ISSUE 21 — DECEMBER 2016

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MAGAZINE

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THE UK'S NO.1 FREE INVESTMENT PUBLICATION

THE END OF GLOBALISATION

WE REVEAL THE WINNERS AND LOSERS

PLUS...

GOOD MORNING VIETNAM

WAKE UP TO THE NEXT EMERGING-MARKETS STAR

SMALL COMPANIES, BIG DEALS

THE SMALL CAPS PUNCHING ABOVE THEIR WEIGHT

NEIL WOODFORD

THE SECRETS TO THE SUCCESS OF BRITAIN'S BEST-KNOWN FUND MANAGER

TRUMPONOMICS

WHAT DOES IT MEAN FOR YOUR PORTFOLIO?

WELCOME

Dear Reader,

Amidst the daily travails of running a business, it's nice to receive feedback from readers – particularly when such feedback comes from a senior figure working at a large, respected company (whose name I cannot disclose):

"[I'm] really impressed.... on multiple levels... like the controversial yet balanced stance and positive approach to some of the world's issues, such as Brexit."

To which I can only say, welcome to the world of Alternative Media!

We may not have been in business for 100+ years. We may not have had US Presidents visit the office of our chairman. Nor have any academics called us a "paper of record". But nowadays, all of that might actually work to our favour.

Not being part of the political and financial establishment? This helps us to call a spade a spade. I went on TV in early November to call an election win by Donald Trump "more likely than not". Back then, the "papers of record" gave Clinton a >90% chance of winning. We got it right, they got it wrong.

Not operating a conventional newsroom with fully employed journalists? We are very agile when it comes to signing up the smartest analytical minds available and we give them the freedom to pursue their research with fewer constraints than they'd have in a large corporation.

Only appearing as an e-magazine? We like to attract a well-to-do, digitally savvy crowd. Printed publications are cumbersome and expensive, and by being completely digital we can focus on the content we deliver to our readers. That in turn brings the right kind of reader to our website.

When we embarked on creating the integrated Master Investor platform – events, e-magazine, blog, social media, e-letters – we had a fair number of people doubting whether we could pull it off. Two years into our experiment, a growing number of private investors and corporate clients are recognising the value of our work.

As I said, amidst the often tiresome work that comes part and parcel with operating any kind of business, that's a great feather in our cap. My team is more motivated than ever to take all this much further in 2017 – with you, our readers, as our foremost priority!

Best regards,

Swen Lorenz
Editor, Master Investor

CONTACTS

ADVERTISING
swen@masterinvestor.co.uk

EDITORIAL ENQURIES
james.faulkner@masterinvestor.co.uk

SUBSCRIPTIONS
admin@masterinvestor.co.uk

FOLLOW US

Master Investor Ltd.
Suite 88
22 Notting Hill Gate
London W11 3JE
United Kingdom

EDITORIAL
Editor Swen Lorenz
Editorial Director James Faulkner
Creative Director Andreas Ettl
Sub Editor Simon Carter

EDITORIAL CONTRIBUTORS
Bill Blain
Robbie Burns
Filipe R. Costa
Caroline Drewett
Richard Gill, CFA
Victor Hill
David Jones
John Kingham
Jim Mellon
Samuel Rae
Nick Sudbury

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CONTENTS

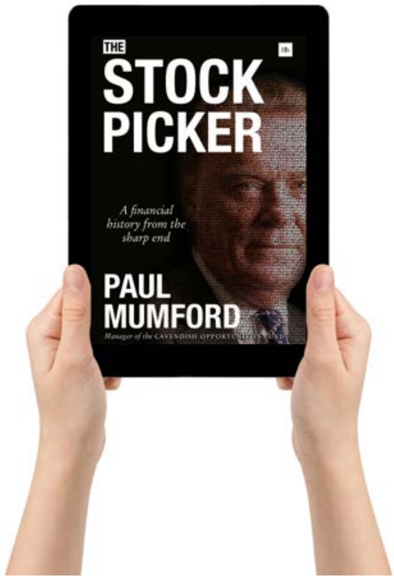
ISSUE 21 – DECEMBER 2016

THE END OF GLOBALISATION

ON THE COVER

ALL OTHER TOPICS

ALL OTHER TOPICS



BY JIM MELLON

MELLON ON THE MARKETS

THE BONDFIRE OF THE VANITIES

Last week I was in New York, and by sheer chance I ended up right next to Trump's golden palace (and of course the many thousands of indignant demonstrators objecting to his position as President-elect). I'd come across on the mighty Queen Mary II, as I find it easier to research new books on the high seas, since phones and other shiny distractions don't work on board.

As everyone knows by now, some notable Brexiteers had a meeting with Trump, ahead of all the usual politicos, including the saintly Mrs May. The day after their meeting, my friends and I met up with the whole Brexit gang for a *long* lunch. I was presented with a copy of *Bad Boys of Brexit* by Arron Banks, which is a terrific read – get hold of a copy if you can!

And I gained some insights, most of which I can't disclose. I *can* say that, in my opinion, the new President will dial back the harsh rhetoric of the election campaign – in fact he is already beginning to do so – and many of his economic policies will be positive.

Already, it is clear that there will be an immediate and substantial cut in corporate taxes (probably to 12.5%) and an amnesty on the repatriation of what is believed to be $2 trillion of corporate cash held abroad. That will probably attract a one-off charge of 10%, which means $200 billion for US Treasury coffers. That's no chump change, and I expect almost all of the monies to be repatriated.

> **"IT IS CLEAR THAT THERE WILL BE AN IMMEDIATE AND SUBSTANTIAL CUT IN CORPORATE TAXES (PROBABLY TO 12.5%) AND AN AMNESTY ON THE REPATRIATION OF WHAT IS BELIEVED TO BE $2 TRILLION OF CORPORATE CASH HELD ABROAD."**

This repatriation will have a GDP benefit to the US, but will be negative for the tax havens where the monies are held. There will be, incidentally, very little FX effect, as most of the cash is already held in US Dollars. I would think that Singapore and Luxembourg based banks will be the biggest losers.

In addition to Trump's likely Reaganite moves, I believe he will also move to quickly cut income tax rates, particularly for the middle class, and will ride the so-called *Laffer Curve* in the hope that fiscal stimulus through tax cuts will increase economic growth – and thereby tax revenues. The economic virtuous circle. It doesn't make US stocks cheap, as dividends are declining, margins are under pressure, and the strong dollar has a negative effect on profits. In fact, apart from some pharma companies, I would say US stocks remain expensive.

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"MY MAIN CALL THIS YEAR HAS BEEN FOR HIGHER YIELDS AND LOWER BOND PRICES, AND CHRISTMAS HAS COME ALL AT ONCE – AT LEAST IN THIS RESPECT."

In addition, just to blow the budget a bit more (and remember the Republicans now hold both parts of Congress), President Trump will start spending more on infrastructure, particularly on bridges and roads. Both of these, I can attest, are in terrible condition in the US, and add major drag forces to productivity.

All these factors are likely to lead to more inflation, and therefore Fed tightening. This is why the dollar is so strong (I do hope you followed us into Japanese yen shorts!). It is also why there has been a global bond rout in recent weeks.

As those who read this missive regularly will know, my main call this year has been for higher yields and lower bond prices, and Christmas has come all at once – at least in this respect.

In recent weeks, a group of certified morons (and the ECB of course) bought large issues of Italian 50-year bonds and Austrian 70-year bonds for derisory running returns. Well, if they didn't know before, they now know what *duration* risk is – and it's cruel! Believe it or not, the Italian bonds are down 20 per cent, and the Austrian bonds are down a whopping 30 per cent. That's showbiz!

This is a real BONDfire of the vanities (of central bankers and aforementioned morons!). And this particular fire has spread *everywhere*, with gilts, JGBs, Treasuries and of course BUNDfires all melting. This bond trade has further to run and I would now increase Eurozone bond shorts, and JGB shorts, and look to US 10-year bonds (rather than 30-year bonds).

This rout in bonds has coincided with a counterintuitive fall in gold and silver prices (though other commodity prices have been rising). This surprises me, because although gold and silver can be affected by higher interest rates, it is my experience that as prices in

economies rise, such inflation *always* outpaces rises in interest rates. This persists until at least the end of the rates-up cycle. And higher inflation is *great* for precious metals.

Of course, Prime Minister Modi of India instituted a call-in of supposedly high value bank notes, with $80 billion worth of scrumpled 500 and 1,000 rupee notes being tendered for lower denominations. This has been causing havoc, and possibly some forced selling of gold. Indians are massive buyers of gold, and I expect that this note-swapping effect will be temporary as far as India's love affair with gold is concerned. Modi is trying to reduce black market and untaxed elements of the economy, and to clamp down on corruption. However, his currency move is likely to severely reduce growth as monetary velocity crashes, and this isn't great for India, at least in the short term.

So, given that gold and silver are probably down temporarily, I would now load up on the precious metals complex, through physical, futures, ETFs, or gold and silver miners. **Fresnillo (LON:FRES)** listed in London, is best for silver, and **Condor (LON:CNR)**, also London listed, is a good play for gold, in my opinion. (I am a shareholder and director of the latter.)

In addition, readers will have noticed that the pound has been rallying, particularly against the weak euro, in the past few weeks. This probably reflects the fact that the sky hasn't fallen in, despite the Bremoaners' dire warnings. But it also reflects something more important. This is the notion that the US bias under Obama towards Europe and away from the UK will be sharply reversed under Trump.

The Federalist Europeans are going to be out of favour with the new regime in Washington. Trump has already made it quite plain (and rightly so) that countries such as France and Germany need to up their defence spending and comply with NATO commitments. The Second World War ended a long time ago, and it is time to realise that the potential enemy isn't a resurgent Germany – and that, as a result, improved

"I THINK THE EURO, AS CURRENTLY CONSTITUTED, HAS BETWEEN ONE AND FIVE YEARS OF LIFE. IT MIGHT BE EVEN SHORTER."

military capability in Europe isn't a bad thing.

On the subject of the euro (and I know I bang on about it), as the winter days draw in, the common currency is gasping and slowly sinking to multi-year lows against the dollar. It's going lower.

In fact, it's toast.

Italy, the Netherlands, Germany, Austria, and France all have elections coming up and any one of them could be the fuse that sets the death spiral into motion. I have said that I think the euro, as currently constituted, has between one and five years of life. It might be even shorter.

In particular I'd keep a very close eye on the Italian referendum on December 4th. It might make Brexit seem like a side show. If Italy leaves the Euro, events will overtake Brexit and almost every bank in continental Europe will be nationalised.

These are interesting times, and great for adaptable, curious and hardworking investors like us. "Make Investing Great Again" is the motto of Master Investor, and we are getting there! (Practising my sloganeering!)

Happy hunting!

Jim Mellon

Click here to follow Jim's trades on Twitter

BY VICTOR HILL

OPPORTUNITIES IN FOCUS

THE END OF GLOBALISATION

WINNERS AND LOSERS IN THE COMING AGE OF ECONOMIC NATIONALISM

2016 will go down in the annals of history as the year that the world changed course. Hitherto, since the 1970s, the main theme of global economic development was *globalisation* – the idea that international borders were inimical to economic development; that tariff-free trade went hand in hand with the free flows of goods, capital and labour; and that it was natural for manufacturing companies to shift production to offshore locations where labour was cheaper.

With the advent of Brexit and an existential crisis emerging in the European Union, plus the election of Donald Trump as President of the USA on a ticket of renegotiating trade deals with NAFTA and China, there appears to be a backlash against globalisation. What's more, many of the forces that have impelled globalisation – especially differential labour costs – are now going into reverse.

> "THE OPPOSITE OF GLOBALISATION IS NOT PROTECTIONISM – BUT RATHER THE RESURGENCE OF ECONOMIC NATIONALISM."

Don't panic. The opposite of globalisation is not *protectionism* – but rather the resurgence of *economic nationalism*. Though, I call it *economic rationalism*. As I shall explain, this has been a much more preponderant force in global geopolitics than is commonly understood – and has never really gone away.

But what would a *post-globalisation* world look like? Who would be the winners and losers? And how can investors position themselves to profit from this trend?

A short history of an economic idea

Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist.

- John Maynard Keynes.

Globalisation is the word for an idea that carries immense ideological baggage. For its proponents – people like Gordon Brown and Anthony Giddens[i] – it is the path to peace, prosperity and progress. For its detractors – from Helena Norberg-Hodge[ii] to Marine Le Pen – it is the scourge of the working class and of the environment, and it represents the ultimate triumph of financial capitalism over the individual.

Before we can grasp what the end of globalisation might mean we have to consider where the idea came from. As the great Keynes said, we might be surprised by how much our thinking is skewed by the ideas of dead economists.

"THERE IS STILL A LINGERING IDEOLOGICAL DIFFERENCE BETWEEN THE FRENCH (AND EU) INSTINCT TOWARDS MERCANTILISM, AND THE ANGLO-SAXON BIAS TOWARDS FREE TRADE."

Mercantilism

First there was *mercantilism* – the idea that emerged in the 17th century, especially at the court of King Louis XIV, that great powers should aim to accumulate monetary reserves through a positive balance of trade in finished goods. This became the dominant political ideology in the early modern period, especially in France and Great Britain, which were engaged in a bitter rivalry for control of colonial territories in North America and elsewhere.

Under the mercantilist system the state banned the import of certain commodities and sought to control the export of others. In France, industries were organized into guilds and monopolies, and production was regulated by the state through thousands of state decrees (the ancestors of modern *EU Directives*). In Britain, government control over the domestic economy was less extensive than in France, as it was limited by common law and, after the Civil War, by the increasing power of Parliament. But the ban on imports – or at least the imposition of swingeing tariffs (especially goodies from France such as brandy and wine) – was rigorously enforced. Evidence for this is that every other pub along the coast of my native Kent is still called *The Smugglers' Inn*!

Free Trade

The modern economic idea of *globalisation* has its roots back in the first half of the 19th century with the rise of **Free Trade**, particularly in Britain. Free Trade was an ideology which held that nations get richer by exchanging goods without tariffs or other non-tariff barriers such as restrictive customs posts and arbitrary licenses and permits. There should be no restrictions on what may be imported or exported. Free Traders did not think that it was necessarily a good thing to run a trade surplus, as that would simply result in an appreciating currency – the foreign exchange market would sort out trade imbalances in time. (Although currencies were generally fixed in terms of the Gold Standard, there were periodic devaluations).

Whereas mercantilism was pursued consciously to attain national advantage, proponents of Free Trade thought that it would benefit *the world as a whole*. Although Keynes does not use the modern term in his *General Theory*, in 1936 he still considered that Free Trade was "Win-Win"[iii].

In my view there is still a lingering ideological difference between the French (and EU) instinct towards mercantilism, and the Anglo-Saxon bias towards Free Trade. This explains some policy differences (and attitudes towards the EU) in our own time.

Comparative Advantage

Now the underlying rationale for Free Trade is the concept of **comparative advantage**. This is the idea that some countries have natural advantages in the production of certain types of products, not just by virtue of geography, climate, and natural resources and so forth but also because of human and cultural resources such as levels of education. In the most simplistic terms, the English are good at making beer and the French are good at making wine (although of course there is (some) English wine and French beer). If nations specialise in making what they are good at, and export those products, they will achieve lower marginal costs. Goods will be internationally more readily available at lower cost than if everyone produced and consumed their own beer and wine without trading them at all. This theory goes back to David Ricardo[iv] (Britain, 1817) and quickly gained currency as Britain rapidly industrialised.

The 1929 Crash, the Great Depression and its aftermath

Much modern economic thinking arises from the lessons of the 1929 stock market crash and the terrible, protracted depression that followed. Governments of the great industrial powers panicked, cut expenditure and imposed tariffs on imported goods. Modern economists believe that this accentuated the Depression. Just remember that US car production did not exceed its 1929 output until 1953!
It was WWII that restored the US and then the world economy though massive stimuli of government spending. Then, post-War, in the *American century*, US multinationals set out to conquer the world. **Coca Cola (NYSE:KO)** and **Pepsi (NYSE:PEP)**, both founded in the late 19th century, were virtually unknown outside America before WWII. By the 1990s their products were consumed from Casablanca to Saigon.

Protectionism becomes a no-no

By 1945, when the Anglo-American policymakers and their victorious allies met in San Francisco to hammer out the post-war settlement (including the United Nations), the prevailing economic orthodoxy was that the protectionist policies of the early 1930s had been a disastrous error. Trade barriers and tariffs persisted but were progressively cut around the world.

The rise of international trade partnerships – the EU, NAFTA, ASEAN

Significantly, the rise of the modern trading blocs, of which the EU is a particular case, dates from about the time that the modern currency system came into effect with the **Nixon Shock of August 1971** when the US Dollar was uncoupled from gold and currencies were left "to float". I seem to have been writing about this a lot recently – because it was a critical moment in modern world history which transformed the world economy.

After WWII the major Western European powers realised that there needed to be a change of model. The Soviet Union held all of Eastern Europe in its iron fist; America accounted for nearly a quarter of the world economy and half of global military assets; the British Empire was in terminal decline. After the Suez fiasco of 1956, the French decided to hold their nose and throw in their lot with Germany. The result was the Treaty of Rome (1958) and, by a succession of subsequent treaties, the European Union (finally proclaimed under the Treaty of Maastricht, 1992).

Britain joined the EEC (as it then was) on 01 January 1973 – within a year of the Nixon Shock, at a time when no one in Whitehall realised that the Euro-train was already heading to a far-off destination called **Monetary Union.** Once again, the British Sir Humphries were totally outfoxed by the French mandarins.

ASEAN (1967) and NAFTA (1992) were never remotely modelled on the EU. They aimed to eliminate tariff barriers and facilitate investment flows but there was never any concession to "freedom of movement" and no talk of a currency union. They were explicit partnerships between *sovereign* states. They tackled thorny issues such as intellectual property rights, but never sought to impose a common system of law, let alone harmonised taxation. Let us be clear that the EU is qualitatively and quantitatively different from any other trading pact in history. In fact, the only equivalent is the German *Zollverein* of 1834, which ultimately led to the unification of Germany. It is, and always has been, a political enterprise.


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The WTO: Trade becomes a branch of global bureaucracy

Then, finally, in 1995, the General Agreement on Tariffs and Trade (GATT) morphed into an international body with its own secretariat, just like the United Nations. The **World Trade Organisation (WTO)** was conjured into existence by the Western powers (principally America) in order to arbitrate, not just on bilateral trade deals, but on the legitimacy of trade itself. Nations which were deemed wanting, like Russia, were kept on the *naughty step* for years, unable to join up until they conformed to its standards.

Actually, the WTO was and is a part of the US-dominated commercial-financial global architecture of the modern period. The **World Bank**, the **International Monetary Fund**, the **International Finance Corporation** are all supranational bodies which are ultimately controlled by the USA (though normally headed by French personnel – the IMF Managing Director, is currently Mme Christine Lagarde).

This is the international financial system that revisionist states like Russia and China now seek to overthrow. Mr Trump might just allow them to do that as he believes that this financial architecture no longer serves America's interests.

International trade has never been controlled by trading blocs

The Chinese, in contrast, have always taken the view that trade between nation states should be determined neither by political considerations nor by concerns about "human rights". Once nations start to impose political criteria on which states they are prepared to trade with, the entire logic of free trade breaks down. In recent decades *sanctions* have been used as a political stick by countries in America's orbit to discipline miscreants, as we know. This also is likely to change under Mr Trump.

Globalisation – good for the rich, but bad for the poor?

It now seems obvious, but I am not sure that it was a conspiracy. The entire globalisation agenda benefited the rich and disfavoured the poor. The rich began to move assets – cash, financial assets, the means of production – to locations where they could either generate higher returns or pay less tax on them. The less-well-off, in contrast, experienced falling wages (and sometimes unemployment) as immigrant labour undercut them, and higher prices for housing and transport, though admittedly lower costs for clothing (Primark!).

The techno-economy combined with globalisation has devastated the indigenous working class in the UK who are now largely dispirited clients of the welfare state. Even the *dog walkers* I meet (and indeed employ) are overwhelmingly middle class, reasonably well educated women who know how to communicate, network and use the internet. The indigenous working class is even squeezed out of the *gig economy*. No wonder they are angry.


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"THIS IS THE NEW BATTLE LINE: GLOBALISTS VERSUS PATRIOTS."


Gino Santa Maria / Shutterstock.com

Globalists versus Patriots

Large multinational corporations were able to relocate production to economies where labour costs were lower than at home. Global investment firms were able to shift money across borders, taking bets on currency fluctuations. The other day, in a Facebook post, I saw the veteran investor George Soros described as a *globalist*. He was being compared with the *patriot*, Donald Trump – whose election he opposed. So this is the new battle line: Globalists versus Patriots.

The decline of the Left & the fomenting insurrection against the elites

Since the 16th-century Portuguese mercantilists hustled into the Indian spice trade to the world of Google's self-driving cars, capitalism has meant many things. Whereas socialism has had one main model (state control of the means of production) capitalism has had many.

What we did not foresee is how quickly the Left would lose popular support, once deprived of its traditional working-class base and supported only by a class of aggrieved students who want to re-write our history and tear down statues at Oxford. Mr Corbyn's Labour Party is rated at about 28 percent in the opinion polls, and falling. It is declining much faster than I foresaw when I declared that ***The Marxists Are Back*** last year. Similarly, traditional parties of the Left are losing ground to parties of the Right all over Europe.

