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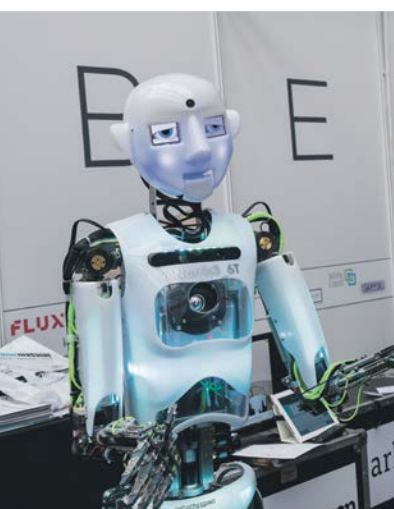
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WELCOME



Dear Reader,

I recently had the opportunity to attend two events for private investors in London. Both were distinctively different from each other and offered an interesting perspective on the changing landscape of the investment industry.

One of the events was purely about AIM-listed shares, and at peak time attracted about 70 investors to the event's presentation stage. The other one was about crowdfunding early-stage companies, and left the 400 seat venue packed to the last seat.

My comparison is unfair, to some extent. Any event's size is also a function of its marketing budget. Still, there was a lesson to be learned. Once derided as a gimmicky trend for funding micro-ventures, crowdfunding has grown to quite a different stature.

Fundraising rounds of several million pounds can nowadays easily be done via crowdfunding websites. A small number of companies have even used the Internet to raise funds in the tens of millions. Many of the common conceptions about this industry are by now actually misconceptions, as my report on page xx spells out.

To introduce our readership to the exciting changes taking place in crowdfunding - and the equally exciting opportunities available on these platforms - we have dedicated this issue's cover theme to a crowdfunding company that our team holds in high esteem.

Syndicate Room operates a unique model. Companies with fundraising plans need to demonstrate that they already have one lead investor with a proven track record. Only then is that company allowed to raise funds via the crowdfunding platform. What's more, the shares offered to the public need to be available on the same terms as those attained by the lead investor, meaning private investors can invest alongside the big boys, and do so at a very early stage of a company's lifecycle.

If you missed the aforementioned event organised by Syndicate Room, then join us at the [Master Investor Show](#) (use discount code "SHOW" to get up to 4 free tickets). You'll be able to meet their CEO, Gonalo de Vasconcelos, and listen to his main stage presentation. His entire team will be there, and most likely they'll also bring along a few exciting, investible ventures to our event.

Best regards,

Swen Lorenz
Editor, Master Investor



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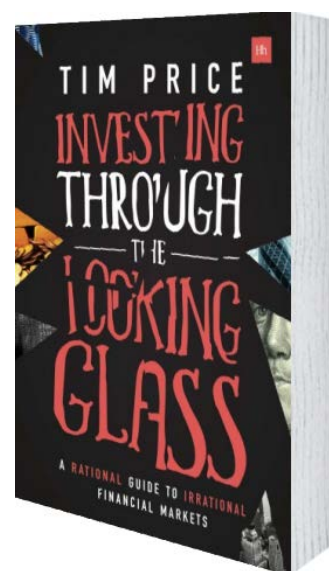
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BY JIM MELLON

MELLON ON THE MARKETS

IT'S TIME TO SHORT GOOGLE

I made a speech a few days ago to a gathering of property entrepreneurs in London. I intended to speak of my excitement about the new science surrounding longevity – and I did – but I think had I not mentioned property I would have been lynched!

So I improvised some thoughts on real estate, and particularly about the UK property market. What is clear to me is that British, and London property in particular, remains generally overvalued relative to the incomes of the average people buying it. Although sterling's fall has made some property more interesting to foreign investors, this is more than offset by the overbuilding that is evident everywhere in the capital and in the major regional cities.

In addition, George Osborne's politically calculated increase in stamp duty (soak the rich!) has backfired, as has so much of what he did. Stamp duty only brings in about 2% of government income, but it has a disproportionately high impact on property sales, which have fallen sharply in recent months. The friction costs of UK property as an investment, already high, are now among the highest in the world, and although there is plenty of pent up demand for housing, squeezing landlords, first time buyers and developers isn't going to solve any crisis.

So, my on-the-spot rumination led me to bet the current Chancellor reverses stamp duty increases, which will probably lead to a short-term bump for real estate. But short-term it will be, because the key issues of affordability, rising interest rates and overbuilding of multi-storey apartment buildings remain.

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I would generally stay well away from anything to do with UK property, and I wouldn't be surprised to see a fall of 20-30 percent in the next few years. That's a big fall, and will drag developers, overexposed banks, estate agents and some builders down with it. Even if it doesn't go down that much, it sure as heck isn't going up, so be careful. If you are in the market for a house or flat, my advice is... wait! If you must buy one, put in low ball bids. You might just get lucky. There is a whiff of desperation in the air.

Of course, the smart operators will always find a way to make money, but I know from experience that when developers are offering high interest rates on "short-term" loans with supposedly high security, there is real distress in the market.

Now, of course, inflation will eventually find its way into property prices, and inflation is coming back – with a vengeance. For the UK, it's a combination of devalued sterling pushing up import prices, the delayed effect

of monetary easing, the end of the Chinese goods deflationary period, but most importantly the "gig" economy is significantly underpaid and the workers want more!

There's a great article in this week's New Yorker about Uber drivers (in the States – but this could just as well apply in the UK). They are making less and less money and working ludicrously long hours, borrowing to buy their cars, and facing higher fuel prices. They and all the other "gig" army people (Deliveroo workers, Sports Direct workers, Amazon packers etc.) have been the backbone of the low wage economy for years now and have been the main reason behind the very low levels of unemployment.

My view is that something has got to give. While I am not for formal pay caps for company managers, I *am* in favour of remuneration at the boardroom level being much more closely related to performance and subject to much greater scrutiny.

Despite the lurid headlines, it isn't true that the world is getting more unequal – in fact quite the opposite. But for the employees – and there

are millions of them – who form the "precariat" in the UK (and in most other developed nations), life is just too miserable and employment conditions are basically feudal.

The effect of this – and I think it will be a global phenomenon – is that corporate profits as a share of GDP will start going down soon, and labour's share will start going up. Already, minimum wages are rising fast in the US (they can't go up too fast or workers will be replaced by machines), and the unemployment rate continues to fall, as it does in the UK.

This is where the bulk of the inflation is going to come from in the next few

years – higher wages for low paid employees – and my guess is that with additional fuel being added by improved bank lending, still loose monetary policy and competitive devaluations everywhere, we could really see some spiky inflation, higher interest rates and ultimately a deep recession.

In those circumstances, load up on gold and silver – I still hold that view, which was a Master Investor 2016 recommendation. Love anything to do with gold, because it is your surest protection against inflation.

Keep selling all bonds, particularly those of the eurozone periphery (and I see that Mr Trump's new am-

“FOR THE EMPLOYEES – AND THERE ARE MILLIONS OF THEM – WHO FORM THE ‘PRECARIAT’ IN THE UK (AND IN MOST OTHER DEVELOPED NATIONS), LIFE IS JUST TOO MISERABLE AND EMPLOYMENT CONDITIONS ARE BASICALLY FEUDAL.”





bassador to the EU agrees with me that the common currency will be obsolete soon). I don't have a strong view on many currencies right now, except that the pound is undervalued against the Euro and that the Mexican peso looks dramatically oversold. We did very well shorting the Japanese yen and then buying it back but it's in a neutral range now. Inflation will probably be good for the Australian dollar; I've reversed my long standing short on that one and am now long.



Nicholas Jackson / Shutterstock, Inc.

When Al Chalabi and I published *Fast Forward* a couple of years ago, we had one solid recommendation that encapsulated everything in the book: buy Google (now **Alphabet (NASDAQ:GOOGL)**). Since then, it's up by 49%

and the **Fast Forward (LON:FFWD)** company we listed is up, weirdly, by the same since listing.

Google once looked like the future – driverless cars, medical innovation, space, AI and machine learning, quantum computing – all rolled into one package. But I now think Alphabet is a huge short, as indeed is **Facebook (NASDAQ:FB)** – but for different reasons. I suspect hubris is creeping into Google's ranks – or put another way, it's just been too easy for them to make money. In summertime, the parties of the Mediterranean are littered with Google executives living high on the hog, and why not?

But this is coming at the expense of the former dynamism of the business. Results released yesterday show expenses soaring as more money is thrown away on quixotic ventures. Meanwhile, the key ad business is slowing and Google is facing competition from other digital platforms.

The fresh-faced enthusiasm the company exhibited 20 years ago has waned, and the rumour is that most of their side ventures are failing. All the while, there is a serious risk that the main search engine might even be regulated (and with it, its returns) as a quasi-utility sometime in the not-too-distant future.

But of course, being the sensitive soul that I am, I have a personal story to relate. Subscribers know that I am re-

searching a new book, and am shortly going to the US to conduct some interviews. I am fortunate to be meeting some seriously big hitters in the longevity field, including leading scientists (Nobel Prize winner included), institutions and companies.

The *only* company which declined to meet was Google's medical venture, Calico. No reason given. That's despite the fact I know a Top Dog at Google!

Since Google was founded on the principle of bettering humanity, one might imagine that there is no better way to further humanity than by keeping people alive in a healthy state for longer – it's surprising that they don't want to explain what they are doing.

Among the many harsh lessons I have learnt in my career (and I know I'm not as rich as the Croesus-like gods who run Google!) is that hubris is the first sign of a flawed enterprise.

It's time to short Alphabet.

Happy hunting!

Jim Mellon



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BY SWEN LORENZ

SYNDICATEROOM

BLAZING A TRAIL FOR PRIVATE INVESTORS SEEKING HIGHER RETURNS FROM EARLY-STAGE INVESTING

If there is one aspect of our work we at Master Investor are particularly proud of, it's spotting trends early. Being an independent publication and having a broad network of high calibre contributors and associates, we can focus our efforts on helping private investors get ahead of the curve.

