, and everybody is looking to the now fabled Jackson Hole meeting at the end of August for clues as to what's going to play out. I write this pre-Jackson Hole, so by the time you're reading this there is a chance you'll have a whole lot more insight into what's going to happen in September than I do right now. There's an equal chance things will be just as murky, but there you go.

Anyway, that's not important right now.

What I feel is important, and what I believe should (but won't) happen, come Jackson Hole is this: The Federal Open Market Committee (FOMC) should sit down, take stock of what's happened over the last seven or eight years, and completely revamp monetary policy. For me it's no longer a case of raising rates by a few percentage points. The economic situation both in the US and the wider international developed world is unprecedented, and it's time for a change.

“FOR ME IT’S NO LONGER A CASE OF RAISING RATES BY A FEW PERCENTAGE POINTS. THE ECONOMIC SITUATION BOTH IN THE US AND THE WIDER INTERNATIONAL DEVELOPED WORLD IS UNPRECEDENTED, AND IT’S TIME FOR A CHANGE.”

I'm not talking anti-establishment, revolutionary change. I'm talking controlled, calculated policy that directly targets the issues in question. This, of course, would need to be put into action in combination with whatever government is in place at the time, but that's perfectly doable, and it has to start with the Fed.

Look at Japan. I talk about it a lot in this Forex column, but I maintain that the Japanese model is exactly what the US needs if it is to continue down a path of growth. The latest reports, and the media that are analyzing them, suggest Abenomics isn't



“I THINK MARKETS EXPECT A RATE HIKE, AND I THINK THIS WILL PLAY INTO THE DOLLAR’S VALUATION BOTH AS WE HEAD INTO THE JACKSON HOLE SYMPOSIUM AND – BEYOND THAT – INTO THE RATE DECISION NEXT MONTH.”

working and that Japan is stuck in a never ending downward spiral. Look a little deeper, however, and this just isn't true. GDP per capita has risen in each of the last five years. It's at the highest level it's ever been. The same applies to gross national income. Employment levels are at their highest since 2008 (admittedly the latest figure of 58% is low relative to the rest of the world, but Japan has an ageing population). A small peak in early 2014 aside, consumer spending is at its highest rate ever.

Ten years ago, if you had made the prediction that Japan would be posting these numbers in a decade, you would have been laughed at. It's only because of the work of BoJ Governor Kuroda, and the combining of his efforts with Prime Minister Shinzo Abe, that Japan

has been able to turn things around. And turn things around it has, despite how the headlines read.

This is what Yellen and Clinton/Trump need to do starting in January. Reporters chasing FOMC members and hanging on their every (and often changing) opinions regarding a half a percentage point base rate rise is farcical, and it's not going to sort anything.

OK, rant over. This is a Forex piece, so how am I going to use this opinion to form a bias in the markets? Well, it's pretty simple. First, I don't believe Yellen will raise rates come September, but concurrently I don't think it will change anything if she does. Yes, we'll see some near term dollar strength, and yes, we'll probably see a weakening of the equities market as capital avail-

ability contracts a little. I think markets expect a rate hike, and I think this will play into the dollar's valuation both as we head into the Jackson Hole symposium and – beyond that – into the rate decision next month. I don't think it will last, however, and I think longer term a restructuring will be necessary, and this will require a devaluation of the US dollar. As such, my near-term bias in the US dollar is long, in that I will be a little more aggressive with my upside breakout entries than I will my shorts.

Longer term, however, I expect the dollar to weaken. How this happens doesn't really matter to me – QE5, negative rates, helicopter money – it's all the same at the end of the day. It needs to be underpinned by a strong policy framework, however, if it's going to work. A wide ranging, government sponsored, infrastructure programme might be just what the US needs right now. Yes, debt is ridiculously high, and such a programme would add to this debt *ceteris paribus*. Untangle some of the waste at government level, however, and I believe this cost could be mitigated, or even negated. But that's a discussion for another day.

Happy Trading!



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BY CAROLINE DREWETT

MILLENNIALS & MONEY

HOW TO BUILD A PROPERTY PORTFOLIO (PART 1)

Getting into the second home market is the Holy Grail for baby boomers. Having a buy to let has come easy to them, as they've paid off their own mortgages and have had ample income in the decade before retirement to pump money into property. However, it is not just the baby boomers that have the opportunity to buy other properties. It can now be in the grasp of savvy Millennials too, if they play their cards right.

Building up a property portfolio is time consuming and takes a lot longer than traditional investing with a bank or capital investment company. It takes an average of 2-3 months to buy a house, and (very approximately) costs £3,000-4,000 in solicitors' fees, surveys and land registry alone, without factoring in stamp duty. But that doesn't mean it isn't worth it. For a start, investing in property means you have control over your own money; it isn't in the hands of a banker you've never met. It is also a solid investment. As with all investments, markets fluctuate, but some are quicker to recover, or slower to fall, than others. Crashes like the one in 2008 are not a regular occurrence. For years, there has been talk of London's property bubble bursting due to lack of foreign

investment, Brexit, or yet another recession. But unlike with stocks and shares, people need property to live, which helps the market to maintain a certain level of stability.

