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MAGAZINE

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AGRICULTURE

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BAG A BARGAIN

INVESTMENT TRUSTS TRADING ON BIG DISCOUNTS

NATIONAL GRID

A DIVIDEND INVESTOR'S DREAM STOCK?

WELCOME

Dear Reader,

Are you an optimist or a pessimist? And why should it matter?

For about half of the population, 2016 has been an annus horribilis. They feel that the vote for Brexit, the election of Trump, a wave of terrorist attacks in Europe, and the death of a considerable number of much-loved celebrities has made this a year they'd rather put behind them. For them, the world looks increasingly grim, and 2017 doesn't hold much promise either. It could even be worse.

The other half, however, feels that these matters need to be put into perspective. They feel strongly that if you step back and look at the cold, hard data, it's clear that life has never been better or offered greater opportunities for the average human being. In their view, this counts for the world as a whole, and not just the developing nations. Needless to say, I count myself in the latter category.

Technology continues to improve at a rapid pace, as do the life sciences that are aimed at making our lives healthier and longer. Successful companies can use a truly globalised economy to scale up more rapidly than ever before. Travel and tourism continues to grow at a healthy rate with each passing year, providing us with quality of life as well as investment opportunities. Bad stuff happens, but on the whole, it's possibly the greatest time to be alive, ever.

At Master Investor, we recognise the risks, but we also see the opportunities. Never before have private investors had access to a broader scope of investments. And never before have companies gone from ground zero to multi-billion dollar enterprises at a more rapid pace. If you get it right, you can earn incredible returns. Or if you already have wealth, there is a bigger variety of financial instruments available to protect and grow your funds than ever before.

My team of freelance contributors and staff writers has once again worked hard to bring together an issue that provides you with ideas and insights that you can use to help you in your analysis. Or, if you are not yet ready to invest, you might want to learn more about the process and have a bit of fun along the way.

The entire staff of Master Investor wishes you a happy and prosperous 2017, and we hope to see many of you at the upcoming Master Investor Show on 25th March 2017. Tickets are available now, just visit http://www.masterinvestor.co.uk/show. Use discount code "MI2017" to snatch a free ticket while they are available to our regular readers.

Best regards,

Swen Lorenz
Editor, Master Investor

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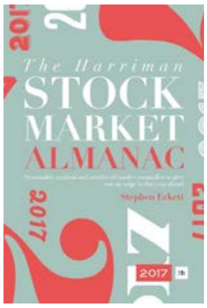

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ALL OTHER TOPICS

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BY JIM MELLON

MELLON ON THE MARKETS

MY OUTLOOK FOR 2017

My family gathered on the Isle of Man for the holiday period, and a jolly time was had by all. The one unpredictable and notorious feature of this beautiful island is the "four seasons in one day" phenomenon, which saw us lurched from lashing rain to bright clear skies in literally a matter of minutes.

And isn't that the story of the markets in 2016? Convulsive gyrations, mostly downwards when the reality of the outcome ran against the conventional wisdom (Brexit, Trump, the Italian referendum); then recovery – and a resumption of the developed world bull markets that have become very long in the tooth, particularly in the United States.

And so we ended 2016 with a positive overall performance by most major indices, but with huge internal rotation on the way. The US dollar has been on a real tear in the Trumpian world, especially as the Federal Reserve has signalled a resumption of interest rate rises for 2017.

Post Brexit, most commentators had a negative view of the markets. There was a strong belief that the apocalyptic pronouncements of the (now derided) cohort of experts, drawn from an army of economists and politicians as well as such luminaries as David Beckham, would be proved right.

Well, surprise, surprise! How wrong they were. And Niall Ferguson, one of the original hand wringers, has had the decency to admit just that!

> **"THE US DOLLAR HAS BEEN ON A REAL TEAR IN THE TRUMPIAN WORLD."**

Although most of these self-declared experts now have the default view of "just you wait and see", they have missed out on a truly huge move upwards in almost all large cap UK stocks, one which carried over to the markets of other major developed nations. Sure, some of that move was due to the positive exchange effect of a falling Sterling (well overdue, Brexit or no Brexit); but much of the move has been due to a realisation that the UK might do quite well out of this after all. Threatening noises from some outright prats in Euroland (M. Barnier comes to mind, along with Herr Martin Schulz and the Prime Minister of Malta (who he, Ed?)) have had little effect on sentiment.

The fact is that the UK economy continues to bowl along quite well. I would wager that 2017 will see another year of circa 2 percent real growth, outpacing all the major European economies for the umpteenth year in a row. I would also forecast that our current account deficit will shrink dramatically, and that inflation will not be anywhere near what doomsayers were projecting – maybe 2 percent. I also pro-

Gino Santa Maria / Shutterstock.com

ject a slight strengthening of Sterling, as the dollar weakens somewhat, and the Euro against the pound also falls. I think the British market is fairly valued, and that investors won't be able to ride a surge as in 2016 – they will have to look carefully for bargains.

The same game was played out post The Donald's election; dire predictions followed by a resumption of bull markets. In each case the paroxysm of anxiety in markets, induced by the collective horror of the liberal elites, was quickly replaced by the reality of President-elect Trump's overall purpose. This is to simplify the ridiculously complex US tax system, to encourage repatriation of offshore cash held by US companies, and to ease the regulatory burden on enterprise. I am sure that the protectionist guff will be toned down, and indeed that new trade treaties will be negotiated, at least in part. I am sure the UK will get a treaty with the US in the immediate post-Brexit period. Within 3-4 years. Considering that the EU didn't manage to negotiate one with the US in the last 50 years, that will be a considerable achievement!

But the good news is now well baked into US prices, which depending on the methodology show the markets to

be somewhere between either ridiculously overvalued or somewhat overvalued. This is especially the case now that the US dollar has risen to 14-year highs against a basket of currencies. This is not a warranted valuation, and while weakness in the yen and in the yuan, as well as in the euro and sterling, might be cheering to their respective central bank chiefs, it isn't justified at these levels.

US earnings are about 50 percent driven by foreign derived income and this will be negatively impacted by the greenback's strength – at a time when earnings were rolling over in any case, partly due to wage pressure.

I have been a big proponent of shorting the yen, but when Evil and I met before Christmas at his local for a small dose of cheer – principally to discuss our shared race horses – we both agreed that the yen's fall was overdone. Sure, the Bank of Japan has been acting like a confetti factory on overtime, but the US isn't Switzerland, and there is a price for everything. The bottom price for the yen has

> **"THERE ARE TWO VERY BIG FAULT LINES IN THE WORLD ECONOMY FOR 2017: THE PERENNIAL ONE IS OF COURSE MY BÊTE NOIR, EUROPE, AND THE SECOND IS CHINA."**

been reached, and I think the US dollar could fall back to 114-115 fairly smartish, which for nimble traders is a good opportunity.

Similarly, I am bullish on the euro at this level. The Eurozone's problem hasn't been one of exports; it has a big current account surplus with the rest of the world, and that will only grow with the multi-year weakness of the euro against the US dollar. The problem for the Eurozone is and has been domestic demand, which remains woeful, particularly in the periphery. There is no end in sight for that, nor is there an easy fix for the Eurozone's banking problems. The euro as a currency will be toast in the relatively near future, and its shape cannot be determined post split-up. But that is at least a year away, and in the meantime, I see a quick bounce in the euro against the dollar to 1.08 from 1.04, and that to traders such as us, is a BIG move.

My friend Steen Jakobsen has highlighted the stresses beginning to show in China, with short-term offshore yuan financing costs spiking, as traders anticipate a devaluation of the Chinese currency. This downturn is exacerbated by very large amounts of capital flight – and this is strongly evidenced by the massive fall in forex reserves at the central bank. One way people get money out of China is via yuan Bitcoin, and that is spiking, too. Tin hats on for this one, as China's problems, while probably containable for the short term, are big. The bad debt situation is dire, and the quantity of debt is almost beyond comprehension.

There are two very big fault lines in the world economy for 2017: the perennial one is of course my bête noir, Europe, and the second is China. Both demand that we as investors remain heavily exposed to gold. Don't worry if it falls a little from here – it's just another opportunity to buy more. I really would be big in gold and silver for 2017; I would remain short bonds, particularly Italian and Japanese bonds; and I would be out of the US market and cautious on markets elsewhere, except for Japan, which has really developed a taste for share buybacks and is still cheap.

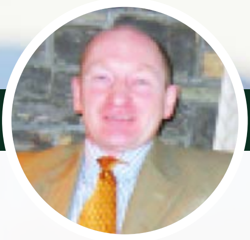
My top stocks for now are **Sony (TYO:6758)**, any Nikkei ETF, any gold ETF, **Billing Services Group (LON:BILL)** in the UK, and **Synergy Pharma (NASDAQ:SGYP)** in the US. My top shorts are almost every bond out there, Amazon (NASDAQ:AMZN), **Facebook (NASDAQ:FB)** and **Plus 500 (LON:PLUS)** in the UK.

People are signing up to the Master Investor Show at a rate of 300-500 a DAY now, so please get your ticket as quickly as possible as it's going to be massive, constructive, educational and fun. It's on 25th March 2017 at the Islington Design Centre in London. I hope to see you there.

Happy hunting!

Jim Mellon

Click here to follow Jim's trades on Twitter



BY VICTOR HILL

OPPORTUNITIES IN FOCUS

AGRIBUSINESS WILL BE THE ULTRA-COOL OF THE 2020s

Farming and food production, long-since a Cinderella business, has just become a cool investment space. This month we look at how to make decent returns from feeding the world.

How a world of 9.6 billion people in 2050 is going to feed itself in an environmentally sustainable and humane way is one of the greatest challenges before us. Food security is about to become a major concern in the UK and elsewhere. I'm talking about the ability to keep a nation of more than 70 million people adequately provisioned in a post-globalisation world of shifting economic allegiances, impediments to free trade and accelerating climate change.

And yet, I'm sensing opportunities. With climate change, in northern latitudes the growing season is getting longer and the variety of crops that can be grown is widening. It's time to lift the veil and explore the exciting world of food production. It can only get more important from hereon in. In fact, economists have been obsessing about food since the dismal science of economics first emerged in the Enlightenment of the 17th century, and even before.

After autarky

The word "autarky" is Greek for self-sufficiency – an idea that goes back to the ancient world. Authoritarian regimes often associate *self-sufficiency* or *self-reliance*, especially where the production of food is concerned, as an essential pre-condition of national freedom. Nazi Germany pursued a policy of autarky in the 1930s under the direction of Hitler's finance minister, Hjalmar Schacht. In today's world the only possible example of a state that pursues a policy of autarky is that last bastion of looney tunes, North Korea. Very few economic statistics for North Korea are available but we know enough about that closed tyranny to say that life for most North Koreans is unutterably awful.

Actually, neither Nazi Germany nor North Korea was a true autarky. Nazi Germany imported foodstuffs from the Balkans and from Scandinavia; while North Korea certainly imports foodstuffs from Russia, China and Iran. But the Nazis sought to put Germany on a war footing and reduced dependency on foreign foodstuffs to an absolute minimum; the North Koreans are in the same mould.

No serious contemporary economist advocates autarky. Trade between countries in foodstuffs is fundamental. (Can you imagine an England that did not import wine? I can't). That said, a high degree of dependence on food imports leaves a country vulnerable to disruptions in supply.

> **"STUDIES SUGGEST THAT PEAK GLOBAL POPULATION WILL BE 10-11 BILLION AROUND 2075."**

Economists and policymakers have been concerned about that vulnerability for some time.

Physiocrats and Malthusians

The French scholar Vincent de Gournay (1712–1759) established the school of ***physiocrats***. This again is a Greek word meaning one who advocates the *government of nature*. **The French physiocrats believed that agriculture, rather than trade and industry, was the source of all wealth.** François Quesnay (1694–1774), in *Tableau Economique* (1758), argued that agricultural surpluses were the core drivers of wealth by flowing through the economy in the form of rent and wages. This later created a debate amongst the neoclassical economists about what drives rent, wages and profits which culminated in David Ricardo's *Law of Rent*. Of course, the physiocrats were writing before the industrial revolution when the largest sector of the economy by far was the agrarian sector.

Thomas Malthus (1766-1834) was an English parson and scholar who wrote the hugely influential work *An Essay on the Principle of Population* (1798). Malthus showed that, barring famine and pestilence, any given human population was likely to grow geometrically and so would double every 25 years. Agricultural output, in contrast, could only grow arithmetically. Therefore, without public action to control fertility (birth control) society was likely at some point to endure mass starvation. Malthus, a clergyman after all, favoured the control of fertility by *abstinence* and *delayed marriage*. Modern so-called *Neo-Malthusians* are keener on contraception. (Interestingly, one of the causes of the decline in fertility rates today is that women are choosing to have children later in life – so Malthus's prediction that *delayed marriage* would come about was not wrong.)

Malthus' work, regarded as eccentric by most modern economists, was massively influential – and not just within the field of economics. Charles Darwin and William Russell Wallace cited it as being critical to the development of their *theory of natural selection*.

Population growth

When Malthus was writing, the population of the world was about nine hundred million. When I was born in the late 1950s it was about two billion. Currently, it is estimated to be 7.4 billion and rising. Fertility rates are declining in advanced countries – in Japan it is down to 1.4 children per woman and in Singapore it is 0.8. But thanks to continuing high fertility in Africa, the world's population will reach 9.6 billion by 2050[i]. The UN is still predicting that it will hit 11.2 billion in 2100, before then declining. Other studies suggest that peak global population will be 10-11 billion around 2075. China's population is set to peak in about 2030[ii].

What is highly probable is that by mid-century the world's population will have increased ten-fold in 250 years. Moreover, with rising living standards, the calorific intake of the average person over that period has nearly doubled. One study suggests that most of the workforce in England and France in 1800 had insufficient food to participate in the labour market[iii]. Hunger was common in Europe even within living memory.

So the amount of food required by 2050 will amount to about twenty times the food required in 1800. Obviously, industrial production will have increased much more than twenty-fold over the same period. The problem is that the world is running out of agricultural land (unless we cut down *more* forests). And water.

Why Malthus was wrong

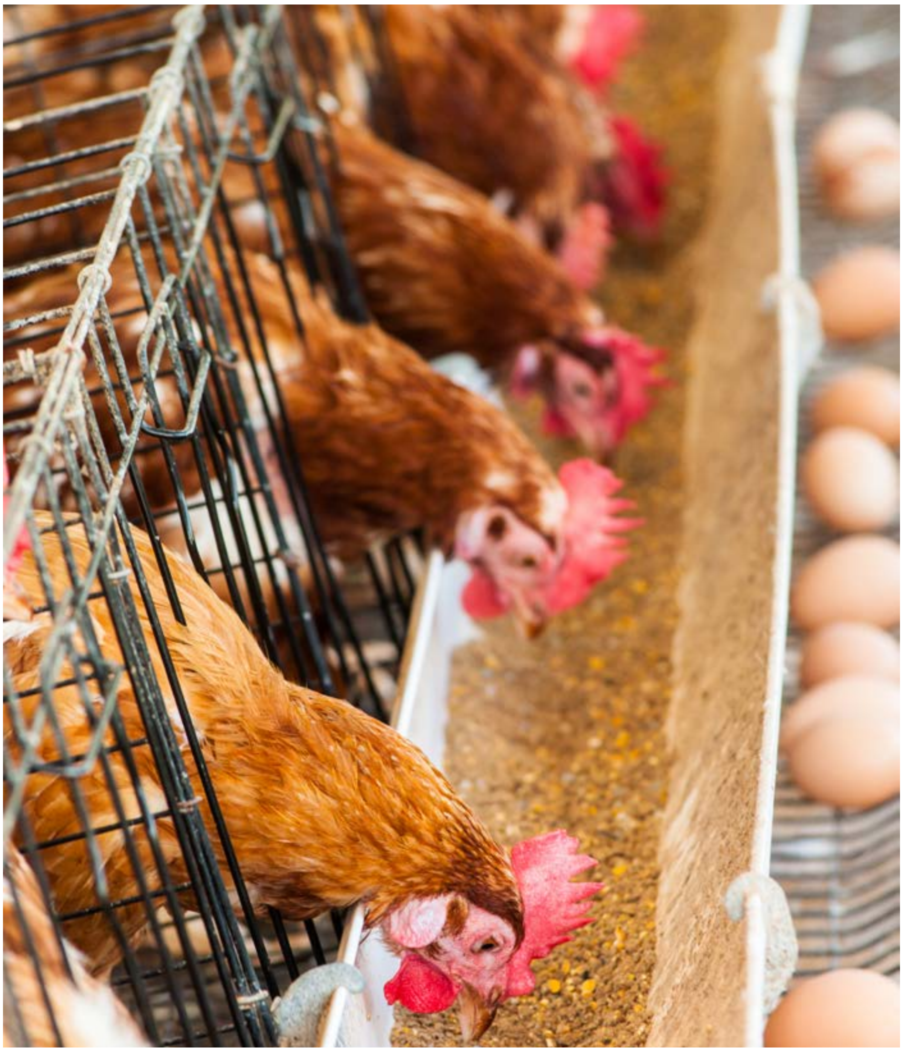
Malthus considered agricultural productivity as a constant and did not foresee that agricultural technology would massively stimulate food production. Even before Malthus, Viscount Charles Townshend (1674-1738) showed how yield could be improved through **crop rotation**. During Malthus' own lifetime, **steam locomotion** revolutionised the distribution of agricultural products. Then, from the last quarter of the 19th century, **chemical fertilizers** (principally synthesised nitrogen, phosphorous and potassium) were widely used to stimulate yields. Furthermore, in the century after Malthus' death, **huge areas were opened up to crop cultivation** for the first time, not least the prairies of the USA and Canada. The growth of international trade then enabled America to become, by the early 20th century, the bread basket of the world.

It is true that some large developing nations, especially China, India and Brazil still experienced food shortages until the early 1960s, since when they have been able to increase food production massively – and now have comparable levels of calorific consumption with Western countries. According to data published by the UN Food and Agriculture Organization (FAO), food supply has been almost constant in America and Europe while it has been rising rapidly in the rest of the world. The rise in the poorer regions of the world means that we are living in a more equal world in terms of food supply. That said, in 2009, the average Indian consumed 2,321 calories per day, as compared with the average American who consumed 3,688 calories per day (nearly 60 percent more).

In terms of the growth of food production overall, the prize must go to China. In 1961 the average Chinese consumed 1,426 calories per day – that's virtually starvation rations for a labourer. By 2009 the figure was 3,036 calories per day. Whatever you may think of the Chinese political system, the fact is that it has succeeded in feeding a population that was until very recently on the breadline.

Key players in fertilizer production

Fertiliser production, which became an important industrial activity in the last quarter of the 19th century, is still a major and growing global industry.



One interesting player in this space is **Uralkali (LON:URALL)** which specialises in the production of potash fertilizers in seven locations in Russia. Its products are exported to over 40 countries. Other global leaders include Germany's **K+S AG (FRA:SDF)** which is the oldest in the world; **Agrium Inc. (NYSE:AGU)** of the USA; **ICL Israel Chemicals (TLV:ICL)**; **CF Industries (NYSE:CF)**; **Yara International (STO:YARO)** – curiously, Norway is the most intensive user of fertilisers per hectare cultivated in the world; **Mosaic (NYSE:MOS)**; and **PotashCorp (TSE:POT)**, the Canadians having the largest producer of all. And don't ignore India's largest fertiliser producer, **Liberty Phosphate (BOM:530273)**.

These companies are classic mature commodity companies, offering relatively little product diversification. You may expect their shares to offer slow capital gains but consistent, and sometimes generous, dividends. That said some fertiliser producers are doing better than others.

Modern technical advances

In the modern world (that is, since 1945) agricultural yields have been increased further by **intensive farming** techniques. These techniques rely on various types of mechanisation, assisted in the last two decades by the power of computer processing and associated technologies. Grain farmers in advanced countries now sow seed using tractors assisted by GPS networks and harvest the crop having surveyed them with drone-powered photography. Also, we should not forget the benefits of improved weather forecasting which helps farmers to sow and reap in optimal weather conditions.

The intensive farming of animals – for example, poultry – has raised ethical concerns and, increasingly, fears about the nutrient content of the meat. In countries like the UK, animal welfare policies are firmly in place; but there are costs associated with this. Even within the EU, ethical producers with high standards of animal welfare compete with imported products from countries with much more lax standards. There are many organisations and websites which are dedicated to this important issue.

The rise of GMOs

The other field that has been harnessed in the fight to feed the world is that of genetics. Genetically modified organisms (GMOs) to date, let us remember, largely encompass various types of seeds and grains.

There are a relatively small numbers of key players in this space. **Monsanto (NYSE:MON)**; **Syngenta (VTX:SYNN)**; **Pioneer**, a subsidiary of **Du Pont de Nemours (NYSE:DD)**; and **Groupe Limagrain** (a private French company) are amongst the global leaders in GMO seed production and distribution. **Monsanto** is reckoned to control about one quarter of global *proprietary seed* production.

Many people still oppose GMO seeds and crops on account of fears about the long-term effects on the ecosystem as a whole; but there is evidence that such fears are subsiding amongst consumers. (Honestly, how rigorously do you check the labels of the food that you buy?) But there is another, in my view more serious, objection to GMO seeds and grains.

This is that, in America and elsewhere, the Government has given corporations like Monsanto the right to patent GMO seeds. And these seeds are usually sterile. That means that farmers, instead of planting seeds and keeping part of the crop for next year's season, have to re-buy each year from the same seed supplier. Such patented, sterile seeds are called *proprietary seeds*.

According to Context Network, the *proprietary seed* market now accounts for 82 percent of the total commercial seed market worldwide.

Now I know that this is controversial but there are now even some *genetically modified animals* out there as well as seeds – though they currently are at an early stage and do not yet represent a significant proportion of the food we consume. **AquaBounty Technologies Inc. (LON:ABYU)**, for example, has created a breed of salmon which can grow twice as fast as typical farmed fish, despite having the same odour, colour, texture, and flavour of normal salmon. They have done this by implanting the growth hormone of the Chinook salmon into the genome of the Atlantic salmon[iv]. This product has yet to be approved by the US Food and Drug Administration (FDA) and, if that approval were granted it would have to be labelled in the USA as a genetically modified animal. How consumers will respond to such labelling remains to be seen.