Reality check: Mr Trump is not a protectionist

Amongst the many provocative things he said during his election campaign, Mr Trump did not threaten to impose tariffs on trading partners. Renegotiating trade deals with China and NAFTA is not necessarily about imposing tariffs. Again, the **Leave Campaign** during our referendum never advocated the imposition of tariffs. It is the Europeans who are now apparently prepared to expel Britain from the Single Market. If somebody else tells me that Trump-Brexit is the end of Free Trade, I would advise them to look at the facts.

The moment a nation-state agrees that free (non-tariff) trade can only be achieved by "freedom of movement" and the relegation of its national laws to supranational courts, it ceases to be a truly independent nation. European powers renounced colonialism after 1945 and withdrew from Africa and Asia and elsewhere where they had once held sway. Only to subjugate themselves to the rule of an unelected political elite in Brussels. The Eastern Europeans – who only managed to disengage themselves for the Soviet yoke in 1991 – turned westwards in the hope of embracing freedom. In so doing they became the colonies of Brussels. The recent Bulgarian presidential election is a pointer of where this is now going.

“IF SOMEBODY ELSE TELLS ME THAT TRUMP-BREXIT IS THE END OF FREE TRADE, I WOULD ADVISE THEM TO LOOK AT THE FACTS.”

A special trading relationship

If Britain has a Special Relationship it is with the three other English-speaking Commonwealth countries with whom we share a head of state: Canada, Australia and New Zealand. If you don't think I'm serious Google: CANZUK.

President Trump – unlike President Obama or a President Clinton – is much more likely to promote a concrete bilateral US-UK trade agreement. And there is good old-fashioned economic self-interest to do so. The numbers are staggering: the Congressional Research Service reports that *the US-UK bilateral investment relationship is the largest in the world*[v], and that Foreign Direct Investment (FDI) into the UK amounted to just under $600 billion in 2012, with $487 billion flowing into the United States from Britain. US firms operating in the UK employ 1.3 million Britons, with nearly a million American jobs provided by British companies based in the USA.

Yet - economic nationalism has always been with us

Just in case you didn't know, Russia and China never signed up to the globalisation credo. Culturally and ideologically, they regard the long-term construction of the national economy as the fundamental objective of gov-

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"PRESIDENT TRUMP WILL CUT US CORPORATION TAX FROM ITS CURRENT LEVEL OF 35 PERCENT. IF HE COULD CHALLENGE IRELAND'S 12.5 PERCENT, THEN, PARADOXICALLY, IT WILL BE GAME OVER FOR GLOBALISATION."

ernment. Outsourcing jobs abroad offends their patriotism. Their borders were never "open", and probably never will be.

And there is another interesting case study in economic nationalism at the very centre of Europe: France. The French, as God created man, created the EU in their own image. They set the entire thing up – not least the Common Agricultural Policy (CAP) – to favour their interests. The French became the sole European power with ambitions to build a network of fast trains powered by nuclear power. In so doing they created their own rule-book. The Gaullist traditions of the French elite are not just mercantilist. They have always been an overt form of economic nationalism.

And what is wrong with economic nationalism? It's just the evolutionary way the world works anyway. Market capitalists believe that numerous parties selling similar products create better products at lower prices thanks to the magic of competition. If companies compete for business, then so should states.

The narrowing of labour rate differentials

Nike (NYSE:NKE) and **Adidas (FRA:ADS)** clearly think that it is cheaper to produce trainers in Vietnam and Indonesia rather than respectively in their native Oregon or Bavaria. One may argue that this has bought benefits to Vietnam and Indonesia in terms of plant investment and employment that might not otherwise have happened. But the point is that the differential between labour wages in Oregon and those in Vietnam is declining over time as Vietnam, a rapidly growing economy, catches up.

Already we have seen American manufacturers pulling out of China, where labour wages have risen sharply in the last ten years, and relocating to Mexico.

And already it is clear that many high value-added businesses do not even need to be in Mexico.

This is the real story of Mr Trump's *Wall* which is – as I hope you have realised by now – a way of emoting symbols of invasion and security: an exercise in subversive semiotics. The Emperor Hadrian used a similar ruse in the province of Britannia in the 2nd century AD – *Keep those ginger barbarians out!*

But the inexorable advance of robotics will further accelerate the erosion of the labour rate differential. It is perfectly possible to imagine an Adidas factory in Bavaria belting out fine trainers by the million with no humans at all. I am sure it will happen; though I couldn't tell you precisely when. Maybe 2040? (I'll be in my dotage watching Mars missions on TV 24/7 – and cared for by a robot nurse.)

And don't forget that a major component of labour rates is employment taxes – *National Insurance* in the UK or *Social Charges* in Europe. In the UK employers are charged 13.8 percent social charges; but in France and Germany they are 40 percent. Presumably, there will be no social charges on robots.

Vietnam, Indonesia, and Bangladesh: *You have been warned.* You have to find other ways to compete apart from low labour costs. Of course, because you are not afflicted with prissy, self-referring neo-Marxist elites (as Europe is) you will never be cursed by insufferable taxes.

The twilight of the tax dodgers

The gaming of tax regimes by multinational corporations is about to be severely curtailed. President Trump will cut US corporation tax from its current level of 35 percent. If he could challenge Ireland's 12.5 percent, then, paradoxically, it will be game over for globalisation.

The mother of all ideological battles has begun

Investors need to understand the political context of the impending economic shift. I was born at the tail-end of the 1950s in an era of cosy *consensus politics* in which politicians re-arranged the deck-chairs on the decks of a sinking liner. This was blown sky-high in my teens by the arrival of one **Margaret Thatcher.** For years, British politics was riven between those who adored her and those who reviled her (most Tory MPs – the knights of the shire etc. – were in the latter camp). But then, in the age of Blair, the political divide closed again.

Having forced market economics down the throats of the Labour movement (as if making *pâté de foie gras*) British politics spun like a gyroscope on a still point between left and right for nearly two decades. David Cameron, when he made his bid to lead the Tories in 2005, advanced himself as a blue-rinsed Blair.

Now while Mrs Thatcher was an instinctive economic nationalist, Blair-Brown-Cameron – *Blameron* as I call them – were instinctive internationalists, globalist interventionists, juridical determinists (they believe that laws should be made by judges, not by legislators) and fervent adherents to the *European Ideal.* They thought that mass immigration was a fair price to pay for overall prosperity – whatever the impact on wage levels for the indigenous working class.

But the Brexit referendum result of 24 June has made the past a foreign country. We are now back to a fundamental ideological confrontation between two irreconcilable world views. On the one hand there are the people who believe that nations are best off controlling their own laws, borders and economies, ideally free to trade with their neighbours and the world at large. They believe in cooperation and partnership – but on mutually advantageous terms. And on the other hand, there are the people who believe that there is some moral imperative to suppressing national interests (especially the interests of the working classes) to some ideal around unfettered mass immigration, "human rights" and transferring national power to unelected supra-national elites.

"IF YOU ARE BRITISH, ARE YOU COMFORTABLE THAT YOUR LEADERS HAVE PERMITTED THAT 60 PERCENT OF ALL THE FOOD YOU CONSUME BE IMPORTED FROM ABROAD?"

ACTION: WINNERS

For now, I'm just going to give you three ideas on the upside.

First, **the defence industry** is set to get a huge stimulus in the age of economic nationalism. In a multi-polar world – a world of Great Powers not entirely unlike that which existed before WWII – spending on national defence is likely to increase across the board. Both Britain and France are nations with proud military traditions which have been undermined in the age of globalisation. We Brits have got two state-of-the art aircraft carriers coming into service over the next 20 months or so – which will have no aeroplanes. Marine Le Pen in France – whether she wins or not – will make it clear that the French have a *Force de Frappe* (nuclear strike capability) with no credible missiles. No wonder the Americans – and the Russians – laugh when Europeans talk about "security".

I have mentioned before that one company in the defence sector stands at the nexus of robotics, artificial intelligence, aerospace and weapons systems: **Lockheed Martin (NYSE:LMT)**. Similarly, anyone who holds a diversified portfolio of UK equities should hold **BAE Systems Ltd (LON:BA.)** (or as I prefer to call them, British Aerospace). BAE's order book has far exceeded expectations this year. (Their products are particularly favoured in the Arab world.) **Dassault Systèmes SA (EPA:DSY)** is also worth a look – nice drones.

Second, **on the currency front,** the gainer short to medium term will be (you've guessed it) the US Dollar. I write this in the third week of November and the Euro is already down more than five percent against the Dollar over the month. As I have consistently warned over this year, the Euro is on a downward course from hereon in. **The Japanese Yen is also vulnerable.** Watch out for possible gains in currencies that have not been impacted as much as North America and Western Europe by globalisation. I spy the Australian Dollar and the Indian Rupee, which are poised to make gains over the next 12 months.

Third, as economic nationalism takes root, combined with a rising world population and the challenges of climate change, **agriculture** will re-emerge from its sackcloth-and-ashes status as the vital global industry that it has always been. Only this time, national food security will be articulated more loudly. If you are British, are you comfortable that your leaders have permitted that 60 percent of all the food you consume be imported from abroad? There is also the environmental aspect: people are becoming more conscious of *food miles*.

Last month I sang the praises of agricultural land. Here, I'll point out two UK food companies that I admire. **Associated British Foods (LON:ABF)** has a number of leading food brands and also owns *Primark* – surely a candidate for a separate flotation. (Be aware that ABF has had an indifferent year.) Also: **Premier Foods (LON:PFD)**. This is a sector in flux. And – hesitating, lest I bore readers further with a personal hobby-horse – English wine, given a favourable fiscal stimulus, could emerge as a major agro-industry. Check out **Chapel Down (ISDX:CDGP)**. English wine has an effervescent future.

ACTION: LOSERS

The coterie of international tax dodgers are heading for trouble. **Apple Inc. (NASDAQ:AAPL), Starbucks (NASDAQ:SBUX), Amazon (NASDAQ:AMZN)** and their ilk will meet their match in President Trump. And they will take a huge swathe of hangers-on with them. I don't think that international trade will fall net-net in the next ten years; but be wary of logistics companies, many of which seem overvalued to me. There is massive overcapacity. Just look at what happened to Korea's **Hanjin Shipping (KRX:117930).**

Then there are **the banks.** The era of globalisation was also the heyday of *financialisation* – just before the 2008 Crash, finance accounted for nearly 15 percent of the US economy. That has been falling ever since. I will explain soon why, thanks to Fintech, we may not even need banks in 20 years' time. **In a post-globalisation world international finance will lose its stranglehold over the world economy.** At least, to that extent, there will be cheers from both Left *and* Right.

The next time a trendy Leftie calls you a *fascist* – as a ludicrous Oxbridge professor recently called all Trump-Brexit celebrants[vi] – remember that you are in excellent company.

Vive la révolution mondiale!

Madame Le Pen, leader of France's *Front National*, recently told the Andrew Marr show[vii] that what is happening now is not an Anglo-Saxon phenomenon – but rather *a global revolution against globalisation.* And the next earthquake could be the election of Marine Le Pen as President of France. The odds are shortening.

{Dear Evil: place your bet now – and please don't complain as you did about not profiting from the Donald!}

Frederic Legrand – COMEO / Shutterstock.com

A world changed irreversibly

Somewhere out there, there is an alternative universe where Prime Minister David Cameron is congratulating President-elect Hillary Clinton on her victory; and where J-C Juncker is drawing up plans to increase UK budget contributions to the EU, and insisting that the Ministry of Defence submits to the will of the **European Army.** What is remarkable is that that alternative universe already seems weird.

As I write this, I'm side-glancing at a TV screen showing Barrack Obama kissing Angela Merkel goodbye. And it already seems like one of those sepia photos of a bygone age.

When Swen Lorenz predicted in these pages in January this year that Donald Trump would win the US presidency, some of our detractors called us *fruitcakes*. Well, readers: Welcome to *high tea*!

i See: The Consequences of Modernity, Stanford University Press, 1992.

ii An anthropologist, most famous for her influential book Ancient Futures: *Lessons from Ladakh for a Globalizing World*, 1991.

iii The General Theory of Employment Interest and Money, 1936, page 335 (Macmillan Edition).

iv *On the Principles of Political Economy and Taxation,* London 1817.

v See: UK Expert: Trump will make the UK-US relationship great again, Independent Journal Review, 11 November 2016 by Lee Cohen. Available at: http://ijr.com/opinion/2016/11/261877-uk-expert-trump-will-make-the-british-american-relationship-great-again

vi *No, this isn't the 1930s – but yes, this is fascism* by James McDougall, Associate Professor of Modern History, University of Oxford. Available at: https://theconversation.com/no-this-isnt-the-1930s-but-yes-this-is-fascism-68867

vii BBC1, Sunday, 13 November 2016.

BY JOHN KINGHAM

THE DIVIDEND HUNTER

HOW I FIND LONG-TERM DIVIDEND GROWTH STOCKS

One major difference between investors who focus primarily on dividends and investors who focus primarily on capital gains is their time horizon. Companies that pay dividends usually do so every six months, so a dividend investor who buys into a company will often have to wait several months before their first dividend appears. Capital gains, on the other hand, occur almost every second of the trading day (as do capital losses). So the time horizon for dividend investors should almost always be measured in months and years rather than days or weeks.

This fact should have a profound impact on the way dividend investors select which companies to buy. From a personal point of view, when I buy shares it is very likely that I'll be holding onto those shares for several years, and potentially as much as ten years or longer. So I am of course very interested in whether that company is likely to sustain and grow its dividend over that sort of time frame. For me the best way to build up a picture of what a company might achieve over the next ten years is to look back at what it has achieved over the past ten years.

Looking back over the last ten years

Thanks to the internet it is very easy these days to get hold of a company's annual reports and financial results for the past ten years. Here are a few of my favourite sources:

ShareScope/SharePad (www.sharescope.co.uk): This is where I get most of my data from as it's very easy to export the numbers to a spreadsheet for further analysis. It's a paid service, but for portfolios north of £30,000 or so I think the benefits can outweigh the costs.

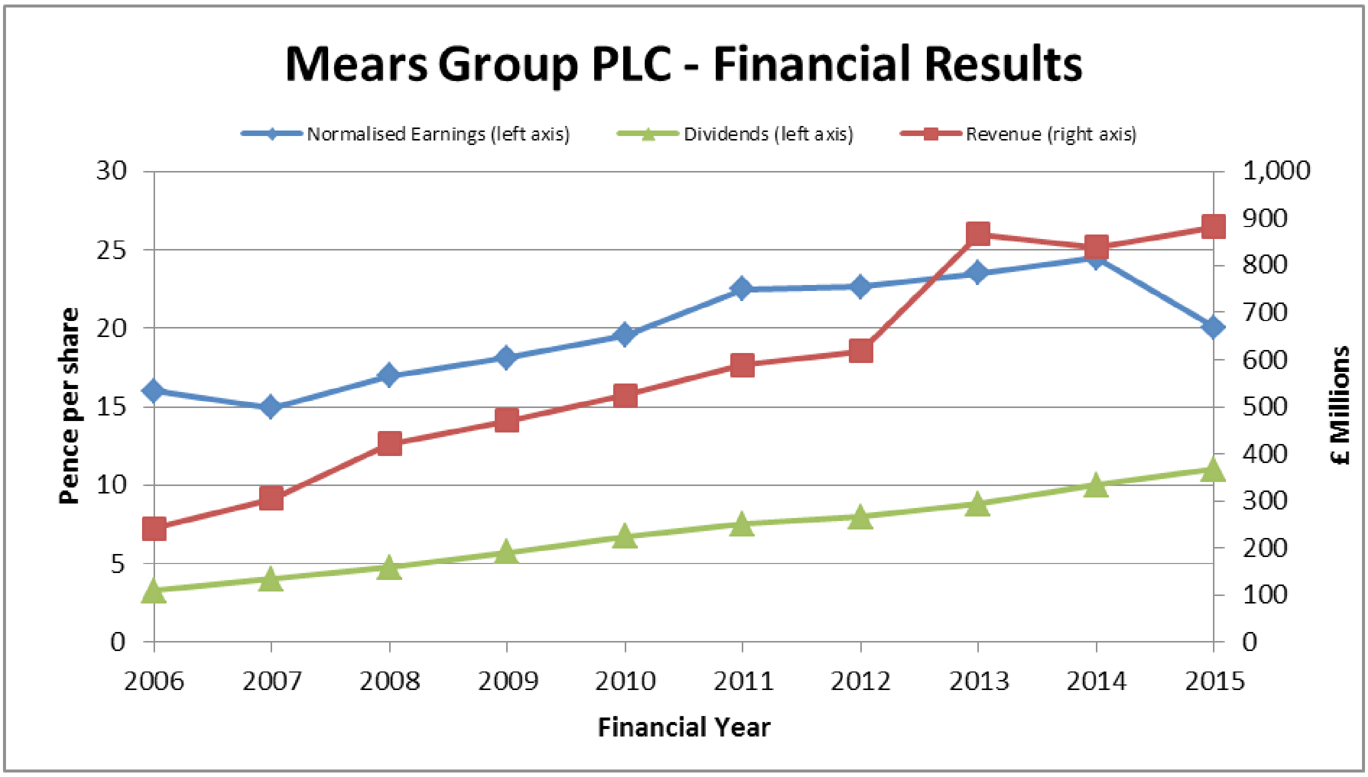
> "FOR ME THE BEST WAY TO BUILD UP A PICTURE OF WHAT A COMPANY MIGHT ACHIEVE OVER THE NEXT TEN YEARS IS TO LOOK BACK AT WHAT IT HAS ACHIEVED OVER THE PAST TEN YEARS."

Morningstar Premium (www.morningstar.co.uk): Although I don't use this paid service anymore, I did for a couple of years and it's another easy way to access data going back ten years. You can also read company reviews by Morningstar analysts, which I found helpful in terms of seeing someone else's point of view.

Sharelockholmes (www.sharelockholmes.com): This is a great low-cost way to get ten years of financial data. It's cheap and looks basic, but it does the job nicely.

FE Investegate (www.investegate.co.uk): With this free website you can search through all regulatory announcements (including annual and interim results) from a company going back ten years or more. It's a labour-intensive way to get the data, but it's a great way to find out what a company's been up to over the last decade or more.

Company investor websites: Most companies today have fairly comprehensive investor websites with links to annual and interim reports going back many years, as well as other documents and presentations. This is where I typically go to build up a picture of what a company does today and how it got there.



> **"I'M WILLING TO INVEST IN A COMPANY THAT HAS CUT ITS DIVIDEND IN THE PAST, BUT ONLY IF THE REST OF THE INVESTMENT CASE STACKS UP."**

This desire to look back over ten years means that any company I invest in must actually have a ten-year track record as a listed company. This immediately rules out IPOs, even of large and supposedly defensive companies like **Royal Mail (LON:RMG)**. However, if a company has the required ten-year track record then it's time to get serious and start kicking the tyres.

This month I'll be kicking the tyres of **Mears Group (LON:MER)**, a leading provider of repair and maintenance services for housing associations and other groups in the UK. You can see Mears' financial results over the last decade in the attached chart. It has the sort of consistent record of growth that most dividend investors are looking for, but we can be much more specific than that.

Dividend growth begins with dividends and profits

A company cannot grow its dividend if it isn't paying a dividend, so I want to invest in companies that will, at the very least, continue to pay a dividend over many, many years. I think the best way to find those companies is to look for those that have already achieved it in the past. So my first investment rule is this:

Rule #1: Only invest in a company if it paid a dividend in every one of the last ten years.

Note that I'm looking to avoid companies that failed to pay a dividend for a whole financial year, i.e. the dividend for a given year is zero. So this rule would not exclude BP for example, which suspended its dividend for a short period in 2010 but still managed to pay a final dividend for that year.

Some investors would go a step further and exclude any company that cut its dividend in the last ten years, but that isn't something I do. That's partly because I wouldn't want to exclude companies that report dividends in foreign currencies, which can cause the dividend to decline in Sterling terms even though it was held or even raised in the reporting currency. I also think it's a bit too restrictive, so generally I'm willing to invest in a company that has cut its dividend in the past, but only if the rest of the investment case stacks up.

In the case of Mears, it has indeed paid a dividend in every one of the last ten years and so it sails through this test with ease. But of course, dividends don't exist in isolation. They are paid out of profits and so profits are the next thing on my checklist.

From an accounting point of view, a company's total cumulative dividend payments should not be more than total cumulative profits, so it's important for dividend sustainability that profits are greater than dividend payments. This may or may not be the case in any one year, but over the longer term it definitely should be true.

However, unlike dividends I don't insist on an unbroken record of profits over the last ten years. Even very good companies can make the occasional loss and so I'm willing to invest even if there were perhaps one or two loss-making years out of the last ten.

My second investment rule is:

Rule #2: Only invest in a company if its ten-year dividend cover is greater than one.

Ten-year dividend cover is simply the ratio of total profits to total dividends over ten years, or more specifically the ratio of total earnings per share to total dividends per share. Also, in order to get a better picture of how the core business is doing, I use normalised or adjusted earnings which remove any "exceptional" income or expense items.

Looking again at Mears, it generated total earnings of 199p per share over the past ten years and paid out 70p in dividends. That gives it a ten-year dividend cover of 2.8, which is obviously well above one.

With those two basic checks in the bag we can now begin to look at measuring long-term dividend growth.