Property's slow movement is exactly the reason it is a safer bet than investing in the stock market. It is also, of course, more time consuming than traditional investing, even once the property has been bought. London agents charge 10-12% to find tenants, and if you want the property managed, they will add another 10-15% so you'll be losing 25% of the rent unless you have the time to maintain the property yourself. This makes the type of property you buy a vital consideration depending on your own circumstances; a new build will require far less maintenance

than a doer-upper in the middle of nowhere. If you want to avoid extortionate fees, you will always require time.

So why is now a good time to get on the property ladder as a landlord? Thanks to Brexit, and with the Bank of England cutting the Bank Rate on 4th August to 0.25 per cent from its already record low level of 0.5 per cent, where it had remained for more than seven years, mortgage rates are the lowest they have been in a number of years. On 23 June, I caught an Uber taxi home as the referendum results were being counted. Most Millennials in London were declaring their doom and gloom across social media about how their world was about to end. But as the first results of the night came in, my driver excit-

“THANKS TO BREXIT, MORTGAGE RATES ARE THE LOWEST THEY HAVE BEEN IN A NUMBER OF YEARS.”





“IF INVESTED WISELY, HAVING A PROPERTY SHOULD BRING IN MORE MONEY THAN YOU CAN SAVE ON THE AVERAGE MILLENNIAL SALARY.”

edly told me he was hoping and praying for the 'out' vote to triumph. Why? It would be the only way he could afford to get on the property ladder. He anticipated that with Brexit would come low interest rates, cheaper houses, and banks would have an increased incentive to lend. And how right he was. As he raced through South London tooting his horn and cheering every time a new constituency result was announced, it appeared to me that astute and switched on investors could make huge gains from the current state of the market.

House prices are indeed forecast to fall 1% in 2017 according to Countrywide, the UK's largest estate agent group. The most expensive areas of London will be the hardest hit as prime central London house prices will fall by 6% in 2016. So the time is certainly ripe to make a move. And this is not likely to

be the start of a crash, with prices recovering to 2% growth in 2018. So, onwards and upwards! Moreover, most banks and building societies have passed on the interest rate cut to mortgage customers, and if you do your research, a lot more than 0.25% can be saved by remortgaging.

Nationwide recently announced that new two-year fixed rates now start at 1.49% with a £999 fee, or 1.89% with no fee. Its three-year fixeds start at 1.79% with a £999 fee, or 2.09% with no fee. HSBC has also revealed a two-year fixed rate on offer at just 0.99%! For those not wanting a two-year fixed deal to end at the time Britain's divorce from the EU is completing, there are attractive five-year deals: the Post Office offers 2.94% for a five year fix with a £995 fee, and Nationwide starts at 2.14% with a £999 fee, or 2.34% with no fee.

Having a mortgage is nothing to be afraid of. More significantly, with 1.65% interest rates (Leeds Building Society) available for buy-to-let buyers, but with rental rates still steady, yields are high. Where else could you gain over 5% on your money? It should be remembered that as the cheapest way to borrow money, you will undoubtedly end up better off if you use mortgages and banks to your advantage. Waiting to save enough money to buy a BTL outright is a misuse of your capital; getting your foot in the door is the most important part. If invested wisely, having a property should bring in more money than you can save on the average Millennial salary. Waiting for more saved capital means that by the time you get round to buying, property prices will likely be out of your range and you'll always be chasing an unobtainable goal.

So what are the most important things to consider when thinking about starting a property portfolio? Assuming you have enough to put down a deposit, your first question should be *what are you aiming to obtain from the property?* BTLs are divided into two areas: rental yield vs. capital gains. Of course, the most expensive areas of Britain, such as London, Oxford and Cambridge can often provide both, but most of

the country is not so fortunate and it should be considered which you are aiming for. For example, average monthly rental rates in London over the last 12 months (TimeOut London) provide interesting reading for aspiring landlords: Pimlico £1,748, London Bridge £1,648, Shepherds Bush £1,416, Euston £1,720, Putney Bridge £1,352. Clearly, this is towards the higher end of the market, but options outside of London also present opportunities. The average rent in Essex is £975 per month, Kent £700, Surrey £1,013, Berkshire £1,000, and Hertfordshire £875. But perhaps, when yields are examined more closely, there are better bargains to be had outside of London, where the initial cost of getting onto the BTL ladder is more manageable. According to Lendinvest, Manchester tops the table with a 6.02% rental yield, followed closely by Liverpool with 5.16%, Cardiff with 5.10%, and Coventry with 5.02%.