"IN AMERICA AND ELSEWHERE, THE GOVERNMENT HAS GIVEN CORPORATIONS LIKE MONSANTO THE RIGHT TO PATENT GMO SEEDS."

The relentless rise in crop yields… is slowing

The rising middle classes of China and India are eating more meat. This is happening at a time when the world is

dedicating more farmland for biofuels (especially in the USA) while attempting *not* to cut down forests (which exacerbates climate change). Therefore, the world's farmers need to continue to boost yields – the tonnage of grain produced per hectare – as they have done over the last one hundred years or more thanks to synthetic fertilizer, pesticides and modern agricultural techniques.

Unfortunately though, there is a problem. A recent peer-reviewed study in the journal PLOS ONE[v] found that **crop yields have not been rising fast enough**[vi]**. At the current rate of increases in yield, production of rice, maize, wheat and soybean will be insufficient to meet demand by 2050.** There are even some important wheat producers (Ukraine, Australia and parts of India) where yields have been flat-lining. Some agronomists talk about a biological *wall* beyond which yields cannot be pushed. Furthermore, the effects of climate change such as the extreme heat waves and droughts that have afflicted Australia in recent years could send crop yields into reverse.

Jonathan Foley, an agro-economist at the University of Minnesota has argued that we will have to approach the problem in a five-pronged strategy[vii]. Firstly, we should abandon bio-fuels and use the land for food production. Second, we should focus on boosting yields most in those countries where yields are already below average – that means Africa. Third, we must concentrate on how to use water and fertilizer more efficiently. Fourth, we should consciously reduce our consumption of meat (vegetarians will approve of that one). Fifth, we must address the scandal of food waste.

Food waste is becoming an important policy issue. In the UK we throw away about 10 million metric tonnes of food a year, 60 percent of which is thought to be entirely avoidable. That's £700 per family[viii] according to a government body. **An economist would say that the high level of food waste suggests that food is under-priced.**

However, the technological optimists have not given up yet. The journal *Nature*[ix] reported last month that scientists at **Oxford University** and **Rothamsted Research** have developed a crop spray that can boost wheat yields by 20 percent by helping crops to use sugar more efficiently. The spray contains a molecule which stimulates the production of sucrose, which naturally occurs during photosynthesis. This technology shows great promise: someone in agro-chemicals is going to make a killing. We shall watch this space.

"AT THE CURRENT RATE OF INCREASES IN YIELD, PRODUCTION OF RICE, MAIZE, WHEAT AND SOYBEAN WILL BE INSUFFICIENT TO MEET DEMAND BY 2050."

The myth of *organic* food

Foods, especially vegetables, which are cultivated with very low levels of fertiliser and pesticides, are usually labelled as *organic*. But the idea that organic food is good for the planet is a myth. Why? Because cultivating organic foods requires more land. That means cutting down more forest – particularly rainforest in developing countries. That, in turn, results in higher greenhouse gas emissions than conventional farming.

Farming is the second source of greenhouse gasses worldwide, a close second to electricity production. And while we can cut emissions from electricity production by converting to alternative sources (wind and solar power) or to nuclear energy, it's not so easy to cut emissions from farming.

True, organic farms support a greater diversity of flora and fauna, but only at the price of taking up more valuable land because their yields are much lower. Paradoxically, therefore, the surest way to cut greenhouse gas emissions from farming is to continue down the road of increasing crop fertility by judicious genetic modification. What we need are crops that can capture more of the sun's energy and thus require less fertiliser. We also need crops that will be more resilient to drought. You can be sure that Monsanto and its peers (see above) are working on it. But the organics industry will have none of this. On 18 November the *US Organic Standards Board* voted unanimously against gene-edited crops[x].

It has also been contested that organic food is better for your health. Of course, the animal welfare aspect is still important for livestock and poultry. The labelling is confusing here as *organic chicken* might mean battery chicken fed on GM-free feed. The main concern for consumers, it seems to me, should be the condition of the animals rather than their feed.

Nor does an organic label guarantee profit. In the USA right now **United Natural Foods (NASDAQ:UNFI)** which specialises in organic grain has been struggling to deliver returns for shareholders thanks to flagging sales.

Upstream and downstream food production

The oil industry is divided by analysts into upstream (explorers and drillers) and downstream (refiners and distributers). Similarly, we can divide the food industry into its upstream (farmers) and downstream (food manufacturers, processors and packagers; and retailers). In a world where government policy was focussed on cheap food, farmers were subsidised either by direct payments (as under the EU's Common Agricultural Policy (CAP)) or favourable tax concessions – or both. For example, in the UK, farmland is not subject to inheritance tax, and farmers can run farm vehicles on cheap *red diesel*.

But the main beneficiaries of cheap food have in fact been the downstream food producers who have been able to buy cheap commodity ingredients (grain etc.) and turn them into branded products commanding huge value added. Some food companies have become massive multinational corporations. And then there are supermarkets, with huge oligopolistic buying power, which can add significant additional margins on top.

Back to the land: the future of farm subsidies

One of the great imponderables of Brexit will be the shape of the farming regime that emerges in the UK after we leave the EU. Mrs May's government moved quickly to reassure farmers that whatever subsidies were provided by the EU under the CAP would be replicated by DEFRA[xi]. But there are those who believe that farming subsidies are a relic of the past and distort the market for foodstuffs.

New Zealand, which has a larger agricultural sector than either the UK or the US relative to the economy, all but abolished farming subsidies in 1984. Agricultural practices thereafter were driven by the demands of consumers, not by efforts to maximize subsidies. At the same time, the whole agricultural supply chain improved efficiency. Food safety became paramount. Businesses that supply farmers in New Zealand have had to reduce their costs because farmers have insisted on better value-for-money. More efficient agricultural production in New Zealand has also spurred better environmental management. The previous overuse of fertilizer has been checked. And cutting subsidies has broadened farm operations to stimulate spin-off activities such as rural tourism.

In the EU and America and across the OECD generally, farm subsidies as a percentage of total farm revenues has been in decline, though the reverse is true in China, Russia and Brazil[xii]. There will be a major opportunity post-Brexit to reappraise the entire farm subsidy regime in the UK. One objection to cutting farm subsidies will be that food prices, in the short-term at least, would be likely to rise, making them less competitive vis-à-vis imported foodstuffs. That might be an argument for imposing tariffs on imported foodstuffs from countries where farm subsidies are rampant in order to create a level playing field. Note that *export subsidies* on agricultural products were effectively outlawed by the WTO deal of December 2015.

The new scramble for Africa

Some global players have been working on food security for some time. In 2011 the **Oakland Institute** reported that hedge funds and other investors had bought or leased nearly 60 million hectares of land in Africa – an area the size of France. They are not alone. Numerous sovereign wealth funds have been buying huge areas of agricultural land in Africa. The Qataris, the Saudis, the Chinese and the Koreans have all brought agricultural land in Africa or secured exclusivity agreements with African landowners to purchase all of their output.

The particular appeal of Africa is that it accounts for about 60 percent of the world's arable land, yet most African countries do not even achieve 25 percent of their potential yield. In her book *Will Africa Feed China?* China expert Deborah Brautigam shows that China actually exports more food to Africa than it imports at present; but that state-owned Chinese agribusinesses are well placed to profit from the forthcoming boom in African agriculture.

According to the International Food Policy Research Institute (IFRPI), for many years agricultural production in Africa failed to keep pace with population growth. That has now been reversed. Examples of success are cotton production in Mali, and horticultural exports in Kenya. These successes have been largely driven by the systematic application of modern farming techniques. Further, soil and water conservation initiatives in many countries have mitigated declining fertilizer subsidies. Effective pest control and animal vaccination have also boosted yields. **And African farmers have been much less timid about using GMOs than their European counterparts.**

The growth of Kenya's horticultural exports, like South Africa's fruit exports, has been supported by the growth of cheap and frequent air freight cargo to Europe and beyond – the same flights that ferry tourists back and forth.

I am not persuaded that deals done between Chinese and Qatari investors in African land are unfair (though I suspect that African rulers have benefited more than the ruled). However, we should be aware that these sources of food are likely to be closed to us in times of international crisis.

Leading global food producers exhibit longevity

Our continental European and American friends are not only good at growing food but also at creating branded food products.

“AFRICAN FARMERS HAVE BEEN MUCH LESS TIMID ABOUT USING GMOs THAN THEIR EUROPEAN COUNTERPARTS.”

Alf Ribeiro / Shutterstock.com

Nestlé SA (VTX:NESN) has its head office at Vevey, and on the opposite (French) side of Lake Geneva, **Danone's (EPA:BN)** mineral water business is located at Evian-les-Bains (though the company's HQ is in Paris). **Nestlé**, the world's biggest food company, had revenues of CHF88.8 billion last year band has a market cap today of around CHF225 billion. **Danone's** sales revenues were about €22.5 billion last year and it currently has a market capitalisation of over €40 billion. When we think of Nestlé we think of a certain instant coffee; yet it is a firm with hundreds of international food brands: it is even the largest producer of baby food in developing countries.

Unilever (LON:ULVR), the Anglo-Dutch multinational headquartered in Rotterdam, is ranked eleven on the list of global food producers[xiii]. Unilever's many food brands include *Flora* margarine, *Hellmann's* mayonnaise, *Knorr* sauces, *Lipton's* tea, *Magnum* ice cream and that iconic British love-or-loathe comestible, *Marmite*. **Kraft Heinz (NASDAQ:NHC)** is of a similar size and was formed 17 months ago by the merger of two US food behemoths. **3G Capital** and **Berkshire Hathaway** invested US$10 billion in the deal. In 2015 **Kraft Heinz** had 13 different brands with US$500 million or more each in annual sales.

The largest native UK food producer, ranked at 47 in the global league, is **Associated British Foods (LON:ABF)**. This company is probably most famous for its ownership of **Primark**, a high street phenomenon which accounts for about a third of ABF's group sales but nearly a half of its operating profits. **ABF** is a diversified group of food, ingredients and retail businesses. ABF's Grocery division is a cornucopia of well-known British food brands. British consumers sip *Twining's* at tea-time and brew *Ovaltine* before bed. They start the day with *Jordan's* cereals and toast made with *Kingsmill* bread. They make curries and stir-fries using *Patak* and *Blue Dragon* sauces. They fry eggs in *Mazola* corn oil and snack on *Ryvita*. Baking enthusiasts use *Silver Spoon* sugar and *Billington's* unrefined cane sugar in their cakes.

Many of these food companies produce other branded goods. For example, **Unilever** produces household products and toiletries. **Nestlé** and **Danone** are competitors in mineral water, which vies for the title of highest value-added product of all time. So they would not necessarily suffer from an increase in commodity prices.

Conclusions

The age of cheap food is coming to an end. Agricultural commodity prices are likely to rise with increasing demand, slowing growth in crop yields, and, potentially globally, a less favourable farm subsidy regime. **The global population is growing faster than food production.** Available land to turn over to agriculture, for the first time in history, is running out. This is what economists call a capacity problem. We cannot afford to cut down more forest as this will only destroy more wildlife habitat and accelerate climate change.

All this will benefit landowners (as agricultural rents will rise) and farmers (as agricultural prices rise). Changes to the subsidy regime in the UK could be accompanied by protection of some

"THE AGE OF CHEAP FOOD IS COMING TO AN END."

UK food products behind tariff barriers if Brexit negotiations go in the direction I anticipate. The demand for fertiliser and GM seed will also continue to rise. Food producers, who buy commodity products, process them and sell on as branded products, may experience downward pressure on margins.

I don't say all wealth comes from agriculture, as the physiocrats did; but investors – and politicians – need to take food more seriously. ***We are all Neo-Malthusians now.***

Action

I have already highlighted a number of key listed companies active in **fertilisers**, **proprietary seed production**, and **branded foods**. And I have recently written about buying farmland in the UK. But let's not forget Africa.

For larger-ticket investors and institutions there are numerous funds buying and operating farmland in Africa, but I shall just mention one. In 1997 David Murrin, polymath author of *Breaking the Code of History* (2011) founded Emergent Asset Management Ltd, now **EmVest**.

EmVest manages the **Emergent African Land Fund**, a private equity fund which buys and manages agricultural land in Africa, with projects in Mozambique, South Africa, Swaziland, Zambia and Zimbabwe. The fund has target returns of 20 percent per annum.

i See: http://www.un.org/apps/news/story.asp?NewsID=45165#.WFPR6lyZmDZ
ii All figures in this paragraph are from *What if we hit peak population?* By Fred Pearce, New Scientist, 19 November 2016, page 42.
iii See: Food Per Person by Max Roser, available at: https://ourworldindata.org/food-per-person NB: Moser draws on findings by Fogel (2004), *The Escape from Hunger and Premature Death, 1700-2100: Europe, America, and the Third World.* According to Roser, daily calorific intake in France rose from 1,846 Kcal per day in 1800 to 3,531 in 2009.
iv See: http://www.enkivillage.com/genetically-modified-animals.html
v Available at: http://journals.plos.org/plosone/article?id=10.1371/journal.pone.0066428
vi See: https://www.washingtonpost.com/news/wonk/wp/2013/07/01/this-unsettling-chart-shows-were-not-growing-enough-food-to-feed-the-world
vii His 2009 article in Scientific American is available at: http://www.geog.psu.edu/sites/default/files/Scientific%20American%20Article.pdf
viii See the WRAP (Waste and Resources Action Programme) website at: http://www.wrap.org.uk/content/uk-handy-waste-facts-and-figures-retail-sector
ix The research paper is available at: http://www.nature.com/nature/journal/vaop/ncurrent/full/nature20591.html
x See: *Care about the Earth? Ditch organic food* by Michael Le page, New Scintist, 03 December 2016, page 21.
xi Department for the Environment, Food and Rural Affairs, located in Whitehall.
xii See OECD table at: http://www.oecd.org/newsroom/agriculturesupporttoagricultureathistoriclowsoecdsays.htm
xiii See: http://www.foodengineeringmag.com/top-100-food-&-beverage-companies-2015

BY TOM STEVENSON, INVESTMENT DIRECTOR, FIDELITY PERSONAL INVESTING

2017: A WATERSHED YEAR FOR INVESTORS?

The most dangerous words in investment are 'this time it's different'. It rarely is. History may not repeat itself but it does rhyme. And markets revert to the mean.

That said, I believe 2017 really will serve up a change of direction after the long slog out of the financial crisis of 2008. The dramatic reversals of expectations last year – Brexit and the US Presidential election, in particular – make this feel like a watershed for investors.

Investors have moved swiftly to place their bets on a very different investment backdrop during the next four years. A number of themes are emerging.

The first is that the lower-for-longer period of secular stagnation that has characterised recent years is drawing to a close. In its place will come a greater focus on growth, with fiscal policy stepping up to the plate to support monetary accommodation, which has done all the heavy lifting – up until now.

More spending, tax cuts and deregulation will provide an equity-friendly backdrop but could flash red lights for bond investors because they will bring with them higher public debt, a wider budget deficit and inflation.

The deflationary ice-age since 2009 has been good for fixed income. The new world will be good for shares. It may be overstating it to say the 30-year bond bull market is over – because plenty of uncertainty remains and investors are still searching for reliable yield – but I expect equities to outperform bonds usefully in 2017.

The other themes are related to this growth narrative. First, I expect to see a more rapid normalisation of interest rates in the US than was expected throughout last year. More fiscal stimulus takes the pressure off the Fed to boost the economy and December's rate hike will be the first of several this year.

> **"THE LOWER-FOR-LONGER PERIOD OF SECULAR STAGNATION THAT HAS CHARACTERISED RECENT YEARS IS DRAWING TO A CLOSE."**

With other central banks adopting a much more cautious stance, I expect the US currency to strengthen further in 2017. That is historically bad news for emerging markets, especially those with dollar-denominated debts. Any slow-down in global trade, if President Trump delivers on his protectionist campaign rhetoric, will also favour a more closed economy like the US.

Another theme that I expect to continue through 2017 had actually started before Brexit and the Trump growth story emerged as key market drivers. However, more populist policies will accelerate the shift from defensive sectors like consumer staples and utilities towards more economically-sensitive, cyclical sectors like retail and financials.

Banks, in particular, should be beneficiaries of faster growth, deregulation and steeper yield curves. When the yields on long-dated bonds rise faster than those on short duration paper, banks are able to capture the margin in the middle more effectively.

Equities will not be the only story in 2017. The search for yield will continue in 2017 as interest rates remain low by historical standards. That argues for commercial property, which is a great source of income and provides diversification to a balanced portfolio. Rents are growing as occupier demand increases after years of too little development. In a low-rate environment, total returns in the mid-single digits will look attractive.

As for commodities, expect a mixed bag. A stronger dollar would ordinarily be a headwind for the asset class. But the Saudis and others in OPEC have clearly tired of trying to put Shale oil out of business. Recent co-ordinated output cuts mean oil looks better supported than at any time in the past two years.

So there's plenty to be optimistic about in 2017. My biggest worry is that the growth story is such a consensus trade. The time to be concerned is when no-one else seems to be. A well-diversified portfolio of well-managed funds, such as those in Fidelity's *Select 50* list is the answer in this positive but uncertain environment.

See the Select 50 list: SELECT 50 >>

www.fidelity.co.uk 0800 41 41 28

>> Look out for my 4 fund picks for 2017 in next month's edition

Please note that the value of investments can go down as well as up. This information, and the select 50, are not personal recommendations for any particular investment. If you are unsure about the suitability of an investment you should speak to an authorised financial adviser. Past performance is not a guarantee of future returns.

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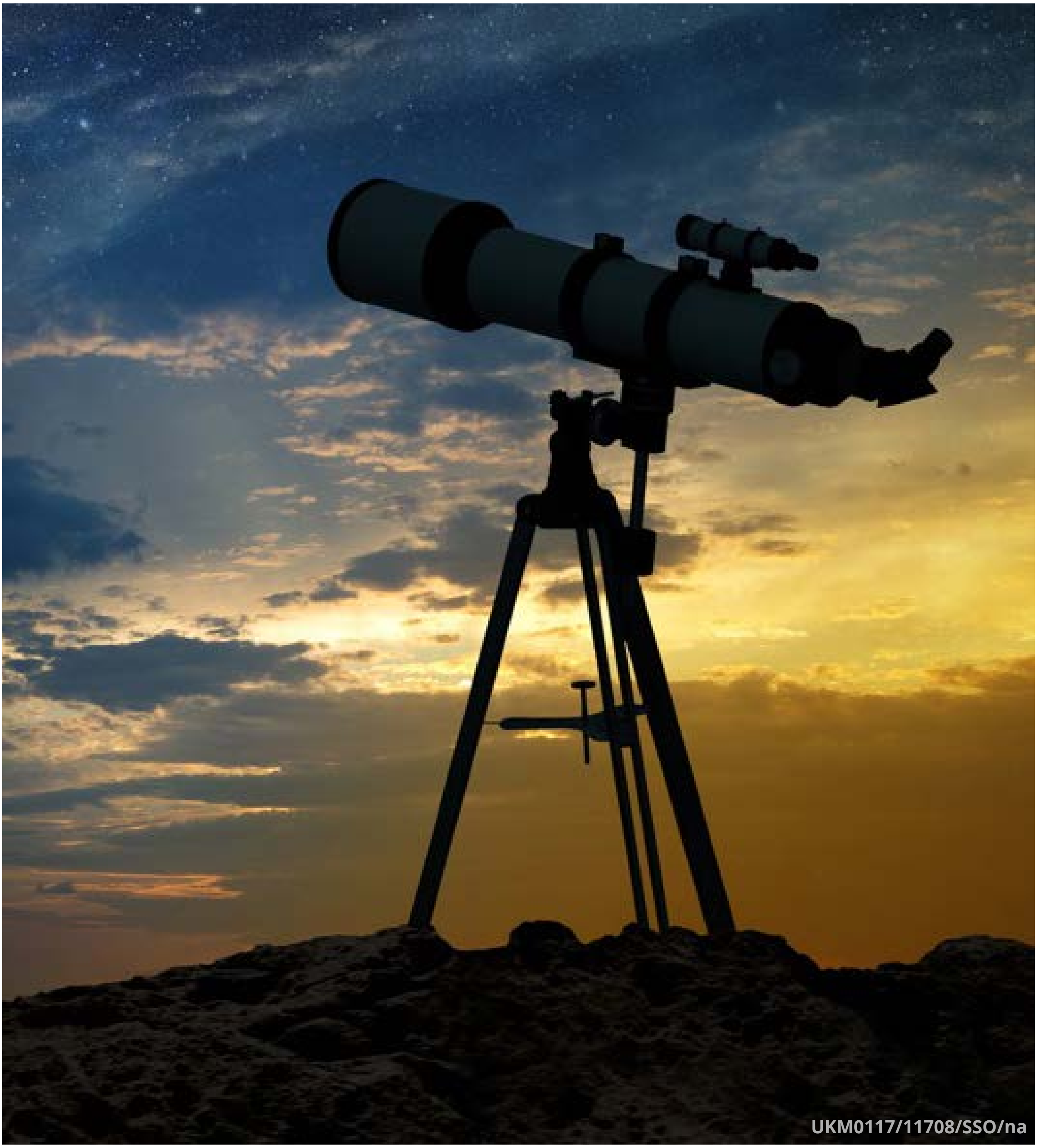

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BY JOHN KINGHAM

THE DIVIDEND HUNTER

IS NATIONAL GRID THE ULTIMATE LOW-RISK DIVIDEND STOCK?

National Grid PLC (LON:NG.) has been in the news recently after announcing an agreement to sell most of its UK gas distribution business. For some inexplicable reason I was watching CNBC that morning and the presenter said something along the lines of "surely income investors can't go far wrong with National Grid's 4.7% dividend yield". And yes, I must admit that a 4.7% yield (at a share price of 930p) from what is perhaps one of the most defensive companies in the FTSE 100 does sound interesting. So interesting, in fact, that I decided to take a closer look. And this is what I found...

A state-anointed monopoly provider

If you ask most people what the UK national grid is, they'll probably say something about it being the electricity grid; a network of pylons, cables, transformers and other such infrastructure which enables the transmission of power from power stations to homes and businesses around the country. That's a reasonable description, and National Grid, the company, owns and operates that infrastructure. If you also include the transmission and distribution of gas in that description, as well a significant and similar business in the US, then you'll have a fair summary of what the company does, but what makes National Grid special is its position as a legal monopoly.