Looking for inflation-beating dividend growth

At a minimum, I want a company to be growing at least as fast as inflation; not just this year but over the long term. So my third investment rule is:

Rule #3: Only invest in a company if its growth rate is above 2%

I use 2% as the cut-off as that's the Bank of England's inflation target. If inflation over the period was markedly different to 2% then I might use CPI inflation as the benchmark instead.

There are lots of different ways to measure long-term growth, but the method I've settled on is one borrowed from Benjamin Graham, the father of value investing. Graham suggested measuring growth between one three-year period (e.g. 2006-2008) and another (e.g. 2014-2016), because this reduces the importance of any one year.

Turning back to Mears again, in the 2006-2008 period it paid annual dividends of 3.3p, 4.0p and 4.75p, giving that period an average dividend of just over 4.0p. In the 2013-2015 period it paid dividends of 8.8p, 10p and 11p, giving that period an average dividend of 9.9p. Growth in the dividend between those two periods was therefore 147%. Since there are seven years between those two three-year periods you can get the annual growth rate by raising 147% to the power 1/7, which gives an annual dividend growth rate of 13.8%. With a long-term dividend growth rate of 13.8%, Mears definitely has a faster dividend growth rate than my 2% target.

"AT A MINIMUM, I WANT A COMPANY TO BE GROWING AT LEAST AS FAST AS INFLATION; NOT JUST THIS YEAR BUT OVER THE LONG TERM."

As I've already mentioned though, dividends don't exist in isolation. If a company's dividend increases are not accompanied by increases in profits, then at some point the dividend will not be affordable. In the same way, if dividends and profits are increasing but revenues are not, then profit margins must be increasing. But profit margins can only go so high which means that revenue growth is necessary if dividend growth is to be sustainable over the longer-term. As a result I like to measure growth across revenues and earnings per share in addition to dividends per share, using the approach I've just outlined.

For Mears, we have 2006-2008 average revenues of £322m versus 2013-2015 average revenues of £862m. That gives a total for revenue growth of 168% and a revenue growth rate of 15.1%. In terms of normalised earnings we have 2006-2008 average EPS of 16.0p and 2013-2015 average EPS of 22.7p. That gives total EPS growth of 42% and an EPS growth rate of 5.1%. I calculate a company's "overall" growth as the average of its revenue, earnings and dividend growth. In this case that's the average of 147%, 168% and 42%, which is 119%, and the annual growth rate associated with that overall growth is 11.8%.

So Mears has an overall ten-year growth rate of 11.8%, and that's well above my 2% target and also well above the average for FTSE 350 companies.

Looking for consistent dividend growth

Ideally I'd like to see a company's divi-

“PROFIT MARGINS CAN ONLY GO SO HIGH WHICH MEANS THAT REVENUE GROWTH IS NECESSARY IF DIVIDEND GROWTH IS TO BE SUSTAINABLE OVER THE LONGER-TERM.”

dend going up every year rather than one which stays flat year after year and is only occasionally bumped upwards. Put another way, I like to see consistent or high-quality growth.

My measure for dividend growth quality is simple: I just count how often a company's dividend went up over the last ten years. In ten years there are nine opportunities to raise the dividend, so a score of nine out of ten (or 100% in other words) is what I'm after. However, I realise that raising the dividend every year is not always possible, so I'm willing to settle for less, but only to a degree. I would also like to see revenues and profits going up every year. Of course, very few companies can actually manage this over a ten-year period, so again I'm willing to be flexible. My rule for this is:

Rule #4: Only invest in a company if its growth quality score is above 50%

In the case of Mears we have dividends per share which increased nine times out of nine, earnings per share seven times and revenues eight times. That's a total of 24 out of a possible 27 increases, or 89% of the maximum. A growth quality score of 89% marks Mears out as a company with highly consistent results over many years, which you can get a good feel for by looking at its results chart.

So there we have four rules, each of which is designed to be an easy way to exclude companies that can't easily be described as generating "consistent, long-term, profitable dividend growth". Of course calculating these metrics by hand would be somewhat boring, but they're very easy to automate with a spreadsheet. Personally I just dump the financial data from SharePad into my spreadsheet (which is available on my website) and it immediately tells me whether a particular company passes each of these rules, or not.

There are still lots of other factors to take into consideration, but next to profitability and debt levels I think a long track record of relatively consistent profits, dividends and growth is more important than anything else.

About John

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

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

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

BY NICK SUDBURY

FUNDS IN FOCUS

GOOD MORNING VIETNAM

Adventurous investors who want to target countries with the highest growth potential might want to think about opening a position in Vietnam. This South-East Asian frontier market has largely been ignored as a source of investment returns, but it looks as though things are about to change as more people wake up to the exciting possibilities.

In 2015 Vietnam relaxed its 49% cap on the foreign ownership of some of its domestic listed companies as part of a wider ongoing package of market friendly reforms. The changes have helped to pave the way for a possible upgrade from frontier to emerging market status.

If Vietnam were to be reclassified it would be a real game changer and attract huge amounts of foreign investment into the local stock market. There is an outside chance that it could meet all the index provider MSCI's criteria by the end of the year, although it would still need to go through the lengthy selection process and is nowhere near inclusion at the moment.

Vietnam is a major exporter of agricultural produce and a large producer of oil. It also has fast growing IT and manufacturing sectors. The economy has held up better than many of the others in the region and achieved annualised GDP growth of 6.4% in the three months to the end of September. The interest rate is 6.5% and forecast inflation is just under 5%.

Another reason to be optimistic is the favourable demographics as half of its 94 million population is under the age of 30 and literacy rates are up above 90%. Like many of the emerging markets it has a growing middle class that should help to support the development of the domestic consumer sector.

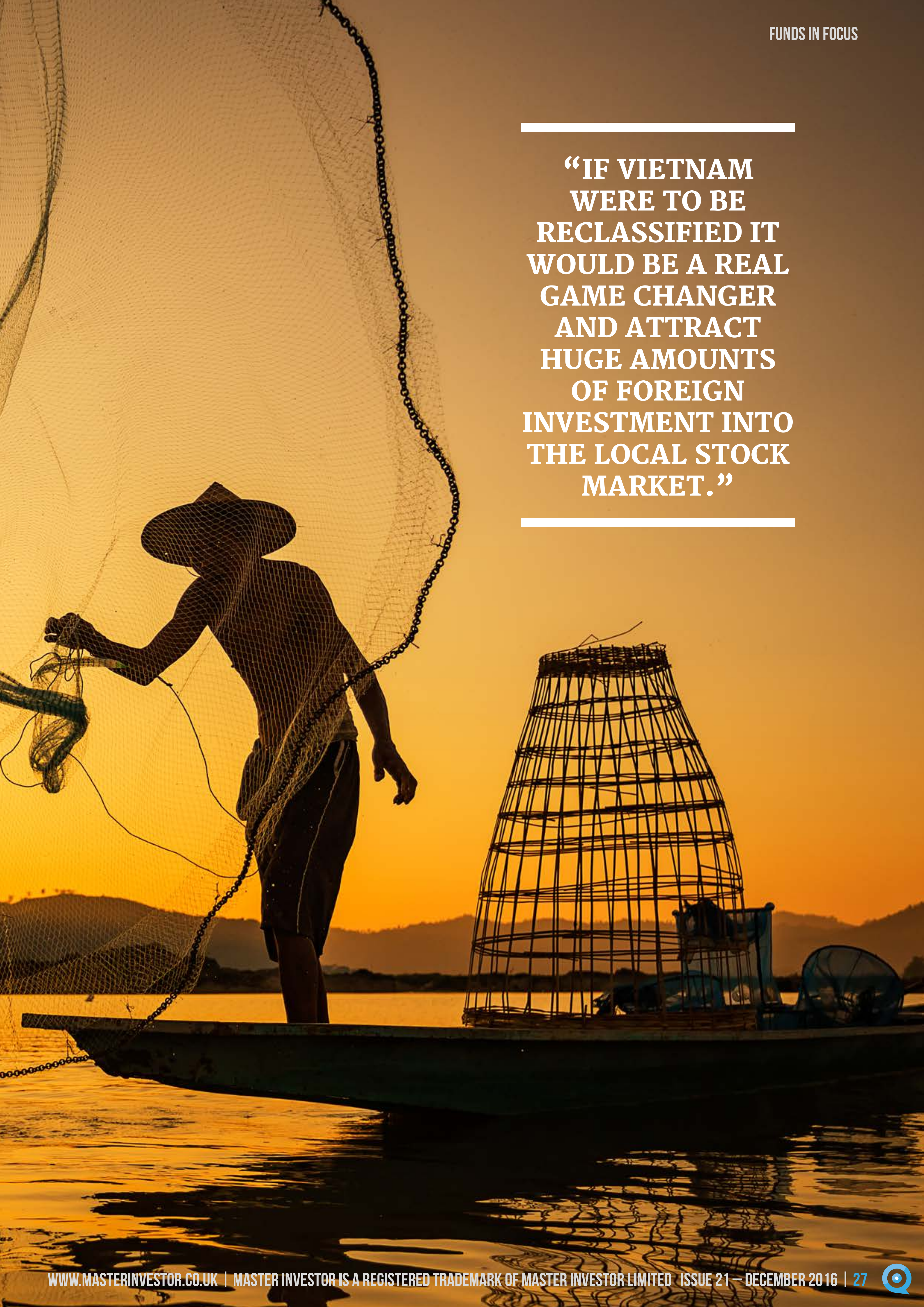
Despite all the positives it is still a one-party communist state, with the economy dominated by state owned enterprises including the banks. There have been some partial privatisations over the last few years, but the process has a long way to go.

It is also worth noting that the stock market is worth less than $100bn and that many of the local companies are relatively small and illiquid. You can get an idea of the extent of the problem when you realise that MSCI Vietnam contains just nine constituents.

Ahead of the curve

Tim Price, director of investment at PFP Wealth Management and the fund manager of the VT Price Value Portfolio, a value orientated fund-of-funds, is a big fan of Vietnam and says that its average monthly wages are a third of those in China. Despite this his analysis suggests that half of the local listed companies trade on a PE ratio of less than 10.

Writing in his latest monthly factsheet he said that Vietnam has become a key destination for foreign direct investment with companies



"IF VIETNAM WERE TO BE RECLASSIFIED IT WOULD BE A REAL GAME CHANGER AND ATTRACT HUGE AMOUNTS OF FOREIGN INVESTMENT INTO THE LOCAL STOCK MARKET."

Jimmy Tran / Shutterstock.com

like Samsung, LG, Intel, Panasonic and Nike all building factories there. The country will also gain access to new markets via Free Trade Agreements with the EU and the Trans Pacific Partnership if ratified.

Price says that SSI Asset Management – a firm that specialises in the region – will shortly be launching the Vietnam Value Income and Growth Fund in a UCITS format. This has an anticipated PE ratio of 10 times earnings, a return on equity of 20%, and an expected dividend yield of 5.1%.


Daniel William / Shutterstock.com

There are also several specialist single country investment trusts with a good example being the £492m **VinaCapital Vietnam Opportunity (LON:VOF)**. Its shares are up 172% over the last five years yet they are trading at a 25% discount to net asset value (NAV).

The fund was launched in 2003 and was upgraded from AIM to the main market in March of this year and then admitted into the FTSE All-Share index in June. It is managed by VinaCapital, which has a team of four investment managers and nine research specialists that concentrate on Vietnam.

According to a recent research note from the investment trust team at Winterflood, VOF provides a high conviction, multi-asset exposure to the country with the top ten holdings accounting for about 60% of the NAV. At the end of September 84% of the portfolio was invested in listed equities, the majority of which they had bought into as pre-IPO stocks. A further 12% consisted of private equity with the balance in cash.

The managers believe that private equity is a good option given the inefficient nature of the Vietnamese capital markets with a float on the local stock exchange providing a decent exit route. In total they have invested in 92 of these transactions since the fund was created 13 years ago.

The team running the VinaCapital fund is optimistic about the outlook, especially the sectors that will benefit from higher domestic consumption and the development of the local infrastructure. They have also identified a number of expected IPOs that they would consider investing in.

"VIETNAM HAS BECOME A KEY DESTINATION FOR FOREIGN DIRECT INVESTMENT WITH COMPANIES LIKE SAMSUNG, LG, INTEL, PANASONIC AND NIKE ALL BUILDING FACTORIES THERE."

VOF is one of the larger and more liquid investment trusts that provides exposure to Vietnam and the Board operates a share buyback programme that should be sufficient to stop the discount to NAV getting much wider. The main downside is the 1.5% annual management charge and the 15% performance fee charged on NAV increases in excess of an 8% hurdle rate subject to a cap of 1.5%.

Other options

Vietnam Holding Limited (LON:VNH) is much smaller with a market cap of £119m and is listed on AIM. It was launched in 2006 and is domiciled in the Cayman Islands. Over the last five years the shares are up 189%, but they currently trade on a 20% discount to NAV.

The management team has built a concentrated portfolio with the top ten holdings accounting for 70% of the fund. According to Winterflood, they have a mid-cap bias with the two key themes being domestic consumption and urbanisation. The managers use a value approach and actively engage with the companies they invest in.

Unfortunately the main problem is that it is very expensive. The annual management fee varies according to the net assets and ranges from 2% down to 1.5%. There is also an extremely lucrative performance fee of 15% of any gain above a 5% compounding return subject to a high water mark.

Another option is **Vietnam Enterprise Investments (LON:VEIL)**, which launched in 1995. It was the first closed-ended fund to invest in Vietnam and offers exposure to listed and pre-IPO shares in the country. The Cayman registered fund has assets of £780m and trades on a 13% discount to NAV. It has a 2% annual management charge but no performance fee.

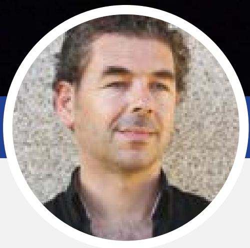
Given the potential lack of liquidity in the underlying Vietnamese shareholdings it is probably safest to stick to an investment trust, although there are a few open-ended funds if you prefer these sorts of vehicles.

One such is **Dragon Vietnam Equity UCITS**, which is run by Dragon Capital, the firm behind VEIL. It is an offshore fund with a 2% annual management fee.

There is even an ETF. The **DB X-Trackers FTSE Vietnam UCITS ETF** has assets under management of £254m and a Total Expense Ratio (TER) of 0.85%. It is benchmarked against an index of 28 stocks with about half of the fund exposed to the financial sector. The fund was launched in 2008 and is down around 68% since inception due mainly to the financial crisis in 2008/09.

Investing in a single country fund is always going to be a high risk proposition, especially when it is linked to a frontier market like Vietnam. You need to be able to take a long-term view and would be well advised to use an actively managed fund with a successful track record and acceptable level of fees. If Vietnam continues to evolve more market friendly practices and is eventually upgraded to emerging market status it should generate a healthy return on your investment.

"GIVEN THE POTENTIAL LACK OF LIQUIDITY IN THE UNDERLYING VIETNAMESE SHAREHOLDINGS IT IS PROBABLY SAFEST TO STICK TO AN INVESTMENT TRUST."



BY FILIPE R. COSTA

THE MACRO INVESTOR

INVESTMENT THEMES FOR TRUMPONOMICS

"I will build a great wall – and nobody builds walls better than me, believe me – and I'll build them very inexpensively. I will build a great, great wall on our southern border, and I will make Mexico pay for that wall. Mark my words."

– Donald Trump (during U.S. presidential campaign, 2016)

The rise of an underdog

It's 8 November 2016. The world lies in shock for the second time in a year. Despite a series of controversies that would have easily destroyed any other candidate, bold promises for extreme policies, and a bunch of racist and sexist comments and behaviour, Trump has made it to the White House. As the superstitious have often warned, *"beware leap years!"*

How such an inexperienced player in the political field could have won the election is certainly a puzzle. But how such a figure could change the way we view the economy, and in such a short period, is even more puzzling. At a time when central bankers are bolder than ever regarding their policy tools; at a time when the world has been submerged in a period of secular stagnation for more than a decade; and at a time academics try to refine and redefine their views on how the economy really works, in order to find answers to the low inflation/low growth puzzle: there is one man that seems to have all the answers to all the questions. Judging by the euphoria after the election result, the market is taking Trump seriously with regard to his promise to *"make America great again"* – indeed, it seems to think he can also make the world great at the same time.

The world has been shocked twice this year. But the real lesson to learn is that shocks may indeed be less shocking than first believed. Let's take Brexit, for example. The UK is not in recession and is doing much better than the EU as a whole. There was an initial extreme reaction to the referendum vote, but markets reversed the initial trend. In the US, the initial negative reaction was even more short lived and markets have, in fact, turned extremely positive. *Why are voters depositing their hopes in extreme options like those that*

Gino Santa Maria / Shutterstock.com

Brexit and Trump represent? Why are people replacing the comfortable status quo with the uncertain unknown? Why do they trust in an inexperienced politician with bold promises? And, more importantly for investors, *how does that impact markets in the near future?* Those are the questions I'm preparing to answer in this article.

A time of disruption

Trump's campaign was coloured by populism and dirty tactics. His reckless comments were often labelled as racist, sexist, and technically deficient. But, at the same time, they also seemed genuine and not dictated by the interests of any single group. The last decade has been marked by a lack of growth, a loss of jobs, a deterioration of living conditions, the decline of America in the world's balance of power, the rise of the central bank as a prominent and independent policy maker, the decline of the middle class, and the decay of mainstream politics. The average American – and the average Brit, for that matter - was searching for new solutions that could mark a clean break with the past. In the UK that came in the form of an EU exit. In the US it came in the form of Trump, who was seen as a real-world pragmatist capable of presenting bold new solutions, independent from the will of any political party or lobbies.

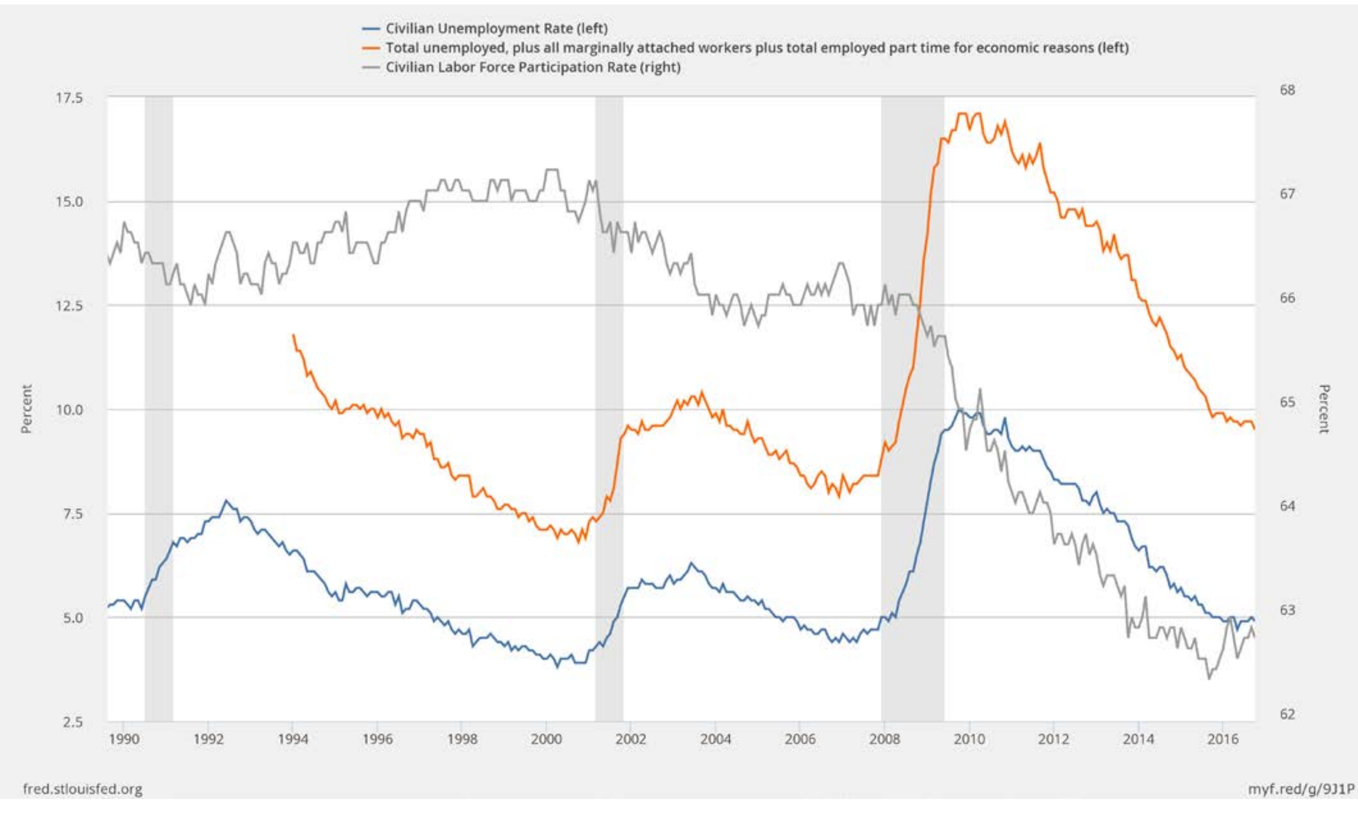
All over the world, populism has been on the rise because people are tired of politicians falling short on their promises. The revolution started with Brexit, spread to the US, and may extend to continental Europe in the near future if there isn't a u-turn in the policy mix.