As part of our investigative work, one trend has struck us as particularly noteworthy. What used to be known as crowdfunding and existed on the fringes of the financial markets is set to enter the mainstream, under a different name, and experience explosive growth. Best of all, it will help private investors who are searching desperately for higher returns. In an age of zero interest rates, such alternatives are badly needed indeed.

Forget everything you ever heard about "crowdfunding"

Mention crowdfunding, and most anyone still thinks of hobbyists using the internet to raise small amounts of money to fund whacky inventions or personal pet projects. Indeed, websites like IndieGogo or GoFundMe do just that, and they do it well.

However, there is a different form of crowdfunding emerging in financial

markets. It's better described as online investing, but with a twist. New platforms are emerging that help private investors get access to opportunities that they previously either had no way of investing into, or which were too difficult for them to evaluate.

One of them, and the best one in our view, is SyndicateRoom.

"SYNDICATEROOM HAS GROWN INTO A PLATFORM WHERE SERIOUS ENTREPRENEURS AND SERIOUS INVESTORS GET TOGETHER."

Founded in 2013, SyndicateRoom has grown into a platform where serious entrepreneurs and serious investors get together. Anyone signing up to be a member of SyndicateRoom has to certify that he or she is either an experienced investor or a high net worth individual. The minimum investment for any single investment opportunity available on the platform

may only be GBP 1,000 but the initial access hurdles make it clear that SyndicateRoom caters to an audience that is serious about investing.

Companies seeking investors, in turn, need to get their investment case past a strict approval process managed by an independent assessment committee. Other such platforms all too often accept fundraising proposals that should never be put in front of the public (see my foreword on page 3). SyndicateRoom has adopted the opposite approach, by strictly weeding out companies that simply are not – or not yet – fit for outside investment.

This approach initially limited the platform's growth somewhat. But it has now paid off with what is an enviable track record:

- 70% of companies that appeared on the platform succeeded with their fundraising
- The average investment from investors is a respectable GBP 15,503.49
- The largest fundraising round carried out by SyndicateRoom was GBP 3.2m
- On average, companies raising funds with SyndicateRoom raise GBP 1,058,090.01

The company has actually decided to move away from the term "crowdfunding" and simply refer to itself as online investment platform. Given its ubiquitousness, and because the platform simply addresses a large audience of potential investors, it's likely the term crowdfunding will continue to stick around for a bit. But the market for raising funds online from the public is maturing, and with it will come what we predict to be explosive growth in user numbers and funds raised.

How it all began

Achieving decent returns on your investment was never easy, and has only become more difficult due to the low interest rate environment.

What hasn't changed, though, is the fact that by investing into early-stage ventures, you set yourself up for potentially tremendous gains. A famous example is Facebook, where the first outside investor put down \$500,000 and subsequently saw the stake become worth more than a billion dollars. There are, however, countless other less obvious examples – especially in the UK, a country where entrepreneurship has always been held in high regard and where there is a thriving industry of early-stage life science, technology and fintech companies.

Early-stage investing is actually fairly common in the UK, but most investors choose to put only a tiny amount of money into this asset class. Lack of information and difficulty in evaluating these ventures are the major obstacles. Indeed, the majority of young ventures do end with investors losing their entire investment. It takes expertise to

“THE DISCREPANCY BETWEEN THE CONDITIONS OFFERED TO EXPERIENCED VENTURE CAPITALISTS AND THE PRICE THE BROADER PUBLIC HAS TO PAY FOR AN EARLY-STAGE INVESTMENT HAS ONLY BECOME BIGGER IN RECENT YEARS. IT’S NOTHING SHORT OF DISCRIMINATORY.”

filter out the winners, and doing so can be a time consuming process, even for those who do have the expertise. Aside from the issue of diversification, the key is ensuring that among the inevitable busts, you end up landing at least one major winner with a ten-fold gain or more.

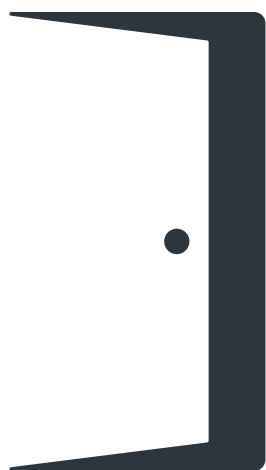
Portuguese-born entrepreneur Gonalo de Vasconcelos experienced the difficulty of fundraising as an entrepreneur and he was also aware of the difficulties experienced by investors seeking to get in on early-stage ventures. Knowing both sides of the equation, he set out to create a solution and change how early-stage investing is done. Thus, SyndicateRoom was born!

Popularising access to these funding opportunities, for which the internet seemed the obvious fit, was only part of the plan. He also set out to resolve what might nowadays be the number 1 factor that is holding back private investors. In effect, anyone who is not already a wealthy, experienced investor is currently being discriminated against by the finance sector.

Your chance to invest on the same terms as billionaires

Where early-stage investing is available, it often discriminates against the little guy. Yes, you are allowed to invest. No, you can't do so on the same terms as the big guys. Peter Thiel bought into Facebook when the entire company was valued at just \$4.9m. The public, however, was only allowed to get in on the deal when the company was already worth \$104bn. The discrepancy between the conditions offered to experienced venture capitalists and the price the broader public has to pay for an early-stage investment has only become bigger in recent years. It's nothing short of discriminatory.

Not so with investments pitched at SyndicateRoom. Each investment round is led by an experienced angel investor and the public is always allowed to invest on exactly the same terms. Accessing early-stage investments at the same price as a leading angel investor is part of the unique proposition offered by SyndicateRoom.



SYNDICATE ROOM

Invest with the professionals



Using this approach, the company has helped resolve a problem that many young companies faced. An entrepreneur often has access to one or two angel investors, but finding additional investors is the proverbial search for the needle in a haystack. Angel investors in turn want entrepreneurs to raise additional funds by themselves, as this provides further proof of a company's concept and plans.

Private investors, on the other hand, want to have a quality filter applied to the early-stage investments put in front of them. They don't have the time and expertise to look through hundreds of pitches, and they don't have the experience necessary to judge these opportunities. They need independent and reliable guidance on what is worth investing into.

All of this is resolved through the investment platform and process curated by the team at SyndicateRoom.

Quality control is exerted through the approval process for new fundraising pitches. Initial backing by an experienced lead investor provides further security that an investment proposal holds up to scrutiny. The companies in turn can easily access a large number of potential investors, and angel investors then see their own investment being supplemented by other investors' money. All bases are covered. It's a win-win situation for everyone.

Using this formula, Cambridge-based SyndicateRoom has already raised money for over 80 ventures, with tens of thousands of private investors registered for access to the platform.

Swen Lorenz interviews Gonçalo de Vasconcelos, CEO and co-founder of SyndicateRoom

We spoke to Gonçalo about his plans for the platform, his advice for private investors who are seeking to participate in these investments, and his further plans to disrupt the finance industry by opening up new opportunities for private investors.

MI: Gonçalo, at the age of 33 you set out to create a new financial services company. Describe to us what led you to embark on this particular venture?

GdV: While I was doing my MBA in Cambridge I started working with business angels, venture capitalists and other professionals investing in early-stage businesses. I could see all these cool, exciting companies they were investing in, but I knew that there was no way someone like me – a relative newcomer and small investor – would be able to invest in the opportunities with them. It was this feeling of being left out of these opportunities that ultimately led to my vision for SyndicateRoom: an open, level playing field where all investors, professional or private, had

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the same fair and transparent access to deals. Ultimately, for each pound invested, everyone who is investing would make or lose the same amount. Nobody would get a better, or worse, deal.

MI: What previous experience did you bring to the table for setting up SyndicateRoom?

GdV: I'd had some experience working with professional investors and early-stage businesses in the past but the biggest factor that led to setting up SyndicateRoom was my passion for equality in the investing space and the drive to make it a reality.

My co-founder and CTO, Tom Britton, has the same drive and also a lot of experience in technology and product development, so we complement each other well.

The success of start-ups is very much down to the personality of its founders; also, their tenacity and willingness to break down barriers and go through walls. Tom and I have that in spades!

MI: In your own words, what is the investor-led approach to equity fundraising?

GdV: We pioneered the investor-led approach when we launched SyndicateRoom in 2013. It links back to the initial vision that people like you and me, private investors who have a certain amount to invest, should have the same fair and transparent access to the deals that the professionals are investing in. What the investor-led approach brings to the table is the knowledge that there is an experienced investor, or group of investors, willing to not only put their money into the deal but also get their hands dirty: conduct their own due diligence, negotiate the valuation, negotiate the terms, and then open the deal up to others to invest with them.

It sounds subtle, but was actually a significant change to how crowdfunding was being conducted at that time (the company-led approach was popular – i.e. where the company set out the terms). Three years later, looking at the success of SyndicateRoom today, the value of the investor-led approach speaks for itself.

MI: Presumably with this approach, many fundraising pitches that

ended up on your desk had to be turned down. Turning away so many potential clients in a booming environment must have been difficult at times?

GdV: No, not at all. The deals we turn down, we turn down for good reason. We want to work with great companies that we're proud to work with and who are proud in return to work with us.

MI: Everyone knows anecdotal stories about one or the other early-stage venture that paid off handsomely for its investors. But the market is not very transparent. Do you have any stats on the long-term average returns that investors can expect to earn from this asset class?

GdV: We recently conducted research entitled *Rise of the Growth Hunters*, which looked at the growth rate of early-stage companies. Beauhurst analysed the five-year change in valuation of a wide portfolio of 578 early-stage UK companies that received equity investment via seed or venture capital in 2011. Between then and 2016, the study found an average compound annual growth rate (CAGR) of 33%, compared to 5% for London Stock Exchange Main Market companies.