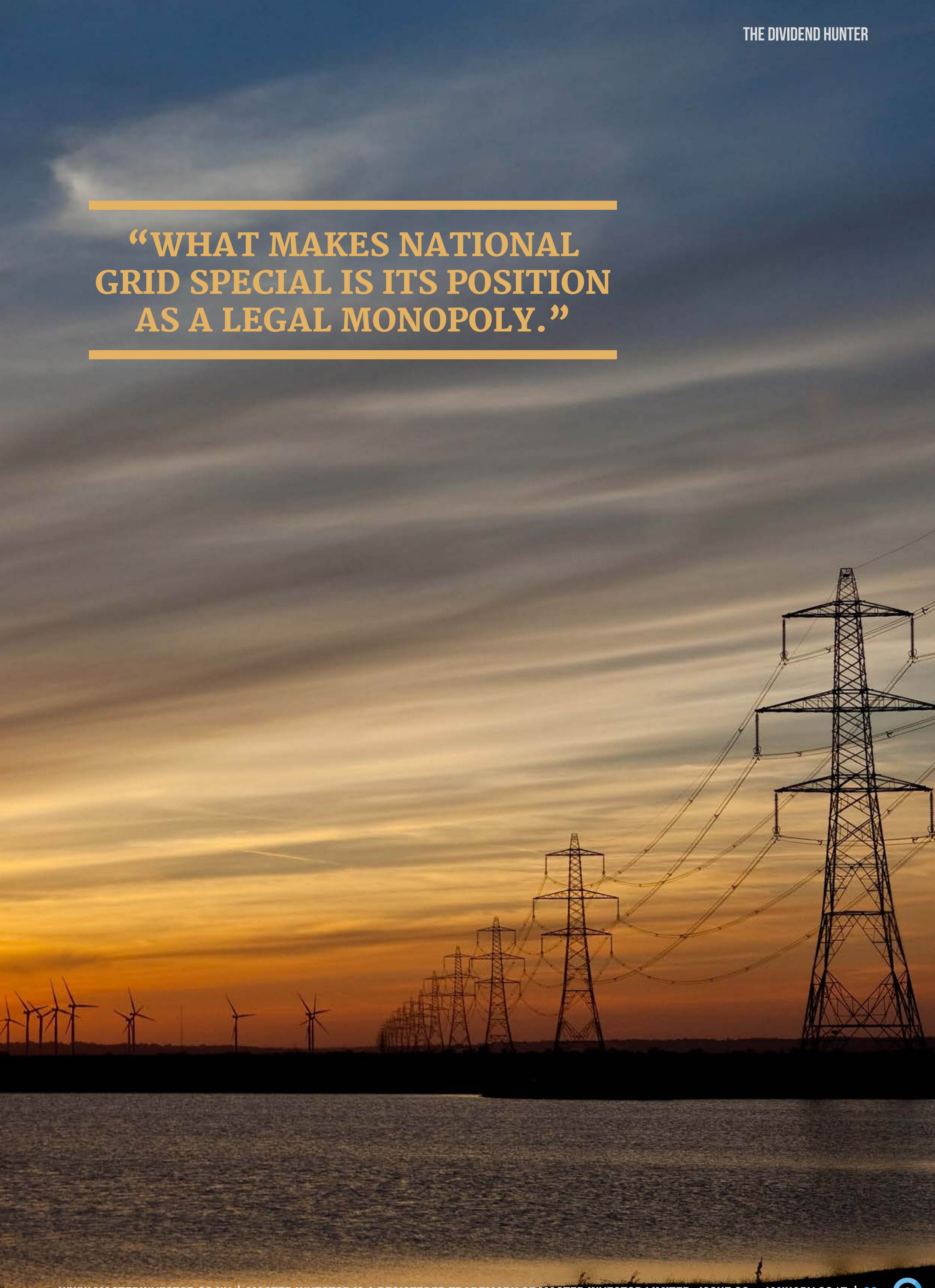
It's a monopoly because it's difficult to foster competition in the supply and operation of relatively fixed and expensive transmission systems like the electricity, gas or rail networks. So rather than rely on competition between firms to provide the infrastructure for low cost, sustainable and secure energy, the UK and US governments instead allow National Grid to operate as a highly regulated monopoly, with strict rules, incentives and penalties covering many aspects of its business.

One example of this regulation is Ofgem's RIIO model (Ofgem is the UK regulator and RIIO stands for Revenue = Incentives + Innovation + Outputs). Under this regulatory model, there are strict rules about what revenues and rates of return National Grid can generate from its "regulated" assets. There are incentives for outperforming targets, such as completing projects ahead of time or exceeding service level agreements, and penalties for underperforming. This is a type of competition, but against regulatory targets rather than other companies.

This is a very unusual setup, so how has it worked out for National Grid over the last few years?

Progressive, well-supported dividend growth

As you might expect, building, maintaining and managing the electricity and gas network is a very defensive business. Booms and busts may come and go, but people still need to



> **"WHAT MAKES NATIONAL GRID SPECIAL IS ITS POSITION AS A LEGAL MONOPOLY."**

cook, heat their homes and boil their kettles. So it should come as no great surprise that the financial crisis had relatively little impact on the company or its progressive dividend.

Another positive feature, as the accompanying chart shows, is that National Grid's revenues and normalised EPS (earnings per share) have also been increasing, more or less in line with the dividend. This is good news because without revenue growth there can be no long-term earnings growth, and without long-term earnings growth there can be no long-term dividend growth.

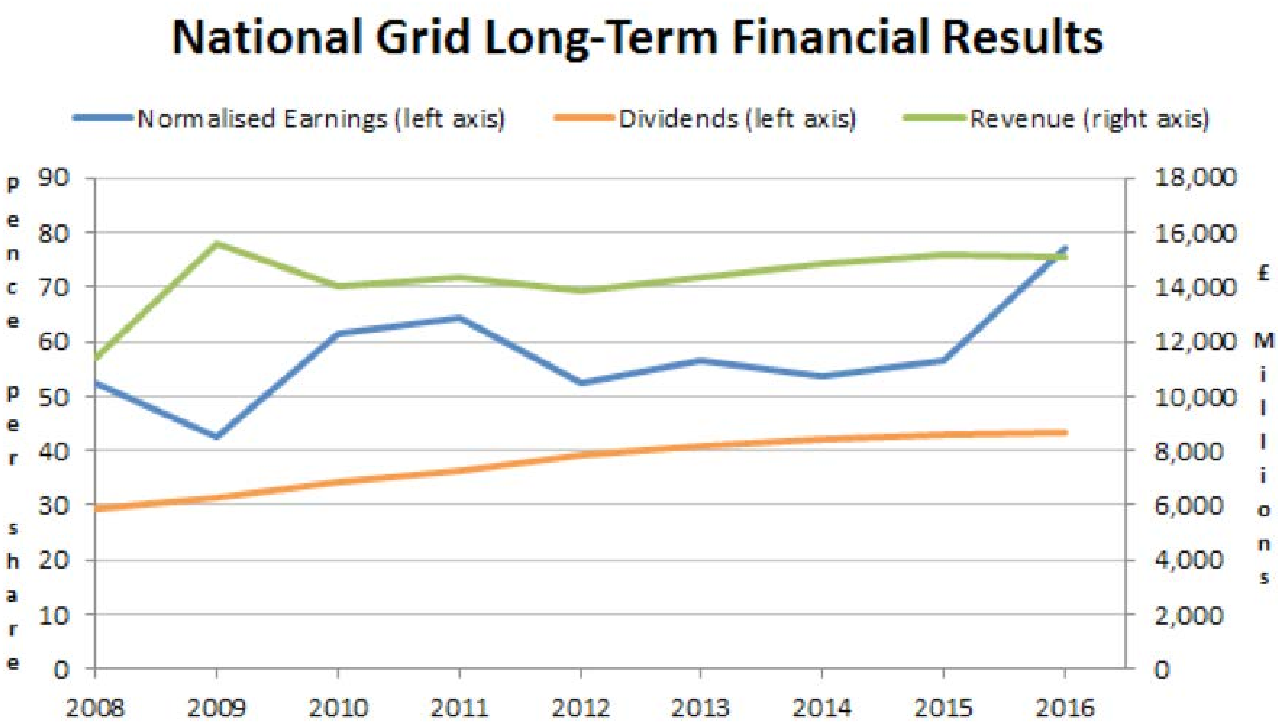
Using the approach to measuring long-term growth that I outlined in last month's issue, National Grid's revenue growth rate was 1.6% per year, its EPS growth was 3.0% per year and its dividend per share growth was 5.1% per year. That gives the company an overall long-term growth rate of 3.3% per year, which is just slightly above the rate of inflation. It's also faster than the FTSE 100's growth rate over the same period of 2.0% per year.

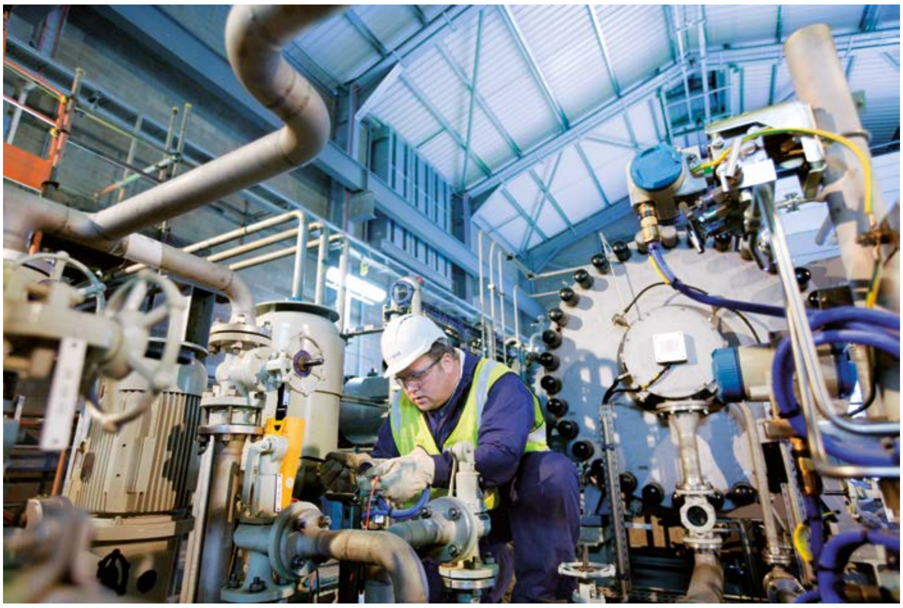
In summary then, we have what appears to be a very low risk company, with a dividend yield of 4.7% and a historic dividend growth rate of 5.1%, which is a very attractive combination. However, in recent years its dividend growth has tailed off. It was running ahead of revenue and earnings growth, so perhaps future dividend growth will be somewhat lower than in the past. Even assuming a future dividend growth rate in line with the company's historic overall growth rate of 3.3% leaves the shares with a yield-plus-growth total return estimate of 8.0% per year (4.7% yield + 3.3% growth). That's slightly above the UK's long-term equity rate of return of about 7% per year, assuming inflation at 2%.

At this point in the analysis I would say that National Grid still looks interesting, especially if you want a good yield with some growth and low levels of risk. But of course there are more factors to consider. For example, National Grid is an infrastructure business and so I would like to know how much cash the company has to continually invest into fixed capital assets in order to keep the UK's lights on and drive future growth.

Massive capital expenditures which are growing all the time

In a nutshell, National Grid is a capital-intensive business. Over the last decade it invested more than £3 billion pounds per year into fixed capital assets, which is more than its average post-tax profits of £2 billion per year.





For most companies this would be a warning sign because companies that have to constantly invest large amounts into capital assets tend to be riskier. Specifically, they are more at risk from inflation and cyclical downturns. In fact one of my investment rules is to be especially wary of companies where average capital expenditures (capex) are greater than average profits, as they are for National Grid.
Another warning sign is the company's high ratio of capex to capital asset depreciation. Very simplistically, depreciation can be thought of as the amount of money a company needs to invest in new capital assets each year to replace existing assets as they wear out. If a company's capex is significantly higher than depreciation then its capital asset base is probably expanding rapidly.

> "WE HAVE WHAT APPEARS TO BE A VERY LOW RISK COMPANY, WITH A DIVIDEND YIELD OF 4.7% AND A HISTORIC DIVIDEND GROWTH RATE OF 5.1%, WHICH IS A VERY ATTRACTIVE COMBINATION."

That can be a problem because a rapid increase in productive assets will usually result in a rapid increase in supply. If supply increases faster than demand then prices are likely to fall, which could reduce profit margins and the profitability of all those new and expensive assets. This effect, which is part of the capital cycle, is compounded when massive investment in new assets has been widespread throughout an industry (think of excessive expansion in supermarkets, miners or oil and gas companies, and what that expansion eventually did to supply, prices and profits).

Over the last few years National Grid depreciated its capital asset base by an average of £1.3 billion each year. That's less than half of the £3 billion it pumped into those assets, so it's adding one or two billion pounds-worth of additional fixed assets each year. That is confirmed in the latest annual report, which shows total regulated assets growing from £31 billion in 2012 to £40 billion today. This triggers another of my investment guidelines, which is to be wary of a company if its average capex is more than twice its average depreciation.

If National Grid were any other company I would set it to one side and make a note saying something like "Requires massive capital investment and has potentially over-invested in new assets and supply which could lead to lower future profitability." However, National Grid is a state-appointed monopoly and so the normal rules do not apply.

For example, although the company is very capital-intensive, it is unlikely to be at risk from a cyclical downturn because people will always need energy, almost regardless of the economic environment. In the case of inflation, if the company needed increasing amounts of cash in order to fund future investment (at higher prices thanks to inflation) then the government could decide to increase its allowed regulatory revenues and profits, effectively guaranteeing its ability to fund that future investment.

As for the rapidly growing asset base, this is not caused by a CEO who is chasing short-term gains to boost the share price and the value of their pay packet (but which will eventually lead to massive oversupply and a collapse in prices and profits). Instead, this huge investment in assets is effectively a demand from the UK government to create the smart grid of the future, where renewable sources of electricity can be connected to the grid at massive scale along with vast numbers of electric vehicles.

Because of these and other related factors, I am much more relaxed about the incredible scale and pace of National Grid's capital investment than I would be if it were any other company. But that isn't the end of the story, because National Grid has even more features which would normally make me run a mile, and chief among them is its enormous debt pile.

Borrowings which would hobble almost any other company

National Grid's purpose is to raise as much capital as is required, as cheaply as possible, and to invest that capital into the electricity and gas networks in order to maintain the power grid of today and to build the smart grid of the future.

The cost of debt capital is lower than the cost of equity capital, so it makes sense to issue bonds rather than shares when additional capital is required for investment. However, issuing too much debt is risky because a downturn might lead to smaller profits and an inability to pay debt interest, at which point lenders may force the company into bankruptcy in order to seize its assets. So most companies have debts which are only a few times greater than their average profits, and generally I won't invest if a company has debts of more than five-times average profits.

But once again, National Grid tramples on that sort of conventional thinking. In its last annual results it had total borrowings of £28.3 billion, almost 13-times greater than its recent average profits of £2.2 billion. Just as exceptional are its net interest payments of just over £1.1 billion. Such overwhelming debt obligations would usually be a disaster waiting to happen, but with this company's monopoly position it somehow makes sense.

After all, the whole point of the company is to raise and deploy vast amounts of capital cheaply and effectively on behalf of the government and citizens of the UK (and to a smaller extent, the US). Debt capital is cheaper, so it makes sense to raise as much debt capital as the company can sustainably manage. The government knows this, and so it designs the market as a monopoly where National Grid can generate long-term revenues and profits that are far more certain than those of other companies. This certainty makes the banks happy, and so they are willing to lend National Grid unusually large amounts of money at low interest rates, which reduces the company's average cost of capital. That lower cost of capital then feeds through into lower costs for the smart grid, which is what the government wanted all along.

"NATIONAL GRID CAN GENERATE LONG-TERM REVENUES AND PROFITS THAT ARE FAR MORE CERTAIN THAN THOSE OF OTHER COMPANIES."

So despite its voracious appetite for capital and its eye watering debts, I don't think National Grid is a basket case. On the contrary, I think there's a good chance it will meet its stated policy of growing the dividend at least in line with RPI inflation, for many years and possibly decades to come.

One for super-cautious income investors

With its yield of 4.7% and future growth rate potential of perhaps 3.3% (a reasonable estimate based on past growth), I quite like National Grid. It isn't flashy, it isn't going to make anyone rich (perhaps apart from the CEO), but it will probably deliver the goods in terms of a steady, long-term, inflation-beating income.

However, that yield and growth together give an estimated long-term total return of just 8.0% per year and personally I like to aim for double digit returns. So National Grid's share price of 930p isn't low enough to get me to invest, but if the share price fell to 750p then the yield would increase to around 6% (as it is for SSE PLC, which I already own) and at that point I might jump onboard.

On the other hand, if you would be happy with a 4.7% yield and good prospects for inflation-beating income growth, then National Grid is definitely worth considering at around 930p.

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 JAMES FAULKNER

AN INTERVIEW WITH

SCOTT GRANT

DIRECTOR & BUSINESS LEADER AT LONDON SOUTH EAST

lse.co.uk has established itself as the UK's leading financial information platform for private investors and day traders. In the following interview, MI Editorial Director James Faulkner catches up with its Business Leader Scott Grant to discuss what makes lse.co.uk so indispensible for investors...

James Faulkner: Hi Scott. Thanks for taking the time to speak with Master Investor. I'm sure many of our readers will already be familiar with London South East (lse.co.uk), but for those that aren't, can you briefly introduce lse.co.uk and give us some background on the company?

Scott Grant: *lse.co.uk came to life in 1998 and took its current guise of a solely Private Investor website in September 2007. We now have well over one million unique visitors to the website each month, and we are part of many private investors' and traders' daily routines.*

JF: What features and services do you currently offer to your users?

SG: *Pretty much everything that could be wished for in terms of share research, including share prices, company fundamentals, news from many sources (including Reuters), the largest and only moderated Share Chat forum in the UK, a weekly 'Share Views' TV show for which the great and the good of the industry are interviewed, subscription services such as Level 2 data... and much more besides.*

JF: So you're pretty much a one-stop shop in terms of data provision for investors and traders.

SG: *It's a ubiquitous phrase yet: yes, that's right!*

JF: You mentioned the subscription services such as Level 2. For those readers who may have heard of Level 2 but have no idea what it is, could you explain what that's all about?

"WE ARE PART OF MANY PRIVATE INVESTORS' AND TRADERS' DAILY ROUTINES."

SG: *It helps to provide insight into the market and what's really happening, giving an extra layer to a person's research and potential trading decisions. The ability to see which Buy & Sell orders are waiting to be fulfilled by Market Makers and the depth and prices on either side can be very useful in being ahead of the game... or possibly at least ahead of other investors!*

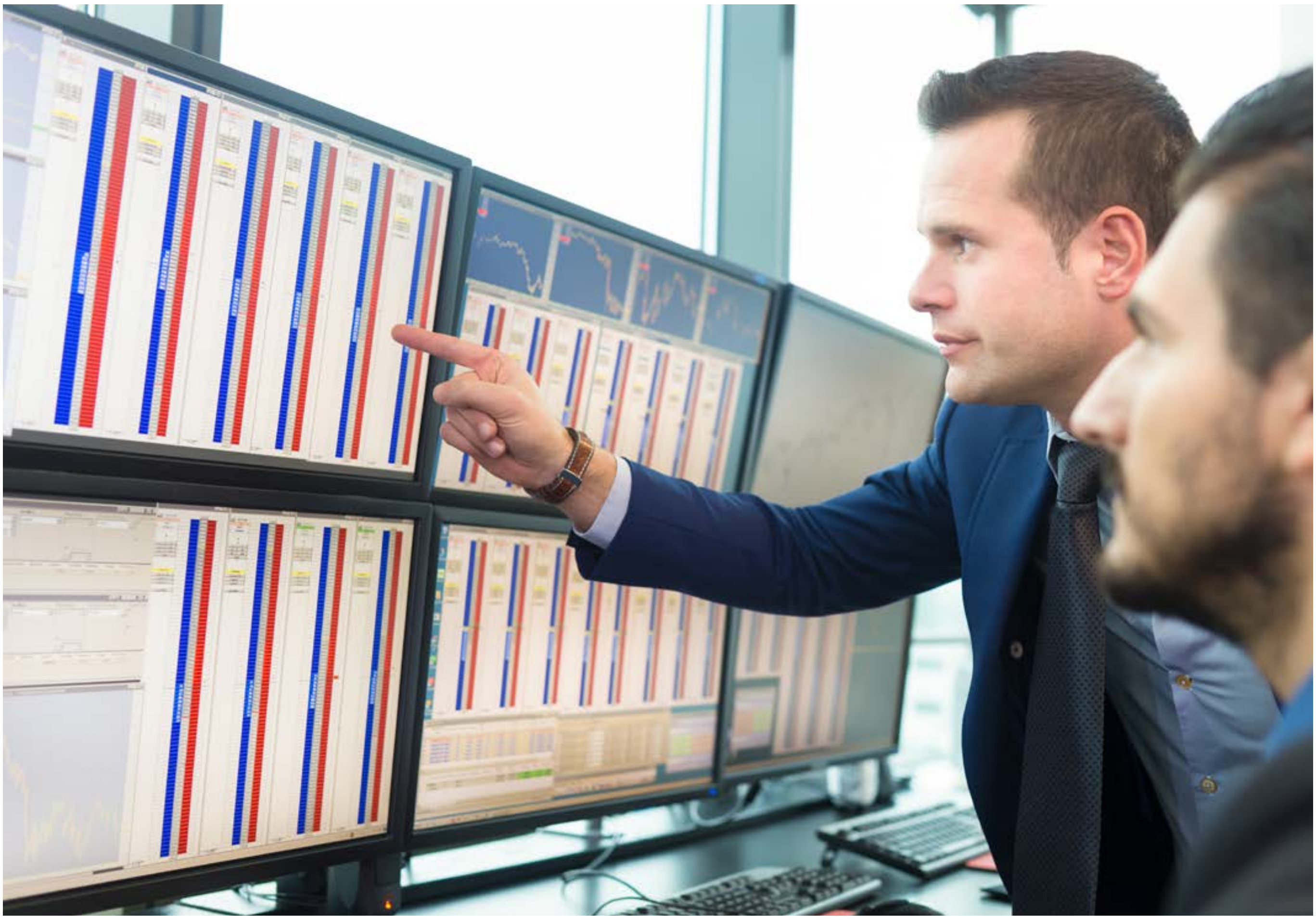
JF: What other subscription services does London South East offer?