Trump's win also reflects the fragile state of the US economic recovery post the financial crisis of 2007-2009. The S&P 500 has gained 220% since bottoming out in March 2009, but the economy is registering annual growth rates that barely surpass 2.0%. Most of the recovery has been in financial markets, not in the real economy, which has led to a massive redistribution of wealth. Central banks replaced governments and pushed up the price of financial assets. The wealth generated did not spread evenly through the economy, as many thought it would.

However, policymakers point out that the unemployment rate has declined from a high of 10.0% to its current 4.9% level. At first glance, the unemployment statistics look good, but they hide an uncomfortable truth. If we use the U6 unemployment measure, which adds back to the unemployment numbers those that are employed part-time for economic reasons and those who are just marginally attached to the workforce, the number grows to 9.5%. While it is undeniable that there has been a massive improvement in the U6 measure from the peak of the crisis (it has declined from 17.1% to 9.5% today), it is also undeniable that U6 has yet to recover to its 2007 level of 7.9%.

"ALL OVER THE WORLD, POPULISM HAS BEEN ON THE RISE BECAUSE PEOPLE ARE TIRED OF POLITICIANS FALLING SHORT ON THEIR PROMISES."

Meanwhile, there is another figure disguising the reality of the unemployment situation – the labour force participation rate. The participation rate has been declining since before the financial crisis. This trend started in 1990, but accelerated during the financial crisis. Before the crisis, 66.4% of Americans were part of the workforce; today, that figure is just 62.8%. Neither technology advances nor the ageing population are proper explanations for this decline. Technology advances have led to a reallocation, rather than an extinction, of jobs, while the ageing population is a very long-term phenomenon



"ONE POTENTIAL SCENARIO SEES TRUMP RENEGING ON A FEW TRADE AGREEMENTS AND RAISING CUSTOMS DUTIES TO MAKE DOMESTIC PRODUCTS MORE COMPETITIVE AGAINST IMPORTS."

which is insufficient explanation for a decline of almost 4 basis points in the participation rate in such a short time period. The rapid decline in the participation rate occurred mainly during the post-crisis period and, as such, it is more likely directly connected with it. If these people were to return to the labour market, the unemployment rate wouldn't look as good as it currently does. So, while technically the U.S. is near full employment, there are millions of Americans that feel like they are living in sub-par conditions.

Tired of observing declines in living conditions, Americans elected Trump as their 45th President, in the hope that he could break with the recent past and drive the U.S. economy towards a healthy expansion. But if disruption brings renewed hopes for Americans, it also brings a mix of global threats. So far, the market has reacted in a very positive manner to Trump, with the main U.S. equity indexes, commodities, and the dollar rising fast. But, as time goes by, several risks will weigh in, as many of the Trump promises pose threats to the global balance of power. A Trump win is a vote against neoliberalism, which, through deregulation, privatisation, and austerity, holds some of the responsibility for the recent decrease in living standards for the average citizen – and the increase in living standards for the top less-than-1% of the population.

Meanwhile, the rise of the central bank and policy experiments ranging from massive asset purchases to negative interest rates have redistributed wealth and done nothing significant for the real economy. Trump has expressed his disapproval of the current monetary policy and promised a re-emphasis on fiscal measures instead. He plans to invest in new infrastructure, cut income taxes, and deregulate some industries to boost growth. His plans are truly huge and will have a complex impact in the real economy and in financial markets.

While it is difficult to plan a full portfolio strategy in response to the Trump win, we can at least identify a few investment themes that may do well as a consequence of the expected action. So far, there has been a massive wave of optimism, which contrasts with the gloomy predictions made before the election should Trump win. While that may be good news, investors should insulate themselves from excessive doses of optimism or pessimism, and instead approach the situation with a clear head.

A few investment themes

Trade & protectionism

Globalisation has been the subject of much criticism, and has often been blamed for the weak economic performance. The popular vote is increasingly turning against free trade and international agreements. Trump promised to repeal a few trade agreements and to create a bigger role for US industry and manufacturing. There will be some kind of retreat for free trade but we just don't know exactly how deep that will go.

One potential scenario sees Trump reneging on a few trade agreements and raising customs duties to make domestic products more competitive against imports. This would definitely help national industries but, to some extent, would finance inefficiency. A similar situation occurred under the Common Agricultural Policy (CAP) within the EU, which subsidised an inefficient sector for years. That was also the case during the 1930s, when the world turned more protectionist as a means to escape the depths of the Great Depression. But protectionism comes with retaliation, as trade partners also tend to increase tariffs, quotas, subsidies and currency depreciation. In the end, global trade declines, inefficiency rises, and the world's population experiences a collective decline in living conditions. Countries that depend heavily on global trade suffer the most.

While the exact position Trump will adopt remains to be seen, emerging markets as a group stand to lose the most, as they depend heavily on their exports to the developed world. They may find alternatives, for example by trying to build regional markets, but will nevertheless go through a difficult period. So, I stand by my previous position, mentioned in my recent blogs, to short emerging markets through the **ProShares Short MSCI Emerging Markets (NYSEArca:EUM)**.

Investors need to be aware of the fact that 44% of S&P500 profits are made outside the U.S. If there is a worldwide escalation in protectionism, these companies will be in big trouble as they will lose markets and would have to rethink their supply chains.

In the field of protectionism, the UK in particular is more vulnerable than others, especially outside the EU. The Leave vote was certainly hoping for a country that would be able to trade globally more freely than as a part of the EU. Under the scenario of escalating protectionism, that scenario may be overly optimistic and the UK may find it harder to hold its own in global trade outside the EU. This development needs careful attention, as the UK is a very open economy (trade represents 56.8% of GDP) when compared with the US (28.1%), Japan (38.6%), Australia (41.0%) and China (41.2%).

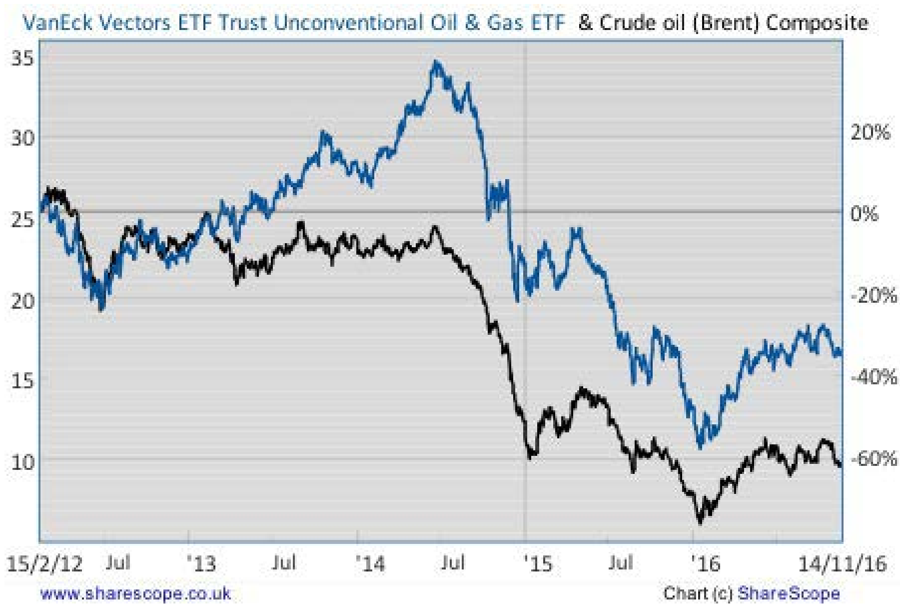
Monetary policy

The pressure on the FED is already evident. Investors are pricing the probability of a December rate hike above 90%, up from around 75% just after the election. Trump has expressed his distaste for the current trend in monetary policy and has accused the FED of having created a *"false economy"*. While he can't fire Janet Yellen outright, he can at least fill the FED with more hawkish policymakers before finally replacing Janet Yellen in 2018, when her term ends. Two new FED positions will be available next year, which Trump will certainly use to help bend the FED to his will. Monetary policy will become more hawkish than previously expected, with consequences in interest rates, yields, bond prices, and the overall economy.

Trade (% of GDP)

Country/Region	2000	2015
Germany	61.4	86.0
Euro area	**69.9**	**85.0**
European Union	68.9	82.6
Mexico	53.1	72.8
Sub-Saharan Africa	68.7	64.3
Heavily indebted poor countries	57.0	62.1
France	55.3	61.4
High income	51.9	60.3
Low income	46.8	58.6
World	**51.6**	**57.7**
East Asia & Pacific	52.5	57.6
United Kingdom	**54.5**	**56.8**
OECD members	47.7	56.5
Low & middle income	50.9	50.1
Upper middle income	50.3	48.6
Latin America & Caribbean	39.1	43.0
Brazil	22.6	27.4
United States	25.0	28.1

Source: *WorldBank, World Development Indicators, updated 14 Oct 2016*



"MONETARY POLICY WILL BECOME MORE HAWKISH THAN PREVIOUSLY EXPECTED, WITH CONSEQUENCES IN INTEREST RATES, YIELDS, BOND PRICES, AND THE OVERALL ECONOMY."

Oil

One of the most sensitive parts of the Trump tenure is energy, particularly oil. The future President pledged to create *"complete American energy independence"* from *"foes and the oil cartels."* A key question that arises at this point is: *Will the U.S. block oil imports?* Judging by the recent reaction from the Saudis, this may actually happen. Trump believes in the internal economy and will do anything he can to protect it. Energy is a politically sensitive sector where the U.S. has the potential to become truly independent but currently depends on the good will of the Arab World and its cartel decisions. It is believed that Trump may appoint Harold Hamm (chief executive of Continental Resources Inc.) as Energy Secretary. Hamm has been a pioneer of the hydraulic-fracking industry in North Dakota and a fierce critic of oil producing countries like Saudi Arabia. At one point during Trump's campaign, Harold Hamm said that *"some of the countries, Saudi Arabia in particular, have been treated too kindly, because of the large supply of oil,"* and threatened *"that may be not the case in the future"*.

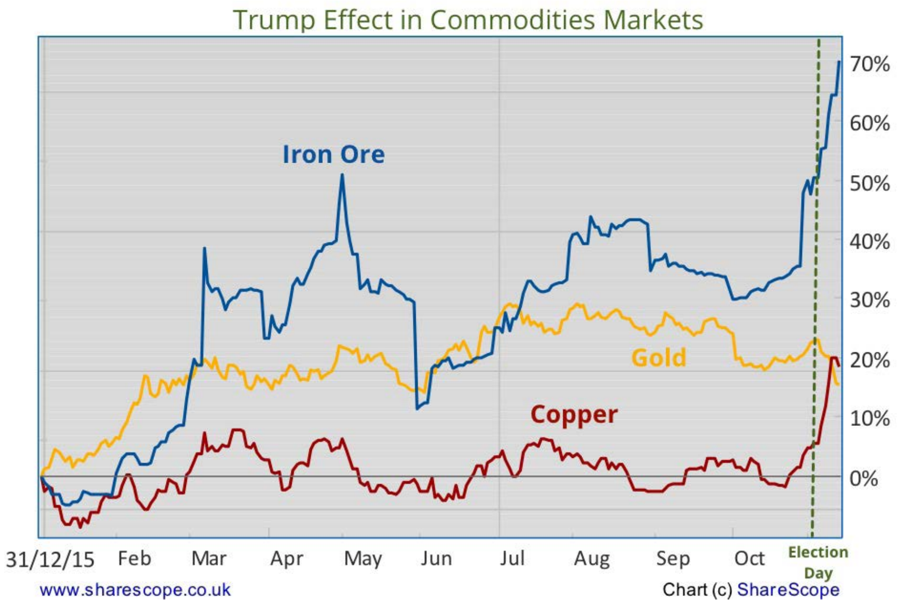
Oil prices dropped from an average of $100 in 2006 to $50 in 2015, mainly due to advances in technology which have been reducing up-front costs and increasing output per well. This trend will likely continue and further reduce the breakeven point for the industry. Oil is currently trading between $40 and $50, a price at which some shale oil businesses are already profitable. These will compete with OPEC in a free market. If Trump decides to impose restrictions on imported oil, the shale industry will boom again. I believe the sector will be somewhat favoured by Trump, which when mixed with an increase in efficiency, is a good reason to get some exposure.

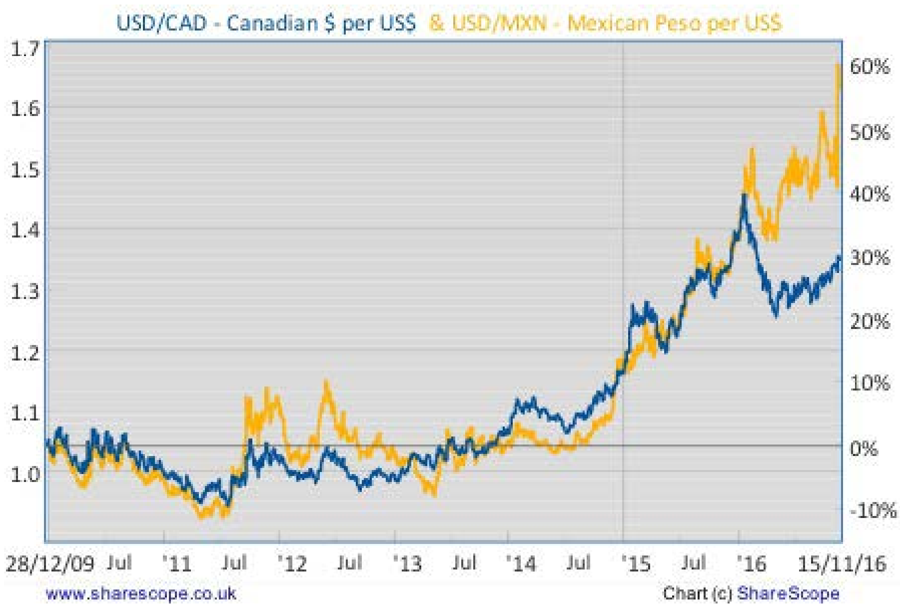
The **VanEck Vectors Unconventional Oil & Gas ETF (NYSEArca:FRAK)** is a good way of playing this theme. This ETF was created in February 2012 and is dedicated to hydraulic fracturing (fracking). It has since lost 35% of its value, which compares with the 60% loss experienced by oil. But with the industry becoming more efficient and Trump threatening Arab oil, this industry may fly high. The main holdings are **Anadarko Petroleum Corp (NYSE:APC)**, **Occidental Petroleum Corp (NYSE:OXY)**, **EOG Resources Inc (NYSE:EOG)**, **Hess Corp (NYSE:HES)**, and **Devon Energy Corp (NYSE:DVN)**. Trump has always been a threat to Saudi Arabia. It should therefore come as no surprise that Saudi Arabia, Qatar, Kuwait and the UAE have donated more than $45 million to the Clinton Foundation in the recent past.

Other commodities

While oil may enjoy some positive momentum, I don't buy into the optimism surrounding base commodities like copper or iron ore. Demand for commodities has been declining over time and if protectionism increases, this decline will just accelerate. China will most likely suffer with Trump, which will have a negative impact in the commodities market. Iron ore (+9.5%) and copper (+5.9%) are some examples of commodities that have seen their prices rise since 8 November, but sentiment may reverse very quickly. One way of playing this out is to short the **iPath Bloomberg Industrial Metals Total Return Sub-Index ETN (NYSEArca:JJM)**, or to short copper and other base metals through futures, ETFs or spread betting.

> **"INVESTORS AND SPECULATORS REGULARLY TRADING THE USD/CAD PAIR SHOULD CLOSELY MONITOR NAFTA DEVELOPMENTS, AS ANY BAD OUTCOME MAY PUSH THE CAD DOWN DRAMATICALLY."**





Nafta

Trump has promised to renegotiate almost every trade agreement. One particularly important agreement is the North American Free Trade Agreement (NAFTA), which involves the U.S, Mexico and Canada. Markets are already discounting the negative impact, particularly with regard to the Mexican economy, pushing the dollar higher against the peso by almost 11% since 8 November. But the Canadian dollar is more or less unchanged during the same period. While the Canadian economy is much stronger than the Mexican economy and thus would be better placed to face some form of protectionism, we should never forget that exports to the U.S. account for 75% of total Canadian exports, while imports from the U.S. account for 66.3% of total imports. The second export destination for Canada is China, representing just 4.1% of total exports. Last year, trade with the U.S. represented 48% of Canadian GDP. Investors and speculators regularly trading the USD/CAD pair should closely monitor NAFTA developments, as any bad outcome may push the CAD down dramatically.

Spending & taxes

America's infrastructure comprising roads, airports, bridges, power lines, pipelines, and other structures and facilities is too old and in need of a major revamp. Trump has already promised a shift in focus from monetary to fiscal policy and to use government spending as a tool to lead the U.S. economy to prosperity. While infrastructure

"TRUMP IS CERTAINLY THE BIGGEST HOPE THE CONSTRUCTION SECTOR HAS HAD IN DECADES."

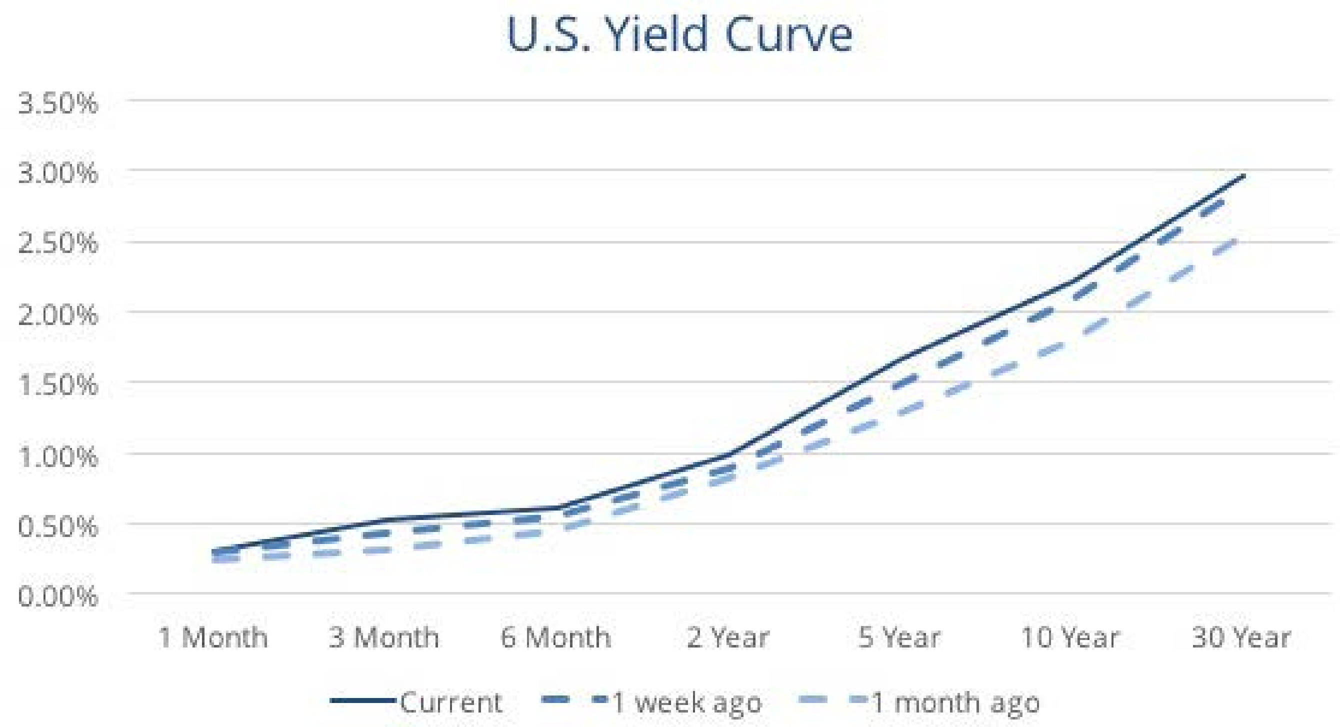
Gino Santa Maria / Shutterstock.com

takes time to be built and repaired, Trump is certainly the biggest hope the construction sector has had in decades. At the same time, Trump plans to reduce the corporate tax rate from 35% to 15%, to approve legislation to allow companies to bring home the $2 trillion in accumulated profits they have parked abroad, and to reduce the top individual income tax rate to 33%.

One way of getting exposure to infrastructure is through the **iShares Global Infrastructure ETF (NASDAQ:IGF)**. It offers a high exposure to the U.S. (near 40% of total holdings) while offering international diversification at a time when fiscal spending will regain life as an alternative to monetary policy. Another sector also worth considering is military and defence. Trump is military-friendly, such that the **iShares U.S. Aerospace & Defense ETF (NYSEArca:ITA)**, the **PowerShares Aerospace & Defense ETF (NYSEArca:PPA)**, and the **SPDR S&P Aerospace & Defense ETF (NYSEArca:XAR)** should all benefit. Small businesses, which are less exposed to international developments, may also benefit more than blue chips. One good ETF to get exposure to small caps is the **Vanguard Small-Cap Index Fund (NYSEArca:VB)**.