If you are relying solely on capital gains, and you aren't looking to collect any monthly profits from the property, you will need to budget for the times when tenants change over and the resulting void periods – as well as any repairs – arise. Equally, if you are gaining rental yields, but are in an area where capital gains are unlikely, you will need to account for not reaping the rewards of such capital gains, and plan to expect only rental earnings from the property. Of course, there is always a risk that a property will go down in value,

and in extreme cases where they totally plummet and devalue by more than what has been invested, you will be deemed to be in 'negative equity'. This is only an issue if you have cash flow problems and are required to sell. For most buyers, if you can weather the storm of a fluctuating property market without selling in a hurry, the property will eventually return to normal and you will be back on track. So it is vital to decide what you are looking for in terms of capital or rental profits before you begin house hunting; these separate income streams are usually

area-specific, and there is no point attempting to gain high rental yields in an area with very low rental prices experiencing a housing surplus.

So what does it all come down to? Starting out on the road to building a property portfolio could be an option for many Millennials, especially in the current economic climate. But it takes time, planning and research. There's no quick and easy solution. There are also plenty of other things to consider, some of which will be discussed in the next issue of Master Investor.

“STARTING OUT ON THE ROAD TO BUILDING A PROPERTY PORTFOLIO COULD BE AN OPTION FOR MANY MILLENNIALS, ESPECIALLY IN THE CURRENT ECONOMIC CLIMATE.”





AUGUST 2016

BEST OF THE BLOG

Is an Oil Spike Coming?

The general consensus on the street has been bearish on Crude since the US became a self-reliant energy producer and exporter. This, coupled with more energy-efficient vehicles may have subdued demand and brought oil prices down to multi-year lows (currently \$49.00). While Russia does not want to cut production, increasingly many OPEC nations are considering it, resulting in

supply uncertainty. To top it off, latest US rig count data showed an increase in rigs. We would like to propose a somewhat contrarian view relative to the street; namely that Oil **may** be due for a spike and we do stress 'may' as it is a volatile asset and one that is subject to a range of global macro-economic and political variables.

Our reasoning, however, is predominantly based on chart technical

analysis. Looking at the weekly chart since 2006, the hedge-fund driven oil price spike surrounding Lehman Brothers in 2008 marked the multi-year high for the commodity when prices reached \$147.00 for a few hours. This resulted in a stochastic and RSI peak followed by a very sharp drop off, mainly driven by a global economic slowdown. Over the years as the economies recovered, oil did too reaching a post-Iraq "new normal" of over \$100.

“OIL MAY BE DUE FOR A SPIKE AND WE DO STRESS ‘MAY’ AS IT IS A VOLATILE ASSET AND ONE THAT IS SUBJECT TO A RANGE OF GLOBAL MACRO-ECONOMIC AND POLITICAL VARIABLES.”

Fast forward to today, and the price found a near-term bottom at around \$27.00, experienced some degree of a 'dead-cat-bounce' to \$50.00 and experienced downward pressure again, predictably, after hitting the 23.6% Fibonacci retracement level. As the stochastic reading on Exhibit A (point A) shows, Oil has found significant support and bounced off a deeply 'oversold' stochastic reading of around 5 back in January. Currently the reading

is around 50, meaning that in the near term, there may be some lack of direction, perhaps even some weakness, given it has breached the 23.6% Fibonacci level from below this month (Exhibit A, point B). But should it retrace to the \$35-38/barrel mark, the price may experience some lift-off to tag the second Fibonacci retracement level of 38.2% or around \$60/barrel (Exhibit A, point C), indicating a possible c. 60% upside, or from current levels

(c. \$49.00), a potential 22% upside.

By Oto Rem Suvari



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Sherlock Holmes & the Mystery of Rising Debt & Falling Rates

A dialogue between the Master and his trusty sidekick, Dr Watson, at 221B Baker Street, unpacks the most intriguing paradox in contemporary economics. Rising government debt levels should drive interest rates higher. Instead, interest rates are plunging to zero and below. As Holmes explains, our ultimate fate might be in the hands of an evil genius.

The door of Holmes's study flung open. Dr Watson manifested himself, apparently flustered. Without removing his bowler hat, he began.

"Holmes! I come hot foot from the City with three extraordinary pieces of information. First, interest rates have been halved to a new historic low of 0.25 percent. Second, government expenditure is rising well beyond forecasts. Third..."

Holmes raised a pale, delicate hand.

"You are about to tell me, my dear Watson, that despite the fiscal impecunity of our government, their bond yields are falling even further..."

"I am dumbfounded, Holmes. You deduced my third point precisely..."

"Elementary, my dear Watson. You see, as a citizen of the modern world and a



man of science, I have made a study of modern political economy and I have finally resolved a mystery that has challenged me for years..."

"Mystery, Holmes?"

"Indeed, my dear Watson. All of economic theory hitherto suggests that indigent governments seeking to raise additional debt, as time goes by and their debt-to-GDP ratios deteriorate, should have to pay higher costs for their borrowing. As their debt costs go up so they should be obliged either to address their deficits by judicious frugality or suffer the indignity and extreme dislocation of default."