SG: *I mentioned our chat forum earlier. There is a Premium section where you can get away from the hubbub of the main board. We also have Live Prices (Level 1), data and an enhanced Level 2 package which includes Alliance News 'Professional'; – a 'squawk'-type live newswire.*

JF: I suppose most people who've heard of London South East know it primarily as a chat forum or 'bulletin board'. Chat rooms have a somewhat ambivalent reputation in the investment community. Give us the case for getting involved in chat rooms as a private investor.

SG: *It's probably best to start with DYOR... Do Your Own Research! There is no substitute for properly researching a company and forming your own opinion. You might then choose to dip into the chat waters. I think that investinglike a lot of areas in life – is a case of separating the wheat from the chaff and filtering the white noise. There are undoubtedly some golden nuggets to be found on chat boards from experienced and knowledgeable people. The thing we are most proud of is the feeling of 'community'. There are lots of what I would term as genuine friendships made in the lse.co.uk chat area. If investors can help each other to be more profitable and wise in*

"THERE ARE UNDOUBTEDLY SOME GOLDEN NUGGETS TO BE FOUND ON CHAT BOARDS FROM EXPERIENCED AND KNOWLEDGEABLE PEOPLE."



their investment decisions, then that can only be for the good!

JF: Why should investors use London South East as opposed to, say, MoneyAM or ADVFN?

SG: *There are a lot of good websites in the Private Investor/Trading space, including the two you mention. I mentioned earlier that our Chat area is moderated, which is a rarity and helps keep a little sanity to what can sometimes be emotive conversations. Another positive to mention for lse.co.uk is our willingness to embrace feedback. I met a few site users at a Jim Mellon speech a couple of weeks back. One has since emailed me some feedback and we have implemented some of his suggestions and scheduled others already. We try to be innovative and proactive, making sure our users have the best experience on our site. Currently, we are working on a 'responsive' version of lse.co.uk which will be able to give investors and users a much better experience.*

JF: You mentioned the social aspect to chat rooms. How is the format coping with the new wave of social investing platforms and other fintech innovations? What does the future hold for financial data providers like lse.co.uk?

SG: *I think the landscape is changing. Social Media platforms such as Twitter are definitely attracting posters from chat forums to converse and support each other there too. I don't think it is a case of 'one size fits all' however. Private investors can use different social media and websites for different purposes. One might be known for its research capacity, while another's specialism might be social trading, and another's could be its financial toolkit, and so on.*

We are grateful for having the largest specialist share chat forum in the UK and have actually seen our posting num-

bers notably increased over the past 12 months. If you present the data in a format that has the end user in mind and responds to their ever-changing needs, data-providing websites should remain, and be vibrant and useful to private investors. The idea is to use our site like a 'home', where you can find all you need yet, at the same time, you can be stimulated to go out and do more specific research, before coming back again.

JF: There certainly are a lot of resources available to private investors these days! Speaking of which, you're attending the Master Investor Show next March. What can investors expect from your contribution to the show?

SG: *We are proud to be associated and a key sponsor of the Master Investor Show. Our input in 2017 is three-fold:*

Phil Thomas (Director of London South East Limited) is hosting the Rising Stars Stage for the day, introducing dynamic, up-and-coming companies. We sponsor this stage.

I am hosting two seminars in a separate area of the Design Centre. I will go through the basics and beyond of how to use our website effectively, taking a couple of well-known companies and topics as examples to give investors some invaluable information to take away.

Lastly, we will have a stand at the event. We urge everyone to stop by and say hello!

JF: It's already shaping up to be a great day and there are still plenty more announcements to follow. Thanks for taking the time to speak to Master Investor today, Scott. I've been using London South East for some time now and I really would urge readers to check it out as it really is a great platform and an indispensable resource for investors.

If you'd like to learn more about London South East and the services they provide to investors, check out lse.co.uk/premium for more information.

LONDON SOUTH EAST

BY NICK SUDBURY

FUNDS IN FOCUS

OUT WITH THE OLD, IN WITH THE NEW

INVESTMENT TRUST PICKS FOR 2017

Looking back it is hard to believe that 2016 turned out the way it did. Even Mystic Meg would have struggled to predict Brexit and Trump and the impact they have had on the world's financial markets. Forecasting is always a mug's game, but analysing the recent performance and its influence on investor sentiment can often uncover some interesting contrarian opportunities.

With all the main regions delivering double-digit index returns from a sterling perspective over the 11 months to the end of November, 2016 was a strong year for the equity markets. The three most profitable areas for UK-based investors were the Emerging Markets, the Far East and the US, with each up around 30% after adjusting for the fall in the pound. Those with money in Japan would have made 20%, with the least lucrative options being the UK and Continental Europe, although both returned about 11%.

Winners

The market returns play a key role in determining the best and worst performing investment trusts, albeit with the proviso that there are always plenty of niche mandates that make it to the top and bottom of the annual league tables. It is also important to bear in mind the beneficial impact of the large fall in the pound on the returns from international funds.

Mainstream options in the top 20 performers included the **BlackRock North American Income Trust (LON:BRNA)** and the **North American Income Trust (LON:NAIT)**, two US funds with share price total returns over the 11 months to the end of November of 42.6% and 47.2% respectively. They were accompanied by three Latin American recovery plays: **BlackRock Latin American (LON:BRLA)**, **Aberdeen Latin American Income (LON:ALAI)** and **JPM Brazil (LON:JPB)** with gains of between 43.5% and 62.7%.

The turnaround in the commodity markets and the strong dollar have made it possible for the specialist funds operating in this area to generate some exceptional returns. **Geiger Counter (LON:GCL)**, **City Natural Resources (LON:CYN)**, **BlackRock Commodities Income (LON:BRCI)**, **Baker Steel Resources (LON:BSRT)**, **Golden Prospect (LON:GPM)** and **BlackRock World Mining (LON:BRWM)** have all made it into the top 20 with returns of 47.9% to 95.1%. Despite this they are all still trading at sizeable discounts to their Net Asset Value (NAV).

Two of the more diversified funds that have done well are **Murray International (LON:MYI)**, which operates in the Global sector, and **Templeton Emerging Markets (LON:TEM)**, which has gained a new lease of life since having a change of manager.

The most successful of all was the little known £20m **Industrial Multi Property fund (LON:IMPT)** with

"PICKING THE TOP PERFORMING FUNDS IS VIRTUALLY IMPOSSIBLE, BUT IT IS OFTEN SENSIBLE TO BANK PROFITS AND REINVEST THE PROCEEDS IN UNLOVED AREAS THAT HAVE THE POTENTIAL TO RECOVER."

a gain of 104.1%. This is a special situation as the Board is looking to refinance its property portfolio and if it cannot do this it will look at alternative ways of delivering shareholder value. IMPT shares are currently trading at an 18% discount to NAV.

Losers

The performance at the other end of the scale was heavily influenced by Brexit, which resulted in relative underperformance by the UK mid cap and small stock sectors. These areas accounted for five of the worst 20 investment trusts with the casualties being: **Schroder UK Mid Cap (LON:SCP), JPM Smaller Companies (LON:JMI)**, **JPM Mid Cap (LON:JMF)**, **Aberforth Smaller Companies (LON:ASL)** and **Montanaro Smaller Companies (LON:MTU)**. These fell between 12.6% and 15.4%.

Weakness in the biotech sector meant that **Woodford Patient Capital (LON:WPCT)** sneaked on to the list as the twentieth worst performer with a loss of 9.5%, with other surprising names including **Jupiter European Opportunities (LON:JEO)** and **Standard Life Equity Income (LON:SLET)**.

Another major casualty was the peer-to-peer sector where **VPC Speciality Lending (LON:VSL)** and **P2P Global Investments (LON:P2P)** lost 17.9% and 22.3% respectively, although their problems were nothing compared to the £20m private equity fund, **Candover Investments (LON:CDI)**. This was the worst of the lot during the 11 months with a share price decline of 55.6% due to the poor performance of its concentrated portfolio, which was also the reason for the 25.3% fall in **Better Capital 2012 (LON:BC12)**.

Discounts and premiums

One of the advantages of looking at investment trusts is that the fluctuations in the discounts can give you a good idea of how sentiment has changed. At the start of the year the average discount across all funds was about 3.5%. This then widened to 7.5% immediately after Brexit before recovering back to 4.5% at the end of November.

In the first 11 months of 2016 10 of the 17 investment trust sectors saw their discounts widen, with the biggest casualties being UK Small Cap and European funds. These experienced an increase in their average discount of 10%

and 8% respectively. At the other end of the scale the biggest improvements were in the UK Property, Biotech & Healthcare, Flexible Investment and Private Equity sectors, where the average discounts narrowed by between 4% and 7%.

At the end of November only three sectors were trading on a premium rating. These were UK Direct Property, Flexible Investment and Infrastructure, with the premiums being 3%, 5% and 13% respectively.

"AT THE END OF NOVEMBER ONLY THREE SECTORS WERE TRADING ON A PREMIUM RATING. THESE WERE UK DIRECT PROPERTY, FLEXIBLE INVESTMENT AND INFRASTRUCTURE, WITH THE PREMIUMS BEING 3%, 5% AND 13% RESPECTIVELY."

All the rest were priced at less than NAV, with the main out-of-favour sectors being UK Small Cap, Global Emerging Markets, Far East ex Japan and Europe. The average discounts in these areas were 15%, 11%, 10% and 10% respectively. This shows that despite the strong returns from many of the different markets there is still a healthy degree of investor scepticism.

Where to invest for 2017

Investors need to stay focused on their long-term objectives and maintain a balanced portfolio that reflects their attitude to risk. Picking the top performing funds is virtually impossible, but it is often sensible to bank profits and reinvest the proceeds in unloved areas that have the potential to recover.

David Coombs, head of multi-asset investments at Rathbones, has recently increased his exposure to the Emerging Markets. This is an area that is out-of-favour largely because of the prospect of higher interest rates in the

US, which would attract capital back to America and increase the cost of dollar denominated debt.

On the equity side he has bought the **Aberdeen Emerging Markets Investment Company (LON:AEMC)**, a respected fund with a decent track record that is trading on a 13.8% discount to NAV.

AEMC is valued at £257m and has a significant exposure to countries such as China, South Korea, Russia, Taiwan and India via a portfolio of managed funds. Over the last year its share price was up 28%.

Nick Greenwood, a fund manager at Miton, has suggested that a sensible strategy would be to invest in a concentrated fund whose performance should be driven by the companies' earnings rather than the wider market. There are a number of vehicles like this with one example being the **Aurora Investment Trust (LON:ARR)**.

The managers of the £44m fund use a value approach and have invested in just 15 stocks with the five largest – Barratt Developments, Bellway, Tesco, Lloyds and Sports Direct – accounting for a massive 56.2% of the portfolio. Its long-term performance has lagged behind the FTSE All-Share, but it has the potential to deliver uncorrelated returns.

Off the beaten track

Greenwood also likes **Macau Property Opportunities (LON:MPO)**, which invests in high quality properties in this Chinese autonomous state. The Macau peninsula is mostly known for its gambling, but the anti-corruption drive on mainland China has meant that sentiment has been extremely negative.

Macau is changing the way it does business and is aiming to replicate the sort of model followed by Las Vegas. Shares in some of the local casino companies have recovered strongly, but MPO has lagged well behind and its shares trade on a massive 43% discount to NAV.

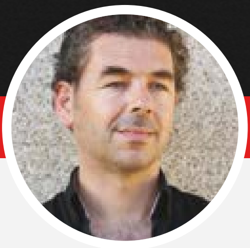
Peter Hewitt, director and investment manager at F&C, has recently highlighted the merits of private equity funds. He said that the sector has just started to perform, yet there are still some attractive valuations.

One fund that he likes is the £552m **HG Capital Trust (LON:HGT)**, which is trading on a 5% discount to NAV. This mainly focuses on the technology and services sectors with many of the underlying holdings having strong growth prospects.

Peter Walls, a fund manager at Unicorn Mastertrust, has recommended the **Polar Capital Global Financials Trust (LON:PCFT)**, which is trading at a 6% discount to NAV. He said that the recent earnings reports from the US banks were encouraging and it is a sector that normally benefits from higher interest rates.

The £216m fund holds a portfolio of 63 stocks and nine bonds, with the largest holdings including the likes of JP Morgan Chase, ING Group, Chubb Corporation, Wells Fargo and BNP Paribas.

Income investors may prefer an idea put forward by David Hambidge, head of multi-asset investment at Premier. He singled out **NB Global Floating Rate Income (LON:NBLS)**, which invests in a portfolio of floating rate US loans that should benefit from increases in US interest rates. The £989m fund is currently yielding 4.3% and the shares have returned 10% this year.



BY FILIPE R. COSTA

THE MACRO INVESTOR

THE RISKS ARE PILING UP IN 2017

"If the euro zone doesn't come up with a comprehensive vision of its own future, you'll have a whole range of nationalist, xenophobic and extreme movements increasing across the European Union. And, frankly, questions about the British debate on EU membership will just be a small sideshow compared to the rise of political populism."

- Nick Clegg, MP

A brave new world

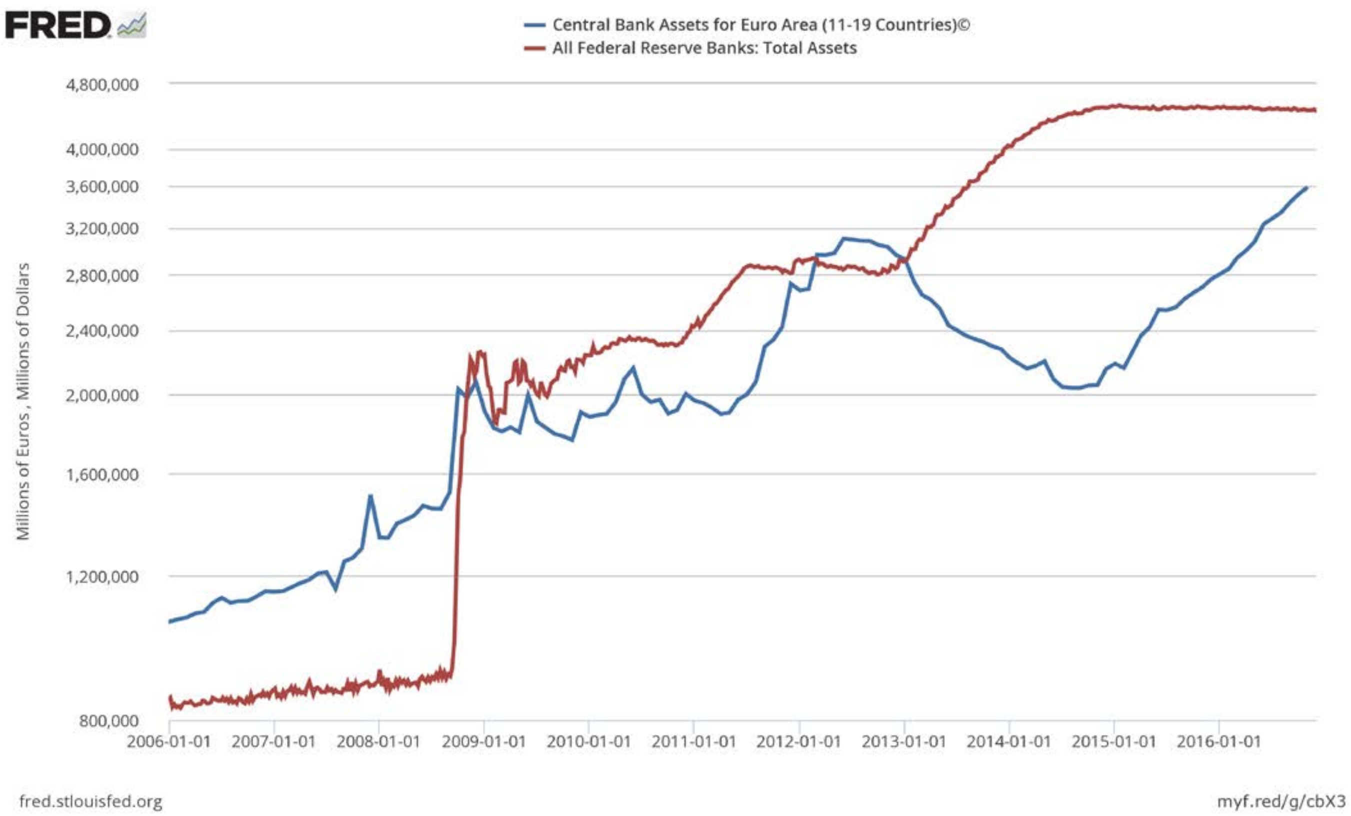
The New Year has just arrived, but it is already filled with a long queue of risky upcoming events, of which politics takes its fair share. Europe will face big challenges, as France and Germany both prepare for general elections, where they will face the growing strength of the far-right anti-European parties. While Marine Le Pen (in France) and Frauke Petry (in Germany) are not expected to win outright, they are at least expected to rise through the ranks and play a bigger part in shaping the future of the European Union.

In the UK, it is time for Brexiteers to turn a vote into a reality. While Brexit takes time to materialise, time also plays against such an outcome, as public opinion can change rapidly and may turn against Brexit. If European economic conditions improve (which is not an unlikely scenario for 2017) and the far-right parties are defeated, sentiment regarding Brexit may shift, in which case it would make the triggering of Article 50 less appealing for the current government. But if those parties gain strength they will make Brexit harder. It's complicated and boring to the extent that Brexit will most likely take years to negotiate and, in the meantime, turn into a secondary issue.

> **"IF SOMETHING IS GUIDING THE EURO AT THIS POINT, IT IS MONETARY POLICY DIVERGENCE RATHER THAN ANY KIND OF EUROZONE UNCERTAINTY."**

In the U.S., the 'man of the year', Donald Trump, will finally ascend to power and start unfolding his big stimulus plans. If he keeps his promises, the U.S. may lead the world into a new paradigm, where fiscal stimulus replaces the unconventional monetary policies that have been followed for many years. A return to Keynesian policies may prove beneficial for global growth. But, with the U.S. economy now operating near full employment, wages and prices may start rising faster than anticipated. To prepare for such a scenario, investors need to prepare for a major rotation in the market where cyclicals and financials are favoured and the bond bubble starts to burst. If a mild rise in inflation would be a good sign for the economy, a strong rise in inflation would just shorten


2017



the economic cycle and lead the U.S. economy into recession faster than would happen otherwise.

In either case, the yield curve is expected to steepen at the beginning of 2017 and monetary policy is likely to shift from dovish to hawkish. Volatility will rise at times because of the political uncertainty in Europe. The odds of inflation rising above expectations are increasing, the end of negative interest rates seems to be approaching, and the euro may not be heading towards its end. If something is guiding the euro at this point, it is monetary policy divergence rather than any kind of Eurozone uncertainty. The rise of the far-right in Europe is a symptom telling us that something is really wrong with European politics. It will help to delay European integration, but won't be enough to reverse it. The will behind EU unity is far greater than the simple trade relations that take centre stage, which makes it strong enough to survive a period of economic contraction. Nevertheless, a rise in populism in continental Europe is bad news for the UK, as the far-right parties oppose outright any soft deal for Britain.

The wild card playing against Europe is terrorism. The rise in populism and anti-immigration sentiment is not only the outcome of austerity but also of the wave of terrorism hitting the continent.

A shift from monetary to fiscal policy

A key development in 2016 has been the wide recognition that monetary policy has already reached its heights and can do little for us at this point. The massive asset purchase programmes rolled out by all major central banks helped stabilise the liquidity squeeze created by the financial crisis but have contributed little to driving consumption and investment higher. Given the size and duration of such programmes they may have created some important economic distortions in terms of wealth distribution and asset inflation as side effects. In some countries, as is the case in Sweden, Switzerland and Japan, national central banks even experimented with negative interest rates, but the experience has been neutral to negative. The governor of the Riksbank (the central bank of Sweden), Stefan Ingves, has often expressed concern with the side effects of negative rates, in particular the creation of a housing bubble. Japan's experience with negative rates sparked a huge controversy about the effectiveness of such measures and has recently led to the recognition that the bank should instead move to steepen the yield curve and not the opposite. In a country like Japan, where government bond ownership is widespread among the public as a store of wealth, a decline in yields along with the flattening of the yield curve just incentivises an increase in savings. At the same time, negative rates weaken banks' balance sheets because they are unable to pass them on in full to their clients and therefore see their profit margins shrink. As a result, banks tighten credit, and the credit channel acts in the exact opposite direction to that predicted by academics.

With most of the developed world embarking on deleveraging policies at the same time, and given the high degree of globalisation, there is an amplification effect that creates a vicious cycle in which recession generates more recession. Adopting austerity policies at such a juncture is no different than a central bank increasing its key rates during a period of deflation. With this in mind, the Brexit vote came as a breath of fresh air to the UK because it triggered a depreciation of sterling and forced the adoption of a fiscal stimulus package, both of which helped break the previous cycle. A Trump win in the U.S. acts in the same way, but on such a large scale that it may have a positive spill over globally. The reliance on unconventional monetary policy is coming to an end (at least temporarily), and investors need to be prepared for a faster normalisation that will have important consequences in the equity and bond markets.

While yields have been rising, there are still many instances of low yields that don't even reflect the ability of the central bank to drive inflation to its target level in the medium to long term. A few examples are Austria (50Y at 1.40%), Denmark (30Y at 0.99%), France (10Y at 0.6%), Germany (on every long-term maturity), Netherlands (30Y at 1.04%), Sweden (10Y at 0.68%) and Switzerland (on every long-term maturity). All of these bonds are such great short candidates that I don't even know which to choose.

Brexit

Will the UK trigger Article 50 or not? I believe that Brexit isn't a done deal as of yet. As time goes by, the likelihood of Brexit, or at least a 'hard' Brexit, decreases. Public opinion changes a lot over time. Trump, Brexit, Marine Le Pen – all somewhat represent the frustration and unhappiness of the population regarding living conditions and the status quo. But, as soon as their wallets are affected, the public changes its opinion again. In the specific case of Brexit, the harder this process becomes, the larger the negative impact on the British economy through reduced economic activity and price increases, which would ultimately impact consumers' finances and their opinions about Brexit. The most likely outcome seems a long and drawn-out process culminating in some kind of solution under which the UK is formally out but remains in the common market. To quote Merryn Somerset Webb, "If it goes on for years and bores everybody to death, the impact of Brexit will be negligible".