In 2011 the cohort of 578 companies was valued at GBP 1.8bn, with an average valuation of GBP 3m. By September 2016, the portfolio value had risen to GBP 7.98bn. An investment of GBP 10,000 in early-stage companies in 2011 would now be worth about GBP 45,000.

MI: No doubt achieving such returns requires dealing with a whole number of investments that go awry?

GdV: Early-stage investing is risky, and some companies will fail – that's the nature of this asset class. But there are real stories of investors making significant returns, when the exits happen. In fact, just two months ago, Oval Medical Technologies, which raised funds on SyndicateRoom's platform back in 2014, was acquired by global pharmaceutical device manufacturer, SMC Ltd.

Investors can build a portfolio that manages risk and also aligns to their risk appetite. With the right portfolio, the successes cover for the failures.

MI: What size portfolio, in terms of the number of investee companies, do you recommend to private investors?

GdV: Diversification is absolutely key, both across sectors and geographies – and also the pure number of investments. Research suggests that 28 is the minimum investment portfolio size required to have a 95% chance of backing at least one company returning 10x or more. It was this research that led to us launching Fund Twenty8, a passive EIS fund which invests in a minimum of 28 companies, across a number of sectors and geographies.

MI: It sounds like this is an area that a lot of private investors still need educating about. What are you doing to make the broader public aware of the opportunities – and risks – of this sector?

GdV: You're right, there's a huge amount of educating to be done. We're very passionate about this and have created a learning tool on our website called the Investors' Academy. It aims to help private investors learn about early-stage investing, by breaking down the jargon and explaining some of the complex industry terms, from preemption rights to drag along/tag along – and valuations (pre-money and post-money). Anyone going into this asset class needs to do so with their eyes open, and SyndicateRoom is committed to educating investors on what they need to know. We also have a podcast called *Angel Insights*, where business angels share their experiences and learnings, from the horror stories to great stories.

MI: Are you getting any kind of resistance from the financial services industry? Surely this is disrupting the business of a whole number of existing players in this field?

GdV: We have faced resistance, especially at the beginning. It's interesting to see the cycles with an industry that's been disrupted. Firstly, you're told 'that's not going to work'. Then when people observe that it is working and your business is doing well, they say 'it's just a flash in the pan'. But as we start to move significant amounts of money around (SyndicateRoom has raised GBP 69m for companies on the platform since launch-



ing in 2013) financial services companies want to collaborate and get involved.

Today, in 2017, alternative finance is becoming mainstream.

MI: You are based in Cambridge. Is that by chance, or did you actively decide not to be based in the City or in London's tech district?

GdV: This is the city that my co-founder Tom Britton and I met in while doing our MBA at the Judge Business School. Cambridge is an entrepreneurial hub with lots of innovation – so the decision to start our business here was natural. Costs are lower than London and we still have access to everything the City has to offer. Cambridge is a fantastic place to be.

MI: Do you have any other exciting innovations in the pipeline? Give us an insight into the mind of Gonçalo de Vasconcelos!

GdV: We innovated a great amount last year, launching into the Public Markets and becoming the only platform to give access to IPOs and placings. We also launched Fund Twenty8, the industry's first passive EIS fund. We're constantly

looking around and seeing how we can improve things and make them better through the use of technology. What can be more efficient and how can we bring value to the end user? Watch this space for more in 2017!

MI: The New Year is still young. What do you expect from 2017, both for your company and the entire finance industry?

GdV: For SR there are exciting innovations coming up in 2017. We've grown fast, laid some great foundations. It's now time to build the houses on top.

For the entire finance industry? That's a tough question. What I do know is that we're going to be impacted by the significant political events which are happening around the world, from Brexit to Trump and the upcoming elections in Italy. It's hard to say how things will play out this year in the UK, particularly in the City of London.

MI: Last but not least, we can look forward to seeing you at the Master Investor Show. Last year, your company attended with an exhibitor booth. This year, you will be speak-

ing on the main stage of the event. Tell us why someone who has a bit of money to invest should come to see your talk and meet your team?

GdV: I'll be talking at the event on early-stage investing. I'll focus on how to get access to those potential high returns, which are more than six times that of the London Stock Exchange Main Market companies.

I'll also be joined by Jim Mellon for a fireside chat. Jim is a phenomenal investor who has led funding rounds on the SyndicateRoom platform. We bring two very different viewpoints and you can expect to see a lively debate on topics from economic events such as Brexit, to investment strategy.

If you're hungry for growth in today's low-yield environment, you should come and meet our team at the show. They're looking forward to telling you more about the investment opportunities on the SyndicateRoom platform, which cannot be found elsewhere.

MI: Thank you.

GdV: My pleasure.



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BY SYNDICATEROOM

FUND TWENTY8

THE ONLY PASSIVE EIS FUND

Fund Twenty8 is the only passive EIS fund that automatically invests alongside Business Angels and VCs, who [according to NESTA](#) can generate average returns in excess of 20% IRR.

And with diversification said to be the only free lunch in finance, Fund Twenty8 will invest in at least 28 companies, as further research suggests that this is the minimum portfolio size required to have a 95% chance of backing at least one company returning 10x or more.

The benefits of passive investing

Research shows that two factors which may increase chances of a return are 1) investing in the sector in which you're most experienced and 2) building a diversified portfolio of ideally uncorrelated investments. Already the problem is apparent: if you only invest in sectors you're intimately familiar with, how can you build in diversification? If you choose all your investments yourself, you will be investing in sectors you don't know.

We believe, with Fund Twenty8, investors are able to gain diversification, potentially reaping the benefits of both a traditional investment fund and investor-led equity investment.

Our passive fund will automatically invest in the private EIS opportunities listed on SyndicateRoom that receive commitment from SyndicateRoom investors. Each of these opportunities will have been led by a professional or lead investor, then backed by other SyndicateRoom members.

Rather than relying on a single fund manager, as with some traditional funds, investments are sourced, structured and invested in by business angels, VCs and other lead investors. The fund then tracks and matches the appetite of SyndicateRoom members, who are sophisticated or high-net-worth investors, to define how much capital is allocated into each deal. This is done on a proportional basis until the company's funding target is met. If an investment is oversubscribed and goes into overfunding, the fund then invests more, securing a larger weighting.

Fund Twenty8 takes advantage of the expertise of other VCs, angels and in-

vestors to invest across sectors, giving you a diversified portfolio. After all, 28 heads are better than one.

Early-stage investing is an exciting asset class. We recently conducted research entitled [Rise of the Growth Hunters](#), which looked at the growth rate of early stage companies. Beahurst analysed the five-year change in valuation of a wide portfolio of 578 early-stage UK companies that received equity investment via seed or venture capital in 2011. Between then and 2016, the study found an average compound annual growth rate (CAGR) of 33%, compared to 5% for London Stock Exchange Main Market companies.



MORE INFORMATION ABOUT FUND TWENTY8

CLOSE DATE: 5th April 2017
MINIMUM INVESTMENT: £10,000
 Click [here](#) to visit the opportunity

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LARGE PORTFOLIO EIS FUND | MULTI-SECTOR EXPOSURE
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This is only directed at professional investors and should not be relied upon by retail investors. The value of investments may go down as well as up. Authorised and regulated by the Financial Conduct Authority (No. 613021). Registered office: 71 Regent Street, Cambridge CB2 1AB.

EIS TAX RELIEFS AND THE GREAT KNOWLEDGE GAP

Although it's been around for more than two decades, a persisting knowledge gap means many investors are unaware of how to access [EIS tax relief](#).

The Enterprise Investment Scheme (EIS) was introduced in 1994 to help smaller, higher-risk, unquoted companies raise finance by offering a series of tax reliefs to investors who purchase new shares in these companies, thereby helping lessen the amount of investor capital at risk.

EIS is complemented by the Seed Enterprise Investment Scheme (SEIS), which mirrors EIS rules but addresses seed-stage companies.

EIS in action

You can get a wider picture of the tax reliefs possible through EIS [here](#) and SEIS [here](#).

'Our own data in the Barclays Entrepreneurs Index reveals that the EIS and seed EIS tax reliefs have been popular measures and contributed to a rise in good conditions for entrepreneurs,' says Richard Heggie, Head of High Growth and Entrepreneurs at Barclays. 'It's crucial that UK businesses have access to a wide range of funding on their journey to growth.'

As you can see from the illustrations given above, the two schemes can offer significant tax reliefs for investors in early-stage businesses, helping manage the risk associated with backing startups and stimulating the UK investing sector. But despite these apparent positives, EIS and SEIS face a significant hurdle.

COMPANY FAILS	COMPANY BREAKS EVEN	COMPANY DOUBLES IN VALUE
You invest £10,000	You invest £10,000	You invest £10,000
You receive £3,000 in income tax relief	You receive £3,000 in income tax relief	You receive £3,000 in income tax relief
The company goes bust and your shares are worth £0	If after 3+ years you sell your shares for £10,000 , you will owe no capital gains tax	If after 3+ years you sell your shares for £20,000 , you will owe no capital gains tax on profit
You receive loss relief equal to your remaining at-risk capital multiplied by your income tax rate.*	Your total gain is £3,000 (£0 profit from the sale plus £3,000 income tax relief)	Your total gain is £13,000 (£10,000 profit from the sale plus £3,000 income tax relief)

* At a tax bracket of 45%, the loss relief would be $£7,000 \times 45\% = £3,150$. Therefore, for £10,000 invested, your real loss is $£7,000 - £3,150 = £3,850$. Source: [Rise of the growth hunters](#), 2016.

“THE ENTERPRISE INVESTMENT SCHEME (EIS) WAS INTRODUCED IN 1994 TO HELP SMALLER, HIGHER-RISK, UNQUOTED COMPANIES RAISE FINANCE.”

“ONE-THIRD OF YOUNG PEOPLE SAY TAX-EFFICIENT STRUCTURES MAKE THEM ‘MUCH MORE LIKELY TO INVEST’ IN EARLY-STAGE EQUITIES.”

People simply don't seem to know what they are.