By Victor Hill



A New Investment Paradigm? NIRPs & Equity Valuations

Are we entering a "new normal" in asset valuations? In an [interesting recent piece](#) in the Telegraph, Tom Stevenson, investment director at Fidelity Worldwide, suggested that the current trend for central bank negative interest rate policies (NIRP) that we are seeing across the globe – and their subsequent impact on rising equity values – could actually represent a "new investment paradigm". He rightly added that such discourse could potentially be pernicious; after all, it is for good reason that the words "this time it's different" can be some of the most expensive in the English language. As in: "Boom and bust", maybe? Pah! Nonetheless, as a practitioner and avid student of financial valuation, the concept certainly raises some interesting points



and potentially challenges textbook corporate finance theory. So how did we get here?

Over the last 40 years, yields have been on a downward trajectory. The Financial Crisis of 2007-09 accentuated this trend. In response to the crisis, central banks lowered interest rates to historically low levels. In 2009 and 2010, this was seen as merely a temporary solution: with the coming uptick rates would spring back to normal. However, the goalposts of monetary "normality" kept shifting. In 2011 and 2012, the conviction was that as central banks rolled back QE programmes, interest rates would naturally rise. In 2013 and 2014, various crises (such as the ongoing Greek tragedy) were blamed for continued depressed rates. By 2015, commodity price deflation and an anticipated Chinese slowdown were the key culprits. Rate rises were always just around the corner. Last year, short-term interest rates in the Danish Krone, Swiss Franc and the Euro dropped be-

“IT IS FOR GOOD REASON THAT THE WORDS ‘THIS TIME IT’S DIFFERENT’ CAN BE SOME OF THE MOST EXPENSIVE IN THE ENGLISH LANGUAGE.”



low zero. Sweden and Japan were the next dominoes to fall into negative territory. [The US could be next.](#)

Just to be clear, NIRPs mean that a bond holder is in effect paying a government to borrow money and that banks are charged for deposits held at some central banks (so far commercial banks have been reluctant to pass this on to customers) as central banks hope to increase the velocity of money for savers, investors and businesses.

By Adam Patterson



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full article](#)

Buying Japan against the Crowd

So here we are again at a junction where policymakers have only two choices: one leads to a merry-go-round that ends and starts at the exact same point; the other leads to a dead-end, forcing a return to the departure point. This has been the choice faced by policymakers over the last few years and it will take some time until they realise the only option they have is to retreat and find an alternate path. The Japanese government and the BOJ are moving in cir-

“THE ONLY PROBLEM WITH THIS GAME IS THE FACT THAT EVERYBODY IS TRYING TO DO THE SAME THING AT THE SAME TIME.”

cles; the Yen and the Nikkei can only move in the same circular fashion. Policy action from the government and the central bank appears to be losing impetus, leading to a stronger yen and a weaker Nikkei. However, Prime Minister Abe's bold bet to reflate the Japanese economy seems credible and I believe new firepower may be added during the month of September.

Monetary and fiscal policy are currently a hot potato game. Now, it is Mr Kuroda's turn, an opportunity he

uses to cut interest rates and increase asset purchases, and of course help the yen to retreat against the dollar to boost the country's exports. But then comes Ms Yellen's turn, which she uses to neutralise others' action by keeping rates flat for longer than expected. The move benefits corporate America, as foreign earnings converted into dollars become more valuable. Then comes Mr Draghi, who despite being caught between a rock and a hard place tries to implement something similar to other central banks. The long-appreciating Euro is then pushed back to earth. This game – let's call it "Currency Wars" – is also played by Mr Carney (it is his turn today) and many others around the world.

The only problem with this game is the fact that everybody is trying to do the same thing at the same time.

By Filipe R. Costa



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BY RICHARD GILL, CFA

READ TO SUCCEED

INVEST IN THE BEST

APPLYING THE PRINCIPLES OF WARREN BUFFETT FOR LONG-TERM INVESTING SUCCESS

BY KEITH ASHWORTH-LORD

There are scores of books for sale about the life, successes and investment philosophies of Warren Buffett. A quick search in the book section on amazon.co.uk for the Sage of Ohama's name brings up no less than 5,591 relevant results. From classic read *The Snowball*, to collections of his timeless shareholder letters, along with hundreds of investment guides, readers are spoilt for choice.

So is there really room on the market for yet another Buffett based book?

When its author is a top performing fund manager, and considered to be one of the foremost authorities on the investment guru, then the answer is clearly yes.

From outer-space to outperformance

Invest in the Best's author, Keith Ashworth-Lord, is a man of many talents. He graduated with a degree in Astrophysics, then obtained a Masters in Management Studies before embarking on a career in the investment markets. Over 30 years he has worked in a variety of roles, winning a clutch of awards for his stock picking skills along the way. However, his current

focus is Investment Director at Sanford DeLand Asset Management, which he set up in 2010.

The firm's flagship product is the Buffettology Fund, notable for being the only fund to have a licence to use the trademarked "Buffettology" name – trademark owner Mary Buffett (Warren's former daughter in law) was so impressed with Ashworth-Lord that she gave him the go ahead to use it. By applying the Business Perspective Investing methodology practised by Buffett himself, as well as Benjamin Graham, the UK focussed fund has delivered excellent returns and significantly outperformed its benchmark since launch in March 2011 (see chart below). Current holdings include small cap favourites Domino's Pizza, Dart Group and Bioventix.