French elections

Unlike the political changes occurring in peripheral EU member states, any major shift in France or Germany is a game changer. If a far-right party wins substantial support in either of these two key countries, the future of the EU could be at stake, as these parties usually push for protectionism, isolationism, and anti-immigration policies, which are all at odds with the EU free-market establishment.

The sluggish performance observed in Europe since the U.S. financial meltdown, and the adoption of ineffective austerity measures that contributed to extend in time and size the unemployment problem, have fed into a growing dissatisfaction among the population. Some of this discontent has found a home in the populist policies proclaimed by far-right parties. Marine Le Pen's far-right National Front has been rising through the ranks and achieved a historic vote in the 2015 regional elections, when it reached more than

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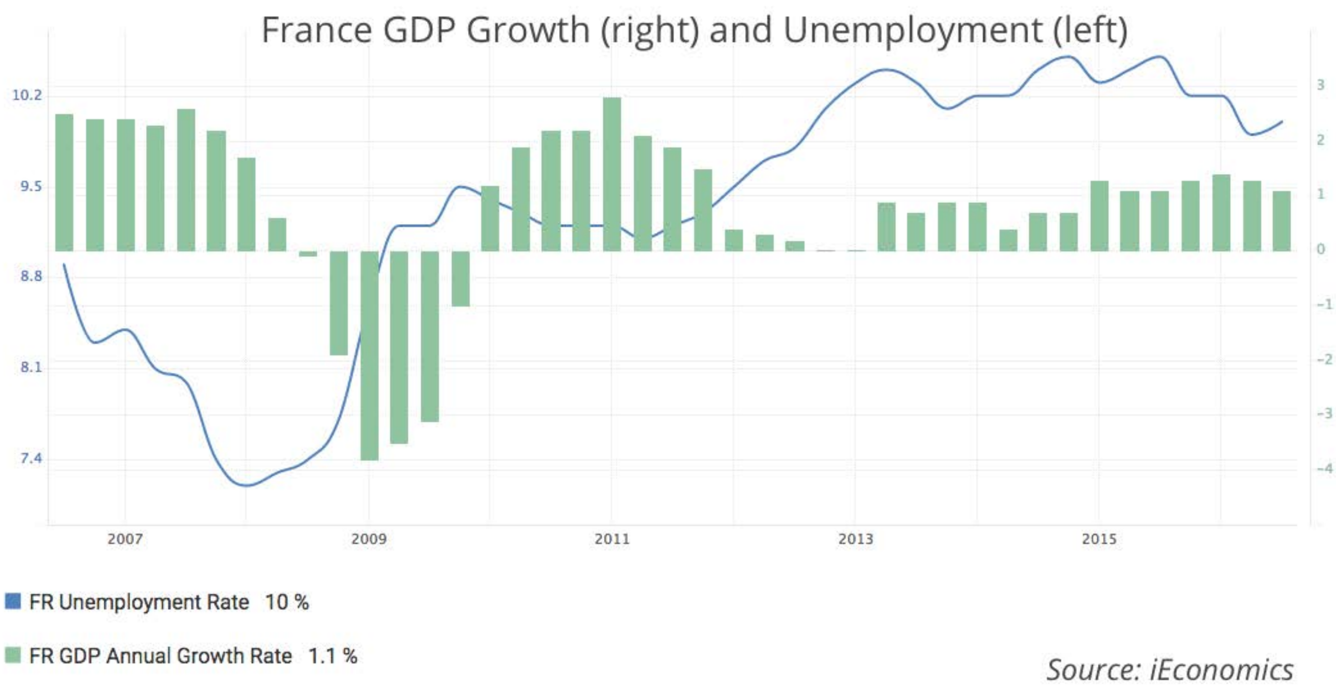


Source: iEconomics

six million votes in the first round. Were it not for some concerted tactical voting from the conservative parties of left and right, the National Front would have elected a few regional presidents. Given the rising popularity of Le Pen, the presidential election of 2017 is a hugely risky event for markets and the future of the EU.

Frederic Legrand – COMEO / Shutterstock.com

The Presidential election will be held on 23 April (first round) and, if no candidate wins a majority outright, a run-off between the top two will be held on 7 May (second round). There are already two main candidates, one from the National Front – Marine Le Pen – and another from the Republicans – Francois Fillon. There is also another noteworthy candidate, from the *En Marche* movement – Emmanuel Macron (ex-Socialist party). As the incumbent president Francois Hollande has declined to run for a second term, the Socialist party has yet to nominate its candidate, which will happen this month. While there are a few reasons for Hollande not to attempt a second mandate, earlier polls showed that, among the biggest names, Hollande would be the only one not to beat Le Pen on a second round vote, which may have played a part in his decision.

Sluggish economic performance and terrorism are boosting the popularity of far-right parties like Marine Le Pen's National Front – but not to the point of

"A LE PEN WIN WOULD MOST LIKELY LEAD TO THE COLLAPSE OF THE EURO AND THE EU AND CREATE A DANGEROUS PATH INTO EUROPE FOR PRESIDENT PUTIN."

winning the election, polls show. The truth is that the recent experiences with Brexit and Trump also shows that polls may fail dramatically when predicting the outcome of an election. But, no matter how bright the picture may be for Marine Le Pen, even if we take it for granted that she will survive the first round, she would still need to reach the 18 million votes that are usually needed to elect a president in France – a hard mountain to climb given the seven million votes she collected in the regional election of 2015.

If Le Pen wins, she has promised to reduce immigration meaningfully and to give priority to French citizens over foreigners for jobs. She also wants to raise trade barriers to protect French industries and build an alliance with Russia. Leaving the euro and ultimately the EU would be a natural consequence of such policies, as they are at odds with the common market. A Le Pen win would most likely lead to the collapse of the euro and the EU and create a dangerous path into Europe for President Putin. Unlike what happened with Brexit and Trump, the market reaction would be more serious, with European equities suffering and the euro capitulating. It should be remembered that Le Pen doesn't just want to leave the EU; she also wants to isolate France from the world, which is not the case with Brexit – nor indeed with Trump, even if at times it seems otherwise. Historical records show that severe economic consequences usually result from such isolationism.

But Le Pen isn't the frontrunner for the presidential election. Instead, Francois Fillon, Emmanuel Macron (*En Marche* candidate) or Manuel Valls (frontrunner contender for the Socialists) have better chances of winning the election on a second round vote. There are certainly significant differences between each of the candidates. Fillon has already promised to cut taxes for corporates and increase consumption taxes, which would have a positive impact on exporters and a negative impact in consumption, in a similar fashion to the Brexit result. But, apart from some minor issues, the status quo regarding the future of the euro and the EU would remain intact. If Le Pen loses the election, the euro and European equities may get a boost in a relief rally, in particular if the election turns out to be more competitive than expected.

Although not as important as the presidential election, we should not completely disregard the legislative election to be held on 11 and 18 June. The rise of the National Front may not be enough to elect Le Pen in May but will most likely contribute to change the exact share of power in the National Assembly in June. Le Pen won only two of the 577 seats available in 2012, but will likely take between 58-64 seats in 2017. While this election may not have the same impact on markets as the presidential election, if Le Pen takes a larger share of the Assembly, she will see her influence in French politics rise.

German federal elections

Unfortunately for the general stability of the euro and the EU, there will be another general election, this time in Germany, scheduled to occur somewhere between 27 August and 22 October (though most likely at the end of September). Unlike the French case, the German election doesn't represent a real risk in terms of who wins the election because Angela Merkel is in a good position to be re-elected as the candidate of the CDU/CSU alliance. But, even if there were a surprise on the cards, the next party with an ability to elect a chancellor would be the SPD, which is already part of the grand coalition (CDU/CSU/SPD) that currently governs Germany.

The main impact that may result from the German election is related to the expected change of power inside the Bundestag rather than to who will be elected. Over the last few years Europe has been weathering troubled times,

	Federal Election 2013	Opinion Poll December 2016*
CDU/CSU	41.5%	35.0%
SPD	25.7%	22.0%
The Left	8.6%	9.0%
The Greens	8.4%	11.0%
FDP	4.8%	5.0%
AfD	4.7%	13.0%

* Infratest dimap poll conducted 7/Dec/16

Source: Wikipedia

De Visu / Shutterstock.com

with southern countries sinking into poverty while northern countries underperform. Germany is no exception and as the far-right has been increasing in popularity in France, alternatives to the current grand coalition have also been on the rise in Germany. According to the latest polls, the Bundestag will expand from a five to a seven-party assembly, as the grand coalition is expected to lose more than 12% of its previous votes. The Left, the Greens, the FPD and in particular the AfD are expected to gain.

When founded in 2013, the Alternative for Germany (AfD) was created as a middle-class centre-right moderate party, opposing the euro, but mainly favourable to the EU. But, under Frauke Petry's leadership, the party has tilted to the far-right and has morphed into a nationalist anti-immigrant establishment, which, meanwhile, was kicked out of the British Conservatives' group at the European Parliament. The latest polls point to a 13.0% share of the vote for the party in the next federal election, which is more than half the SPD's expected vote. While certainly still short of allowing the party to take control of the Bundestag, its rapid ascent is alarming in terms of the future of the EU.

While the federal election in Germany will not be a death knell for the euro, it will dictate the broad European policy that will be followed over the next few years, in terms of member-states' scope to engage in fiscal stimulus, monetary policy dovishness, the European integration project, and Brexit negotiations. Angela Merkel has been torn between a soft stance, allowing debt restructuring and more fiscal stimulus while being neutral in Brexit negotiations to better fit the European needs; and a more hard-nosed stance to better fit the German electorate and the grand coalition intents. If the grand coalition loses its strength, as is widely expected, the Bundestag will become a seven-party assembly and Merkel's actions will be even more limited than they currently are.

Regarding Brexit, the SPD and the Greens don't favour any soft negotiations with the UK. The Left is also against it. Meanwhile, the AfD will see an opportunity for revenge for having been expelled from the British-dominated Conservative group in Europe. To a certain extent, I would say that the pound will face some volatility as the result of a more uncertain outcome for Brexit and the German election, particularly if the CDU/CSU/SPD bloc doesn't reach the necessary majority of votes. If the rise of alternative parties is significant, the prospects for fiscal stimulus will erode, pressing the ECB to extend its asset purchase programme and to keep rates at very low levels (if not negative), in which case the euro would be a loser, particularly against the dollar.

"TRUMP HAS BEEN THE BREATH OF FRESH AIR EUROPE WAS IN NEED OF, RATHER THAN A REAL THREAT. MONETARY POLICY DIVERGENCE WAS THE BEST THING THAT COULD HAPPEN TO THE ECB."

But don't forget inflation

Europe will be scrutinised by an unhappy population that has experienced sluggish growth and high unemployment for many years. The French and German elections will be key tests for the current European establishment and will shape the sentiment in equity markets and the euro in the short term, while also giving important clues about the expected progress for the Eurozone, as a currency union, and the EU, as a full integration project.

The rise of alternative organisations and extreme parties is a consequence of the prolonged sluggish performance observed globally and acts like an accusing finger pointed by the population at the current establishment. But, as soon as the global trend changes course, these alternatives will lose their initial strength. Europe has been crossing stormy seas, but progress has been made to date. In fact, the prospects, while "tilted to the downside" according to Mario Draghi, are improving fast, mainly because Trump has been the breath of fresh air Europe was in need of, rather than a real threat. Monetary policy divergence was the best thing that could happen to the ECB and the rise of dissatisfaction is pushing Europe towards a less stringent stance towards public finances. France, the UK, and even southern countries like Portugal have allowed themselves some fiscal slippage to fight sluggish growth.

The greater threat now appears to be inflation. Without fiscal stimulus, monetary expansion simply led to asset-price inflation. But with fiscal stimulus being the new mantra, and provided that central banks take time to normalise policy, consumer inflation will be generated. While taking note of the major political events that will occur throughout the year, particularly in Europe, I believe investors should focus their attention on that prospect.

BY RICHARD GILL, CFA

FROM ACORNS TO OAK TREES

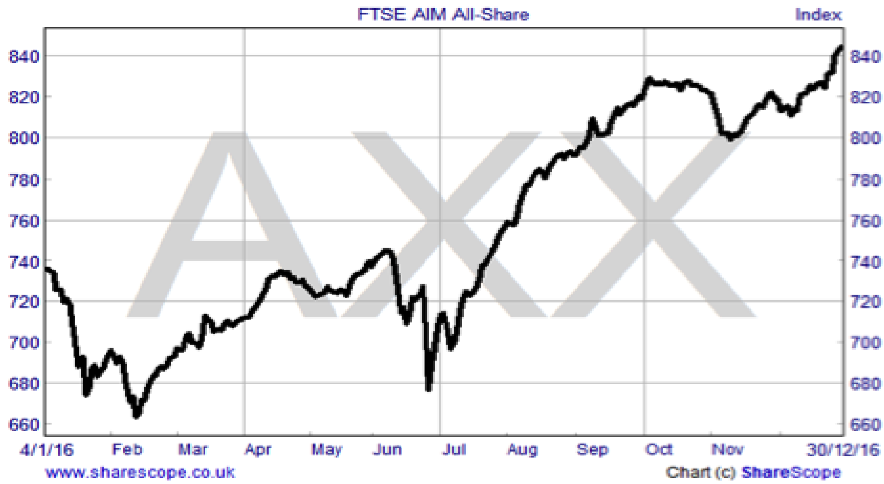
FOLLOW THE FUND MANAGERS FOR A PROFITABLE 2017

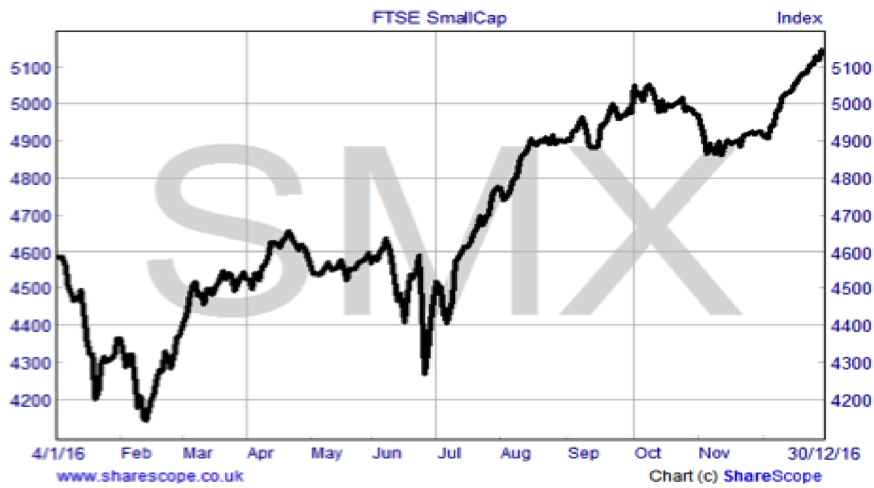
As we say goodbye to 2016 it's time for my annual review of how the UK small cap markets have performed, and for a few investment ideas for 2017.

In general, small caps had a good year in 2016, with the FTSE AIM All Share gaining an impressive 14.2%. The FTSE Small Cap Index was slightly behind but still put in a decent gain of 11% *and* reached an all-time high. However, their larger blue-chip cousins outperformed over the year, with the FTSE 100 up by 14.4% to a record high as mining stocks recovered and a weakened pound boosted the value of the internationally heavy index. In co¬ntrast, the mid-cap FTSE 250 only gained 3.7% over 2016, but again managed to reach an all-time high in October as the UK focussed index recovered from a slump caused by the aftermath of the EU referendum result.

So 2016 was a good year on the whole for small cap investors, and further analysis of the numbers highlights several interesting points.

Taking AIM as a proxy for small caps as a whole, the wider AIM All Share index





Source: Sharescope


2017

"OF THE TOP 20 TOP PERFORMING AIM STOCKS IN 2016, 12 WERE IN THE MINING OR OIL & GAS SECTORS."

(which is weighted by market cap) was once again driven by a strong performance from its larger constituents. The FTSE AIM 100 index, which represents the largest AIM companies by market capitalisation, rose by 15.5%, although the AIM UK 50 index slightly underperformed the wider market, rising by 14.1%.

AIM's largest company, the online fashion business **ASOS (LON:ASC)**, now valued at £4 billion, was a major contributor to the All Share's performance, rising by a solid 43.8% over the period. Its second-largest index constituent, the cannabis medicine firm **GW Pharmaceuticals (LON:GWP)**, also performed well, rising by 84% before cancelling its listing in December. But its third-largest firm, the biotech business **Hutchinson China Meditech (LON:HCM)**, was a drag, falling by 18.6%.

More notable amongst AIM's larger companies were the performances from tonics business **Fevertree Drinks (LON:FEVR)** and online fashion firm **boohoo.com (LON:BOO)**, shares in which rose by a respective 90% and 264%, taking both their valuations through the £1 billion market cap barrier.

Marvellous microcaps

As an alternative way of looking at small cap performance during the year, I create my own basic index which in contrast to the AIM All Share takes an equal weighted approach, or in other words considers the performance of AIM stocks as a whole on an *average* basis. To do this I take all AIM companies which were listed on the market at the beginning of 2016 and remained listed for the whole year. I do not consider new listings during the year or those which left the market for whatever reason (takeovers, going bust etc). There are 944 qualifying companies, to which I give each an equal weight in my theoretical index.

Of these, 434 companies (46%) finished the year with a higher share price, 12 (1.3%) were flat and 498 (52.7%) lost value. So just like in 2015, a throw of a dart at a list of AIM companies at the start of 2016 would have been more than likely to hit a losing stock. However, crunching the numbers shows an *average* gain per AIM share of 22.92% as a number of lower capitalisation small cap stocks put in stunning performances over 2016, thus skewing the numbers to the upside.

Big winners

2016 was the year in which natural resources companies made a powerful comeback as a raft of commodities saw a resurgence in their price. Of the top 20 top performing AIM stocks in 2016, 12 were in the mining or oil & gas sectors.

At the top of the tree was fertiliser developer **Harvest Minerals (LON:HMI)**, shares in which gained 2,942% after the firm made significant advances at its prospects in Brazil. Also gaining over 1,000% were investment business **Mercom Capital (LON:MCC)** and Ecuador based copper/gold miner **SolGold (LON:SOLG)**. In fact, 87 AIM stocks doubled in value or more over 2016.

Name	M Cap (£m)	Price change (%)	Sector
Harvest Minerals	19.2	2,941.7	Mining
Mercom Capital	10.7	1,362.5	Oil & Gas
SolGold	341.2	1,023.5	Mining
Jersey Oil & Gas	12.4	945.8	Oil & Gas
Public Service Property Inv.	1	827.8	Real Estate Investment

Table: 5 biggest AIM winners in 2016

"THE CASH GENERATIVE NATURE OF PATISSERIE HOLDINGS ALLOWS IT TO INVEST IN NEW STORE OPENINGS ENTIRELY FROM ITS OWN FUNDS."

At the bottom end of the market 26 AIM stocks dropped by 80% or more. Notable fallers include former stock market darling **Stanley Gibbons (LON:SGI)**, with shares in the collectables company falling by 86% after it suffered a string of profit warnings and funding issues. There were similar problems at temporary accommodation provider **Snoozebox (LON:ZZZ)**, which was down by 93% over the year and is now trading at just 0.55% of its 2013 peak.

Follow the fund managers

With the data for 2016 showing many multi-bagging shares, did the small cap fund managers, whose job it is to pick out such stocks, manage to significantly outperform the market? Using data from Trustnet's UK Smaller Companies category the best five performing small cap funds of 2016, out of a universe of 47, were:

Fund	Manager(s)	2016 gain (%)
Cavendish AIM	Paul Mumford	29.4
Jupiter Smaller Companies	James Zimmerman	23.4
The MI Discretionary Unit Fund	Simon Knott	19.5
TB Amati UK Smaller Companies	Paul Jourdan, Douglas Lawson, David Stevenson	15.3
Marlborough UK Micro Cap Growth	Giles Hargreave, Guy Feld	14.5

Data source: Trustnet. Note: Performance measured from 1st January 2016 to 28th December 2016

While all top 5 funds significantly outperformed the benchmark gain of 7.3%, it is noteworthy that only 26 out of the 47 funds in the Trustnet UK small cap universe managed this feat, with six *losing* value. In addition, 2015's top performing fund managed to outperform 2016's top performer by over 5 percentage points despite 2015 being a weaker period for small caps in general. So well done to Conor McCarthy and Darren Freemantle of MFM Techinvest Special Situations, who came in 6th spot for 2016 with a gain of 14.3%.

Here follows three small cap stocks which some of last year's top performing funds are hoping will perform well in 2017.

PATISSERIE HOLDINGS

Where better to seek guidance for 2017 than from the top performing fund of 2016? Paul Mumford's Cavendish AIM fund delivered a 29.4% gain over the year, continuing the City veteran's long history of outperformance – see the previous issue of Master Investor for my review of Mumford's recent book.

Cavendish has recently taken a slice of **Patisserie Holdings (LON:CAKE)**, the AIM listed casual dining company which owns the Patisserie Valerie and four other café and bakery brands. The company was brought to market in May 2014 by majority shareholder, Chairman and serial entrepreneur Luke Johnson, who has since seen the share price rise by an impressive 82%.

Patisserie Valerie opened its first shop on London's Frith Street in 1926 and 90 years on now owns and operates around 190 outlets around the country which provide a range of cakes, patisserie, breakfasts, lunches, teas, coffees and other delights. The company operates a vertically integrated business model, with all products made at seven in-house bakeries before being freshly delivered to its cafes on a daily basis. Supporting the network of stores is a rapidly growing online channel, which saw sales up by 23% in the last financial year.

Making dough

The year to 30th September 2016 saw Patisserie Holdings deliver its tenth consecutive year of growth, with revenues up by 13.3% at £104.1 million and pre-tax profits rising by 18.2% to £17.2 million. This was driven by the opening of 21 new stores around the country, slightly ahead of the firm's 20 new stores a year target. Net cash stood at £13.3 million at the year-end following a very strong cash flow performance which saw a net operating inflow of £18.6 million. The cash generative nature of Patisserie Holdings allows it to invest in new store openings entirely from its own funds, with £8.7 million being invested in capex during the year.