Bonds, yields & inflation

With Trump planning to spend trillions over the next few years, both GDP and inflation are expected to regain life. Estimates for GDP growth and inflation, obtained by the WSJ from 57 academic, business and financial economists from 9 November - 11 November, just after the election result, was for an average growth rate of 2.2% and 2.3% in 2017 and 2018 respectively, and an average inflation rate of 2.2% and 2.4%. These estimates have been revised higher to reflect the Trump effect in the economy and may end up revised even higher if Trump deploys a bolder spending package. With unemployment near 4.9%, the extra spending will start delivering price increases relatively quickly. Forecasts for 10-year bond yields are now heading to 3.0% for 2018.



> **"CHINA HOLDS AROUND $1.2 TRILLION OF U.S. TREASURIES. IF THEY DECIDED TO DUMP THESE BONDS, EITHER TO SUPPORT THE YUAN ORE MERELY IN RETALIATION TO U.S. PROTECTIONISM, U.S MARKETS WOULD CRASH."**

As Trump unfolds his plan, bond prices are expected to continue to decline (ergo yields rise), with a particularly significant impact on longer-dated bonds. For speculators, the preferred trade is to short longer dated bonds which offer the highest exposure to yield changes. For long-term investors with a focus on long positions, the best long option is for shorter maturities of less than 5 years, as these minimise the impact of any rise in yields. A simple way of shorting longer-dated U.S. bonds is through the **ProShares Short 20+ Year Treasury RTF (NYSEArca: TBF)**. An easy way to go long the short-term part of the yield curve is through the **iShares 1-3 year treasury Bond ETF (NYSEArca:SHY)**.

The Dollar

The prospect of a boost in aggregate demand is already leading to an inflow of funds to the U.S. and an outflow from Emerging Markets. When taking into account the expectation that monetary policy is also expected to become more hawkish, the net result is a very bullish outlook for the dollar. The strong dollar will have a tightening effect abroad, and will be particularly bad for Emerging Markets, due to their large levels of dollar-denominated debt. Mexico, Chile, Turkey, the Philippines and Russia are some of the countries that may be susceptible.

A few words about China

The connections between China and the U.S. are huge. First of all, China accounts for 50% of America's net trade deficit. As such, if Trump seriously tries to cut the country's trade deficit through protectionism, China would top the list of those which stand to lose the most. As a consequence, China would have to make a choice between allowing the yuan to devalue or tighten monetary policy. Given the current leverage of the Chinese economy, a tighter monetary policy could be disastrous for the country on a number of levels.

But China holds around $1.2 trillion of U.S. Treasuries. If they decided to dump these bonds, either to support the yuan ore merely in retaliation to U.S. protectionism, U.S markets would crash. With this in mind, I don't believe Trump will play hardball with China because China has the tools to sink the American ship.

Some final remarks

One of the most important parts of Trump's plan of action comes from the final recognition that monetary policy alone is insufficient to drive growth and that central banks went too far, creating more distortions than real benefits. In future, there is an important role for fiscal policy to play as an adjustment tool.

During the last few decades we have witnessed the rise of the independent central bank run by academics who dictate our fate through the use of cashless models that are unable to explain the dynamics of the real world. During the next few years, we will most likely see a decline in central bank independence, as both Donald Trump and Theresa May have pulled no punches when expressing their distaste for the current state of monetary policy. And crucially, they do have the tools to limit central bank action.

Another important lesson is directed at conventional politicians, who have failed to find ways to drive economies towards prosperity. The rise of alternative politicians everywhere is a sign of massive public disapproval for the current strategy. The EU, in particular, will go through a tough process of either finding alternative economic models or dealing with disintegration.

BY RICHARD GILL, CFA

FROM ACORNS TO OAK TREES

SMALL COMPANIES, BIG DEALS

THREE SMALL CAPS SET TO GROW BY ACQUISITION

There are generally considered to be two ways in which companies can grow their earnings. The first, and most common for businesses both large and small, is *organic* growth – whereby a company expands its existing, or "internal", operations via increasing sales, breaking into new markets or launching new products for example. Inorganic, or *acquisitive* growth is the opposite, and sees a company look to deliver growth via the purchase of another business and adding it to its own.

While often considered to be one of the more exciting and potentially lucrative sides of equity investing, acquisitions don't always go as planned. In fact, finance academics have long been critical of the M&A arena, with study after study finding that the majority of deals fail to deliver as expected. A 2011 paper by the Harvard Business Review, which reviewed a number of studies in the area, suggested that the failure rate for mergers and acquisitions stands at the surprisingly high figure of between 70% and 90%.

Deals can fail for a number of reasons.

For example, a high powered CEO looking to build up their empire (and their salary) might go on an acquisition spree without regard to whether the companies being bought are a good strategic fit. Sometimes, the merging of two companies can look like a good idea on paper, but the practicalities of integrating them often turn out to be more difficult than thought, especially in people-driven businesses with clashing corporate cultures. Many times the failure comes down to the simple reason of the wrong price being paid for what is being bought – ITV agreeing to buy Friends Reunited for up to £175 million in 2005 then selling it for £25 million four years later is a perfect example.

> **"THE FAILURE RATE FOR MERGERS AND ACQUISITIONS STANDS AT THE SURPRISINGLY HIGH FIGURE OF BETWEEN 70% AND 90%."**

Despite many disasters, acquisitions, if they are done correctly, can offer the opportunity for growth and value creation. Here follows three small cap companies which have announced acquisitions recently which I believe look like being positive for shareholders.

CHESNARA

In one of the largest small cap deals so far this year, life insurance and pensions business **Chesnara (CSN)** recently agreed to buy Legal & General Nederland, a Dutch life and pension insurer, for €160 million. This is one of many deals that the company has announced during its time on the market, having listed in May 2004 in order to acquire UK life assurance business Countrywide Assured and then going on to act as a consolidator in the fragmented insurance industry.

> **"€151 MILLION OF DIVIDENDS WERE PAID OUT TO PARENT COMPANY L&G OVER THE THREE AND A HALF YEARS FROM THE BEGINNING OF 2013."**

As of today Chesnara has operations across three European countries.

The UK activities mainly comprise "closed book" life insurance and pensions businesses (closed book meaning that new contracts are only issued to existing customers). There are similar operations in Sweden, trading under the Movestic brand, although here they are open to new business. Following the 2015 acquisition of life and general insurance business the Waard Group, Chesnara also has closed book operations in the Netherlands. Like most insurance businesses the company makes its revenues via income from insurance premiums, investment income from investing those premiums, along with other fee and commission income.

Chesnara is one London listed business which has managed to perform very well by implementing an acquisitive strategy, with its strict purchasing criteria and success in integrating acquired businesses resulting in pre-tax profits growing from £4.6 million to £42.8 million between 2004 and 2015. As at 30th June 2016 the company had a total of 907,000 policy holders, £5.1 billion of funds under management and net assets of £295.4 million.

Doubling up the Dutch deals

As announced on 24th November, Chesnara has agreed to buy Legal & General Nederland (LGN) for the equivalent of £135.6 million, with one of the main strategic attractions being the further expansion of the company's Dutch operations. Founded in 1984 as a subsidiary of finance giant Legal & General, the acquired company, which is open to new business, is a specialist provider in the term assurance market and a market leader in investment-linked products.

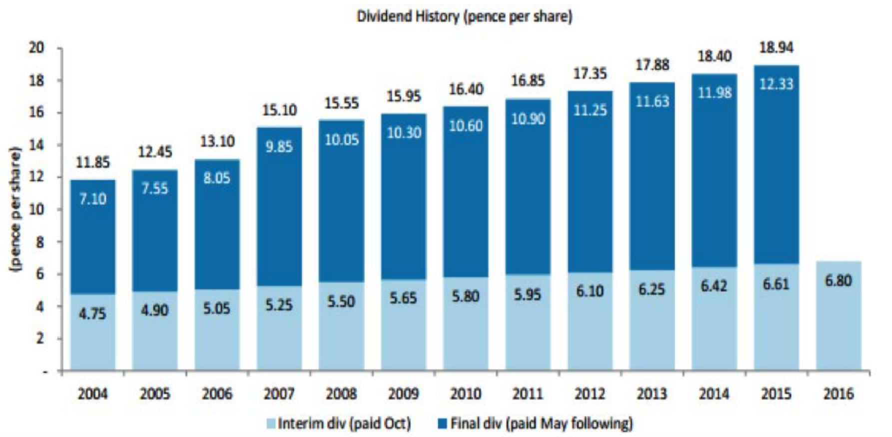
As at 30th June 2016 LGN had €2.2 billion of funds under management, c.170,600 policy holders and in 2015 made total income of €265.4 million, with net operating cashflow of €21.5 million. Various accounting quirks have made the reported profit figures erratic over recent years, but reflecting the strong cash generative nature of the business, €151 million of dividends were paid out to parent company L&G over the three and a half years from the beginning of 2013.

To fund the deal Chesnara is to raise c.£70 million via a placing and open offer at 300p per share (only a 2.9% discount to the previous day's closing price) and is organising new debt facilities of £100.2 million. The deal is expected to complete during the first quarter of 2017 assuming it is approved by various external parties, including the Dutch financial regulator.

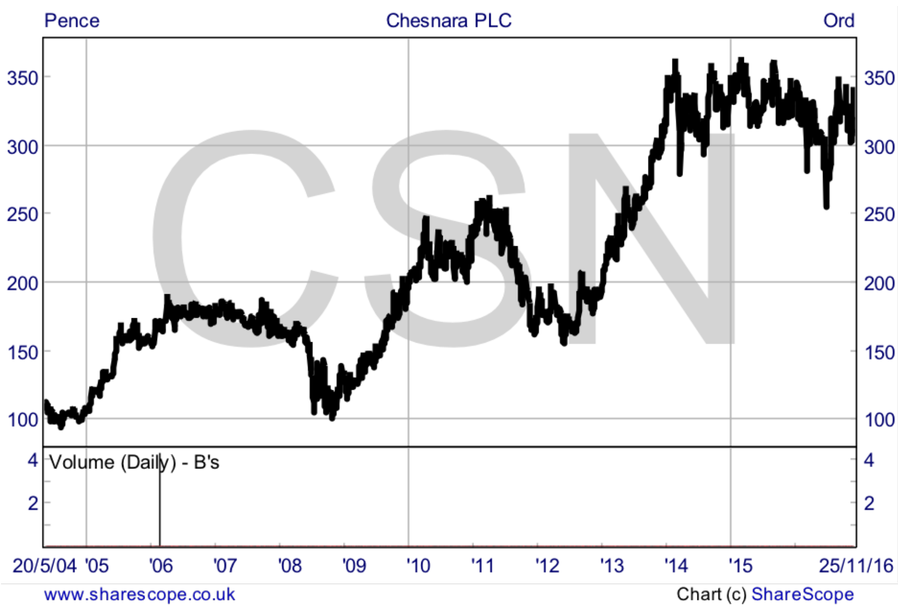
Other benefits of the acquisition include an immediate enhancement to Chesnara's Economic Value (EcV), an alternative measure to net assets used within the insurance industry. The consideration to be paid for LGN represents a 33% discount to its estimated EcV as at 30th June and combined with the planned equity fundraisings is expected to enhance Chesnara's own EcV by 7.6%. So the deal is expected to be value accretive in its own right and then further accretive on an earnings basis once complete – although no time frame has yet been given. The acquisition is also expected to have a positive impact on Chesnara's regulatory capital ratios, and, crucial for a successful integration, management believe there is a "strong cultural fit" between the two companies.

A share for life?

Chesnara is a bit of a boring company in operational terms, with its insurance industry jargon often being difficult to understand. But its track record of strong shareholder returns are definitely not boring. The company has delivered capital gains of 191% since close on the first day of dealings, with 196.62p per share worth of consistently growing dividends (see chart) taking the total gain to 382%.



Source: Chesnara admission document



Investors reacted well to the proposed L&G Nederland deal, sending the shares up by 8.7% on the day of the announcement. They currently trade at 342.5p, having recovered from lows of 255p seen in June following the result of the EU referendum vote.

Chesnara is now capitalised at £432.9 million and trades at a discount of 5.9% to estimated economic value as at 30th June 2016. This discount will become more pronounced (ceteris paribus) should the EcV enhancement expected from LGN come to be. Providing further potential gains, the expected dividend yield for 2017 is a very attractive 5.7%. **So on a value, income and growth basis I believe Chesnara looks like an attractive proposition.**

I also note that current shareholders (who were on the register as at 22nd November) have the opportunity to buy into the open offer at 300p per share on the basis of 3.69 new shares for every 100 held – that's a discount of 12.4% to the current market price.

CONVIVIALITY

Drinks business **Conviviality (CVR)** is a company I have covered in Master Investor Magazine before, as recently as February this year in fact. But given its success in growing by acquisition its inclusion in this article is apposite.

Conviviality listed on AIM in July 2013 as Conviviality Retail, a franchise business which had a portfolio of 611 off licences across the UK selling cheap booze to thirsty punters. Operating under the flagship Bargain Booze brand, the company earned money via franchisee fees and selling stock to store operators on a wholesale basis.

In line with its strategy to expand into the South of England and increase the focus of its wine offering, Conviviality announced its first acquisition in September 2013. The maiden purchase was that of **Wine Rack**, a London based retailer of wine, spirits, tobacco and related products, for a total of £1.65 million. In May 2014 came the £1.7 million purchase of **Rhythm and Booze**, an alcohol retailer with 37 stores in Yorkshire and the North East, followed up by the £6 million acquisition of **GT News**, an independent convenience retailer with 37 stores largely in the East Midlands and Yorkshire, in February 2015.

But these deals were small in comparison to the company-making transaction which Conviviality finalised last October.

For a total enterprise value of £200 million Conviviality bought the alcohol and soft drinks wholesaler **Matthew Clark**, with the deal so large it amounted to a reverse takeover under AIM rules. It brought to the business an additional £811 million of annual revenues, with Matthew Clark supplying 17,000 pubs, bars, hotels and restaurants around the UK with its stock. The deal looks to have performed well so far, with Matthew Clark having grown adjusted EBITDA by 18% from the date of acquisition to 1st May 2016, with the integration of the business and delivery of synergies said to be ahead of plan.

Fancy another?

Despite the Matthew Clark acquisition more than trebling the size of the business in revenue terms, Conviviality was still thirsty for more deals. To that end, in May this year the company revealed the £60 million acquisition of wine, spirit and beer distributor and wholesaler **Bibendum**.

Founded as a wine merchant in 1982, Bibendum has since grown its operations to deliver to c. 4,000 customers and c. 8,000 outlets across the UK both on- and off trade. Specialising in wine, the business consists of five separate divisions which offer drinks wholesaling and supply, drinks sourcing, specialist wholesaling and even pop-up wine events. For the year to March 2016 Bibendum was expected to make revenues of c.£270 million, thus taking the Conviviality group pro-forma annual revenues to over £1.4 billion.

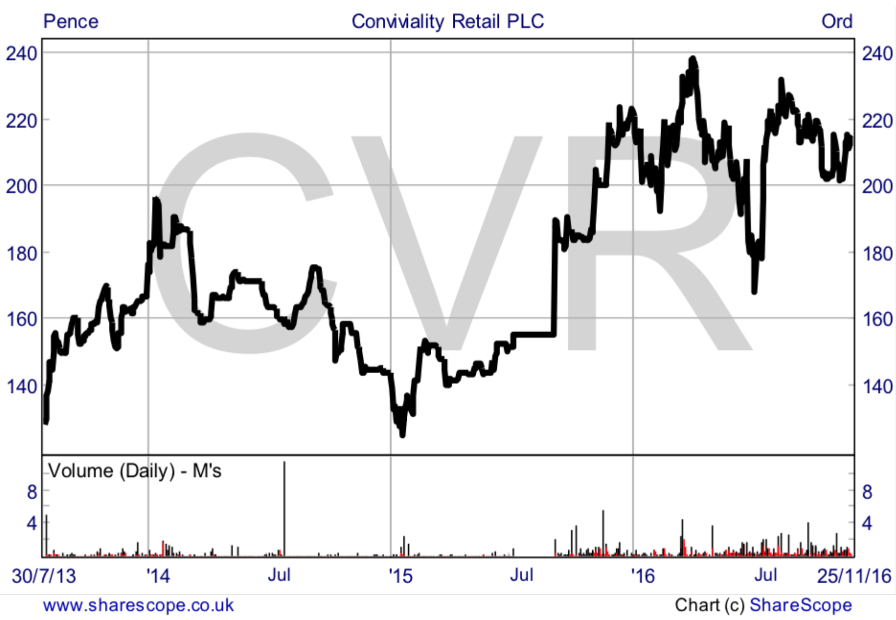
"THAT LOOKS GREAT VALUE FOR A COMPANY WITH A GOOD TRACK RECORD AND AN EXCELLENT REPUTATION FOR INTEGRATING ACQUISITIONS."

A number of benefits are expected to be delivered from the acquisition, including increased buying power, cross selling opportunities and operational synergies with the existing businesses. The deal was funded by the net proceeds from a £32 million placing, £10 million of debt facilities, with £20 million of liabilities from Bibendum also being taken on. It is expected to be earnings enhancing in the current financial year (to April 2017), with a recent trading update confirming that integration plans are, like with Matthew Clark, ahead of plan.

Time to top up?

Investors in Conviviality have had cause for celebration, with the shares currently trading at 213.75p, up by 114% since IPO. The company is capitalised at £317 million and trades on a multiple of just 10.4 times market consensus forecasts for around 20.5p of earnings in the year to April 2017. As the first full year's trading comes through from Bibendum, the multiple falls to 8.9 times for 2018. I believe that looks great value for a company with a good track record and an excellent reputation for integrating acquisitions. What's more, there is income on offer too, with an expected 12.45p dividend for 2017 equating to a yield of 5.8%.

Analysts at Investec have a 280p target price on the stock, which implies upside of 31%. Cheers!



KEYWORDS STUDIOS

We now come to perhaps the most prolific acquirer on the whole of AIM.

Listing in July 2013, **Keywords Studios (KWS)** is a service provider to the video games industry. The company came to market with a strategy to grow organically and also to consolidate the highly fragmented video games services sector. Ahead of most investors' expectations, Keywords has completed a total of 14 acquisitions since listing, which on average equates to around one every three months.

Founded in 1998 as a video games language translator, Keywords has benefited from a boom in the industry over the past two decades, as well as from the trend of content publishers and developers outsourcing ancillary services.

The recent acquisitions have given Keywords a truly international focus, with the company now operating in 15 countries across Europe, South America, North America and Asia, catering for 50 languages and 14 different games platforms. The firm's blue-chip client base includes 21 of the top 25 games companies, including Microsoft, Sony, and Square Enix, and 7 of the top 10 mobile game companies by revenue, including maker of top seller Candy Crush, King. Other recent popular titles worked on include Halo 5: Guardians, Street Fighter V and Rise of the Tomb Raider.

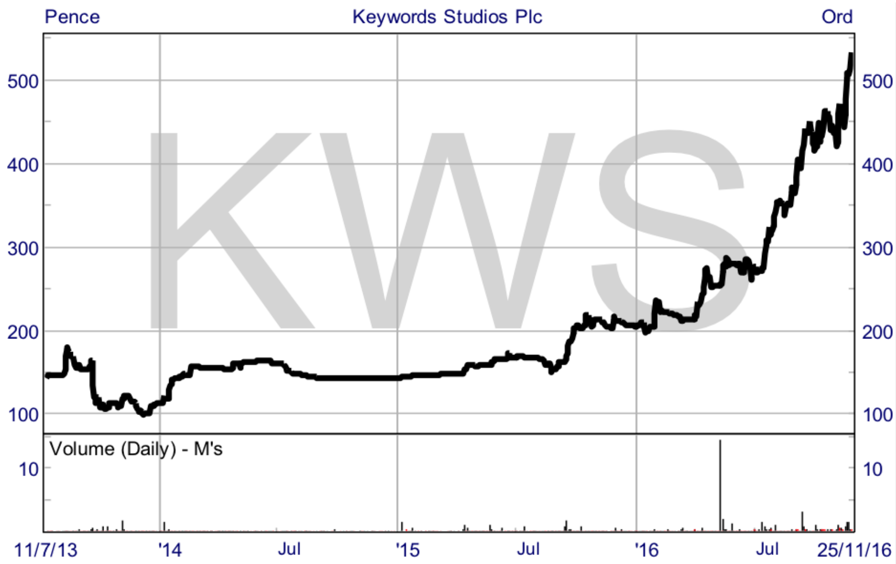
Keywords' financial track record is exceptional, with revenues having grown by a compound annual rate (CAGR) of

59.5% between 2010 and 2015 to just under €60 million, with net profits up by a CAGR of 55.3% to €3.25 million over the same period.

Synthesising growth

With 14 acquisitions having been made in the past three and a half years, this article is too short in scope to cover them all. But Keywords' largest deal, completed this April, perhaps perfectly demonstrates the company's strategic attitude. For a maximum consideration of €18 million the company bought Synthesis, a leading provider of localisation, audio and localisation testing services. As well as expanding the company's existing offerings in these areas, the deal added annualised revenues of €16.9 million and pre-tax profits of €2 million to the group, and expanded its operational base into Germany, France and Taiwan.

Another attractive facet of the acquisition strategy is that Keywords has not built up large levels of debt in order to fund its expansion. The deals have been largely funded by the net proceeds from the £10 million IPO fundraise, various secondary placings and by issuing new equity to vendors. At the end of June this year there was net cash of €3.5 million on the balance sheet, with the only major borrowings being a €4 million working capital facility.



Power up your portfolio?