Secrets of Success

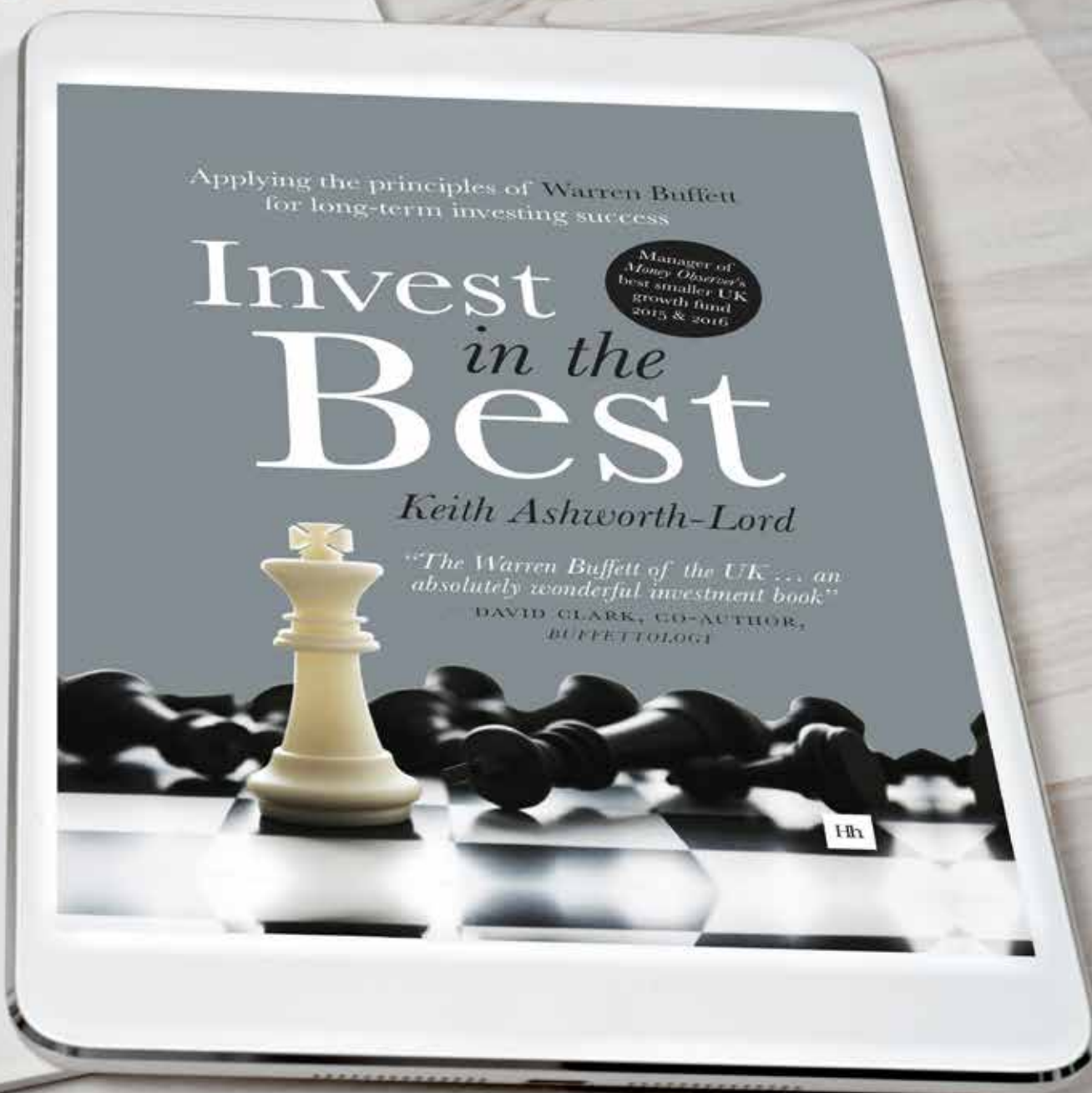
So how has Ashworth-Lord's fund been so successful? He puts this down to one simple reason which echoes Warren Buffett's investment philosophy: buying superior businesses at prices that make business sense.

Invest in the Best focuses on applying this methodology, which is encapsulated in the previously mentioned

investment style known as Business Perspective Investing. And it is a good old fashioned investment text, interspersed with case studies, explaining in detail how the investment style works, and teaching investors how to put it into practice themselves.

To give a basic explanation, Business Perspective Investing is a long-term, fundamentals based investment method which argues there is no philosophical distinction between buying shares in a company and buying the company in its entirety. As such, when analysing a company investors should dig as deep into the quality of the business as someone who was going to buy the whole thing.