'Once again, the message that shines through most brightly from SyndicateRoom's Rise of the Growth Hunters report is that whilst EIS and SEIS continue to be a vital source of funding for SMEs, for investors, a knowledge gap persists whereby awareness of EIS and SEIS is significantly below that of more traditional investments, such as [ISAs](#) and pensions,' says Mark Brownridge, CEO of the EIS Association.

Young people leading the way

SyndicateRoom's Rise of the Growth Hunters research showed that 18-to-30-year-olds are far more likely than older investors to use [tax-efficient investment](#) structures, such as EIS and SEIS, to make early-stage investments.

In fact, one-third of young people say tax-efficient structures make them 'much more likely to invest' in early-stage equities – a much higher reading than the other age groups (see barchart below).

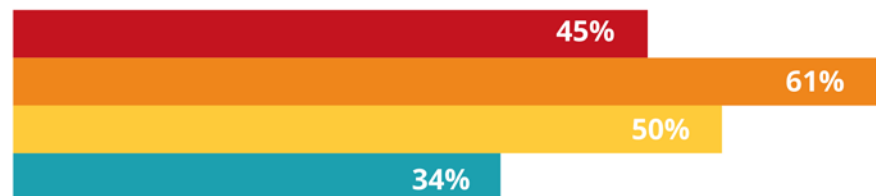
'A lack of information, access to opportunities and awareness of the EIS tax regime among older investors are just some of the issues investors face. We estimate that if these barriers are broken down, up to £25bn of investor demand could be released into early-stage equities in the next 12 months,' says CEO Gonalo de Vasconcelos.

Many of the [private market deals](#) that list on SyndicateRoom are EIS and/or SEIS eligible, while [Fund Twenty8](#) is a passive EIS fund.

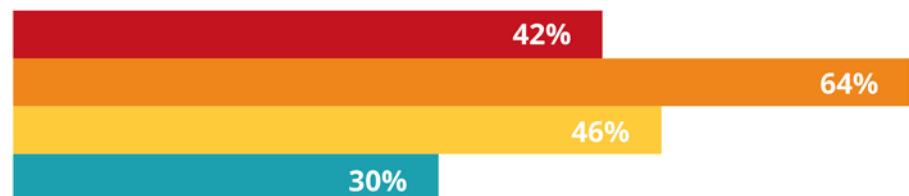
Further findings as well as the methodology used for obtaining these results may be found in [Rise of the growth hunters](#), the complete PDF of which is available free to download [here](#). We hope you find it both insightful and, in this uncertain economic climate, inspiring. And remember: we'd love to hear what you think.

How would you rate the impact of EIS/SEIS on encouraging early-stage equity investing?

EIS



SEIS



Retail investors



18-30



31-50



51+



SYNDICATE ROOM

Invest with the professionals

FUNDED ON SYNDICATEROOM

SyndicateRoom is proud to have helped 80+ UK businesses secure more than £69m in funding since launching in September 2013. All the companies we list have professional investors on board, and with this 'smart money' comes expert advice and a valuable network of contacts. What follows is a selection of the companies that have successfully raised funds.



FUNDED ON SYNDICATEROOM

Recycling Technologies

*Recycling Technologies' second SyndicateRoom round overfunded to **£1.5m** (216% of its target) in November 2016 with the help of 135 investors.*

As a society, we're all aware of our over-consumption of plastic. While things like 5p charges for carrier bags can make a difference to consumption, plastic production is nevertheless set to double in the next [20 years](#). Conservative estimates suggest that in 2010 alone, [8m tonnes](#) of plastic were thrown into our oceans. That equates to five carrier bags of plastic waste for every foot of coastline in the world.



What has become abundantly clear is that current recycling methods aren't effective at tackling the problem. In 2012 the EU produced [57m tonnes of plastic](#), of which [only 6.6m tonnes](#) were recycled (mostly high-quality drinks and milk bottles). The rest, known as Mixed Plastic Waste (MPW), was landfilled, incinerated for its energy or discarded.

Recycling Technologies has developed and protected a system which is able not only to recycle MPW, but also turn it into a valuable hydro-carbon, Plaxx™.

Brytlyt

*Brytlyt overfunded to **£306,000** (153% of its target) in September 2016 with the help of 31 SyndicateRoom investors.*

Brytlyt disrupts the software technology needed for processing and analytics to greatly enhance its market's number one purchasing criteria: speed.

Lead investor Jos Evans, investing £75,000 into Brytlyt, was joined by five other business angels at the start of the round, bringing Brytlyt very close to its minimum target.



Brytlyt operates in a market worth \$2.2bn in 2016, when it was growing at 30% per year.

Unlike established competitors, Brytlyt uses graphics processing units (GPUs) for data processing. The company believes the massive improvements in performance, and the equally fast fall in production costs, makes GPUs a formidable tool for data analytics.

Indeed, based on its own tests, the company's offering has gone from being 3x faster to more than 8x faster than the current market leader and world record holder, Exasol.

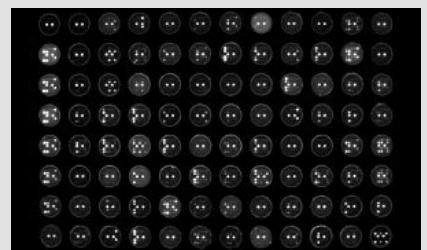
What's more, with the huge improvements afoot in the GPU industry, Brytlyt expects to be up to 24x faster than Exasol by Q1 2017.

Brytlyt raised funds to deliver a commercial product and begin securing orders.

Nalia

*NALIA Systems overfunded to **£491,844** (126% of its target) in September 2016 with the help of 78 investors.*

Currently, to conclusively diagnose many diseases, patients must wait for a scheduled blood test and then wait again while complicated tests are performed in laboratory environment. Aside from the frustrating delays of waiting for test results to come through, there are significant costs associated with the transportation, processing and storage of samples.



FUNDED ON SYNDICATEROOM

NALIA have created a point-of-care, lab-grade diagnostics array that delivers results in 20 minutes. This gives doctors the in-house tools they require to diagnose certain diseases from within their surgery. Although still in prototype mode, a first customer has already been secured.

In addition to this potentially disruptive technology, NALIA also has an already established – revenue-generating – service, which creates tests for diseases that require custom arrays.

Cambridge Nutraceuticals

*Cambridge Nutraceuticals successfully overfunded to **£1.067m** in its 2016 round on SyndicateRoom.*

Cambridge Nutraceuticals has built an ecommerce business that deals in developing and marketing supplements to scientifically proven to deliver more of the good stuff to you – including its core product, Ateronon Hearth, also known as The Tomato Pill.

Ateronon contains LactoLycopene (a powerful antioxidant, ten times more potent than Vitamin E, which is found predominantly in tomatoes and has proven benefits for those with chronic health conditions) and helps the body to absorb it efficiently.

The nutraceuticals market is worth \$150bn worldwide and is growing at a rate of 7% each year, according to estimates by management consultants AT Kearney. It's Cambridge Nutraceutical's IP and patent protection, as well as its close links to the University of Cambridge, that allow the company to prove its product in clinical trials and distinguish itself from its competitors.

This round was led by Angel investor Peter Keen. Funds raised in this round will be used for marketing activities focussed on customer acquisition and retention, as well as allowing the team to engage in a greater number of clinical research projects, bolstering the company's scientific IP and press activity.



Axol

*In February 2016, Axol Biosciences triumphed even its own expectations by hitting its overfunding target of **£1m** (upped from £700K) on SyndicateRoom.*

Activists and researchers alike have long called for a replacement for animal testing – a practise that is widely criticised as costly, unreliable and immoral. Using Nobel Prize-winning technology, a Cambridge-based company, Axol Biosciences, has found a way to produce stem cells from human blood and skin cells which can then be turned into heart cells, brain cells and blood vessel cells and used for scientific research. These cells are created in Axol's labs, and have been used by many pharmaceutical companies and research institutes.



Axol's CEO and Co-founder is Dr Yichen Shi – a man described by super angel Jonathan Milner (who led the round alongside Darrin Disley) as 'a very exciting young entrepreneur who can walk through walls'. Dr Shi identified the need for 'a high-quality supplier of human cells ... with all the critical ingredients for successful research' during his doctorate in neuroscience and stem cell biology from the University of Cambridge. From there he went to to create Axol, where innovation, quality and customer service are the key drivers.

“SYNDICATEROOM IS PROUD TO HAVE HELPED 80+ UK BUSINESSES SECURE MORE THAN £69M IN FUNDING SINCE LAUNCHING IN SEPTEMBER 2013.”





BY JOHN KINGHAM

THE DIVIDEND HUNTER

IS M&S'S NEAR-6% DIVIDEND YIELD BIG ENOUGH?

Marks & Spencer is one of the most obvious dividend-paying stocks in the UK market. With so much attention from investors a company like this should be priced correctly (or so the theory goes), with shares that have no chance of generating market-beating returns other than by pure luck. That may or may not be true, but what I do know is over the last 15 years investors would have done very well buying M&S shares when the price fell below 300p and then selling within a few years for a gain of anything between 50% and 100%.

Of course there is far more to investing than simply buying at some historically successful price, but with a current price of 333p and a dividend yield of 5.6% I do think Marks & Spencer is worth looking at in some detail.

A cyclical company with a track record of highs and lows

I mentioned above that M&S shares have fallen below 300p more than once over the last 15 years and then subsequently performed well each time. In fact the shares have traded in a range between about 300p and 600p for more than two decades. This reflects two features of the business: first, that there is no strong growth trend; and second, that the company is cyclical.

“I DON’T THINK IT WOULD BE TOO HARD FOR M&S TO HAVE A TRULY PROGRESSIVE AND CAUTIOUS DIVIDEND STRATEGY SIMPLY BY KEEPING ITS TEN-YEAR DIVIDEND COVER RATIO CLOSER TO TWO AT ALL TIMES.”