The new store pipeline for 2017 is said to be strong, with six stores already opened since the year end, contracts exchanged on two sites and nine sites being in advanced negotiations. Further growth opportunities come from Northern Ireland where a first store was opened in 2016 with an attached bakery which has capacity to support another 10 stores. A similar bakery in Edinburgh is also believed to have capacity for a further 10 stores.

Have your CAKE and hold it?

Patisserie Holdings is a quality company, with a strong brand name, good growth opportunities, a debt free balance sheet and, at 78%, high gross margins. As such, this quality is reflected in the current stock market valuation.

On consensus market forecasts for around 15.9p of earnings in the current financial year, the shares trade on a multiple of 19.5 times at a price of 310p at time of writing. While the historic dividend yield is only a nominal 0.97%, Patisserie has a progressive payment policy. With earnings cover being high at 4.5 times I can see the dividend being substantially increased in the medium to long-term, especially given the cash generative nature of the business.

Analysts at Canaccord Genuity, with the caveat of being the house brokers, have a target price of 405p for the shares, implying upside potential of 31%.

FULCRUM UTILITY SERVICES

Not only has the Techinvest Special Situations fund performed well over the past two years, its longer-term track record is also impressive. Over the five years to 30th November 2016 the fund gained 140.3%, compared to a return of 30.2% in the FTSE All-Share and just 23.22% in the FTSE 100. This next stock is Techinvest's largest holding.

Fulcrum Utility Services (LON:FCRM) came to AIM in July 2010 following its reverse takeover by investment firm Marwyn Capital I. Bought as a turnaround situation for a nominal consideration from the National Grid, Fulcrum is an independent energy and utility infrastructure and services provider and the only independent provider covering the whole of Britain.

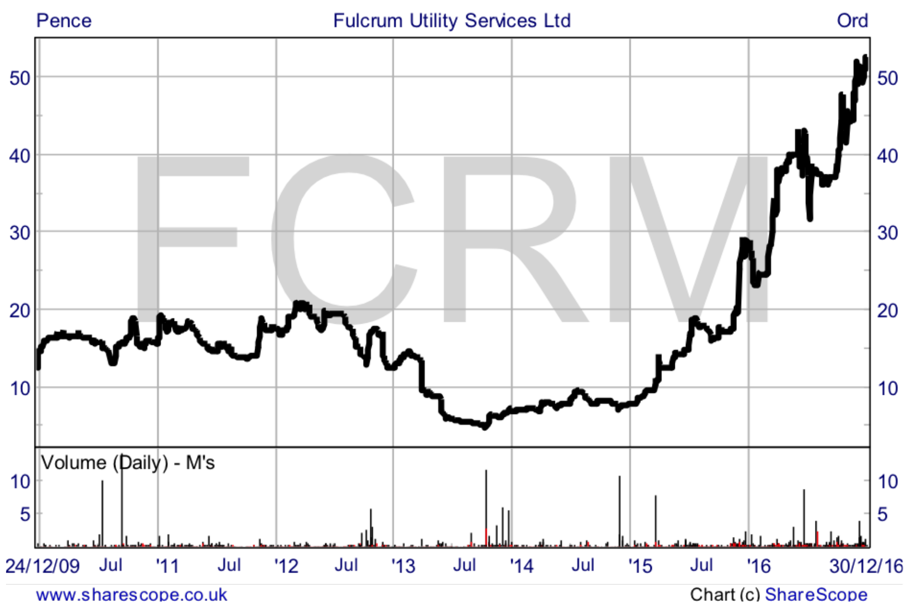
As of today the company's main business, Infrastructure Services, provides unregulated utility connection services to residential, commercial and industrial markets throughout the UK – the utilities connections sector was deregulated by industry regulator Ofgem in the late 90s/early 2000s in order to open up competition.

Fulcrum's services range from the design, installation/alteration of gas/electricity connections for single site properties, such as factories, to large multi-site projects. The company is also licensed by Ofgem as an Independent Gas Transporter, operating pipelines used to transport gas to homes and commercial properties from the main UK gas network, thus providing a secure revenue stream.

Levering control

Bought as a loss making company six years ago, Fulcrum management have now turned the business into a profitable, cash generative, growing and debt free concern. Reaching profitability for the first time in the 2015 financial year Fulcrum has not looked back since.

Highly anticipated results for the six months to September 2016 showed revenues up marginally, by 0.6% to £17.2 million. But due to a focus on improving margins pre-tax profits almost doubled, from £1.6 million to £3.1 million. Highlights of the half included the winning of a £4 million project to install a new 12km gas pipeline to a food



manufacturing plant, a £1.4 million gas pipeline installation project and a £1 million contract to install 4km of electrical cabling to a hospital development. At the end of the half the order book stood at £24.4 million, up by 12% over six months.

The balance sheet is solid, with net cash standing at £12.5 million at the period end, boosted by a £3.8 million net cash inflow from operations during the half (even after an outflow of £1.1 million from capitalising pipeline assets). Fulcrum also has access to a £4 million credit facility, which is undrawn at present, should it need further funding.

Shares at a turning point?

Fulcrum had a good 2016, with the shares ending the year at an all-time high of 52.5p, taking the market cap to £87.5 million. Consensus market forecasts for the year to March 2017 put the shares on a multiple of just over 15 times, falling to 13.5 times in 2018, which looks attractive given the growth being seen.

"FULCRUM MANAGEMENT HAVE NOW TURNED THE BUSINESS INTO A PROFITABLE, CASH GENERATIVE, GROWING AND DEBT FREE CONCERN."

Following the recent results Fulcrum also has credible income attractions. After paying a maiden dividend in 2015 the company has adopted a formal policy which is looking to pay a dividend twice covered by underlying, sustainable profits, with the payments split one-third and two-thirds between the interim and full year payments. Given the interim payment of 0.6p we are looking at a total dividend for the year to March 2017 of 1.8p, which yields a decent 3.4%.

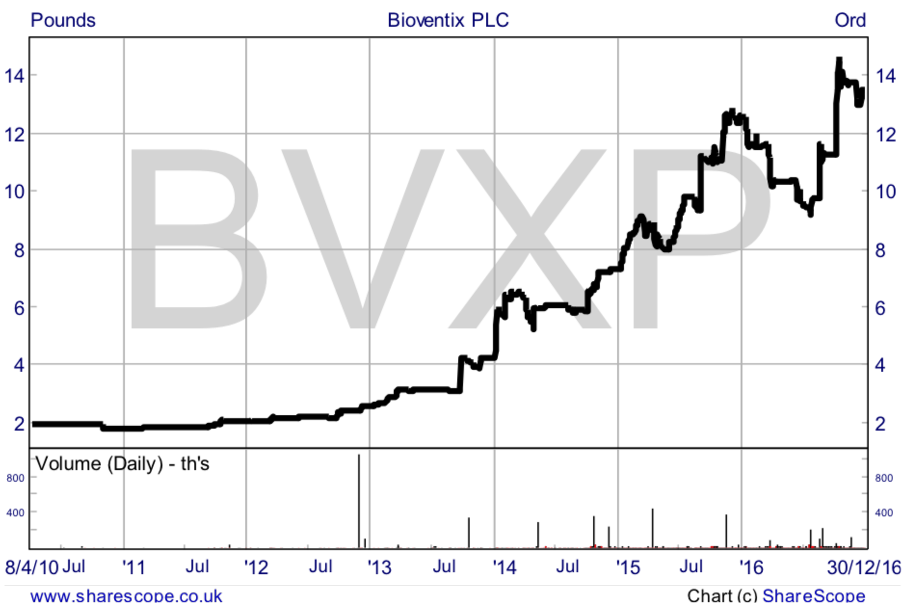
House broker Finncap's target price is 61p, implying 16% upside, although should the company continue on its current growth path I believe the longer term potential is much higher.

BIOVENTIX

Finally, one of the top holdings in the Amati UK Smaller Companies Fund is **Bioventix (BVXP)**, a specialist biotechnology business which is one of the top performing small cap companies of the past five years. The company earns its income by developing and supplying high-affinity monoclonal antibodies for use in clinical diagnostics, such as blood testing. Generated from sheep, Bioventix's portfolio of antibodies are sold to a range of multinational clinical diagnostics companies, with revenues being earned via fees paid during the development process but mostly from ongoing royalties (two-thirds of the total last year).

This royalty based business model means than Bioventix generates a consistent income stream and sizeable gross margins on its sales – 91% in the last financial year. Combined with

a tight control of administration expenses, the result is a highly profitable business which also delivers high levels of operational cash flow. The track record as a public company has been excellent, with net profits between the 2010 and 2016 financial years growing by a compound annual rate of 35.5%.



Ram-ping up revenues

The last financial year (to June 2016) was another good one for Bioventix and its shareholders, with revenues growing by 27% to £5.5 million and pre-tax profits up by 35% to £4.2 million. Performance was driven by increased sales of the company's vitamin D antibody and expansion into the Chinese markets. With cash building up on the balance sheet the decision was made to supplement the traditional dividend with a special payment of 20p per share, taking the total for the year to 62.5p.

In the current financial year growth opportunities come from the further roll out of customer vitamin D testing products. In the medium-term significant opportunities are seen via a partnership agreement with Siemens Healthcare Diagnostics whose troponin (a protein vital to muscle contraction) test features a Bioventix-created antibody. Further research activities are ongoing and are looking to generate revenues in the years from 2020.

Market bleating returns

Having risen by 559% over the past five years shares in Bioventix currently trade at 1,350p, capitalising the business at £68.83 million. Trading on a multiple of 18 times forecast earnings for the current financial year they remain highly rated but deservedly so given the track record of growth and cash generation. Even if we don't consider the potential for further special dividends (which look likely) the yield for 2017 is an attractive 3.8% assuming a 51p payment is made as forecast.

Overall, Bioventix is a quality stock which should continue delivering in the coming years.

BY SAMUEL RAE

FORENSIC FOREX

CURRENCY PREDICTIONS FOR 2017

As I write this, the year is drawing to a close, and the festive period is pretty much here. Financial asset markets are winding down for a week or so of low volume at the end of December, and the commercial retail season is in full swing. It's been a huge year pretty much across the board – politically, economically, socially and more – and all of these factors have aggregated to what looks set to be a year filled with uncertainty.

Uncertainty, yes, but this doesn't mean we can't put forward some projections as to how we think things might play out, and – more importantly – how these projections will influence the majors. Those familiar with my strategy will be aware that I run with a pretty cut and dry approach; I enter on a small number of candlestick signals, using the daily charts on the majors only. Nothing particularly exotic, and a slow and steady approach. Set and forget, and see what sticks.

It's been good to me for a long time now, and I have no intentions of changing my technically dominant playbook any time soon. That said, I like to let the fundamentals seep into my positions to a degree. Nothing game changing, and I never let a fundamental bias affect my decision to enter or not (if price tells me to get in, I get in), but I do let my fundamental bias impact my risk management decisions to a degree.

If price tells me to enter in line with my bias, I might be a little more aggressive with my target placement than I otherwise would have been against my bias. A little more room on my target allows for a little more room on my stop loss. The reverse, of course, is true, if the signal is against my bias.

It's this element of my strategy we've focused on primarily for the purposes of our Forensic Forex discussions. That's the interesting part, after all. So, with this in mind, and as we head into the aforementioned uncertain times, let's try and put some expectations together as to how I'm forming, and on what I'm basing, my fundamental bias in the majors.
First up, the USD.

I've been profoundly bullish on the greenback all year, and for the most part, I expect this to carry through in to 2017. With Trump at the helm I'm expecting the equities market to remain strong for at least the first portion of 2017, and for the remainder, I expect uncertainty (and the risk of sentiment this implies) to keep dollar buying supported.

There's one thing that concerns me, and that's the Fed's aggressive rate hike forecasts. Yellen is projecting three for 2017. That's pretty strong, and if it comes to fruition, the dollar will be equally strong, but I'm a bit concerned as to whether she's being overly optimistic. This time last year, the Fed projected four hikes for 2016. We only got the one. If the Fed can't make good on its hike schedule, we may see some weakness. That aside, however, I'm looking for strong bullish entries in the USDJPY, and some nice short opportunities in the EURUSD.

"I'VE BEEN PROFOUNDLY BULLISH ON THE GREENBACK ALL YEAR, AND FOR THE MOST PART, I EXPECT THIS TO CARRY THROUGH IN TO 2017."

Which brings us to the Euro.

Again, pretty much all year, I've been bearish Euro, and again, I expect this to continue for the foreseeable future. Germany is struggling to prop up an already weak single currency zone, and I just don't see where growth is going to come from; that is, growth that will allow the ECB to be a little more hawkish. As the region wavers, and geopolitical uncertainty mounts, there's going to be plenty of downside pressure on the European economy and – by proxy – its currency. Short EURUSD, short EURGBP.

Let's close this out with a look at Sterling.

I like Sterling right now, and it's probably the only currency on which I've pivoted towards the end of the year. Yes, the Brexit (I'm sick of saying this word) situation hangs over the UK, and the negotiations as the uncoupling comes to maturity are going to make for a rocky ride, but I think the UK economy far outweighs its European mainland counterpart (when aggregated, that is) in terms of potential, and I think the rest of the world recognizes this fact. The US is going to have to use the UK as a gateway to Europe whether it wants to or not, but I think it wants to, and there are advantages on both side of the Atlantic to a sound UK-US relationship. I think as Europe declines, the UK will gain strength both economically and in terms of global credibility, and this will translate to some aggressive monetary policy at the BoE, and in turn, some strength for Sterling. Short EURGBP, flat GBPUSD.

Let's see how things play out, see you on the other side!

BY DAVID JONES

CHART NAVIGATOR

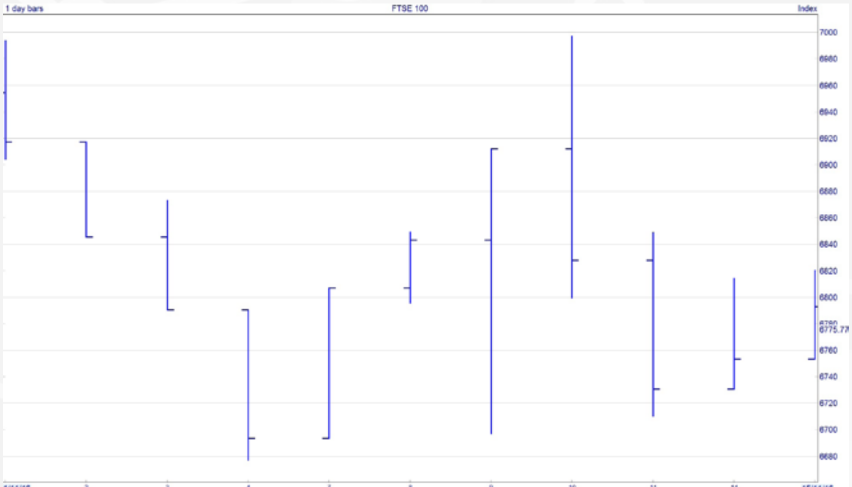
HOW TO UNDERSTAND CANDLESTICKS

This month we will take a look at a sub-division of the world of charting and technical analysis – the Japanese candlestick chart and a couple of associated patterns.

This form of representing price data has become very popular in recent years. It is an approach that is thought to date back to the 18th century, amongst Japanese rice traders. It was only in the 1990s that these charts started becoming much more popular amongst Western traders and investors, thanks to the publication of the book "Japanese Candlestick Charting Techniques" by Steve Nison.

First of all, the basics. Let's take a look at how a candlestick is actually constructed. If you are familiar with the concept of bar charts for market analysis it uses the same price data (but if not don't worry – I will assume no knowledge and start from the ground up).

In any particular time period – and for the purposes of this I am going to stick with daily data – there are four separate points of price information: the high for the day, the low for the day, where the market opened and of course where it closed. Traditionally this would be represented by bar charts, an example of which is shown below.



This is a bar chart of the FTSE 100 from the first half of November. Each vertical bar represents one day of trade. The low of the bar represents the lowest price reached by the FTSE on that particular day and, unsurprisingly, the high shows the FTSE's high point for the day. On the bars you can see horizontal lines – one on the left and another on the right. The left horizontal line shows where the FTSE opened that day – and the line to the right shows the closing price. So far, so straightforward. Chartists have used these types of charts for decades, updating by hand before computer software made it easy for anyone to call up a chart for all sorts of markets.

Candlestick charts don't do anything particularly magical with this open, high, low, close data. But in candlestick charting, the difference between the open and the close is considered all important – where did the market start the day, and where did it finish. So one way to think of a candlestick chart is a bar chart with this difference shaded in. Here is the same FTSE chart as above but now displayed as a candlestick chart.


JUL
AUG
SEP
DEC

The shaded-in part of the chart is referred to as the "real body" of the candle. In this example, where the market closes lower than the open this is coloured in red, and where the market finishes higher than its opening price the colour is white. The market may have an incredibly volatile day, but if the close is only a little bit different to the open then the candle will have a small body. Conversely, if the market opens and just goes up or down all day, the body will be larger. You can see an example of this on 7 November on this chart – the white candle that is left after the market had sold off for the previous four days. Clearly on this day sentiment changed and the buyers came back into the market.

Much of the analysis of candlestick charting patterns is to do with the bodies of these candles, and for this month we are going to take a look at two very common patterns. They are variations on the same theme and are known as "engulfing patterns". The reason for this name is very simple – it is when the body of one candlestick engulfs, or completely covers the previous day's body. Much of Japanese candlestick charting looks at trying to weigh up the battle between the bulls and the bears in the market – who is winning, whether the tide has turned. Like all approaches to markets it is not something that works all the time, but in my experience engulfing patterns can be a useful tool for tracking the first changes in sentiment.

"JAPANESE CANDLESTICK CHARTING LOOKS AT TRYING TO WEIGH UP THE BATTLE BETWEEN THE BULLS AND THE BEARS IN THE MARKET – WHO IS WINNING, WHETHER THE TIDE HAS TURNED."

These are reversal patterns – so one of the prerequisites to set up an engulfing pattern is for the market to have been in a trend before the pattern occurs. Here is the FTSE from February 2016.

The first bit we are interested in here is the move on 12 February. A sustained move lower at the beginning of the chart saw the FTSE fall from 6,100 to 5,500 – a sizeable drop. But then the trading on 12 February saw a strong move higher and the market close on the highs – usually a bullish sign that there should be more to come. But what we are interested is the body of the candle on this day, relative to the previous day's down red candle. You can see that the 12 February candle covers the body of the previous day. This is the bullish engulfing set-up. It is a suggestion that sentiment is changing.

An aggressive way to trade this would be to buy the market on the next day's open, with a stop-loss under the low of the previous day. By definition, the market should not drop below the low of the bullish engulfing candle, if it is going to work. It is a reversal pattern so the market should continue reversing!

As it turned out, this worked well. Over the next few days the FTSE recovered more than 300 points. Interestingly (to chart geeks like me at least), there was another bullish engulfing candle towards the end of the chart, when the FTSE dropped back for a couple of days. The candle engulfed and the market took off once again.

For every bullish pattern, there is normally a corresponding bearish, or negative, one. This is the bearish engulfing candle which occurs after the market has been trending higher and then there is a day that engulfs the prior day "up" candle. Here's another from the FTSE.

This is from last August. You can see the index had been moving steadily higher with no down days until 16 August. This day ended up being a bear-

“THESE ARE NORMALLY A GOOD HINT THAT SENTIMENT IS STARTING TO SHIFT – PARTICULARLY WHEN THEY OCCUR NEAR AN OBVIOUS LEVEL OF PRIOR SUPPORT.”

ish engulfing candle. Once again, one strategy would be to sell-short with a stop above the high of the candle. This is another that worked well and saw the market move a good 150 points lower.

These are of course examples used with the benefit of hindsight to illustrate the point. The real world of trading and investing is never quite as perfect – these signals don't work all the time and that is what stop-losses are for. But in my experience, particularly on longer term charts showing daily and weekly candles, these are normally a good hint that sentiment is starting to shift – particularly when they occur near an obvious level of prior support.

I have focussed on the FTSE as it is a market that most of us will be aware of – but also to demonstrate that these patterns do crop up at least a few times a year in most markets. Of course, the same principles can be applied to individual shares and here are a couple to keep an eye on. I have chosen weekly candles for these examples to fit it with the more longer term view of the typical investor.

The first one to watch is the car dealer **Inchcape (LON:INCH)**.

The share price has actually been in decline for the best part of 18 months but there has been lots of support around the 600p mark which has brought in buyers. Over the past week or so there has been a reversal in short-term sentiment at least – you can see the large engulfing candle from the week before last. That is one reason this is interesting to me – but also the 560p/600p area has proved to be a good floor for the share price since 2014. If confidence is going to start coming back in anywhere then this is as good a place as any.

It is a similar setup on the second share to watch – retailer **Dunelm (LON: DNLM)**.

It is another share where 2016 has not been the best of years, but once again the past couple of weeks do suggest that recent negative sentiment may be turning around. There was an engulfing candle last week and this strength has continued. The zone where the strength has come back also ties in well with support from July ahead of the 720p mark. Assuming we are going to see a recovery from here, the share price would be expected to hold once again above this level.

These engulfing patterns are not some sort of "chart voodoo" that are going to be right every time. But, for traders and investors alike, they can be a heads-up that previous sentiment could well be on the turn, giving low risk/high reward opportunities across different time frames and in a host of markets.

BY FILIPE R. COSTA

HOW TO INVEST LIKE...

ANTHONY BOLTON

"For some reason I have always felt happier going against the crowd and generally feel uncomfortable doing what everyone else is doing. So many pressures in the investment business encourage one to do the opposite and go with the crowd."

— Anthony Bolton,
"Investing With Anthony Bolton: The Anatomy of a Stock Market Winner", 2006

A Garland of Carols

While writing this column, I'm listening to some beautiful classical music that fits perfectly into the festive season. The angelic coral voices from *"A Garland of Carols"* help me relax and find inspiration to write about the legendary British investor Anthony Bolton. Believe it or not, the man featured in this month's column is a great classical music composer. Influenced by the British composer Benjamin Britten and an enthusiast of classical music with chorus and solo vocal features, Anthony Bolton has composed music that has been performed at St. Paul's Cathedral and that currently inspires me through Spotify.