After a short introduction, which explains how the author came to develop his own investment philosophy, the next few chapters concentrate on applying the principles of Business Perspective Investing to screen for companies for investment consideration. The main focus in this initial analysis stage is to look for "quality businesses", or in other words those that exhibit a number of characteristics which enable them to flourish over the long term. These include a simple business model, transparent financial statements, high cash flow, superior com-



**“IS THERE REALLY ROOM ON
THE MARKET FOR YET ANOTHER
BUFFETT BASED BOOK?”**





Buffettology fund performance since launch. Chart source: Trustnet

petitive advantage, and many others which are covered throughout the core text of the book.

Looking for these characteristics can only be seen as an initial step in making an investment decision however, because great companies might not always sell on the market at a great price. So chapters eight and nine then take the reader through a number of ratio analyses and valuation techniques which can help them determine whether a stock is trading below its "intrinsic value" and thus worthy of a buy. Small cap wonder stock James Halstead is used as an example throughout the ratio analysis, showing how investors could have spotted a winner by analysing metrics relating to sales, earnings, cash and assets. The author also highlights how non-accounting information provided by management, such as number of stores, or number of employees, can be used to provide useful insights into companies. The valuation section could almost be a beginner's guide, explaining the key concepts of the PE ratio, price to book value and others, but is also a useful refresher to more seasoned investors about the benefits and pitfalls of each approach.

The final chapter offers some useful advice on how investors can manage a portfolio of investments, including on when you should make the decision to buy and sell and how important dividends can be to total returns. My particular favourite concept is, "buying £1 for less than £1", otherwise known as the margin of safety. The greater the margin, the higher the return when the markets eventually realise the true value of a company.

The author is also an advocate of concentrating wealth in conviction ideas, going against the modern view that by adding more holdings you reduce risk. After all, if you invest in only a few great companies you won't need other holdings to offset losses from the bad ones.

Conclusion

Invest in the Best is a great book for all types of investors. Professionals will be able to see how their top performing peers do so well and those considering a career in fund management will learn a lot from it. Private investors too will get an insight into how to make excellent returns over the long term.

“INVEST IN THE BEST IS A GREAT BOOK FOR ALL TYPES OF INVESTORS.”

If the performance of the Buffettology fund wasn't enough to convince you to take Ashworth-Lord's approach to your investments then take note that he has never had an investment go bust in his entire career. He also wrote this book overlooking the swimming pool at his second home in Florida. He states this in the book, not to show off per se, but to highlight that without successful investments he would never have had the chance to buy another property in a beautiful location. After reading this book, you might be able to too!

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BY ADRIAN KEMPTON-CUMBER

THE FINAL WORD

THE ART OF ANTICIPATION

I hear a lot of noise coming from the black community demanding that they receive reparations for the slave trade, although curiously nothing at all about the black slave traders that sold their ancestors into slavery. Well I'd like to stake my claim while we're at it. I'm not in any way African, or at least no more than anyone else. English as far as records go back. And I'd like to claim for the slavery of my ancestors. It wasn't called slavery of course, but serfdom. Our English ancestors were robbed twice of land, or killed for it – by the Church and by the monarchy. I demand reparations so get in line: my claim is older and therefore first.





Is any of that realistic? No, of course it isn't, and actually if anything it's divisive, unhelpful dialogue. But people aren't realistic. I'm really not sure why people hope unrealistic things will happen. It almost seems to be a hangover from when it wasn't yet scientifically invalid to pray – if they don't actively 'hope' things turn out alright they're not doing their bit. As investors we can't use hope. It is of no value to us at all, and it's certainly not relevant in causality. We can't control events with our minds because there are no such forces that allow that in the world we live in. We have to analyse and be right.

Making successful investments is dependent on correctly anticipating future events. I'm reminded of that bit in 'Back to the Future' where Marty McFly (Michael J. Fox) plays 'Johnny B Goode' and his '80s guitar-hero antics didn't have any connection to the '50s. This is how I feel a lot of the time. I join dots and see what's going to happen. There's no point telling most people as, in spite of my track record, people still think that what they don't want to happen simply won't happen, or even can't happen. This is to our advantage though. Much as I'd like a rational society, it'd be a lot harder to take money off people in the markets.

The Labour party is a good example of denial. They won't admit they're two parties, and until and unless they split into two parties (or they have a mass defection) they'll remain unelectable, and not even a credible Opposition. They are also too scared to contemplate the fact that, once Brexit actually takes place, in order to re-join the EU the Scots will vote to leave the UK and then the Tories will win for the next 50 years, unless and until there's electoral reform. And electoral reform is far less likely right now as the majority voted against STV just a few years back. If you present people with reality they'll accuse you of being a misery guts or a killjoy, while they busily 'hope' things will turn out alright. Shoot the messenger much?

What do we really know about the future though? My maxim is those who don't learn from history are doomed to repeat it. And since that's more or less everybody, that's what happens. It repeats. As investors, if we know that it re-



peats, we can make money by leaning into it repeating. Everything socio-political and economic is cyclical, from wars to political unrest to racism (aside from cultural racism which is pretty permanent, you don't hear people moaning about people taking their jobs in times of economic prosperity – it's cyclical).