The lack of a strong growth trend is not all that surprising. The company started out in the 19th century and is about as mature a business as you'll find anywhere. The UK has been well and truly saturated with M&S stores for a long time and so the company's miniscule long-term growth has come mostly from inflation, real wage growth and an increasing UK population.

I've included a chart which shows Marks & Spencer's financial results over the last few years and it more



MARKS & SPENCER

or less covers one business cycle. The chart starts off with a recession around 2008-2010 and with M&S cutting its dividend. After 2010 (or thereabouts) the economy stabilised and the dividend was increased, then held for a few years and then increased again. So the chart shows an economic bust and a slow recovery,

but that recovery has yet to turn into a boom.

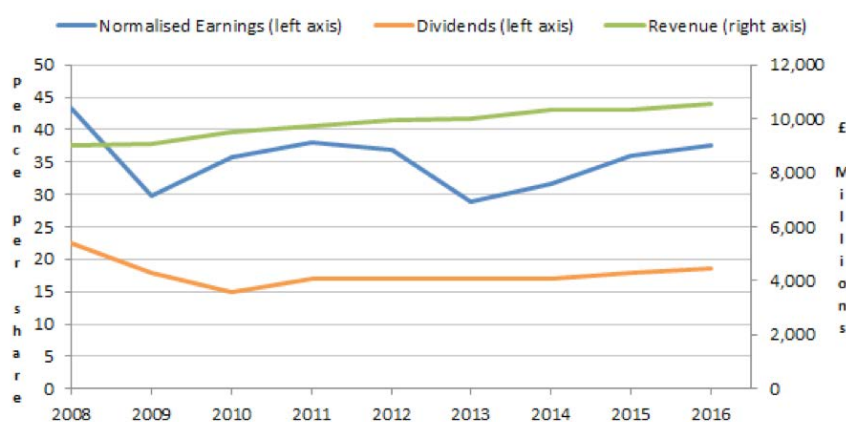
The company's share price reacted to these events as you might expect. During the bust of 2009 it fell as low as 200p and was below 300p for about a year. The dividend yield was over 6% for much of that time which

must have been very attractive for those who know that recessions do not last forever. During the recovery investors were much more optimistic and in 2015 Marks & Spencer shares were selling for more than 500p. In fact at one point that year someone paid almost 600p per share.



Faiz Zaki / Shutterstock, Inc.

Marks & Spencer Financial Results



Boom, bust, repeat

This is a story that M&S investors have heard before, such as during the 1990s boom when M&S more than doubled its dividend and then cut it by almost 40% when the inevitable bust arrived in 2000. Or during the mid-2000s boom that followed, when M&S again doubled its dividend and then cut it by a third in the 2009/2010 recession. Over those 20 or so years M&S has been unable to sustain its dividend for long once its ten-year dividend cover (the ratio between the company's current dividend and its ten-year average earnings) falls below 1.5.

For example, after a long run of progressive dividend growth the dividend reached 14.5p in 1999. At the time the company's ten-year average earnings were 20.2p giving it a ten-year dividend cover ratio of 1.4. The next year the company's results sagged and the dividend was cut back to 9p, increasing its ten-year dividend cover to a more reasonable 2.2. The same thing occurred in 2008 when the dividend was pushed up an almost laughably optimistic 23% in a single year to 22.5p. At the time the company's ten-year average earnings were just 23.9p giving it a ten-year dividend cover ratio of 1.1. Over the next two years the dividend was rebased

to 15p as the post-2009 recession hit, giving the company a much more sustainable ten-year dividend cover ratio of 1.8.

To some extent these recurring dividend cuts are understandable as M&S operates in the cyclical high street retailer sector. I still think it's slightly disappointing though. I don't think it would be too hard for M&S to have a truly progressive and cautious dividend strategy simply by keeping its ten-year dividend cover ratio closer to two at all times. I think this would be much better than its historic strategy of raising the dividend too quickly, only to cut it back during the next inevitable recession.

Is a dividend cut on the cards?

Currently the company's ten-year average earnings are 35.8p and its dividend is 18.7p. This gives the company a ten-year dividend cover ratio of 1.9, which is well above the historically dangerous zone of 1.5 or less, so I don't think a dividend cut is very likely anytime soon. I think M&S has this fairly cautious dividend cover because we haven't had a boom period to follow the

2009 bust, and so management have yet to become overly optimistic about the company's future. Start to worry when you see several years of double-digit dividend growth and excessive exuberance from the CEO.

Slow growth fails to keep up with inflation

So the company is cyclical and has a somewhat bumpy track record, but I also mentioned that it has no strong growth trend. You can see this in the most recent cycle (the period covered by the chart) where M&S managed an overall growth rate (a combination of revenue, profit and dividend growth over ten years) of just 0.3% per year. That, of course, is not exactly electrifying. Over the same period the FTSE 100 managed to grow, using the same measure, by 2% per year. Clearly then, M&S is a slow growth company which isn't keeping up with inflation or the UK stock market as a whole.

However, just looking at overall growth misses an interesting aspect of M&S, which is that it is effectively two highly integrated but quite different businesses, one which sells clothing and homewares and another which sells food. Not only are these two businesses different in nature, they've also had very different results since the turn of the millennium.

M&S's future may lie primarily in food

If you dig into the archive of M&S annual reports you'll see that clothing and household revenues were around £4 billion in 2000 while food revenues were less than £3 billion. Lay out the annual reports for the following 16 years and you'll see two completely different stories. In clothing and homewares (i.e. non-food) you'll find a total lack of sustainable growth, leaving non-food revenues in 2016 at around £4 billion, pretty much where they were in 2000. In food you'll find revenue growth in almost every single year, leaving 2016 food revenues at £5.5 billion, almost exactly double their 2000 level.

So what's going on here? I'm sure an entire book could be written about M&S's trials and tribulations over the

last couple of decades, but here's my very much condensed version:

Marks & Spencer clothes are gradually falling out of the mainstream because they are failing to attract sufficient numbers of younger people to replace their traditional older customers as those customers depart this mortal world. There have been innumerable efforts to turn this situation around but none have succeeded in any meaningful or sustainable way, other than perhaps to slow the decline.

In food the picture is very different. Following a run of success from the food business, M&S decided to start opening food-only stores, smaller Simply Food stores and "food on the go" railway concessions in 2002. In that year there were only a handful of each, but the programme worked and rapid expansion followed. Today there are over 222 Simply Food stores owned by M&S in the UK and over 349 operated by franchisees, an amazing 62% of the company's entire fleet of 914 UK stores. Yes, the Simply Food stores are typically smaller than the company's combined clothing and food stores, but their sheer number negates that and they are the major reason why

58% of Marks and Spencer's revenues now come from its food business.

This distinction between the food and non-food businesses is important because it may be a glimpse into the longer-term future of M&S. The clothing business may be in terminal decline, or at least terminal stagnation. The food business on the other hand may be able to continue growing at the almost 5% per year it's achieved over the past 16 years. Once the UK is saturated with Simply Food stores M&S may be able to roll the idea out internationally to drive longer-term growth. This process has already started with some franchised Simply Food stores

**"I WOULDN'T BE
IN THE LEAST BIT
SURPRISED TO SEE
MORE THAN 70% OF
M&S'S REVENUES
COMING FROM FOOD
WITHIN THE NEXT
TEN YEARS."**



urbanbuzz / Shutterstock, Inc.



in France, but I must admit that M&S does not have a good track record of international expansion.

Of course this is pure speculation, but I wouldn't be in the least bit surprised to see more than 70% of M&S's revenues coming from food within the next ten years. And this isn't simply idle speculation because I, like most potential M&S investors, want to know whether long-term dividend growth is a realistic possibility for this company or simply wishful thinking.

Prospects for dividend growth have a massive impact on what sort of share price and dividend yield make sense today, but before I talk about the share price I'd like to mention one of the enduring risks to this business, which is its considerable financial obligations.

Large debts and pension liabilities make M&S riskier

For some reason or other M&S has traditionally chosen to carry a heavy debt load relative to many other high street retailers. Larger debts can boost profits during good times, but they can also increase the damage done during downturns and I think that Marks & Spencer's habit of cutting its dividend during a recession exists in no small part because of its heavy debt load.

Its current total borrowings of £2.2 billion are exactly four-times the company's five-year average normalised post-tax profits of £0.55 billion. This ratio of debts to average profits is my primary measure of financial leverage and a ratio of four is interesting because that is exactly my preferred

upper limit for cyclical companies. In other words, M&S has about as much debt as I'd be willing to stomach from a cyclical company. Admittedly, M&S is relatively defensive for a cyclical company, but I would still prefer to see those debts come down by perhaps 50%, and I would much rather see that happen during the next boom than an overoptimistic and probably short-term increase in dividends.

“MARKS & SPENCER'S HABIT OF CUTTING ITS DIVIDEND DURING A RECESSION EXISTS IN NO SMALL PART BECAUSE OF ITS HEAVY DEBT LOAD.”

The other major financial obligation I look at is defined benefit pension liabilities. I'm looking to avoid pension liabilities that are more than ten-times the company's recent average profits, which as we just saw are £0.55 billion for M&S. Unfortunately M&S fails this test as its pension liabilities are a whopping £8.1 billion, some 14.6-times its average profits. The scheme is currently in surplus, but if that were to change then a deficit of £1 billion or more could easily be on the cards, and M&S would be legally obliged to remove that deficit by diverting cash away from shareholders and towards the pension fund (the company is already paying almost £30 million a year into the fund to defend the surplus). One positive point is that the

scheme has stopped accruing future benefits for current members in order to reduce risk, although of course this is not such a positive point for the affected employees.

Normally this massive pension would be a deal breaker for me, but perhaps if I was in a good mood then I might still consider an investment in M&S because I do think the business is fundamentally sound. But what price is the right price to pay?