Shares in Keywords Studios have been amongst the best performing on the whole of AIM in the year to date, as I write trading up by 161% at an all-time high of 532.5p.

The performance was helped by a November trading update which revealed that adjusted pre-tax profits for the year to December 2016 would be significantly ahead of expectations and no less than a record €14 million. This was mainly driven by the acquisition of Synthesis, which saw higher levels of activity in the second half, along with strong like-for-like growth across the rest of the business. Also encouraging was the comment that the acquisitions made in 2016 are integrating well and performing in line with expectations.

Capitalised at just under £290 million, Keywords trades on a multiple of around 30 times consensus earnings forecasts for 2016, falling to around 27 times for 2017. There is also a dividend of around 1.3p per share being pencilled in for 2016, but representing a yield of just 0.24% this is not the major attraction here.

While the shares currently attract a premium rating I believe that this looks to be justified given the growth being delivered and the company's track record of making good acquisitions. And with further potential deals being assessed, the figures for 2017 and beyond could have some serious upside to them. **For investors with a slightly higher risk tolerance, Keywords is a risky buy.**

BY FILIPE R. COSTA

HOW TO INVEST LIKE...

NEIL WOODFORD

"We do not focus on short-term performance issues; we focus on the valuation of fundamentals. Our disciplined approach guides us, we believe, to the best opportunities in the stock market and we are very patient investors. We expect our performance to improve when the market begins again to focus, as it inevitably will, on valuation."

— Neil Woodford, 2011

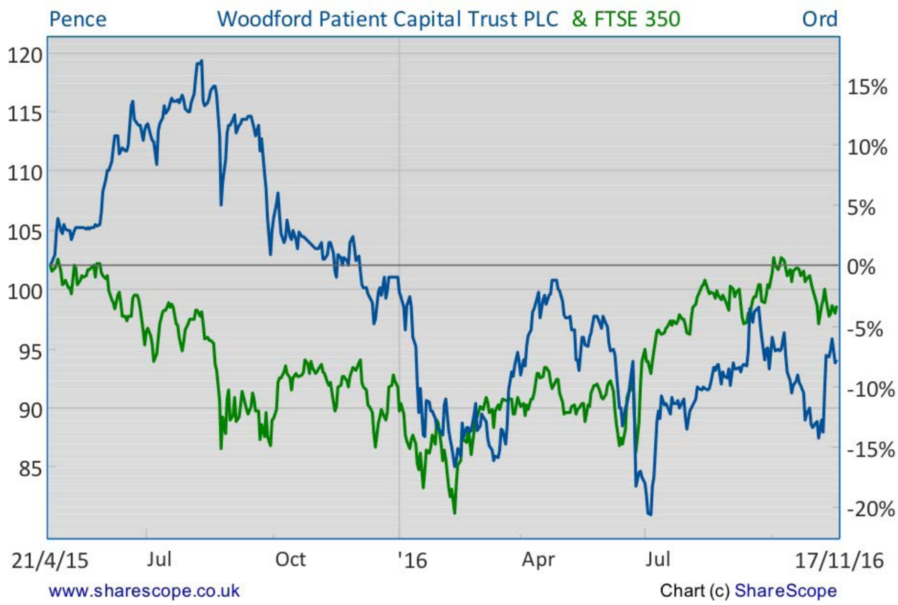
A brilliant performance

The investor reviewed in this issue is a well-known fund manager who spent 25 years at the helm of the main Invesco income funds before founding his own investment shop. Like most of the investors reviewed in previous editions of this column, Neil Woodford is a value investor with a focus on the longer term. He believes the short term focuses too much on sentiment, and can therefore be a period where prices and value often diverge.

Neil Russell Woodford, 56, graduated in Economics and Agricultural Economics from the University of Exeter in 1981 and later pursued postgraduate studies in Finance at the London Business School. His finance career started with the Dominion Insurance Company and, in 1987, he became a fund manager with Eagle Star. One year later he moved to Invesco Perpetual where he would stay for the following 25 years and establish himself as one of the most respected portfolio managers in the UK. He ran the Invesco Perpetual Income and Perpetual High Income funds, with £10.4 billion and £13.6 billion in assets respectively, achieving an average performance of around 13% per year. An investor pledging £10,000 to these portfolios in 1988 would have around £230,000 in 2013, which compares with £97,500 if invested in the FTSE All-Share.

In October 2013, Woodford announced that he would leave the following year to found his own fund business. In April 2014, he finally left his role as Head of UK Equities at Invesco, after almost 26 years with the company, to start Woodford Investment Management LLP. Just two months later, he launched the company's first fund – the Woodford Equity Income Fund. He was able to raise a record £1.6 billion during the offer period for the new fund. Other high profile funds that were launched at the time all fell short of raising anything near Woodford. Examples include Richard Buxton's Old Mutual UK Alpha fund and Philip Gibbs' Jupiter Absolute Return fund, which raised £270 million and £250 million respectively.

The main aim of the Woodford Equity Income Fund is to deliver income and growth by investing mainly in the UK. When compared with its benchmark, this fund has a current tilt towards the healthcare industry, which Woodford believes is positioned to outperform other sectors. Consumer Services and Oil & Gas have significantly reduced exposures.



The second fund – **Woodford Patient Capital Trust (LON:WPCT)** – is the largest listed investment trust in the UK and has a high exposure to potentially disruptive early-stage growth companies, with more than half of its holdings being in unquoted companies. The name "Patient" reflects the focus on long-term results over short-term fluctuations. Its top holding is **Prothena Corp PLC (NASDAQ:PRTA)**.

A beautiful mind

During the 1990s, when everybody was concerned about the tobacco industry, Woodford was almost alone in buying shares of **British American Tobacco (LON:BATS)** and Imperial Tobacco (now **Imperial Brands (IMB)**), which he has since insisted on keeping as top holdings in his portfolios. But, while the crowd was focused on the concerns that legal action by U.S. authorities against these companies would lead them to bankruptcy, Woodford stuck to his convictions and held tight. Woodford spotted that the authorities pursuing legal action against these companies held large quantities of bonds in the very same companies, which would have left them financially exposed in the event of the cigarette companies going bust. That was enough to convince Woodford these companies would never be allowed to go bankrupt. At the same time, the threat of legal action was acting as a kind of protectionism to the existing companies, turning the market into an oligopoly, as no other player was willing to enter an industry with such levels of legal uncertainty. Buying at depressed prices, Woodford was able to make a fortune.

During the technology bubble of the 1990s, which led the Nasdaq Composite to decline from a top of 5,047 in March 2000 to 2,470 at the end of that year and then to 1,114 in October 2002, Woodford escaped unscathed, as he avoided the sector altogether. While the bubble was inflating and momentum strategies were driving huge profits for many of his colleagues, he was lagging behind and underperforming the market. But soon, as the bubble burst, everyone realised how adept Woodford was in being able to spot sentiment-driven trends and to avoid them, and instead invest in

"WOODFORD TARGETS A TIME HORIZON FOR HIS INVESTMENTS OF AT LEAST 3-5 YEARS, AND HE OFTEN HOLDS EQUITIES FOR MUCH LONGER THAN THAT."

value-driven opportunities to deliver strong returns over the long term.

The main beliefs behind Woodford's strategy

Woodford is mainly a value investor with a focus on the long term. Over the years he has sought out the best investment opportunities in quoted and unquoted companies, while trying to balance investment risks. The best way to reduce these risks is by extending the investment horizon, he believes. Based on the investment strategy followed by Woodford in managing his two investment funds, we can identify four main beliefs:

(1) Long-term focus

"Investing has always been about a long-term focus on value, an endeavour that aims to exploit the valuation anomalies that will always exist in the financial markets. It isn't easy because it involves doing something different to the crowd, having the courage to back your convictions, the humility to constantly doubt them, and the persistence to test the "what if I'm wrong?" hypothesis every single day."

In a recent article, Woodford expressed his dislike for momentum strategies and other trend-following gimmicks. He believes the whole industry is oriented to the short term, mainly due to a strong pressure on fund managers to obtain high performance not only in the long run but also during every other time horizon. Such pressure shifts their focus to the short term, forcing them to follow the crowd, which means a higher focus on prices and much less on value and fundamentals. Value investing often entails having to oppose the crowd. But, as sentiment can sustain valuation discrepancies for long periods of time, value investors must be prepared to face periods of underperformance. As they face pressure to perform over short periods of time, fund managers are ill prepared to act as value investors.

In the end, most of these fund managers can't beat the market and the high fees they charge are not justifiable, as investors can usually get better value by following passive strategies. Fund managers are generally obsessed with price, asset type, sector and industry, instead of the specific fundamentals of a company. Fund managers thus turn themselves into trend followers, who ride the sentiment wave in the belief that they can get out before all others do.

Today there are many examples of this madness. Why are people buying bonds with negative yields? After all, the money would be better off parked under the mattress, wouldn't it? But investors are front-running the central bank; they are buying not because there is any value, but because they expect prices to be pushed higher by a greater fool than them – the central bank.

Woodford targets a time horizon for his investments of at least 3-5 years, and he often holds equities for much longer than that. The turnover in his Equity Income fund has been around 16.0%, which implies an average holding period of over six years.

(2) Active strategy

Value investing requires doing something different from the crowd, otherwise it would be turned into trend

following or a passive strategy. That means buying stakes in undervalued companies, tilting a portfolio towards the sectors providing the best opportunities, and capturing what the crowd is unable to capture.

(3) Company engagement

He believes that a real investor should participate in corporate decisions and help unlock a company's potential over time. In acquiring a stake in a company's profits, an investor is also acquiring a stake in decision making, and should therefore drive change whenever necessary.

(4) Absolute focus

While there's nothing wrong with comparing the return of a fund to the return of a broad market index in order to evaluate the benefits of active management over passive strategies, the real truth is that investors do require positive absolute returns. An absolute return of -3% may be considered good if the relevant market returns -7%: in relative terms, such a return represents outperformance of 4%. But still, Woodford believes that the fund manager has not done a good job if the fund falls in value, even if the market has delivered an even worse outcome. Protecting capital is always the first priority and then investors should focus on delivering a positive return over time. While there are periods of negative absolute performance, over the long-term an investment should deliver positive absolute returns, regardless of the performance of the broader benchmark.

A few words on Brexit...

Woodford seems unsurprised with the Brexit vote result, which he believes is a consequence of public dissatisfaction with the current trends within the global economy. While acknowledging Brexit obviously has implications for the UK and the EU in particular, Woodford believed that the initial negative market reaction was too extreme and

"HIS PORTFOLIO WAS ALREADY 'DESIGNED FOR A CHALLENGING WORLD, CHARACTERISED BY LOW GROWTH, DEFLATION, DEBT PROBLEMS, WEAK PRODUCTIVITY AND TROUBLING DEMOGRAPHICS', ALL OF WHICH REMAIN EXACTLY THE SAME NOW AS BEFORE THE BREXIT VOTE."

did not reflect the true long-term impact of Brexit. Woodford recognises the short-term implications of Brexit may impair GDP growth in the UK for the next 18 months or so, while boosting inflation during the same period, but he also believes the long-term outlook for the UK economy is pretty much unaffected by Brexit. Uncertainty is expected to rise at times, as a consequence of the ongoing negotiations with the EU, but this should ameliorate over time. In terms of portfolio implications, he believes that nothing has changed from the perspective of a long-term fund manager. His portfolio was already *"designed for a challenging world, characterised by low growth, deflation, debt problems, weak productivity and troubling demographics"*, all of which remain exactly the same now as before the Brexit vote.

...And a few more, on Trump

"We had our fair share of political shocks recently but this one, arguably, trumps

them all. I am surprised that Donald Trump has emerged as the winner of the U.S. Presidential election."

Against all odds, Donald Trump won the U.S. Presidential election. Woodford attributes the result to the "extent of discontent and frustration that now prevails across Western democracies". A vote for Trump is not just a vote for his ideas and commitments but rather a vote against the political establishment from a growing part of society that is discontented with the economic performance since the global financial crisis.

After such a divisive and incendiary campaign, the world might appear justified in expecting some major shifts in policy. But, while the vote and the future President seem extreme, the Brexit experience suggests that there is no reason to panic or overreact. Some change in policy is expected, but such change may be much more limited in practice than publicised by Trump during the campaign. Emerging markets and debt will eventually underperform and the focus will shift to domestic priorities at the expense of free trade and globalisation. Some parts of the U.S. economy will be more favoured than before, others will suffer, but in the end the shift will have a smaller impact than previously thought by many, Woodford believes.

A Trump win is favourable for Woodford's portfolios through an expected positive effect on the healthcare industry, as his portfolios are tilted toward this sector. Clinton was expected to approve some legislation to cap drug price increases, and this idea has already been dismissed by Trump. This will boost short-term sentiment, but the long-term picture remains relatively unaffected, Woodford believes.

A few final words

Woodford is one of the most trusted and respected British fund managers, and has been delivering consistent profits to investors over time. Through the years he has been able to diverge from the crowd and to focus his investment strategy on value discovery and never on price discovery. For him, the short term is led by a random walk, influenced by sentiment and whim. But in the long term the "valuation and fundamentals of a company are the only things that matter and, like gravity, those things will reassert themselves".

Source: Woodford Funds

BY SAMUEL RAE

FORENSIC FOREX

TRUMPONOMICS AND ITS GLOBAL CURRENCY IMPLICATIONS

A lot has happened since the last iteration of this Forensic Forex series hit the press, and much of it unexpected. The topic on everybody's lips, of course, is the Trump presidency, and what it means for pretty much every aspect of the global economy. The level of uncertainty we are seeing in markets right now is almost without parallel, and that means different things for different sectors.

Biotech, for example, is rocketing. Why? Because markets saw a democratic administration as potentially terminal for many of the current practices in the space – practices from which many of the big and medium sized Pharmas generate a lot of money. This potential has weighed on sentiment in biotech and pharma over the past six months and more, and with Trump winning the November election, this weight is lifted.

Solar stocks are on the other side of the spectrum. In what Trump has promised will be a revival of the flagging coal industry, the President elect has essentially rewound much of the progress made by solars across the last half decade, and it doesn't look like there's any near-term reprieve on the cards.

Moving to macro, the chances of a rate hike before the year draws to a close look to have gone up (although we could easily argue that the chances were pretty high whoever won the election). This, of course, is not great for Wall Street and the huge raft of companies that have become pretty much entirely dependent on quantitative easing and – by proxy – easy money.

> **"THE LEVEL OF UNCERTAINTY WE ARE SEEING IN MARKETS RIGHT NOW IS ALMOST WITHOUT PARALLEL."**

On the opposite end of the spectrum are retirees, who are relying on interest-rate linked savings vehicles. This group looks set to benefit from a higher return on their pension pot. What we're interested in, however, is what this Trump presidency is going to do to the dollar, and other majors across the globe. That's where my money is made, so here are my thoughts.

First up, a simple one. The dollar is going to rise on the back of an interest rate hike, and so a medium to long term bullish greenback is almost a no brainer. Not only will a boost in rates translate to strength, but the aforementioned uncertainty will boost dollar acquisition as market participants look to diversify away from equities (which will likely take a hit when rates jump) and hedge against a shock. The degree to which rates rise is up for debate, but I'm expecting something pretty considerable. 5% is likely over a twenty-four month period. Yes, it seems a little extreme, but in my opinion it's very realistic.

Second, the Canadian dollar is probably going to weaken, as is the Aussie. Exactly what so-called Trumpo-

nomics will entail remains to be seen, but one thing looks almost certain – the US will become increasingly protectionist, and this could damage trade relationships between NAFTA countries and beyond.

Increased trade friction translates to a tougher economic climate in those nations that are on the losing end of any reform (in this instance, Canada, Australia, etc.), and a tougher economic climate translates to the necessitation of dovish policy. Dovish policy, in turn, means a weaker currency. That's why the peso is crumbling right now; and while we won't see the Canadian dollar and the Australian dollar fall to the same degree as their Mexican counterpart, there's going to be some fallout.

The yen is a particularly interesting one. The above conditions apply to the yen, in that any protectionist policies put in place by Trump – and there will be some – are going to weaken the yen versus the dollar. While the likes of Canada and Australia are concerned about this potential, Japan, however, is delighted about it. I expect Shinzo Abe and Trump to get on just fine. Why? Because a strong dollar means a weak yen, and a weak yen is great for the Japanese economy.

Japan has spent the last two decades trying to artificially weaken its currency, with the goal of reducing the price other countries pay for its exported goods. So, I expect a long-term weakening of the yen, as championed by Japanese policymakers and as buoyed by US economic policy, and – by proxy – I hold a bullish USDJPY bias in my day to day trading operations. We'll see spikes against my bias, of course, but for me the trend is already in motion, and set to continue for the foreseeable future.

I'm still waiting to see what happens in the New Year before forming a solid euro or sterling bias. Sterling remains weak on Brexit, but I can't see this lasting too long – perhaps into the second quarter of 2017 – and the euro, well, I've held a bearish euro bias for more than twelve months now, and in all honesty, I don't expect that to change near term.

Now we get to wait and see how all this plays out in the real world...

"A MEDIUM TO LONG TERM BULLISH GREENBACK IS ALMOST A NO BRAINER."

BY DAVID JONES

CHART NAVIGATOR

HOW TO UNDERSTAND THE RELATIVE STRENGTH INDEX (RSI)

The last twenty years have seen significant growth in the use of technical analysis and charting. The growth of the internet and much more trading by normal retail investors has played a big part in this. As its use has increased, the software we use to try to analyse markets has got ever more sophisticated. On the whole this is a good thing. But I think it can give a false sense of hope to some when it comes to predicting market direction.

Let me explain. Last time around we looked at the simple process of identifying and following trends – the absolute cornerstone of charting for a lot of people. As charting software has moved ahead, the area that has seen the biggest growth has been the section of technical analysis referred to as indicators and oscillators – or as I will often disparagingly refer to them – the squiggly lines at the bottom of the price chart.

Oscillators will take a chunk of the historical price data and crunch it in various ways. Different oscillators will try to show whether a market is overbought or oversold; whether it could be about to start a new trend; whether the price is doing something other than what would normally be expected within the trend; or how volatile the market is now compared to its historical performance. There's a vast list of oscillators available – it must easily top 100 by now.

> **"WHEN USED IN CONJUNCTION WITH OTHER APPROACHES TO MARKET ANALYSIS OSCILLATORS CAN DEFINITELY HELP REFINE THE TIMING OF A TRADE OR INVESTMENT."**

When it comes to trying to get market direction right, every little helps of course. But one of the drawbacks of oscillators for the new investor or trader is the belief that if the parameters can be tweaked *just so*, the secrets of the markets will be uncovered, and untold riches are just around the corner.

You can tell I am just a little sceptical about the value of these various squiggly lines. But don't discount them completely – when used in conjunction with other approaches to market analysis oscillators can definitely help refine the timing of a trade or investment. To introduce the idea we will take a look at one of the most basic types of oscillators – and one that came right at the forefront of this mathematical revolution for crunching data – the Relative Strength Index (RSI).

"TYPICALLY, IF THE RSI HAS A VALUE ABOVE 70% THE MARKET IS SAID TO BE 'OVERBOUGHT'. IF THE RSI READS BELOW 30% THEN THE MARKET IN QUESTION IS SAID TO BE 'OVERSOLD' AND IS DUE A BOUNCE."

The RSI is a momentum indicator. It tries to measure the speed of change of price movements. It always has a value between zero and one hundred percent. Typically, if the RSI has a value above 70% the market is said to be "overbought". It has moved up too far too fast and is overdue a small correction at the very least. If the RSI reads below 30% then the market in question is said to be "oversold" and is due a bounce.

Typical values for RSIs are 10-day or 20-day but it really can be whatever you choose. A shorter-period RSI will produce more signals but will also generate more false signals due to the "noise". A longer-period RSI will deliver fewer buy or sell signals but they may well lag the actual market movement by a small margin at least, due to the longer period smoothing out the volatility of the indicator.