We also know that the behaviour of a population takes a long time to change, usually by attrition. The future is so often hiding in plain sight. It was 'Earth Overshoot Day' on the 8th August. That's the day when we have consumed the resources that the Earth can replace in a full year. Yet people deny that overpopulation is the problem. We know nothing is being done to control population growth. Bizarrely, all it would take is to educate women in developing and poor countries to use birth control, and take charge of their reproductive destiny. But the religious right in the US won't be subscribing to

“MUCH AS I’D LIKE A RATIONAL SOCIETY, IT’D BE A LOT HARDER TO TAKE MONEY OFF PEOPLE IN THE MARKETS.”

that sort of programme, ergo it's not happening. So in the fullness of time there will be a plague of humans (David Attenborough describes us as such already) and when adequate proportions are reached we can expect 90% of the population to die off quite quickly, because behaviour won't change and we are ultimately doomed to this logical outcome. That'll be hard to make money out of though, as and when it does happen. Hey ho!

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The near future, by which I mean the next 20 years, will be about higher temperatures (more rain), population growth (demand for goods/resources and land/migrants) and economic decline or stagnation for many countries (social unrest/civil war/war/more inequality).

How do I know that? Well, by and large, human behaviour doesn't change much, and certainly not in the short term. So whatever is responsible for the trend of higher temperatures on Earth, even if there is an element of nature involved, higher temperatures mean more rain – that's just basic science. Population growth is a given. Nothing is being done to discourage it and the Chinese – the only nation that has made any effort at all – is stopping the one baby policy having become a top heavy society over the years they've been running the programme. As for economic decline, even if in reality it's just normalisation after many years of growth in emerging nations, there is certainly no global growth.

So what I've done there is not so much predict what's going to happen, as what's not going to happen. Ongoing trends aren't likely to change suddenly, especially when it comes to human behaviour. What's *not* going to happen is often clearer than what *is*. It's a very



useful tool for future predictions, and those are what we base our strategies on. For example, the Irish GDP grew at 26% this year. Last August I picked out Ireland as a star performer. So then I'm just waiting for reality to catch up. I don't get too many surprises, although that was better than expected, so not an unpleasant surprise. One surprise, which I didn't invest in, was Le Pen's Front National not doing well in the local government elections in France because the other candidates withdrew tactically to thwart the voters. I expect her to win the presidency because in times of economic decline right-wing politics flourish. Merkel's going too next year. Generally, politicians have little direct impact on the global economy but, like [predicting the Leave win](#), I do expect to read the trends and 'political marketplace' right. The uncertainty that things like elections create is resolved when the result comes, and I want to be on the right side of the move.

What's going to happen in the UK? Well we need to go back to the financial crisis to see that. Gordon Brown did nothing to protect us from the financial meltdown. Rescuing banks that should have gone to the wall and then following the Americans down the low interest rate rabbit hole was not a long-term solution. In turn, the FSA also did little to protect us with their laissez-faire approach to regulation. In 2009 we should have had a full blown recession. However, with interest rates low and the exodus of Euros from the continent and into the tax haven of UK property, we managed to avoid the symptoms, at least here in the South East. But did that avert a recession?

No is the short answer. We have been in recession since 2009. Inflation appearing to be in very low single figures makes it look like GDP is positive, but it's not. Real inflation is more in the region of 6%-10% for the man in the street.



What we have is in fact a slow-mo recession. Pensioners' income is higher than the average wage in the UK if you didn't know, and this has been widely reported in the mainstream press. With low interest rates what we have is economic death by a thousand pip cuts.



You can see the cracks. Lots of industrial action (Southern Trains leading the way there) combined with poor management and a lack of fiscal control leads to spectacular failures like BHS. If interest rates don't rise soon expect some FTSE100 Blue Chip companies to be swallowed into their pension black holes. Then follows the slow death of the housing market, just like in Japan where 65% falls were recorded over 15 years. Everything is moving away from the middle. And it is a burgeoning middle class that gives society stability. Expect more civil unrest then.

In fact it beggars belief that the Bank of England cut interest rates after the pound started its long-overdue correction around the time of the EU referendum. If the devaluation of the pound was so bad one might ask Carney, "Dude! Seriously? WTF!?"

Of course, with a low pound, property prices still haven't been hit as there's a fire sale on for everyone outside of the Sterling Zone. One good thing (perhaps just one) that Osborne did was to lower the Corporation Tax Rate. Basically, we're not going to see any domestic start-ups so why not have foreign companies headquarter themselves here. Britain isn't open for business; it's an international slightly upmarket trailer park and our unskilled workforce are the trailer trash.

I think Victor Hill and I are the only Master Investor contributors talking about geo-political risk in Europe, or anywhere else for that matter. I'm expecting conflicts to erupt in places where old wounds haven't healed, like the Balkans. If Northern Ireland does leave the UK, following Scotland, in order to re-join the EU, then no doubt sectarian violence will re-emerge there. Germany is considering reintroducing conscription. Do you need to know more? Theresa May says she would press the button if push came to bomb and what she's doing there is sabre rattling. Britain may be on its own now but don't mess with us!