333p could be good, but 300p would be better

At its current price of 333p and with a dividend yield of 5.6% I think M&S shares are quite attractively priced. Each week I build a stock screen of dividend-paying companies and M&S currently ranks 85th out of 230, so it's just outside the top quartile. Generally I like to stick to buying companies that are in the top 50 and to join that club M&S would have to drop below 300p, at which point it would have a nice 6.2% yield as well.

If I did invest in M&S there are a few things I might suggest to its management. These are: 1) Pay down debts before increasing the dividend; 2) Reduce those pension liabilities through a deal with an insurance company; 3) Institute a cautious and progressive dividend policy to avoid future dividend cuts; 4) Continue the shift towards food and find ways to repeat food's UK success overseas.

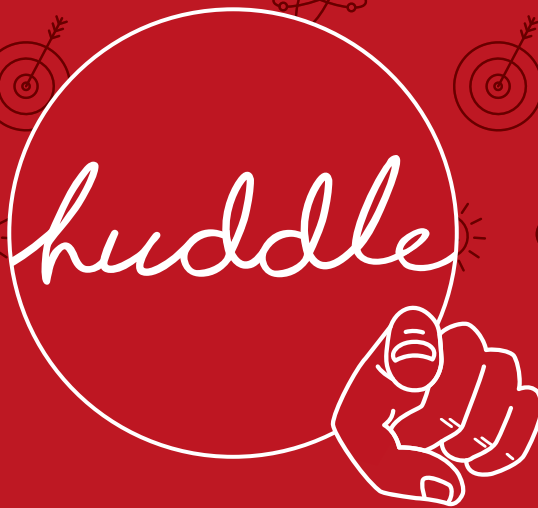
If M&S followed those four actions then I think inflation-beating dividend growth could be sustainable over the longer-term.

About John

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

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

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



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BY TOM STEVENSON, INVESTMENT DIRECTOR, FIDELITY INTERNATIONAL

TOM STEVENSON'S BIG FOUR

FOUR FUNDS TO EXPLOIT GLOBAL TRENDS IN 2017

In last month's issue, I set out my thoughts on the year ahead, describing 2017 as a watershed for investors. This month, I want to flag four funds which I'm using to play the economic, political and market changes I expect to see in the months ahead. The election of Donald Trump as America's 45th President has ushered in a radically different investment environment. It is regime change in more than one sense. My fund picks this year reflect this new investing backdrop because I'm aligning my investments to four key themes that I expect to unfold throughout 2017.

The first of these is the widespread belief that a Trump Presidency will be focused on creating a higher level of growth in America. That was Trump's promise and he will need to deliver on it to avoid 'buyer's remorse' among his blue-collar supporters. What the new growth agenda means is more government borrowing and a higher deficit to fund a programme of infrastructure spending. It also signals tax cuts and less red tape. All of these are potentially good news for equity investors.

I'm playing this equity-friendly environment with one of my favourite global

**“I’M ALIGNING
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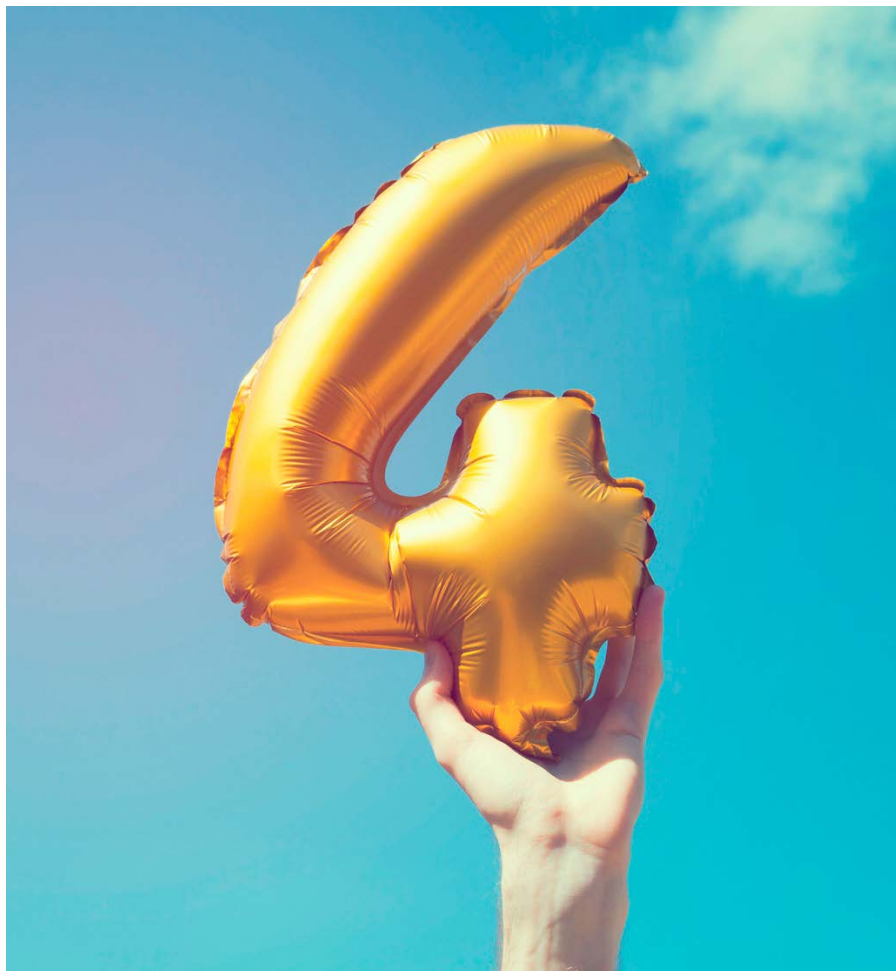
equity funds, the Rathbone Global Opportunities Fund. This is a slightly more defensive fund than I might ordinarily choose in today's higher growth environment but that doesn't worry me unduly because there will be road bumps along the way and a solid buy and hold fund like this one will provide some good ballast to my portfolio.

The second theme is related to the US growth story. It is the expected out-performance this year of developed stock markets, notably America's, over emerging markets. The fund I've chosen to play this is the Old Mutual North

American Equity Fund, managed by Ian Heslop. This is quite a quantitative fund, relying on mathematical modelling and lots of data-crunching. Heslop reckons this is the best way to capture any changes in market sentiment and behaviour before they are fully priced in by the market. The Old Mutual Fund has a good track record through the cycle.

Theme three relates to the ongoing shift away from so-called 'expensive defensive' stocks towards companies that are more exposed to the ups and downs of the economy – shares known as cyclicals. The way I'm playing this shift is via the Fidelity Special Situations Fund, run by Alex Wright. He is a true contrarian investor, a worthy successor to Anthony Bolton who ran this fund for many years. He is unafraid to buy shares that other investors are not interested in and he has a definite cyclical bias. Banks, in particular, are a heavy weighting in his fund.

The final theme is a knock-on consequence of America's growth story. I expect higher growth and inflation to encourage the Federal Reserve to tighten monetary policy more quickly than expected in America. That will open up a divergence with central bank thinking elsewhere in the world and should boost the value of the dollar. That in turn will be good news for the world's exporters and overseas earners, in places like Europe and Japan. One of my favourite Japanese funds is the Schroder Tokyo Fund, managed by Andrew Rose. He is an old Japan hand who has a good track record and is well placed to benefit from the improving fundamentals in the Japanese stock market. The currency-hedged share class will protect against a weaker yen.



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BY VICTOR HILL

OPPORTUNITIES IN FOCUS

THE TWILIGHT OF THE BANKERS



They nearly blew up the world with crazy exotic instruments called derivatives, conceived in an orgy of greed. They were bailed out by panicked governments who thought they were "too big to fail". They were subjected to new rules because everyone knew that their much vaunted "risk models" didn't work. And then they were challenged to cope with the weird world of near-zero interest rates.

They were exposed as criminally fraudulent in numerous countries. They stopped lending to small businesses and private individuals unless the risks were inconsequential. Yet they continued to pay themselves huge bonuses.

And all the while they could not see that their very *raison d'être* was being undermined by the relentless advance of technology. Their historic functions were being disrupted by the internet: in particular, crowdfunding, digital wallets and other advances in "Fintech". Just as music downloads torpedoed the traditional music business, banks are now being hit by disruptive technology.

Schadenfreude is occasionally permissible. Bankers face a huge problem: banks' return on capital is likely to remain below the cost of capital for banks for the foreseeable future. That spells their demise.

This is the twilight of the bankers as we have known and not loved them. But while a slice of the economy slides slowly into oblivion it's time to flag up the Fintech winners who will profit from their demise. My essay this month is a game of two halves. First we're going to a funeral. And then we're going to a party!



15 September 2008: the day the world changed

That day we awoke to learn that Lehman Brothers had finally tumbled and the global financial markets were in meltdown. We don't need to rehearse the causes here. Only to say that the financial crisis of 2008 – the Credit Crunch – was a pivotal moment in recent economic history. We came perilously close to a systemic financial crisis in which the entire economy would have ground to a halt.

As we know, the banks were saved by government intervention. In the UK **Lloyds Bank (LON:LLOY)** was rescued at a cost of £20 billion and **Royal Bank of Scotland (LON:RBS)** was effectively nationalised at a cost of some £46 billion to the Treasury. The UK Government has now sold down most of its stake in Lloyds and has got most of its outlay back. Not so with RBS, which is still 84 percent state owned, and whose share price is still depressed. The £500 billion of short-term loans and guarantees were largely recovered.

In the USA the Troubled Asset Relief Programme (TARP) was bankrolled with government funds to the tune of US\$700 billion. Of the five Wall Street investment banks, which had hitherto been regulated not by the Fed but by the SEC, Lehman Brothers was liquidated, Bear Stearns and Merrill Lynch

were absorbed by commercial banks while **Goldman Sachs (NYSE:GS)** and **Morgan Stanley (NYSE:MS)** transformed themselves into commercial banks. (Goldman's counterparty positions with the failed insurer AIG were covered by the Federal Government). In both countries interest rates were slashed to create sufficient liquidity within the traumatised banking system to stave off further defaults.