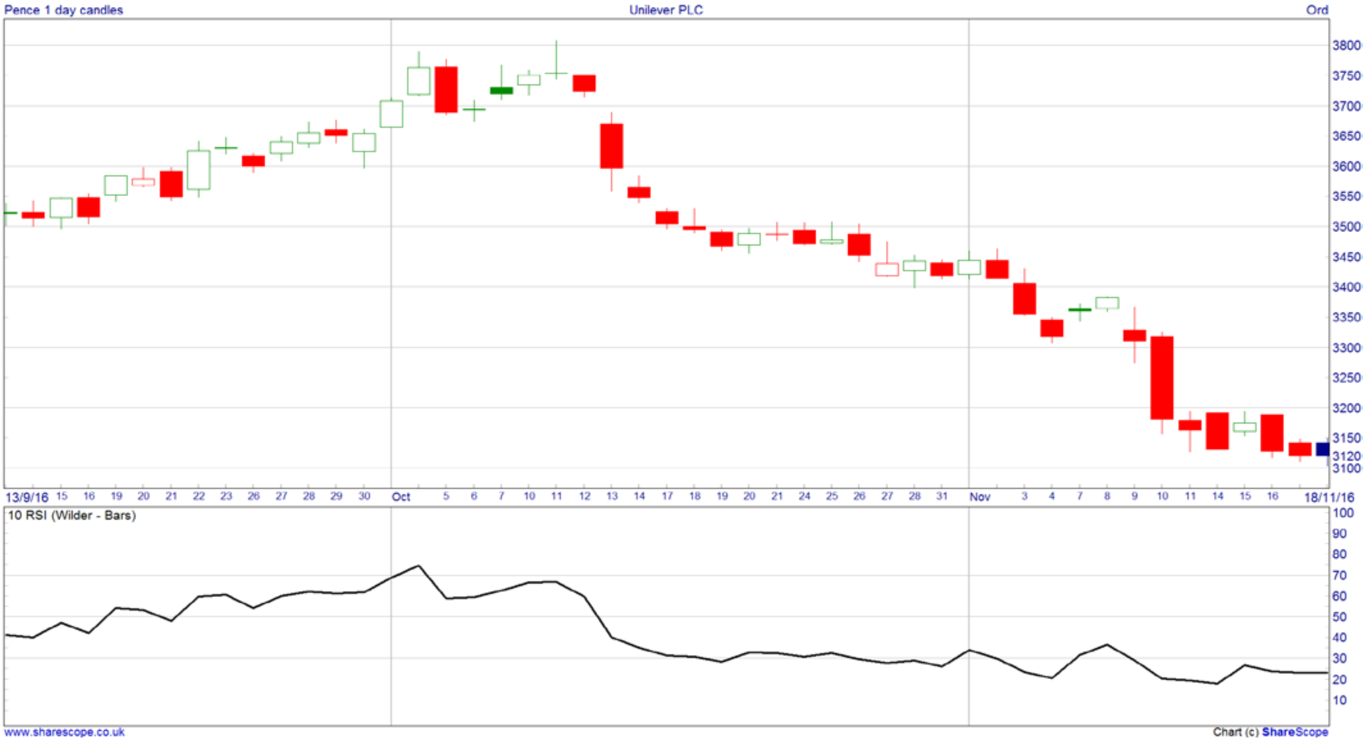
Let's look at some typical buy and sell signals on some UK shares. The examples shown use a 10-day RSI.

Here's a good example of a sell signal followed by a buy signal. The price chart is on top, with the prices represented by candlesticks (more on this approach in a future article). And at the bottom we have our squiggly line, the 20-day RSI. When the RSI is above 70, the expectation is for the market rally to start to falter. When the RSI is below 30 we are expecting the strength to come back in.

On the Lloyds chart it can be seen that during August the price recovered from the low 50p area to above 60p. You can see the RSI moving higher in line with the price. By early September the RSI was in overbought territory above 80%.

You can see sentiment changing towards the share price of Lloyds. After a sharp rise, sellers came in and pushed the price lower for much of the next six weeks. This served to drag the 10-day RSI lower. So low in fact that by the second week of October, the RSI had dipped below the 30% mark, suggesting the price was now oversold. It's a sign that the slide has been perhaps a little over-extended and, if you are following the RSI, it is time to get ready for a rally.

Over the next six weeks into November, the price did indeed recover, pushing back beyond 60p once again. This Lloyds chart is a pretty good textbook example of how the RSI is meant to perform.



Of course, it is always easy with the benefit of hindsight to find excellent examples. And it is not a major leap to convince yourself you have found the Holy Grail of market analysis! But there is one well-known drawback with the RSI and it is well illustrated with this next chart.

The share price of Unilever started falling in early October. As it fell, the RSI understandably slipped into oversold around the middle of the month, with the Unilever price trading around the 3,450p mark. This was the suggestion that the slide was now overdone and it was time for the buyers to come back in.

Unfortunately, the share price of Unilever doesn't pay much attention to the state of its 10-day RSI. The decline has continued since then and the price is a good 10% lower than that first RSI oversold signal.

If you are blindly following RSI overbought and oversold signals you should do okay in sideways markets. But if a market delivers a real trend it will usually get you to call the end of that trend far too quickly – with predictable results for your overall profit and loss account. If using the RSI in this manner, arguably a safer approach is to only take the signals in the direction of the main trend. If the market is going up, look to buy into the trend when the RSI reaches oversold, and vice versa.

However, to try to avoid the RSI going against a trend too quickly, the chartists came up with a new twist on how to interpret it – and in my opinion it is a more reliable use of the RSI than just the straightforward overbought/oversold approach. This is the idea of *divergence*. Let's expand on that a bit.

Most oscillators just take the historical and current price, crunch it around a bit and display the data. In the great scheme of things, if the price is rising then the RSI should be rising too. If the price is falling, then the RSI also slides. But it's when this *doesn't* happen that we have the signal known as divergence. Although not as common as the overbought/oversold signals, divergence signs are thought to be more reliable.

"ALTHOUGH NOT AS COMMON AS THE OVERBOUGHT/OVERSOLD SIGNALS, DIVERGENCE SIGNS ARE THOUGHT TO BE MORE RELIABLE."

Here are a couple of examples.

During the summer of 2016, the share price of Royal Dutch Shell slid lower. It would rally, but would then slip back, eking out fresh lows. But the RSI was making *higher* lows. This is known as *bullish divergence*. With the RSI trending higher it can be a suggestion that even if the share price trend is still down, the pessimism is running out of steam. An aggressive strategy here is to be a buyer when you see confirmation of the bullish divergence, with a stop loss order just beyond the lowest low.

Of course for every buy signal there is its mirror image sell signal – and in this case that is known as *bearish divergence*. Take a look at this chart of Imperial Brands.

The share price hits a high in July, falls back slightly and then just about scrapes out to a higher high in the middle of August. But you can see the RSI has completely lost interest and is already making a lower high, suggesting – for now at least – the bullish momentum is fading.

Here's a current set up to keep an eye on in the weeks ahead.

FTSE100 media business WPP had been declining since early October. November saw it hit a fresh low for this correction, but the six-year trend for WPP is most definitely up. But look at the RSI – the latest low is higher than the last one, despite the price moving lower. This is the bullish divergence set up, suggesting the slide could well be running out of steam.

Like all approaches to market analysis the RSI doesn't work all the time. But when used to gauge the strength of the current trend, I do think it can be a handy addition to an investor's or trader's view of the market.

BY ROBBIE BURNS

ROBBIE BURNS' TRADING DIARY

IT'S THE MOST WONDERFUL TIME OF THE YEAR

Surely it can't *already* be that time of the year when we discuss the Santa rally? I guess it is. I've just told my son Santa doesn't exist but he says he already knew. While Santa doesn't exist the so called Santa Claus rally definitely does. Indeed, during the last three years I've made a fortune out of it.

What's amazing about the last three years is that all you had to do to make money was place a long bet on the FTSE to run for the last ten trading days of the year.

What's even more amazing is that over the past three years you'd have got 300-400 points upside each time (assuming you'd held firm, of course). If history repeats itself this year then it could be in the bag again.

Usually the first ten trading days in December aren't so good, and the market tends to go down. Newspapers often report that the "Santa rally hasn't happened", but that usually turns out to be complexly premature.

We should really consider the Santa rally to be just the last few trading days before Christmas. I usually quit the trade before New Year's Eve – maybe even the day before. Sometimes it starts to drift before the year end.

So how's the best way to play it? Some people use options, but being a simple soul I just prefer a good old fashioned spreadbet. If you'd just put on a tenner a point in each of the last three years you could have made £12k.

And now the warning! After all there is no such thing as a free Xmas lunch in

"WHILE SANTA DOESN'T EXIST THE SO CALLED SANTA CLAUS RALLY DEFINITELY DOES. INDEED, DURING THE LAST THREE YEARS I'VE MADE A FORTUNE OUT OF IT."

the markets! The FTSE has topped out around 7,100 a few times. What if the market is around 7,100 as we hit the last ten days? Could it really zap up another 400 points?

Perhaps our best hope is a FTSE fall leading to the last bit of December. And of course this could be the year it doesn't happen! You may want to consider a stop loss and perhaps decide how much you are willing to lose if it does go wrong.

Consider the FTSE trades 24 hours a day bar weekends so things could hit the index overnight – and also the spread widens overnight too. If you are going to use a stop be careful where you put it!

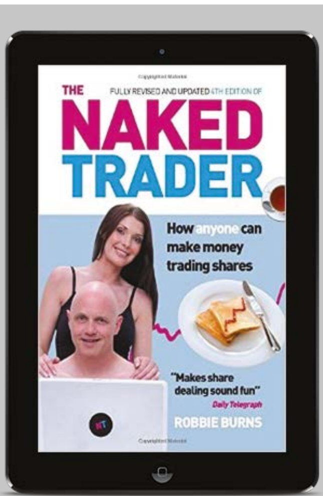
But why is there a Santa rally? To tell you the truth I don't have a clue. Lots of conspiracy theories abound. Some say fund managers push it up to get a better year-end return, while others just put it down to low volumes near the year end. Well, really, who cares why?

Good luck if you play it and I hope it brings you lots of lovely loot. But don't overdo it and lose too much either.

Thanks so much for the lovely feedback from Master Investor readers on my new book, *Trade like a Shark*. Indeed, I am thrilled a number of you really sold your crap shares that had been going down – forever – thus clearing the decks to start again.

That's brilliant news, and those of you who did it could really end up as shark-like investors. I'm also glad to have put a lot of you off trying to gamble forex and binaries. Both markets are a surefire way to lose all your money. The stories from real people in the book appear to have helped some of you to get out of bad gambling habits.

All the very best of trading to all of you for 2017 – I shan't be here next month as I'll be lying on a beach in Dubai – so see you in February!



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

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

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

BY CAROLINE DREWETT

MILLENNIALS & MONEY

HOW TO BUILD A PROPERTY PORTFOLIO

PART IV: EXPANDING YOUR PORTFOLIO

So you've bought your first home, and you're finally on the property ladder. It may seem like you climbed a mountain to get onto the ladder, stretching every last penny and foregoing every evening out for the past two years to get here. So of course you feel that there's no way you'll be able to ever do this again, let alone multiple times to become a property mogul. But don't despair...

The Post Office has found that the average age for moving from a first home into a family home is now 42, which might seem like a lifetime away. But rest assured; the hardest part is done. The highest hurdle was getting on the ladder where the odds are eternally stacked against you.

As a first time buyer, you had no mortgage history, no proof of how reliable you are, you were high risk to lenders, and therefore only had access to unfavourable rates. All combined to make it even harder to get on the ladder. But now that you're on, the real fun can begin.

The first thing to accept when looking to start a property portfolio is that there will be some level of risk involved. You have to speculate to accumulate. To think that a property portfolio will be easy with no lending, no mortgage, no risk, is naive.

Naturally, some baby boomers have the luxury of buying a buy-to-let outright, but just because they can, it doesn't mean it's the best option for them financially. Many baby boomers have never had to face the uncertainty faced by Millennials, which means they have neither the need nor the inclination to start grappling with risk in retirement. As Millennials have experienced financial difficulty and a harder road to financial freedom than their parents, they have also been forced to learn about risk and to make every penny count, and they should use these tough experiences to their advantage.

Borrowing money has been a part of Millennials' lives since setting foot at university (for some, even earlier) and yet baby boomers keep telling us to avoid it. We may not have any choice in borrowing; some of us will be borrowing for decades to come, so we might as well see the positives in it and make the most of it. Borrowing allows us to expand and

"AS SOON AS YOU BECOME A HOME OWNER, YOUR HORIZON OF OPPORTUNITIES EXPANDS."

accumulate, and mortgages are the cheapest way to do this.

As soon as you become a home owner, your horizon of opportunities expands. You are now considered reliable to mortgage lenders, and if you live in the South, your property's capital will likely be increasing faster than you can earn, so you're getting wealthier by the day, although you won't realise it. As you pay your mortgage off and your property increases in value, your outstanding debt becomes smaller in relative terms so that your loan-to-value decreases. Now is the perfect time to take that 'paper profit' out and use it to your advantage.

In the days following the referendum, home-owners up and down the country were panicking about their house value crashing. But the truth is that unless they intend on selling, they can wait until prices go back up. They hadn't lost any money; they were no worse off; but the potential profit from selling the house had disappeared. Equally, as house prices around the country go back up again, you can withdraw money without having to actually sell. Re-mortgaging your home gives you the ability to gain a ready-made deposit for a second home without lifting a finger – as long as you have bought the right 'starter-home' to begin with.

Applying for a buy-to-let mortgage is relatively simple once you have your own home. Lenders tend to only ask for a household income of £25,000 (although virtually all lenders will ask for a 25% deposit) as the lending is based on the property's yield rather than the owner's salary. As the starter home that you live in should have as much potential for capital gains as possible, the second home should have as high a rental value as possible. This is especially important for those who are risk averse, and want to ensure that they have as much cushion as possible in anticipation of interest rates rising.

"RE-MORTGAGING YOUR HOME GIVES YOU THE ABILITY TO GAIN A READY-MADE DEPOSIT FOR A SECOND HOME WITHOUT LIFTING A FINGER."

Having your own home that is on a fixed mortgage rate will help you to control your outgoings. But the risk of a buy-to-let is greater, as alongside interest rate fluctuations, you must factor in the possibility of void periods, as well as rental fluctuations and essential works on the property. Having high rental yield will mean that every month you can save, so that there is a bank of savings to cover a two month void, or a broken down boiler.

Buying near your own home will save you necessary panic expenses. Whilst you want to look after your tenants as well as possible, you also want to avoid not being there when you're needed, which could lead to their calling an expensive emergency plumber at the first sign of trouble, if you are unable to go over and inspect for yourself.

Once you are more secure and have a second income coming in, you can think about saving for a third property. Some lenders have started offering 10-year fixed mortgage rates, so if you intend on opting for a 10-year repayment, your chances of defaulting are extremely minimal. Once you have bought your first property, the buy-to-lets shouldn't cost you (i.e. you should be making a profit), so having one or having six requires no extra income from you. Many lenders will only allow you to have three mortgages with them, but other than that, the possibilities are endless.

Taking the plunge and expanding your empire couldn't come at a better time. Central London properties are down an estimated 7% at the moment; what was previously out of reach has, all of a sudden, become attractive.

NOVEMBER 2016

BEST OF THE BLOG

The big flaw in Trump's reflation plan

We have reached a point where people are so tired of the current economic model that they're willing to support anyone promising to do away with the status quo and make life great again. It's hard to find fault, because the current model is obviously rotten and is overwhelmingly biased towards the incumbent wealthy. But, with Trump now elected as President, things may change quite rapidly in terms of monetary policy, fiscal spending, and ultimately in terms of growth and inflation. Or so we're told...

Until now, we have watched interest rates collapse and central bank assets soar. But such policy, mixed with fiscal tightening, has been relatively ineffective in terms of boosting growth to pre-crisis levels. Most of the positive effects have been lost in the translation from higher asset prices to higher growth, as the link between the financial economy and the real economy is clearly misunderstood by central banks. Explaining why central banks lost that link, what they can do to boost growth and how Trumpian fiscal spending may fare is my goal today.

> **"WITH TRUMP NOW ELECTED AS PRESIDENT, THINGS MAY CHANGE QUITE RAPIDLY."**

Until the 1980s, central banks targeted monetary aggregates like M1, M2, M3 or some other measure of the money supply, because they relied heavily on the quantity theory of money, which predicts that an increase in the rate at which the money supply is growing will lead to a proportional increase in the inflation rate. Roughly speaking, if a central bank increases the money supply by 4%, it will induce a 4% increase in prices. Ergo, to keep inflation under control, the central bank needs to control the money supply.

Until the 1980s, monetary targeting worked well around the world, but then central banks lost the link between the money supply and inflation and decided to abandon monetary targeting. The words uttered by Gerald Bouey, a former governor of the Bank of Canada, express the sentiment among central banks at the time: *"We didn't abandon the monetary aggregates, they abandoned us."*....

By Filipe R. Costa

Click here to read the full article

"I WAS PARTICULARLY SCEPTICAL OF THOSE TWO BROKERS TRYING (AND SUCCEEDING FOR A TIME) TO HYPE UP SIRIUS MINERALS' SHARES IN AUGUST."

Reality strikes at Sirius Minerals

SIRIUS MINERALS PLC

Shares in Sirius Minerals have rightly suffered a major pullback over the past few days, and many private-investor enthusiasts for the stock have been badly burned. The trouble with Sirius is that there is a lot of questionable analysis out there in the public domain right now. Here's my attempt at setting the record straight...

The theme underlying all my posts has been how to value a share – particularly those in the mining sector. Readers will have noted my scepticism that anyone in the markets – analysts included – knows how to do it properly. My scorn is particularly directed at 'bogus' valuations for long-term projects where an 'NPV' per share 'target' is relied on by almost all analysts (as far as I can see) to bamboozle investors.

I was particularly sceptical of those two brokers trying (and succeeding for a time) to hype up Sirius Minerals' shares in August (in order, of course, to ingratiate themselves into the accompanying juicy commissions gravy train) before the capital raise necessary to get its Yorkshire polyhalite fertiliser mine up-and-running in six to ten years' time.

We now see my lesson (derided by some at the time) coming home to roost in a big way – after a lag during which time the 'vacuum of ignorance' and 'momentum' effects prevailed over any realistic value per share. The institutions just wouldn't buy into those bogus 'targets'. Nor anywhere near them! ....

By John Cornford

Click here to read the full article

Trump: The silent majority bites back

The great American people have spoken. And the opinion polls were wrong. Again. Those beautiful bellwether states of Ohio, Florida and Georgia called for Mr Trump who is, this morning, the President-Elect of the United States.

All over the world "experts", liberals and lefties are swooning in disbelief, sick as parrots. A flock of black swans (to continue the bird metaphor) has pooped generously on their feathered heads. Just like on 24 June.

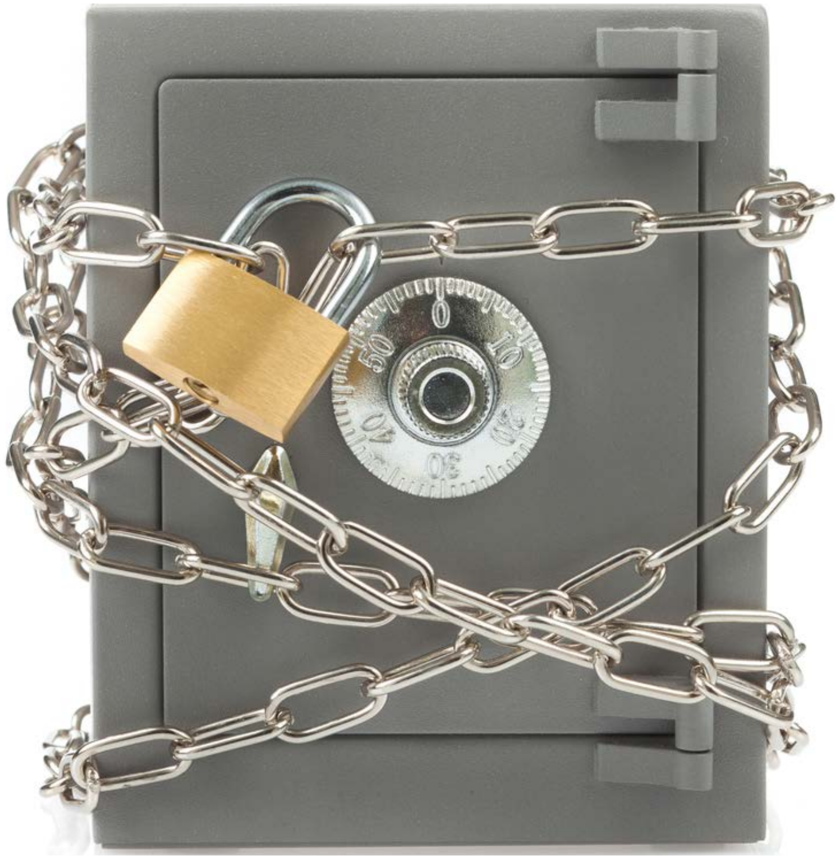
I'm not going to attempt to analyse here why a reality TV star-cum-billionaire is set to move into the White House while professional politico Mrs Clinton faces retirement. But I'd like to highlight a few themes that will assert themselves in the months to come under a Trump presidency. This is a good moment for investors to stick their finger in the wind.

Just like in Britain during the Brexit debate, a great mass of ordinary people has taken the opportunity to vote against the politics of business-as-usual. While the world burns and the international financial system teeters, Washington has been absorbed in discussion of transgender bathroom rights. As in Britain, ordinary Americans have felt that their fears about unbridled immigration have been ignored by the political elites.

Call it populism if you will, but the rise of social media has facilitated the mobilisation of the masses in a way that the revolutionary socialists of the early 20th Century could only have dreamed of. Henceforth, political elites will have to work harder to maintain their traditional supporters' fickle allegiance – not least in Europe....

By Victor Hill

Click here to read the full article



Star fund manager strikes cautious note

The Personal Assets Trust (LON:PAT) has just released its interim accounts for the six months to the end of October. It is one of the most cautiously positioned investment trusts on the market, yet has an excellent long-term track record, so it is well worth having a close look at the manager's latest update.

Sebastian Lyon of Troy Asset Management has been running the fund since March 2009 with the aim of protecting and increasing (in that order) the value of shareholders' funds per share over the long term. He also has skin in the game as he owns Personal Assets shares worth more than £3m.

Lyon's Investment Advisor's Report makes sobering reading:

"The past six months have seen remarkable financial extremes. UK interest rates have been cut by 0.25% to a 322-year low. 10-year UK gilt yields have reached an all-time low of 0.5%. Sterling's effective exchange rate fell to a 168-year low (according to the Financial Times). Elsewhere, Japanese and German sovereign 10-year bond yields have turned negative as investors buy to lock in capital losses. All is not well with the financial world."