So how do we make money out of this? There are lots of sectors I could look at. Forget defensives. I really like the defence sector, especially as the UK is a global player in the arena. I wrote a piece last year about having [defence stocks in your pension](#). BAE Systems plc (LON:BA.) was 460 then. Now it's 540. But just look at that chart! It appears poised to break out of the ATH which, like many UK stocks, was in

1998. This could be huge. It's possible that we might even see the FTSE100 itself become attractive. Part of this, don't forget, is that everything is cheap for foreign investors, and the amount of [foreign money in the UK market](#) has been trending higher for years. So it represents real gain to us because we are not exposed to the currency risk. If you don't feel morally at ease with selling arms, let the Chinese, Russians and Americans take our business. The world won't be any safer and no fewer people will die. And we will be losing our differential in the global market place. That's the price of Utopia.

“IT BEGGARS BELIEF THAT THE BANK OF ENGLAND CUT INTEREST RATES AFTER THE POUND STARTED ITS LONG-OVERDUE CORRECTION AROUND THE TIME OF THE EU REFERENDUM.”

Hello, I'm from the future, and that, boys and girls, is how I won a gold in Brazil, as predicted last [October](#), and here's the final score in [August 2016](#). Team AKC!



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MARKETS IN FOCUS

AUGUST 2016

GLOBAL EQUITIES

Index	Last Month %	YTD %	Proximity to 52w High*
Hang Seng	5.0	5.7	
Russian Trading System	2.7	25.0	
DAX Xetra	2.5	-1.9	
Nikkei 225	1.9	-11.1	
IBEX 35	1.5	-8.2	
Bovespa	1.0	33.6	
NASDAQ 100	0.9	4.2	
FTSE 100	0.8	8.1	
Euronext 100	0.0	-3.4	
CAC 40	0.0	-4.3	
S&P 500	-0.1	6.2	
Dow Jones	-0.2	5.7	
S&P/ASX 200	-2.3	2.3	

COMMODITIES

Commodity	Last Month %	YTD %	Proximity to 52w High*
Crude oil (Brent)	8.5	22.9	
Crude oil (Light Sweet)	8.4	17.4	
Sugar (No. 11)	6.9	27.2	
Coffee	3.4	20.4	
Cocoa	1.8	-10.3	
Natural Gas	0.6	19.2	
Iron Ore	-3.3	36.6	
Gold	-3.3	24.3	
Palladium	-5.0	18.6	
Soybean	-6.0	9.4	
Copper	-6.2	-2.7	
Silver	-7.9	37.3	
Platinum	-8.5	17.9	

FOREX

Pair/Cross	Last Month %	YTD %	Proximity to 52w High*
USD/CHF	1.5	-2.2	
EUR/CHF	1.3	0.9	
USD/JPY	1.2	-14.1	
EUR/JPY	1.1	-11.4	
EUR/GBP	0.6	14.5	
USD/CAD	0.6	-5.4	
GBP/AUD	0.5	-12.8	
EUR/USD	-0.2	3.1	
GBP/USD	-0.7	-9.9	
AUD/USD	-1.1	3.6	

CENTRAL BANKS - RATES & MEETINGS

Central Bank	Key Rate	Next	After
BOE	0.25%	Sep 15	Oct 13
ECB	0.00%	Sep 08	Oct 20
FED	0.50%	Sep 21	Nov 02
BOJ	-0.10%	Sep 21	Nov 01
SNB	-0.75%	Sep 15	Dec 15
BOC	0.50%	Sep 07	Oct 19
RBA	1.50%	Sep 06	Oct 04
RBNZ	2.00%	Sep 22	Nov 10
BOS	-0.50%	Sep 06	Oct 26
BON	0.50%	Sep 22	Oct 27



FTSE 350 TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
OneSavings Bank PLC	30.7	-23.9	
Balfour Beatty PLC	27.3	3.3	
DFS Furniture PLC	26.0	-16.6	
G4S PLC	23.8	0.8	
Polypipe Group PLC	23.6	-14.8	

FTSE 350 BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Evraz PLC	-25.2	71.7	
Aggreko PLC	-20.8	10.2	
Randgold Resources Ltd	-19.4	75.0	
Hikma Pharma PLC	-18.8	-9.7	
Acacia Mining PLC	-17.7	157.1	

FTSE 350 SECTORS TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Construction & Materials	12.4	20.5	
Banks	12.1	-5.0	
Oil Equip, Serv & Dist	12.0	13.9	
Food Producers	9.1	-0.1	
Automobiles & Parts	7.5	5.7	

FTSE 350 SECTORS BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Industrial Metals	-25.2	71.7	
Fixed Line Telecom	-6.5	-17.1	
Mining	-5.7	50.2	
Gas, Water & Multiut	-3.4	8.5	
Pharma & Biotech	-3.0	8.5	



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