Subsequently, in Europe, the European Sovereign Debt Crisis precipitated Europe's own banking crisis. The first Greek bailout of 2010 was more about the rescue of the French and German banks (which carried huge exposures of Greek government debt) than about restoring the Greek state to financial good health.

Since Mario Monti, ECB President, vowed in July 2012 to do *whatever it takes* to save the Euro, the eurozone has pursued a zero interest rate policy (ZIRP) and then a negative interest rate policy (NIRP). In a NIRP world banks

must pay the central bank to hold overnight funds at the central bank – what I have elsewhere called [Alice in Wonderland Economics](#). This has a tangible impact on their bottom line. (Remember that, for banks, net interest income NII equals interest income minus interest costs).

Japan had had its own Credit Crunch back in the early 1990s since when it was never able to recover the robust levels of economic growth that it had enjoyed in the previous 40 years.

Regulatory regimes have been tightened in Europe with the Basel III capital adequacy requirements, now to be superseded by Basel IV. In the USA, the Dodd-Frank Act of 2010 made it much harder for banks to engage in risky trading activities.

And yet there is still a sense that the bankers got away with it: that the banking industry was more securely insulated from the fallout of the Crisis than its customers – you and me.

“MY ESSAY THIS MONTH IS A GAME OF TWO HALVES. FIRST WE’RE GOING TO A FUNERAL. AND THEN WE’RE GOING TO A PARTY!”





Consequences of the Credit Crunch

Government finances across the developed world – America, Europe and Japan – [have never recovered from the Credit Crunch](#). Debt-to-GDP ratios have declined to historically unprecedented levels and, in most countries such as Britain, are still deteriorating as it has proven impossible to reign in health and welfare expenditure. More importantly, no country in the West has been able to return to its 1945-2008 trend growth rate. These two factors are intimately related as it seems very likely that massive government borrowing has "crowded out" private investment.

It was inevitable that banks, given more onerous capital adequacy and liquidity requirements, would experience reduced levels of return on equity (ROE). Unlike any other kind of business, banks can increase ROE just by increasing leverage, and indeed in the run-up to the Credit Crunch many banks were severely over-leveraged, especially the Wall Street investment banks which were never subject to the Basel II rules.

Post-Crunch banks were compelled to shrink their balance sheets as old loans matured and new more rigorous lending criteria reduced the flow of new loans. Taken together, banks are now generating lower returns on smaller loan books.

Reputational meltdown

Not content with blowing up the global financial system, banks were exposed as mobsters. Since the Credit Crunch, a plethora of banking scandals has been unveiled by prosecuting authorities in numerous countries.



In the UK most of the major lenders were found to have misled customers regarding payment protection insurance (PPI) and were required to pay out an estimated £37.3 billion¹ in fines and compensation. **Barclays (LON:BARC)** and **UBS (SWX:UBSN)** were convicted of having rigged the London Interbank Offer Rate (LIBOR) by reference to which nearly all lending rates are set. Barclays was fined US\$435 million

by UK and US regulators. And **Standard Chartered (LON:STAN)** was fined US\$327 million in the US for sanctions-busting in Iran and Libya.

This was the tip of the iceberg. In May 2015 six global banks were convicted of rigging the foreign exchange markets. **JP Morgan Chase (NYSE:JPM)** was exposed for fraudulent trading in the *London Whale* scandal. **Wells Fargo (NYSE:WFC)** was busted for creating two million fake customer accounts. **Deutsche Bank (FRA:DBK)** and **Credit Suisse (VTX:CSGN)** were fined US\$7.2 billion last year by the US Department of Justice for mis-selling mortgage backed securities.

Reuters has estimated that the top 20 global banks have been fined US\$235 billion since 2008. While not all of those fines are "real" cash, they represent a staggering drain on bank capital at a time when banks were trying to retrench.

Not to mention that a number of banks have been accused of working unpaid interns to death and exhibiting racial prejudice. Bankers ceased to be the *Masters of the Universe*; rather they began to look like a bunch of moral imbeciles.

The upshot has been tighter and more pervasive regulation which in turn has pushed up compliance costs. Both UK and European regulators are pushing



“FOR THE FIRST TIME IN PERHAPS 300 YEARS WE CAN IMAGINE A WORLD IN WHICH MARKET PARTICIPANTS COULD RUN BUSINESSES WITHOUT A BANK ACCOUNT.”

for "open banking" which would oblige lenders to share otherwise hidden customer data, making it easier for consumers to compare financial products. That in turn means more intensive competition.

A false dawn?

When I wrote about [the outlook for European banks](#) in the March 2016 edition of the MI magazine, European bank stocks were heading south in spectacular fashion, led by Germany's **Deutsche Bank (FRA:DBK)** and **Commerzbank (FRA:CBK)**. And while some of us have been waiting for the demise of Banca Monte dei Paschi di Siena, somehow it has not croaked. Nor has the anticipated European banking crisis erupted – yet. In fact, over the twelve months since the end of January 2016 the **STOXX EUROPE 600 BANKS ETF (LON:XS7R)** has risen by 32 per cent. This has led some analysts and investors to suppose that the great banking crisis is over.

But while the European banking system staggers on, despite the problems which are specific to Europe (too many banks, low growth and the imbalances associated with a flawed currency union), there is an existential crisis awaiting banks globally. Their very reason for existence is being undermined by Fintech start-ups which are about to eat their lunch.

What is the purpose of banks?

Undergraduate economic text books assert that banks have three functions. They take deposits; they make loans to customers (individual and corporate); and they facilitate payments (either from one account to another in their own bank or to an account held with another bank). In order for an institution to call itself *a bank* it must be a *licensed deposit taker*. Received opinion since the late 18th century has been



that these three things can only be carried out by banks: therefore we cannot escape them (like death and taxes). Banks Hoover up surplus funds and lend them to those who are in cash deficit (but who have every chance of repaying their debt). This is known as *intermediation*. All other banking activities like trading and underwriting are ancillary to this.

But with the rise of the internet, other forms of financial intermediation have become possible. Increasingly, new businesses are being funded through peer-to-peer (P2P) lending portals such

as [LendingCrowd](#). And various types of digital wallets, now widespread in developing countries, enable people to receive income and make payments through their mobile phones.

I am not saying that banks are going to disappear overnight; but for the first time in perhaps 300 years we can imagine a world in which market participants could run businesses without a bank account.

Traditional banks do also offer their account holders a range of value-added services from brokerage accounts,



“BANKS MUST ADAPT TO THE REALITY OF A MACROECONOMIC ENVIRONMENT THAT OFFERS HIGH DOWNSIDE RISK WITH LIMITED UPSIDE GAIN.”



foreign currency purchases and credit cards to home and travel insurance. But such services can be provided by non-bank financial institutions. Note also that a number of the new breed of specialist business lenders and leasing companies are not licensed deposit takers.

Challenges ahead

According to a recent report by McKinsey & Coⁱⁱ, international banks are facing formidable challenges on three fronts. First, they face a weak global economy; second there is the challenge

of *digitization* or Fintech; and third there is the question of more onerous regulation. These three things, taken together, threaten to reduce profits for the global banking industry in the years ahead. Developed market banks are most affected, says McKinsey, with US\$90 billion of profits at risk. Emerging market banks are also vulnerable, especially to the credit cycle.

McKinsey's global banking review concluded that of the major developed markets, the United States banking industry seems to be best positioned to face these challenges. The industry

there also anticipates a friendlier regulatory environment under President Trump. Japanese and US banks have up to US\$45 billion of profits at risk by 2020. Banks in Europe and the United Kingdom have US\$35 billion of profits at risk. More severe digital disruption could further cut their profits from US\$110 billion today to US\$50 billion in 2020. McKinsey thinks banks' ROE could be halved by 2020.

Emerging market banks face a different challenge. They are structurally more profitable than their counterparts in developed markets, with ROE generally well above the 10 percent cost of capital. But they are more vulnerable to the credit cycle.

During economic downturns the default rate always increases; but in less mature economies it sky-rockets. A slower global growth outlook could result in additional credit losses of up to US\$250 billion, of which US\$220 billion would be in China, McKinsey's report finds. But with their current high levels of profitability, Chinese banks would probably be able to withstand these losses.

The costs of risk management and compliance have shot up in recent years. And additional proposals – the embryonic Basel IV framework – are likely to impose stricter capital requirements, more systematic and periodic stress testing, and new provisions for operational risk.

Banks must adapt to the reality of a macroeconomic environment that offers high downside risk with limited upside gain.

The march of Fintech

Meanwhile, innovative Fintech start-ups are on the march across the globe. Fintech is having the effect of boosting bank competition and driving down margins. Some emerging-market banks are managing well, offering innovative mobile services to customers. In June last year **State Bank of India (BOM:500112)** set up a INR2 billion fund to finance Fintech start-ups. But McKinsey's report finds that in the largest emerging markets – China and India – banks are losing ground to digital commerce platforms that have moved rapidly into banking services.





**“IN 2011
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are using them less, and when they do – for example, to deposit a cheque – they do not enjoy the experience. In 2011 there were 478 million *customer interactions* in Britain's bank branches⁴. Last year it was less than 280 million. The reason is of course that most people and businesses are managing their accounts through internet banking.

True, many small businesses still need to deposit cash takings, although increasingly they can do this from new-style ATMs. As for large businesses, like supermarkets, the reason that they offer cashback at the tills is so that they will not have to deposit cash at the bank, which is costly.

Overall, another 3,000 or so bank branches are set to close across the UK over the next three years. This is bad news for the 4.5 million seniors whom Age UK estimates are not connected to the internet – but they are now a minority demographic. The inexorable trend is away from retail bank branch networks towards internet banking platforms.

Some of the new "challenger" banks have tried to change the concept of what a branch is. **Metro Bank (LON:MTRO)** has "stores" instead of branches; **Virgin Money (LON:VM)** offers "lounges". But whatever you call them, these are still cost centres. Overall though, it seems that challenger banks understand Fintech better, and have been nimbler at rolling out digital-only models.