But Bolton is best known as being one of the most talented British investors of all time – a man who has been able to outperform a whole industry for almost 30 years. Starting with just a few million pounds under management for the then newly created Fidelity UK, he turned millions into billions through consistently delivering huge returns to investors. Someone who invested £10,000 with Bolton at the end of 1979 would have accumulated around £1.5 million by the end of 2007 when he left his main fund management activities. Over that time period, Bolton recorded a 19.5% annual performance, clearly outpacing the 13.5% annual return that was achieved by the FTSE All-Share. The Fidelity UK flagship fund – Special Situations – quickly became the UK's largest open-ended fund.

"SOMEONE WHO INVESTED £10,000 WITH BOLTON AT THE END OF 1979 WOULD HAVE ACCUMULATED AROUND £1.5 MILLION BY THE END OF 2007 WHEN HE LEFT HIS MAIN FUND MANAGEMENT ACTIVITIES."

Chance always plays a role

Not all great investors started off by making money at an early age. Anthony Bolton, 66, a slim figure with brown eyes and curly greying hair, cer-

"I AM LOOKING FOR STOCKS THAT ARE UNFASHIONABLE AND CHEAP, BUT WHERE THERE IS SOMETHING WHICH WILL RECAPTURE INVESTORS' ATTENTION BEFORE TOO LONG."

tainly doesn't fit into the conventional image of a great investor. After pursuing an engineering degree at Trinity College, Cambridge, Bolton had to be encouraged by his father to get a job. But he soon realised he didn't want to become an engineer and, through the influence of family and friends, he landed a job in the City at the merchant bank Keyser Ullmann. Only later did he step into the investment arm of the bank and start dealing with stocks. He stayed for five years and then moved on in the direction of the Schlesinger group.

While at Schlesinger, Bolton learned more about stock research and analysis and fund management, while also meeting Richard Timberlake, who would be a key element in driving him to success with Fidelity Special Situations. Another key factor was his wife's counsel, which encouraged him to look for a job at the nascent Fidelity UK. Timberlake had departed from Schlesinger in the direction of Fidelity to help set up the UK operation in 1979. By then, Bolton's experience in terms of fund management was meagre but his wife insisted that he had nothing to lose in speaking with Timberlake. Chance guided Bolton in the right direction. In 1979, he married his wife, Sarah, and started a prominent career at Fidelity UK, becoming one of the firm's first London-based fund managers.

The rise of Fidelity Special Situations

Richard Timberlake was willing to create a fund primarily focused on capital growth to complement Fidelity's existing stable of more defensive-oriented funds. Bolton suggested the creation of a fund similar to one he had helped manage while at Schlesinger, which was a special situations trust with a mandate to search for capital growth opportunities in an aggressive and contrarian manner. The new Fidelity Special Situations trust would be created with a similar purpose of seeking out companies that were attractively valued with regards to net assets, dividend yield and expected earnings per share. Later, Bolton described the fund as investing in companies with recovery potential, strong growth, assets whose value hadn't been generally recognised, some special product featuring a market niche, takeover potential, subject to restructuring and/or management changes, and not widely researched by others. Leveraged by quality in-house research, Bolton could gain an advantage over the market and uncover profit potential. The Special Situations trust was about exploring the potential of investing in companies that had been disfavoured by the broad market and then waiting for an improvement in sentiment that could reunite price and fundamentals. As Bolton once described his fund management activities:

"I manage my funds with an above average risk profile, based on contrarian stocks... my ideal is a company where things have gone wrong, but where it looks as if things may be changing. I am looking for stocks that are unfashionable and cheap, but where there is something which will recapture investors' attention before too long."

Other Funds

The Special Situations trust was a hard sell at the beginning and struggled at around £2-3 million in size for some time. But, as the fund delivered in terms of performance and hit the top tables, investors started to take notice. The fund was created as a unit trust because Bolton always loved to manage money freely without the burden of facing trustees, who question every action and press for short-term profits to the detriment of the long-term focus that the fund manager should always have in order to be able to deliver consistent profits over time. In fact, the technical difference between the general nature of a unit trust and other kinds of funds bears some of the responsibility for Bolton's success.

As his star rose, Fidelity gave Bolton a few more funds to manage. In 1985 he started managing the Fidelity European fund, in 1990 the Fidelity European Growth fund, in 1991 European Values plc, and in 1994 Fidelity Special Values plc. At a time when the European market was underdeveloped, Bolton saw a great opportunity to apply his strategy that had been previously tested with huge success in the UK.

In 2005, 25 years after starting his career at Fidelity, Bolton announced he was stepping down from actively managing funds. The Special Situations trust was split into two funds to better manage its size and, at the end of 2007, Bolton stepped down completely from its management, albeit still retaining a position at Fidelity, particularly to help uncover talent and train fund managers and analysts. In 2010 he made a return to active fund management for a period of three years to manage China Special Situations plc, a London-listed investment trust aimed at capturing value in China, which was fully subscribed from the very beginning at £460 million. In April 2014, he finally retired from active management. When he stepped down from the UK Special Situations fund in 2007, Fidelity experienced some large withdrawals, as investors believed that the best part of the strong performance was due to Bolton's stock picking abilities. But later, and mainly because Bolton had carefully chosen the new fund management team and stepped down only gradually, the funds ended up reversing these initial outflows.

Bolton's Strategy

Bolton is a contrarian value investor who believes he can gain an advantage over the market through doing his own research and opposing the herd. At a time when no one else was doing so, Bolton and his team kept in close contact with the management of the companies they were invested in, with regular visits to get a better view of the business. While Bolton borrows much from Warren Buffett, his strategy shares more parallels with Peter Lynch's buy-and-rotate than with Buffett's buy-and-hold. The average holding period for a share in the Special Situations trust was 18 months, as Bolton regularly re-evaluated the prospects for all his portfolio holdings, selling stocks that had converged to fundamental value to seek out other nascent opportunities.

"WHILE BOLTON BORROWS MUCH FROM WARREN BUFFETT, HIS STRATEGY SHARES MORE PARALLELS WITH PETER LYNCH'S BUY-AND-ROTATE THAN WITH BUFFETT'S BUY-AND-HOLD."

Bolton's strategy is relatively simple and coincides with the path value investors usually follow, but with some interesting adjustments. While value investors generally agree that being in close contact with a company's management is an important factor, most

would discard technical analysis as a valuable tool. But Bolton believes technical analysis is a great confirmation tool that serves to adjust the proper size of a position selected through fundamental analysis. We can summarise the key points from Bolton's strategy in 15 components, as follows.

(1) Research the business meticulously to understand its key characteristics

Making money through investment requires a disciplined approach. There's no shorthand or lazy approach that can deliver consistent profits. Investors seeking abnormal returns need to uncover all they can about the stock they want to invest in. The first step requires gathering a good deal of information about how a company makes money, what its competitive position is, how valuable its franchise is, and whether it can sustain its business for many years or not. Investors should be looking for some quality product in a niche market that makes people buy it without the company needing to enter price wars that would bring down its margins to unsustainable (or uninteresting) levels. When the iPhone and the iPad were first introduced, they were market movers that gave Apple a competitive advantage that would last for many years. Bolton was able to back a few gems over the years, which include the now struggling – but back then high-flying – Nokia. He uncovered Nokia's potential well before everyone else, at a time when mobile phones were a nascent market.

(2) Understand the key variables that drive the business

A second step involves understanding how everything works in reality. The variables affecting the company should be identified to evaluate the risks. A company may sometimes be exposed to a few important external factors that may turn it into an uncompetitive business. Exchange rates, commodity prices, interest rates and taxes are all examples of such factors. The competitiveness of an exporter is largely tied to exchange rate movements, just as the fortunes of Easyjet are to oil prices and those of Glencore to commodities prices. At this point a range of macroeconomic scenarios may be valuable to get a clear picture about the risks affecting the particular stock.

(3) Meet with the company's management

Meeting with corporate insiders is valuable to get a view of the people and the strategy being pursued. It helps an investor understand the quality of the business and the variables affecting it. This way, an investor is able to build a more accurate valuation model. At the same time, a short conversation with management may help the investor form a view on how realistic the strategy may or may not be, and thus be

"HE UNCOVERED NOKIA'S POTENTIAL WELL BEFORE EVERYONE ELSE, AT A TIME WHEN MOBILE PHONES WERE A NASCENT MARKET."

"BOLTON OBSERVES THAT COMPANIES WITH 'WEAKER BALANCE SHEETS' HAVE ALWAYS BEEN AT THE TOP OF HIS WORST PERFORMERS LIST."

prepared to discard businesses that look sound but whose management is too optimistic and more prone to take unnecessary risks.

(4) Examine a range of valuation metrics

Bolton mentions a few metrics he believes are important: price-earnings ratios, the ratio of enterprise value to gross cashflow, free cashflow ratios, cashflow return on capital relative to invested capital. In general, Bolton believes investors should purchase stocks from companies that have a strong ability to generate cash in an uncomplicated fashion.

(5) Put the valuation in perspective

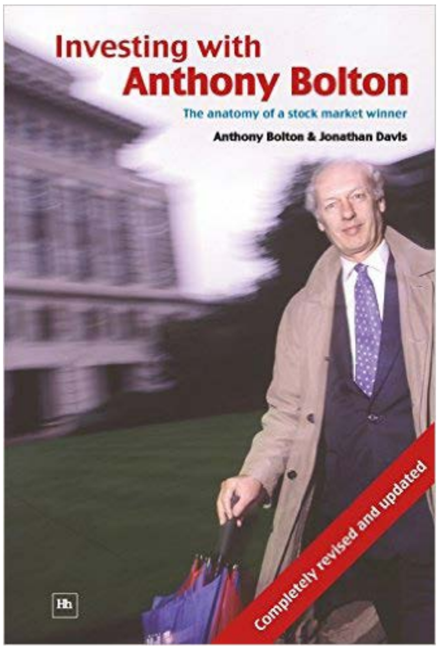
After evaluating a company's metrics, investors should put its valuation in perspective, both in relative terms by comparing with peers, and in absolute terms as a reality check. Low relative price ratios certainly make a company's stock more attractive than the stock of its peer groups, but it isn't a sufficient reason to take a stake. There are times when the absolute price ratios are all too elevated for a whole industry or sector. The dot-com bubble is an example of a situation when investors could find some price ratios that were low in relative terms, but that wouldn't pass the reality check of the absolute comparison.

(6) Look at the balance sheet to understand the financial risks

Value investors are always concerned about the balance sheet in terms of debt, leverage and the cash position of a company. A company with a weaker balance sheet, where debt is high and cash is low, would most likely not survive a financial crisis or an economic recession. When events move against them, these are the companies where investors stand to lose the most money. Bolton observes that companies with "weaker balance sheets" have always been at the top of his worst performers list.

(7) Take a look at insiders' trading activity

Academic research shows that insider dealing provides some useful information about a company's prospects, under certain conditions. Investors should look for multiple transactions and in particular at purchases (as sells are many times the result of insiders exercising the options granted on performance). A manager with a strong view on future performance and who believes the shares of the company are undervalued may buy larger amounts. Because of the restrictions attached to insider dealing this indicator should not be used in isolation, but serves as a confirming or non-confirming tool.



(8) Take a look at the list of shareholders

Takeover prospects are always a good way of making money, so looking at the list of shareholders to investigate if there's a "corporate angle" to the stock, is always a good starting point.

(9) Take a look at institutional ownership

Investors should also look at the institutional ownership and investigate whether there is under or over-ownership, and identify the key recent trends.

(10) Seek ideas from a variety of sources

Investors should analyse recent news, comments, opinions and other sources of information. While the main idea is to avoid going along with the crowd, there is no plagiarism in investment, which means that investors may very well get investment ideas from others (provided that they then went through a thorough research process to confirm value).

(11) Re-examine your investment thesis at regular intervals

Bolton's strategy is not a buy-and-hold one, and therefore requires some portfolio turnover to occur from time to time. When prices converge to fundamentals, investors should look elsewhere for opportunities, as the initial investment thesis is no longer in place.

(12) Forget the price paid for the shares

Such price is an important piece of the decision-making at the time of purchase but largely irrelevant thereafter. The decision to keep or sell the shares at any one point should be driven by the comparison of current prices with fundamentals. Past prices are only psychologically important.

(13) Be a contrarian

The concept of being a contrarian is not a kind of permanent opposition to what others do, but rather the realisation that when everyone else is worried about something, those concerns should largely be reflected in the price. By that time, sentiment is very low and the shares may be oversold. A contrarian is someone that is able to understand the extent of overreaction and take a position to exploit it.

(14) Being a contrarian is no short-term business

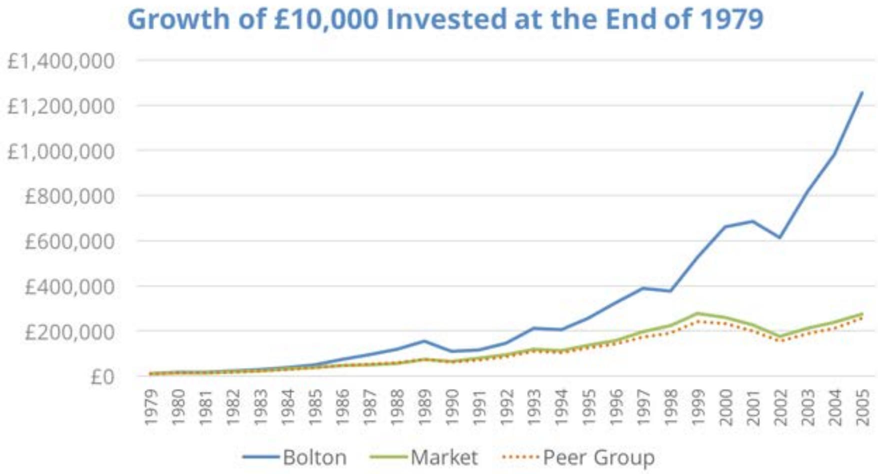
The process of buying at low prices when sentiment is depressed and waiting for sentiment to revert to normal levels and price to converge to fundamental value takes time to unfold. While Bolton believes investors can get an edge through thorough research of the fundamentals of a company, he doesn't believe in market timing and in being able to achieve consistent profits in relatively short periods of time. In line with Benjamin Graham's thinking, Bolton believes that *"in the short run, the market is a voting machine but in the long run, it is a weighing machine."*

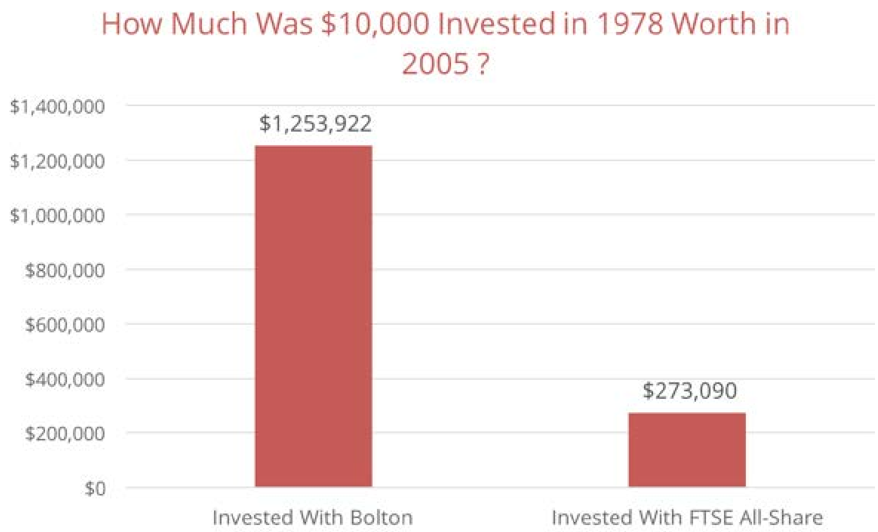
(15) Complement research with technical analysis

While technical analysis shouldn't be used as primary decision criteria, it is very helpful when deciding on the size of the position to be taken. If fundamental analysis points in favour of an investment, then the position taken by Bolton would be larger if technical analysis confirms the positive signal, but smaller (if not avoided or delayed) if technical analysis points in a different direction. Bolton uses technical indicators as confirming or refuting tools, in particular when taking decisions regarding the larger market capitalisations.

A few final words

Anthony Bolton is an example that life holds many surprises and that sometimes the most prominent roles and tasks in life start accidentally. Nagged by his father to find a job and later encouraged by his wife to walk the extra mile, Bolton moved in the direction of the big investment management business. Faced with the triple challenge of marrying, moving house and moving jobs in a relatively short period of time in 1979, Bolton made the move that would turn him into one of the most respected fund managers in the country. His performance is north of 20% per annum over a 27-year period, a record that stands up against the likes of Benjamin Graham (issue 13), Warren Buffett (issue 14) and Peter Lynch (issue 15). During that period, Bolton's funds always featured in the top of the performance tables, as he always deviated from the market proxy to capture value. But what's really intriguing about Bolton is the fact that size didn't matter to his performance. He explains that from just 30 holdings, the Special Situations trust grew to over 200 holdings because of its growing size. But while even Bolton recognises the risks to performance that come with size, the performance of the Special Situations trust was never impacted.





DECEMBER 2016

BEST OF THE BLOG

Earthquake in Italy: European banks tremble

Yesterday, Italy became the most recent domino to fall in the global populist revolution about which I wrote in this month's MI magazine. If Mr Cameron (score: 48 percent) resigned at half past eight in the morning, Signor Renzi, the Italian Prime Minister (score: 40 percent) resigned at midnight. He had offered the Italian people some quite reasonable constitutional reforms (reduction in the powers of the Senate and a curtailment of regional governments) but they used the vote to register their general dismay with the status quo. Another metropolitan sophisticate Prime Minister has been humbled.

With a NO vote seeming inevitable in the Italian referendum, the Euro fell below $1.06 in late trading late on Sunday, down 0.8 percent from Friday's close. The common currency had already registered sharp losses since the beginning of November, when it was trading close to $1.13. This morning European bourses have thus far shrugged off the vote (the FTSE-100 opened higher), though bank stocks are down. Italian government bond yields have risen sharply.

"WE ARE FACING THE PROSPECT OF A EUROPEAN SPRING IN 2017 WHICH WILL MAKE THE ARAB SPRING OF 2011 LOOK LIKE A SUNDAY AFTERNOON PROMENADE."

As I have been arguing for some time, we are facing the prospect of a *European Spring* in 2017 which will make the *Arab Spring* of 2011 look like a Sunday afternoon promenade. These seismic political shocks come at a time when the European banking and financial system is extremely fragile. Italy, with a banking sector burdened with unparalleled volumes of non-performing loans (NPLs) and a state sector sinking under unsustainable levels of debt, is under extreme financial stress. Yet, being the third largest economy in the Eurozone, *it is too big to fail.* But how could it be saved?

French and German banks are highly exposed to the Italian banking sector. A possible systemic crisis across the European banking system would have huge repercussions for Europe's economy. *How bad is it? What are the policy options available to the ECB and European governments? And how can savers and investors in the UK – where we are mired in the imponderables of Brexit – best protect themselves?....*

By Victor Hill

Click here to read the full article

Why Whitbread is set to prosper from Brexit

It's easy to look at Brexit and come to the conclusion that it will be bad for all UK-focused companies. After all, it brings uncertainty, change and a potentially negative impact on the UK's overall economic performance.

However, as with any situation, there will be winners and losers. Some companies will see their sales and profitability fall if reduced spending and investment become a reality. However, other companies could record little change in their performance, while some will inevitably benefit from Brexit.

Among those companies which are well-placed to prosper from Brexit is Whitbread (LON:WTB). The Costa and Premier Inn owner has a loyal customer base, which means that its sales performance may be more akin to a consumer staple than a consumer discretionary. Further, Premier Inn in particular could benefit from consumers trading down to budget hotel options, while the company's international growth potential remains high. Therefore, in my opinion Whitbread will prosper from Brexit.

In theory, a cup of coffee is a discretionary item. Nobody has a requirement to drink coffee. However, for the 16% of British adults who visit coffee shops on a daily basis, it is more likely to be considered a must-have item as opposed to something they can do without. Therefore, whether their incomes rise at a faster or slower pace

than inflation, coffee drinkers are unlikely to reduce the amount of coffee they consume.

This is highly relevant for Whitbread because its Costa division accounted for 37% of its revenue in the most recent financial year. The Bank of England forecasts that inflation will reach 2.7% in 2017, which is relatively likely to exceed the pace of wage growth for most UK workers. Therefore, the UK could experience a similar situation to that of the credit crunch, when disposable incomes fell in real terms. This caused consumers to either delay, reduce or end spending on discretionary items....

By Robert Stephens, CFA

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The Fed is behind the curve

For the second time in a decade, the Fed has hiked its key interest rate target. One year after the first hike, the central bank decided to give continuity to a new tightening trend that is still expected to evolve very slowly over time. Policymakers at the FED now expect three rate rises in 2017, with the mean

projected year-end rate now standing at 1.37%.

Although the market was surprised with a slightly more hawkish stance than adopted at previous committee meetings, it failed to price the high likelihood of a few important eventualities, which may lead to future surprises.

Equities are off record highs, the yen and the euro are on a downtrend, and gold is free falling. But most of these trends will most likely revert in the short term, as there is still huge optimism regarding corporate America and the FED decision was widely expected, after all. But in the medium term, risks will mount again.

"ONE WAY OR ANOTHER TRUMP IS RECORDING WIN AFTER WIN."

One way or another Trump is recording win after win. Janet Yellen and other policy officials have been emphasizing the fact the central bank is independent from the government... and they're quite right, in the sense that Donald Trump does not yet constitute government.

The truth is that both Trump in the U.S. and May in the UK are ushering in a new era where the respective central bank may have a lot less scope to deploy unconventional policy measures than it had during past government tenures....

By Filipe R. Costa

Click here to read the full article

Hadrian's Wall is an attractive proposition for income seekers

Since the financial crisis of 2007-09 the banks have pulled back from some of their traditional lending activities and left a gap in the market that others have been able to take advantage of. A prime example is loans to small and medium sized enterprises (SMEs), with many of these organisations having to look elsewhere for the capital they need to run their businesses.

Lending to SMEs can be a lucrative area as the interest rates are normally higher than for personal loans and can be up at the 9% or 10% level. The challenge is to make sure that the borrowers can pay it back, which is why a new secured lending fund operating in this sector is worth a closer look.