"In the West there is rising political anger, epitomised by the outcome of the UK referendum in June. Now, Trump has trumped Brexit. But there remain plenty more invidious choices to be made by disgruntled electorates, including in Italy's constitutional referendum in December and in the 2017 elections in France and Germany. We hold the view that political outcomes are likely to offer investors asymmetric risks, skewed to the downside."

He points out that the FTSE 100 index has been range bound between 6000 and 7000 points for that last three and a half years – other than the occasional brief breakout – and says that this shows that investors have not been well rewarded for taking risk....

By Nick Sudbury

Click here to read the full article

BY RICHARD GILL, CFA

READ TO SUCCEED

THE STOCK PICKER

A FINANCIAL HISTORY FROM THE SHARP END

BY PAUL MUMFORD

I think I have mentioned before in my book reviews that active fund managers, as a whole, are a pretty poorly performing bunch. Reflecting this, a recent study by S&P Dow Jones Indices found that 73% of 25,000 active funds in the UK failed to outperform their benchmark in the ten years up to the end of 2015. This kind of performance wouldn't be tolerated in any other industry. Can you imagine a surgeon who only performed three-quarters of operations successfully being able to continue practising, or a plumber who only fixed 27% of boilers getting any new business?

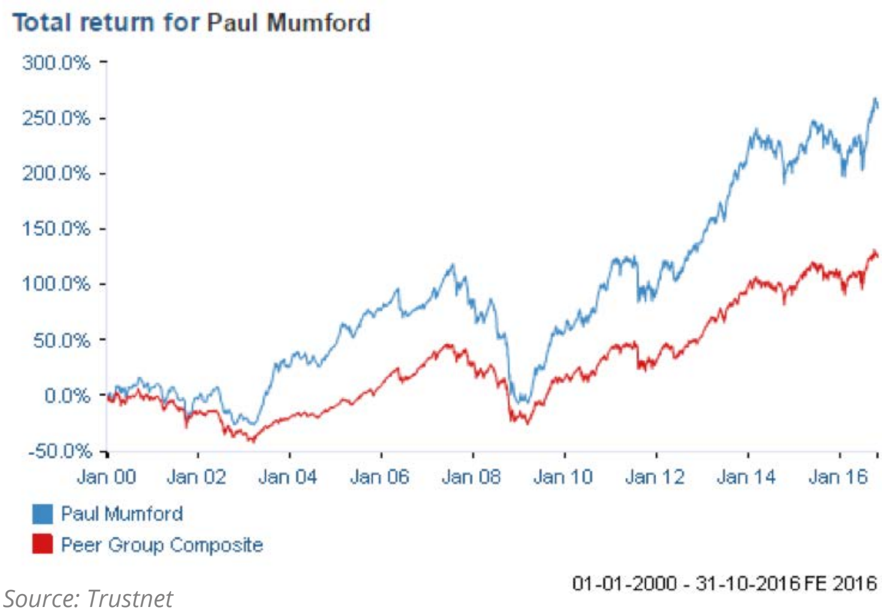
But of course there are exceptions to the rule

Author of *The Stock Picker* is Paul Mumford, one of the City's veteran and better performing active fund managers, having over 50 years' experience in the markets. Having worked as an analyst for Norris Oakley Brothers and later as a smaller-companies expert at R Nivison, he moved to fund management in 1988 when he joined Glenfriars. Mumford currently runs the Cavendish Opportunities Fund, AIM Fund and Select Fund, having a stock picking strategy based on finding under-valued and unloved shares. As the chart below from Trustnet shows, he has an excellent track record, having significantly outperformed the market since the turn of the century (and before that as well).

The Stock Picker is different to many books on the market in that it is not an investment guide per se. Instead the book is an autobiographical take on Paul Mumford's life, taking the reader on a three part journey, beginning with his schooldays, through to his investment career, extracurricular activities and everything in between.

The first part of the book covers Mumford's early life as a schoolboy in Dorking and as a stockbroker in the City of London. From the outset it wasn't clear that he was set for a great career in finance, being the first sixth former at his school to get the cane and being told by his headmaster that his "*...prospects of success look bleak*". But an entrepreneurial streak was clear, with early business ventures including selling cigarettes to school mates and acting as a bookmaker to his fellow pupils (and even his housemaster).

Leaving school with few qualifications Mumford took a brief holiday before applying for a job as a settlement clerk with specialist iron and steel stockbro-



Source: Trustnet

kers Norris Oakley Bros. He quickly got hired, despite his former headmaster failing to give him a reference, starting on the princely sum of £6 a week plus luncheon vouchers. These were the mid-1960s in the City, the days of stock jobbers, noisy trading floors, messenger boys, chain smoking managers and irritating colleagues singing annoying songs (some things never change).

"PAUL MUMFORD HAS PRETTY MUCH SEEN IT ALL, FROM THE BIG BANG TO THE DOTCOM BUBBLE, INDUSTRY PRIVATISATION TO THE RISE (AND FALL) OF AIM, ALONG WITH NUMEROUS STOCK MARKET BOOMS AND CRASHES."

Mumford enjoyed the job, learned the tools of the stockbroking trade and, getting the investing bug, started to dabble in the markets himself. After rising up the ranks, including a move to the banking department and passing his stock exchange exams (with merit), he went on to become a highly successful broker.

Part 2 of the book covers Mumford's years as a fund manager. In February 1988, then working at Glenfriars, the Glenfriars Investment Opportunities Fund (now the Cavendish Opportunities Fund) was launched with Mumford as its manager. Having developed a contrarian investment style following the 1973/74 stock market crash, this was seen as the perfect time to launch a new fund given that equity markets were just starting to recover from the effects of 1987's Black Monday collapse. We are taken through a reminiscence of the fund's history, with Mumford regaling stories of which stocks did well for his investors, along with tales of those which didn't perform so well.

One of his best ever performers was gas mask manufacturer Avon Rubber, which he first bought in 2002 at a price of 130p per share. At the time the shares looked good value, offering a dividend yield of 5.8% and trading at just 7 times earnings. By 2008 however the company was loss making and highly indebted and the shares tanked to just 25p. But with the company having heavily invested in developing a new respiration mask for the US Department of Defense (DoD), Mumford held on and even topped up at 67p. Following a $112 million contract win with the DoD Avon shares subsequently rose 12-fold from Mumford's top-up price.

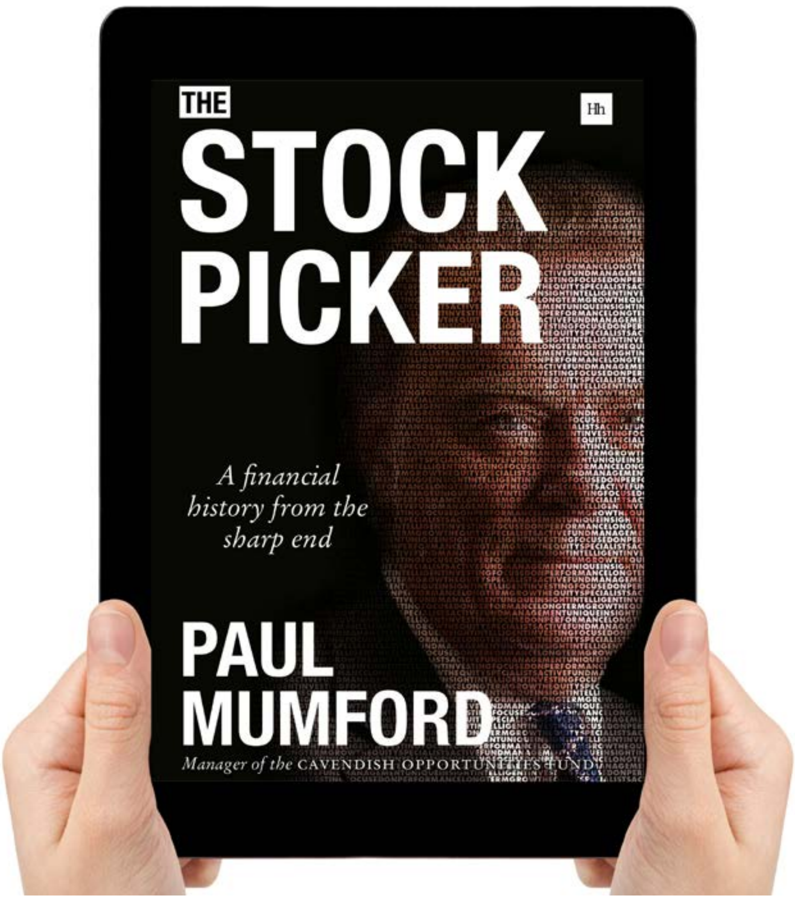
Finally, in Part 3 the author goes into more detail about the investment process that he has honed over the decades. Mumford is unashamedly a bottom-up stock picker, frequently a contrarian, using fundamental analysis to identify undervalued shares across all market sectors. He invests purely in UK listed shares and, unlike in the past, ignores blue-chip shares to focus on small caps.

As for where he gets his investment ideas, sources range from traditional broker reports to more unconventional informants such as his cat! But he finds that the most useful way of identifying an attractive investment is by reading company results. To that end, Mumford makes a point of being at his desk by 6am every day in order to trawl through the newspapers and company announcements – exactly what you want from your fund manager!

Conclusion

As you would suspect after five decades in the markets, Paul Mumford has pretty much seen it all, from the Big Bang to the dotcom bubble, industry privatisation to the rise (and fall) of AIM, along with numerous stock market booms and crashes. His reminiscences of all are written in an engaging and entertaining manner, providing lively, detailed and nostalgic accounts of how the stock market has changed over half a century, along with key insights into the experiences of a top performing fund manager.

Aside from the personal nature of the book, it will be useful to other investors who want to gain an understanding of how Mumford finds bargain shares, what he believes makes for a quality company and the most important lessons that he has learned as an investor.



BY BILL BLAIN

THE FINAL WORD

BELIEVING THE IMPOSSIBLE

One of the most overused quotes in the repertoire of market analysts is "believe six impossible things before breakfast", from Alice through the Looking Glass. The line would certainly seem to cover the market's reaction to Donald Trump's election and subsequent moves across asset classes.

Just a few weeks ago we had all convinced ourselves Trump would be the worst thing ever for America and the world, and that economic activity across the globe would immediately be smothered by a tide of American protectionism should he win.

Apparently not.

Markets reacted to Trump in ways the "thought-leaders" of the liberal press never believed possible. Far from the massive sell-off many newspaper pundits predicted, stocks have risen – mainly on the realisation that things are never quite as bad as you think they may be and the hope that he won't prove so bad after all.

Bond prices have crashed in the expectation that the new Trump administration will embark on a massive fiscal spending frenzy, but also on the very hawkish Fed statements about raising US rates in December and more hikes to follow next year. Despite the "worst ever" candidate being elected president of the USA, the dollar has surged.

"MARKETS REACTED TO TRUMP IN WAYS THE 'THOUGHT-LEADERS' OF THE LIBERAL PRESS NEVER BELIEVED POSSIBLE."

Now the press is getting itself agitated on who will be in Trump's cabinet; exactly what policies will be proposed; or looking for every crack or crevice to declare the vital transition process will break down before his inauguration in January. Perhaps we should relax, breathe deeply and wait and see what happens (although even the mere rumour Sarah Palin might be involved caused me some sleepless nights).

There has been much speculation that Trump's election sets precedent for further disenchanted electoral protest votes to come – causing yet more market destabilisation. I'm afraid I rather fell for that hyperbole when I recently described Brexit and Trump as the beginning of the West's Arab Spring.

But all the extraordinary post-Trump moves confirm what experienced market participants have known all along: markets seldom go where the "noise" would lead you to expect. After the vote, the market moves can be seen as rational (well, sort of). Sadly, no one trades as well as Harry

Albert H. Teich / Shutterstock.com

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Hindsight: to trade profitably it's important to a) understand what is coming next; and b) correctly anticipate how markets will pre- and re-act to it!

It's always worth bearing in mind one of my key market mantras: "The Market has but one objective – to inflict the maximum amount of pain on the maximum amount of participants."

Bearing that rule in mind, what are the key things we should be worrying about as 2016 wends its way to a weary close, and we look towards 2017?

Europe: An Arab Spring of discontent and disintegration?

In the wake of the Trump victory we've seen a flurry of articles suggesting the same forces of anti-establishment, illiberal and discontented masses will see similar protest votes erupt across Europe, destabilising markets and causing the "inevitable" breakup of the Euro. There have been predictable calls to "short" Europe, and the Euro has crashed against the win-all dollar.

These writers argue the vast swathes of unemployed youth and discredited political elites in Europe will see exactly the same circumstances that spawned Brexit and Trump.

We've got the critical Italian referendum next month, where it looks inevitable the Government will fall. Next year, many pundits speculate on the likelihood Marine Le-Pen will win election as the next French President on an anti-Europe platform.

Calm down dears...

"BRITS AND YANKS ALIKE SAGELY NOD AND AGREE THAT EUROPE AND THE EURO CAN'T POSSIBLY WORK. SCIENTIFIC STUDIES ALSO PROVE THAT BUMBLE BEES CAN'T FLY."

Anglo-Saxons delight in talking down Europe. Brits and Yanks alike sagely nod and agree that Europe and the Euro can't possibly work. Scientific studies also prove that bumble bees can't fly.

Certainly the economic arguments against the Euro have been apparent and mounting since the project's inception. The ECB's accounting ledger – Target 2 – shows Europe has a massive internal imbalance between members: everyone is short to Germany. The inability of heavily indebted European Sovereigns to institute fiscal spending to combat unemployment and the fact the ECB has quietly mutualised Europe's debt through its bond-buying programmes makes it look like yet another example of "Alice in Wonderland".

Yet all these pundits who declare Europe will inevitably collapse have got it wrong in the past. The debt crisis did not cause the Euro to implode. Political fractiousness between the Bundesbank, Germany and everyone else has been "overcome". And we should not underestimate the sheer will and determination of Europeans to make it work. This is particularly true of younger voters. Despite youth unemployment being at record levels across much of Europe, young voters are overwhelmingly in favour of the EU.

And there is another trend at work in terms of likely "Brexit-like" protest. Look at Spain and Greece, where protest parties, Podemos and Syriza are long established. Both have seen their popularity plummet as they've failed to deliver the promised miracles. It's easy to be radical one day but face reality the next.

The Big Lie at the heart of the protest votes – as we characterise Brexit and Trump – is that they are unlikely to deliver on promises. We will see a classic over-promise, under-deliver whiplash.

In the UK it's increasingly looking like Brexit will become a long, hard slog over many tortuous years. The apparent enthusiasm of UK shoppers to spend, spend, spend in celebration could well be tempered in coming years by negativity as the costs and arguments stretch into years.

In the US it's going to be interesting to see how Trump delivers his promises to "make America great" and meet the expectations of his voters. If he succeeds, that's all well and good; a reanimated US will deliver global growth. If he fails to show progress he will find himself treated just like the Washington Establishment he claims to be replacing – by being shown the door in the 2020 elections. (Essentially the same thing is happening in Greece where current radical incumbents are finding themselves as popular as fish well past its sell by date.)

And the political elites in Brussels have the time on their hands to wait for any rebellion to calm down...

Meanwhile, what next for UK property?

Ever since I started out as a young banker back in the mid 1980s, I've been counting cranes. Most mornings I'll peer out the office window and count the number of construction rigs I can see to the horizon. It's been an instructive exercise – the number of cranes tends to lag economic activity, and it's really quite amazing how quickly the skyline changes in line with perceived sentiment.

Of course it all rather depends on where the office window is. In the mid-80s I was based in the heart of the City. In the wake of Big Bang I saw the rise of Broadgate and Bishopsgate and new carbuncles spread across the City. In the early 1990s I moved to Canary Wharf and watched the unprecedented speed at which a new financial centre (larger than Frankfurt and Paris combined) emerged in just a few short years.

In 2007 I moved back to the City and watched the cranes disappear in the wake of crisis. It's interesting how the quality of buildings seems to improve as the number of new builds declines. In 2012 I realised I was getting old when we moved to offices in Moorgate and I found myself in a new-built office tower – I'd gone to the opening party of the building that preceded it! And then I moved back to Canary Wharf.

From the office I can see more cranes than ever before. All the way to the horizon are new builds. But it's very different; most of the new builds are residential rather than office space.

And this is very significant. Thus far property speculators have been pretty blasé about the fact that much of the current glut of off-plan tower-block apartments have been sold to Asian investors. In many cases these investors put up 10% deposits. In the wake of Brexit and the pound's subsequent crash (and now in light of the surging dollar) these investors aren't so confident in Sterling. They've written off the deposits. Many of these apartments are back for sale.

Who is going to buy them? Young professionals? As banking bonuses become a distant memory who can afford a £500k one bedroom apartment a few miles east of Canary Wharf? The new affluent-classes of software and Fin-Tech developers want lofts in interesting places like Shoreditch or work from home in the country.

My own experience of the new millennium generation just entering the work force is that they are faced with low pay, few quality jobs on offer, and have an inbuilt resistance to working the way their parents did – I really don't expect my otherwise fantastic kids to be buying their own homes any time soon.

So who is going to buy this glut of expensive London property? The affluent baby-boomers with retirement cash to invest have just been chased out of the "buy-to-let" sector by the government via new taxes and limited tax relief.

The consequence could be a London facing a demand/supply crisis – and if London sneezes, the rest of the UK property sector will catch the plague. Although the capital is short of housing, the new builds I see from the office aren't priced to sell. Something has to give – and I'm expecting it will be smart professional investors who benefit over the long term, through buying up distressed rental assets to create a new quality rental sector. Perhaps we'll get the kids out the house after all.

"WHO IS GOING TO BUY THIS GLUT OF EXPENSIVE LONDON PROPERTY?"

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

MARKETS IN FOCUS

NOVEMBER 2016

GLOBAL EQUITIES

Index	Last Month %	YTD %	Proximity to 52w High*
Dow Jones	5.4	10.1	
Nikkei 225	5.1	-2.7	
Russian Trading System	4.6	38.1	
S&P 500	3.4	7.2	
S&P/ASX 200	2.3	2.7	
CAC 40	1.5	-1.7	
Euronext 100	0.3	-3.2	
NASDAQ 100	0.2	3.1	
DAX Xetra	-0.2	-2.0	
Hang Seng	-0.6	4.4	
FTSE 100	-2.5	8.2	
Bovespa	-4.6	37.3	
IBEX 35	-5.0	-9.2	

COMMODITIES

Commodity	Last Month %	YTD %	Proximity to 52w High*
Palladium	23.7	33.9	
Copper	19.1	23.8	
Natural Gas	11.6	51.1	
Iron Ore	11.2	78.0	
Crude oil (Brent)	5.8	44.7	
Crude oil (Light Sweet)	4.8	38.2	
Soybean	1.9	19.5	
Platinum	-7.3	2.6	
Silver	-7.4	20.3	
Gold	-8.1	10.9	
Coffee	-8.3	15.2	
Sugar (No. 11)	-10.2	25.7	
Cocoa	-12.7	-25.5	

FOREX

Pair/Cross	Last Month %	YTD %	Proximity to 52w High*
USD/JPY	9.4	-5.2	
EUR/JPY	5.6	-7.0	
GBP/AUD	5.3	-15.9	
USD/CHF	2.8	0.9	
GBP/USD	2.3	-14.6	
USD/CAD	0.0	-3.8	
EUR/CHF	-0.8	-1.0	
AUD/USD	-2.9	1.8	
EUR/USD	-3.5	-1.8	
EUR/GBP	-5.6	15.0	

CENTRAL BANKS - RATES & MEETINGS

Central Bank	Key Rate	Next	After
BOE	0.25%	Dec 15	Feb 02
ECB	0.00%	Dec 08	Jan 19
FED	0.50%	Dec 14	Feb 01
BOJ	-0.10%	Dec 20	Jan 31
SNB	-0.75%	Dec 15	Mar 16
BOC	0.50%	Dec 07	Jan 18
RBA	1.50%	Dec 06	Feb 07
RBNZ	1.75%	Feb 09	Mar 23
BOS	-0.50%	Dec 20	Feb 14
BON	0.50%	Dec 15	Mar 16

FTSE 350 TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Antofagasta PLC	26.9	50.3	
KAZ Minerals PLC	26.8	264.1	
Tullett Prebon PLC	25.3	19.1	
Aldermore Group PLC	23.6	-6.2	
Ashtead Group PLC	22.6	38.5	

FTSE 350 BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Fresnillo PLC	-26.8	67.0	
Acacia Mining PLC	-23.5	117.8	
Essentra PLC	-22.3	-51.7	
Ashmore Group PLC	-21.9	9.8	
Mediclinic Int PLC	-21.7	-37.7	

FTSE 350 SECTORS TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Industrial Metals	16.9	233.7	
Life Insurance	7.6	-4.2	
Tech Hard & Equip	7.2	-21.1	
Aerospace & Defense	4.9	13.4	
Mining	4.3	100.7	

FTSE 350 SECTORS BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Mobile Telecom	-13.0	-15.5	
Gas, Water & Mult	-10.0	-4.4	
Tobacco	-8.4	7.4	
Health Care Equi & Serv	-7.8	-7.3	
Electricity	-7.5	-3.6