Hadrian's Wall Secured Investments (LON:HWSL) raised £80m when it floated on the LSE in June. It will use the money to invest in UK commercial loans secured by assets such as equipment, plant and machinery, property and trade debtors. Once the capital has been fully deployed the fund will target an annualised dividend yield of at least 6% on the £1 issue price and it expects that this will increase over time.

It had been hoped to attract in excess of £150m of funding from the initial placing but the demand was lower than anticipated, although there was no shortage of potential borrowers, with the fund having letters of intent in respect of £500m of investment opportunities. These were from the likes of the specialist lender Wellesley & Co, the peer-to-peer provider Landbay Partners and the online platform FundingKnight.

The fund is run by International Fund Management Ltd, which is a part of the Channel Islands-based Praxis IFM Group, but the management has been delegated to Hadrian's Wall Capital Ltd, a specialist that operates in this area....

By Nick Sudbury

Click here to read the full article

BY RICHARD GILL, CFA

READ TO SUCCEED

THE HARRIMAN STOCK MARKET ALMANAC 2017

SEASONALITY ANALYSIS AND STUDIES OF MARKET ANOMALIES TO GIVE YOU AN EDGE IN THE YEAR AHEAD

BY STEPHEN ECKETT

As 2016 comes to a close and with another year upon us it's time once again for Stephen Eckett to repeat his annual literary tradition by writing the latest edition of The Stock Market Almanac. Part diary, part trading guide and packed with facts, figures and marvellous miscellanea, this is the ultimate handbook for any investor who is planning to tackle the financial markets in 2017.

As in previous years, the Stock Market Almanac offers readers a preview of key financial and economic events which are due to transpire over the next 12 months, all laid out in an easy-to-follow diary-style format. But my favourite part, providing entertainment as well as useful trading ideas, is Eckett's famous seasonality analysis, which looks at historic trends and patterns in the financial markets, some of which you will be familiar with and others being a little more obscure.

Readers will be pleased to know that last's years Almanac was accurate in many respects, with much of the analysis pointing towards a positive year – as I write this review (just before Christmas) the FTSE 100 has gained 13.2% in the year to date.

2017 – Cocks and stocks

In contrast to 2016, 2017 is a bit sparse in terms of major global events which have been seen to have a historical effect on the financial markets. The US elections are over for another four years, as are the Olympics, and, being an odd year, there are no big international sporting events to capture the world's attention. Nevertheless, there are still a clutch of more minor happenings to plot stock market performance against.

> **"PART DIARY, PART TRADING GUIDE AND PACKED WITH FACTS, FIGURES AND MARVELLOUS MISCELLANEA, THIS IS THE ULTIMATE HANDBOOK FOR ANY INVESTOR WHO IS PLANNING TO TACKLE THE FINANCIAL MARKETS IN 2017."**

For example, on 21st August the US will experience the first total solar eclipse for almost 100 years that will pass from sea to shining sea. While there is no evidence that eclipses have any direct physical effect on humans, they certainly have brought about some strange psychological effects throughout history – from human sacrifices to appease the gods to noisy rituals carried out to scare away whatever beast was thought to be "eating" the sun. But do eclipses affect the stock market? Eckett's analysis of 15 total solar eclipses visible from the US since 1900 shows that the Dow tends to fall on the day prior to and on the day of an eclipse, before rising the following day – maybe a sign of sunshine coming back to the markets.

On the other side of the world, China will be welcoming in the year of the rooster in 2017. But in contrast to the current year of the monkey, history tells us that investors aren't in for an egg-celent time. Prior to the current year, monkey years since 1950 saw the S&P 500 rise by an average of 7.3%. And with the US index having surged by 22.5% to all-time highs so far in the current monkey year, investors look set to continue to profit from our primate pals. However, rooster years are the only Chinese zodiac years that have had a negative annual return, the S&P falling by an average of 4% in every rooster year since 1950. That's a truly foul performance.

Back of the net (profits)?

Just as the almanac is an annual literary tradition it has been my own personal custom to demonstrate that analysis of historic data can always flag up potential anomalies if you look hard enough. Before investors consider trying to take advantage of apparent market irregularities which pop out of the numbers, they should always remember that "correlation does not imply causation", or in other words, a link might be suggested between two variables but it doesn't mean there is a valid reason for one causing the other. Before taking the plunge investors should research if there are any fundamental economic reasons behind an anomaly's existence.

To demonstrate this effect in previous years I have analysed stock market returns in the months following the promotion of my football team, Bradford City, and the performance of stocks based on letters of the alphabet. I go back to football again this year and analyse whether the shirt colour of the FA Cup winners can predict stock market outperformance.

Since the FTSE 100 index was launched in 1984 the winners of the FA Cup have predominantly worn either mainly red or blue shirts, with only Tottenham Hotspur's win in 1991 providing us with another triumphant tint. On 19 occasions since 1984 a team wearing a red shirt has been victorious, with 13 wins for the blues. Since 1984 the FTSE 100 has on average gained 2.52% between the FA Cup final date and the end of the year. Further analysis shows that when a team wearing a red shirt wins the cup the FTSE goes on to beat the above periodic average gain 63% of the time, compared to 54% of the time for years with a blue victory.

So should investors be cheering on Arsenal and Manchester United this year in order to increase their chance of better investment returns?

Well, no. This is another classic example of data mining. Of course there is no valid economic reason for the colour of a football shirt to affect how a financial index, consisting of multi-billion pound international companies trading across a variety of sectors, performs. So basing investment decisions upon the result of one football match is a strategy as silly as West Ham moving to the former Olympic stadium – unless of course you can buy shares in the football team itself (see last year's almanac for this more sensible football results based investment strategy).

A great gift

While it might be a bit too late to buy the Stock Market Almanac as a Christmas present, this is still an ideal gift for any investor who wants to gain an edge in the markets in 2017. As well as the main diary section, the book has a chapter dedicated to detailed stock market statistics – which are useful for both information purposes and developing trading strategies to beat the markets next year – and is finished off with a useful reference section. Given the raft of information provided here, a small investment into the almanac could well pay itself off many times over.

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BY TIM PRICE

THE FINAL WORD

THE DEATH OF NARRATIVE

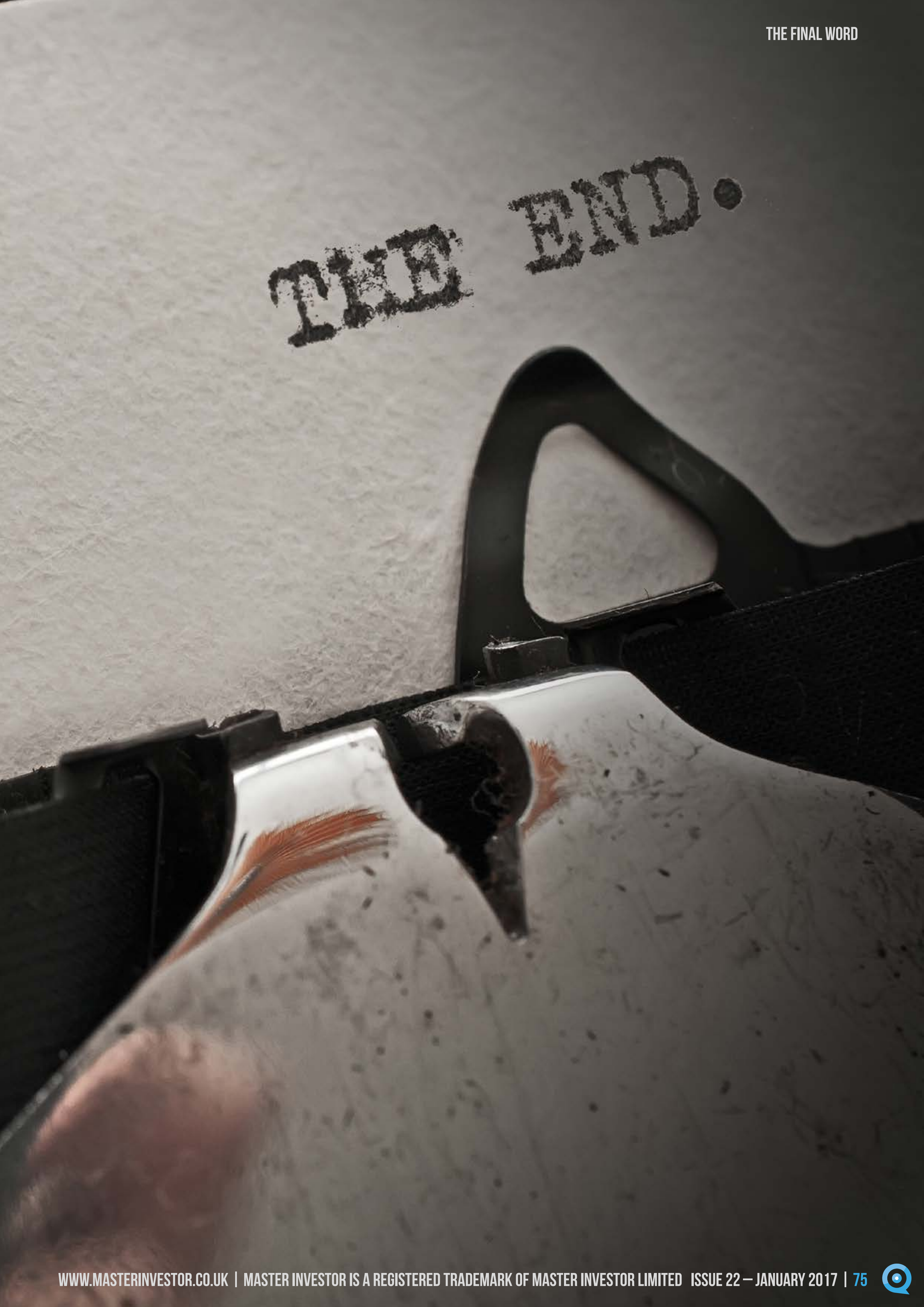
2016 incorporated many themes, but the one I would suggest is most pertinent to private investors could be called 'the death of narrative'. To put it another way, whenever Groupthink encountered the prospect of a geopolitical sea change, it would turn out to be irretrievably wrong. Brexit couldn't possibly happen – until it did. Trump couldn't possibly get elected as US President – until he did. And I suspect that the Trump victory will ultimately be judged by historians as the election that Twitter won. We may all have just experienced 'peak press'; the relentless rise of "the Donald" was not just a coup against the Establishment, it was an extraordinary repudiation of the power of conventional media.

As a passionate advocate for the 'Leave' campaign, even I have been taken aback at the ferocity of the 'Remoaner' backlash. The best analysis I have seen of the Brexit verdict came in the form of a fizzingly eloquent essay in *The New Statesman* by the philosopher John Gray. Take this, for example:

"Predictably, there is speculation that Brexit will not happen. If Britain can vote for Brexit, it is being argued, surely anything is possible. But those who think the vote can be overturned or ignored are telling us more about their own state of mind than developments in the real world. Like bedraggled courtiers fleeing Versailles after the French Revolution, they are unable to process the reversal that has occurred. Locked in a psychology of despair, anger and denial, they cannot help believing there will be a restoration of an order they believed was unshakeable."

First there was Brexit and then the US political and cultural Establishment got well and truly Trumped. At which point a new word, or rather an old word with a cynical new twist, entered the popular lexicon: *populism*. Again, John Gray was at the top of his game and far ahead of the crowd:

"As it is being used today, "populism" is a term of abuse applied by establishment thinkers to people whose lives they have not troubled to understand. A revolt of the masses is under way, but it is one in which those who have shaped policies over the past twenty years are more remote from reality than the ordinary men and women at whom they like to sneer. The interaction of a dysfunctional single currency and destructive austerity policies with the financial crisis has left most of Europe economically stagnant and parts of it blighted with unemployment on a scale unknown since the Thirties. At the same time European institutions have been paralysed by the migrant crisis. Floundering under the weight of problems it cannot solve or that it has even created, the EU has demonstrated beyond reasonable doubt that it lacks the


THE END.

"AS AN ASSET MANAGER, I FAILED IN JUNE 2016, AND STILL FAIL TO SEE TODAY, HOW BRITAIN'S INTERESTS ARE BEST SERVED BY MEMBERSHIP OF A VISIBLY FAILING ECONOMIC BLOC."

capacity for effective action and is incapable of reform."

There can be no denial that the Brexit campaign was murderously savage and devoid of rational argument – on both sides. But what was most disconcerting was the utter lack of anything positive to say about the European project from the Remain camp. The only arguments floated related to the economic misery that Brexit would entail.

I voted not as an asset manager (and therefore not patting my wallet as I entered the polling booth) but, first and foremost, as a libertarian. What mattered to me was reversing a profound confidence trick – that, back in 1975, the country had voted to remain in what was termed a common market. Not a political union. Whether we were lied to by our European cousins or by our own politicians is now somewhat academic.

But as an asset manager, I failed in June 2016, and still fail to see today, how Britain's interests are best served by membership of a visibly failing economic bloc. This year will be another tired and dismal procession of bank failures, bailouts and restructurings that fly in the face of the single market's rules for state support and which suggest that Brussels' biggest export to the rest of the EU should really be fudge.

Just how did the narrative around Europe's voluntary self-immolation get so badly distorted? Perhaps because the Establishment, and its media interests, followed John Gray's damningly described behaviours to the letter: they were, and remain, "locked in a psychology of despair, anger and denial".

One of the best books I read in 2016 was Yuval Harari's 'Sapiens'. In our prehistoric past, there were at least six human species inhabiting the planet. Now there is just one: homo sapiens. Us. Harari asks how it came to be that "we" beat out all our ancient ancestral cousins. His answer: homo sapiens possesses a unique ability to believe in stories. A village of one hundred people requires no external administration because it can order its affairs for itself. But a city of a million needs a hierarchical infrastructure. How can a country send off perhaps thousands of men to fight in the cause of national self-interest, quite possibly to die? By instilling myths that people can believe in.

We are, in other words, suckers for narrative. Faced with uncertainty, we crave something we can believe in, irrespective of whether it may be objectively true or not. This evolved behaviour is just as powerful in investment markets as in any other context. Ben Hunt of Salient Partners is particularly good at writing about the markets through the prism of narrative (and through the lenses of history and game theory) – you can find his excellent research on these topics at http://www.salientpartners.com/epsilon-theory/.

The bottom line is that the big narratives started to collapse in on themselves last year. Narratives, or we could perhaps call them memes, have their own evolutionary potential. As bad narratives fail, they get replaced by stronger, more robust ones.

I prefer to go back to the source. Historians talk about two different types of source material. Primary sources are documents that were created at the same time as the events they depict: diaries, manuscripts, interviews etc. Secondary sources were produced after the event, at arms' length, with the passing of time.

In financial markets, almost all sources are secondary, especially anything produced by the financial media. At the risk of seeming pretentious, here is where Marcus Aurelius has something to say:

"Everything we hear is an opinion, not a fact. Everything we see is a perspective, not the truth."

The financial media are all about perspectives. The investment world is one giant drama to them, with supposedly benignly intelligent mediators sculpting actionable advice from the rough maelstrom of the markets. Well, perhaps. I incline instead toward the view of Thomas Schuster of the Institute for Communication and Media Studies at Leipzig University:

"The media select, they interpret, they emotionalize and they create facts... The media not only reduce reality by lowering information density. They focus reality by accumulating information where "actually" none exists... A typical stock market report looks like this: Stock X increased because... Index Y crashed due to... Prices Z continue to rise after... Most of these explanations are post-hoc rationalizations... An artificial logic is created, based on a simplistic understanding of the markets, which implies that there are simple explanations for most price movements; that price movements follow rules which then lead to systematic patterns; and of course that the news disseminated by the media decisively contribute to the emergence of price movements."

In the financial markets, then, there is only one primary source close to objective truth: the price alone, as determined in a free exchange between willing adults. Everything else is supposition.

And this is why today's investment environment is so uniquely fraught – because the prices of just about everything are being distorted by central bank intervention. Are there fair prices being assessed in any asset class, anywhere, free from the malign intervention of unelected monetary technocrats?

I would argue 'No'. But we all have to play the hand we're dealt. So in the context of a bond market that seems on the cusp of reversing a 35 year bull run, and amid stock markets goosed higher by trillions of dollars' worth of funny money, it makes most sense from a risk/reward perspective to favour defensive value in relation to the listed equity markets. Those investments may still be overpriced, but if it's possible to purchase the shares of high quality businesses run by principled, shareholder-friendly management at a discount to an objective assessment of their inherent value, why buy anything else?

"THERE ARE STILL POCKETS OF VALUE OUT THERE IN THE EQUITY MARKETS – YOU JUST HAVE TO EXTRICATE YOURSELF FROM SLAVISH PURSUIT OF THE INDICES TO GO OUT AND FIND THEM."

After eight long years of QE, isn't everything expensive?

The reality is also 'No'. As the late, great Canadian 'value' manager Peter Cundill often said, there is always something to do. There are still pockets of value out there in the equity markets – you just have to extricate yourself from slavish pursuit of the indices to go out and find them.

For example, over 40% of the entire Japanese stock market trades below book value. Over a third of the Japanese stock market offers an Enterprise Value / Cash Flow yield of over 15%. The equivalent percentage for the Chinese market is very nearly zero.

And corporate Japan, like a supertanker, is finally starting to turn. John Seagrim of CLSA has coined the phrase "the new High Rollers club" to describe the forces that are driving domestic stock purchases in Japan. To qualify, you need to commit at least ¥4 trillion to the stock market each year. The Bank of Japan is a founder member: they bought ¥6 trillion of Japanese stock ETFs in 2016. Corporate Japan bought ¥6 trillion of stock by way of buy-backs. The Government Pension Investment Fund – the largest pension fund in the world – finished 2016 on track to buy ¥5 trillion in stock. And Japanese retail investors, by way of NISA accounts, probably bought ¥4 trillion in stock last year.

That combined total works out at ¥21 trillion – or over 5% of the Topix free float. For the first time in years, the Japanese stock market now has strong domestic support. And it is super-cheap. Japanese stock valuations are equivalent to those that prevailed in the US after the Great Depression. This is history book stuff.

2016 was a year of false narratives, in which conventional thinking got slaughtered. Rather than succumb to false narratives and Groupthink in 2017, my best advice would be to concentrate on price, and ignore pretty much everything else.

About Tim
Tim Price is manager of the VT Price Value Portfolio and author of 'Investing Through the Looking Glass: a rational guide to irrational financial markets'. To find out more, visit www.pricevaluepartners.com.

DECEMBER 2016

GLOBAL EQUITIES

Index	Last Month %	2016 %	Proximity to 52w High*
Russian Trading System	10.9	51.2	
DAX Xetra	7.6	6.5	
IBEX 35	7.1	-2.5	
CAC 40	5.6	4.3	
FTSE 100	5.3	14.4	
Euronext 100	5.2	2.6	
Nikkei 225	4.4	0.4	
S&P/ASX 200	4.1	7.0	
Dow Jones	3.3	13.4	
S&P 500	1.8	9.5	
NASDAQ 100	1.1	5.9	
Bovespa	-2.7	38.9	
Hang Seng	-3.5	0.4	

COMMODITIES

Commodity	Last Month %	2016 %	Proximity to 52w High*
Natural Gas	12.1	59.3	
Iron Ore	10.7	82.1	
Crude oil (Brent)	10.4	52.8	
Crude oil (Light Sweet)	9.6	45.4	
Platinum	-0.5	1.4	
Sugar (No. 11)	-1.6	26.6	
Gold	-1.9	8.6	
Soybean	-2.6	16.4	
Silver	-3.6	15.4	
Copper	-5.4	16.6	
Cocoa	-9.4	-33.0	
Coffee	-10.1	7.7	
Palladium	-11.5	20.7	

FOREX

Pair/Cross	Last Month %	2016 %	Proximity to 52w High*
USD/JPY	2.0	-2.7	
EUR/JPY	1.3	-5.8	
GBP/AUD	1.1	-15.1	
EUR/GBP	0.7	15.6	
USD/CHF	0.1	1.7	
USD/CAD	0.0	-2.9	
EUR/CHF	-0.6	-1.6	
EUR/USD	-0.7	-3.2	
GBP/USD	-1.3	-16.2	
AUD/USD	-2.5	-1.2	

CENTRAL BANKS - RATES & MEETINGS

Central Bank	Key Rate	Next	After
BOE	0.25%	Feb 02	Mar 16
ECB	0.00%	Jan 19	Jan 19
FED	0.75%	Feb 01	Mar 15
BOJ	-0.10%	Jan 31	Mar 16
SNB	-0.75%	Mar 16	Jun 15
BOC	0.50%	Jan 18	Mar 01
RBA	1.50%	Feb 07	Mar 07
RBNZ	1.75%	Feb 09	Mar 23
BOS	-0.50%	Feb 14	Apr 26
BON	0.50%	Mar 16	May 04

FTSE 350 TOP

Sector	Last Month %	2016 %	Proximity to 52w High*
Drax Group PLC	33.3	54.6	
IP Group PLC	28.4	-12.8	
Sky PLC	26.9	-10.9	
Allied Minds PLC	25.2	17.5	
ITV PLC	22.9	-25.4	

FTSE 350 BOTTOM

Sector	Last Month %	2016 %	Proximity to 52w High*
NEX Group PLC	-45.5	-47.9	
CMC Markets PLC	-41.5	-54.1	
IG Group Holdings PLC	-41.2	-38.4	
Int Personal Finance PLC	-38.2	-40.4	
Sports Direct Int PLC	-11.8	-51.7	

FTSE 350 SECTORS TOP

Sector	Last Month %	2016 %	Proximity to 52w High*
Oil & Gas Producers	10.8	50.1	
Media	8.8	5.8	
Oil Equip, Serv & Dist	8.5	25.5	
Real Estate Inv Trusts	7.3	-10.6	
Electricity	7.3	4.9	
Automobiles & Parts	7.0	7.6	

FTSE 350 SECTORS BOTTOM

Sector	Last Month %	2016 %	Proximity to 52w High*
Industrial Metals	-4.8	211.6	
Aerospace & Defense	-1.1	11.9	
Financial Services	0.4	-1.6	
General Industrials	1.6	25.6	
Software & Comp Serv	1.7	14.5	
Mining	1.8	101.5