In developed economies, regulators, who were initially more conservative about the entry of non-banks into financial services, are now gradually opening up. Over time, Fintechs will be able to insert themselves between banks and their customers, capturing the vital customer relationship and presenting an existential threat. Imagine if **Facebook (NASDAQ:FB)** or **Amazon (NASDAQ:AMZN)** decided to offer digital payment services. (As surely they will).

If banks want to survive, McKinsey is proposing a three-pronged strategy.

Firstly, banks should cut costs and improve the health of their balance sheets. They need to protect revenues by managing capital and risk more efficiently. Digitization is only one part of controlling costs. Ultimately, banks will only be able radically to keep costs down by reducing staff numbers.

Secondly, if a cost-cutting agenda is defensive in nature, banks also need to go on the offensive. They must re-orientate their business models back towards the customer by establishing the bank as a platform for data and digital analytics and processes. And they need to link up with Fintechs, and other banks, to share costs. They also need to streamline their IT structures.

Thirdly, the industry must move beyond traditional restructuring and re-

new the banking model via new technology – especially data management.

Further downward pressures on bank profits

Investment banking – underwriting and intermediating credit and securities – doesn't pay any more. Investment bank revenues have fallen by around 30 percent since 2010ⁱⁱⁱ while costs (mostly salaries) have hardly budged. Despite the amazing advances in software, most banks still maintain huge back offices in glass and metal skyscrapers in downtown commercial centres.

The end of bank branches in the high street

Big banks have been rolling out futuristic high street branches in the US and elsewhere, but according to a report published by Goldman Sachs in 2015, they are wasting their money. Within a decade the retail bank branch model will be dead according to Peter Diamandis, executive chairman and co-founder of Singularity University^{iv}. He predicts that most main street bank branches will be gone in the US by 2025. Last year saw the highest level of bank branch closures in US history, according to FDIC data.

Here in the UK, high street bank branches have been closing at a record rate. This is because bank customers

Nothing can stop banks going digital-only

By 2020 at least 66 percent of the global population will be online, according to PHD Ventures. That could mean as many as 5 billion additional consumers, backed by internet-expansion projects like Facebook's [Internet.org](#) and Google's [Project Loon](#). Project Loon is a proposed network of high altitude balloons traveling on the edge of space, designed to extend internet connectivity to people even in the most remote rural areas across the world.

Fund managers threatened by "Robo-advisory"

Fund managers sailed through the Credit Crunch and its aftermath relatively serenely, their fees, costs and margins largely unbowed. The fly in the soup for fund managers is that they are being robotised faster than they can issue performance excuses.

Munnypot (see box) claims that almost a third of British citizens don't currently save anything at all, although

76 percent say they would like to. But almost a quarter dismiss saving accounts as "pointless" due to record feeble interest rates. These are the people who have been overlooked by conventional banks.

The brave new world of Fintech

London's Silicon Roundabout is a Fintech hub as is Silicon Valley, California. But Fintech is not just confined to London and LA. Last September I wrote about [India's Fintech Revolution](#). India is a good example of how large numbers of people are using Fintech who have never been traditional bank customers.

Huge numbers of people have been excluded from the banking system because they do not meet the eligibility criteria. Globally, 38 percent of adults do not use any formal financial services and 73 percent of the world's poor do not have a bank account. This is attributed primarily to onerous requirements involved in opening a bank account in many countries – ex-

acerbated by anti-money laundering (AML) regulations. The United Nations together with the World Bank has launched *Universal Financial Access* – a programme to boost financial inclusion by 2020 covering 25 countries including India.

With the rise of universal mobile telephony there has been a revolution in the way that people without bank accounts receive remittances and buy goods. An outstanding example of achieving financial inclusion is **M-PESA**, Kenya. (*Pesa* is the Swahili word for money). Launched in 2007 by **Vodafone (LON:VOD)** for **Safaricom** and **Vodacom Tanzania**, the largest mobile network operators in Kenya and Tanzania respectively, it has since expanded into Afghanistan, South Africa, and India. In 2014 it was rolled out in Romania and in 2015 in Albania. M-PESA allows users to deposit, withdraw, transfer money and pay for goods and services easily with a mobile phone. It is now used by over two-thirds of Kenya's 45 million people, many of whom consider that they no longer require a conventional bank account.



Ten Fintech firms that are changing the world

Founded in Edinburgh, [AimBrain](#) is a mobile biometrics platform based on behavioural, facial and voice recognition systems to authenticate transactions. This firm wants to do away with passwords by tracing the way that users swipe and tap their smartphone screen to identify them. **AimBrain's** patent-pending approach to biometric authentication aims to eliminate fraudsters and to provide the appropriate level of protection for each unique environment.

You have probably heard of [Blockchain](#) (OTCBB:UBIA): they invented the first decentralised digital currency – **Bitcoin**. Founded in 2009, its **bitcoin wallet** now has eleven million users. Anyone can generate bitcoins using Blockchain's *bitcoin miner*. Bitcoins are stored in your digital wallet. You can then use these to pay anybody anywhere in the world without having recourse to the banking system. The advantage is that it is secure and that there are no transfer or foreign exchange charges. As I write this, one bitcoin is worth US\$895.78. Bitcoins can be converted back into "real" money at any time. Devotees of bitcoin transactions claim that it is destined to become *the global currency*. Others are more sceptical. There are other digital currencies which have sought

to imitate bitcoin but, so far, **Blockchain** leads the pack.

The German smartphone-enabled mobile bank [N26](#) has signed up 8,000 users within its first year of launch. **N26** says that new clients can open an account in under eight minutes, withdraw from any ATM, get real time text notifications after every transaction and send and receive money instantly with other **N26** customers. Account holders can make cashless payments to any merchant who accepts **MasterCard** (NYSE:MA). **N26** has formed strategic partnerships with other Fintech players. It is planning to offer savings, investments and insurance products shortly.

[Property Partner](#) is a platform that allows users to invest in individual properties across Europe. Investors are invited to view prospective residential property investments online which are picked by property expert Robert Weaver. Properties are organised into different categories. Prospective investors then click on the property and are able to buy "shares" in it. These "shares" entitle the investor to a portion of the rental income from that property plus any capital gain arising from its sale. **Property Partner** takes care of lettings, maintenance costs and legal fees. It charges a one-off two percent entry fee on money invested with no annual charge. The

business has crowdfunded over 170 properties, with more than £25 million invested in just over 12 months.

[Revolut's](#) vision is to make travel money a thing of the past. It provides a global money app that includes a debit card, currency exchange, and peer-to-peer payments which can easily be downloaded from its website. Revolut currently charges no fees for the majority of its services, and claims to use interbank rates for currency purchases. The company's card can be used anywhere in the world where **MasterCard** is accepted. The accompanying app boasts a range of useful features, including an option to block the **Revolut** card if the card is stolen. The start-up was founded in London in June 2014 by Russian nationals Nikolay Storonsky and Vlad Yatsenko. Since the launch of the card in July 2015 they have signed up over 80,000 users who spent more than £200 million last year. [Nikolay reckons](#) that if you are expecting to spend €500 in Europe then you can save up to €50 with a **Revolut** card.

Indian mobile commerce platform [Paytm](#) (still private, but a probable floatation on the Mumbai market within three years) has grown from a mobile phone top-up service to an e-commerce platform, to a bill payment service and then to a digital wallet in just seven years.





Founder CEO Vijay Sharma expects that Paytm wallet users will reach 500 million by 2018 from the current 130 million. **Uber** launched in India with **Paytm's** wallet as its sole digital payment platform. Even rickshaw drivers in Delhi accept payment by **Paytm**. **Paytm** also lends money to Uber drivers (mostly ex-Indian Army guys) to get loans to buy their vehicles.

Zhong An (China) is a joint venture between **Alibaba (HKG:1688)**, **Tencent (HKG:0700)** and **Ping An Insurance (HKG:2318)**. It is a Chinese online property insurance company utilising data mining technology to assist with product design, underwriting, insurance claims, marketing and risk management.

Based in Palo Alto, **Wealthfront** is an automated investment service that aims to make it easy for anyone to get access to world-class, investment management advice without high fees and no minimum account size. **Wealthfront's** investment management team, led by Dr Burton Malkiel, author of *A Random*

dom Walk Down Wall Street, has designed a service offering a portfolio diversified across uncorrelated asset classes, customized according to the client's particular risk tolerance. Each selected asset class is accessed through a low-cost, passive ETF. **Wealthfront** continuously monitors and rebalances client portfolios to maximize long-term returns. The service also attempts to minimize clients' tax liabilities. It uses Modern Portfolio Theory (MPT) to identify the ideal portfolio for each client.

Munnypot is an online savings and investment portal launched last year which offers financial advice at a fraction of the cost of a financial adviser. The service requires a minimum investment of £25 per month and/or a single investment of £250. It provides a "chat-based" user interface that advises people on their savings and investment decisions. The interface learns about prospective clients' financial situation, risk profile and financial goals (saving for a deposit on a house, retirement planning etc.). **Munnypot** then of-

fers clear advice on where to invest money, and monitors clients' investments 24/7. People looking to invest a total contribution of between £250 and £2,500 pay a £5 one off fee for initial advice and a monthly monitoring fee of just 42 pence. **Munnypot's** target demographic is the 16 million people in the UK who need financial advice but feel that they are locked out of the system. "We are determined to help Britain fall in love with savings again", says Simon Redgrave, Director.

London-based **Funding Circle** is a loan platform for small businesses. Investors can browse businesses that the platform has already evaluated and approved for lending. Once approved, businesses post their loan requests on the platform, and investors can then bid the amount of money they wish to lend and the interest rate they require. Currently over 20,000 small businesses have raised £1.9 billion in new finance via **Funding Circle** from nearly 60,000 private investors who earn an estimated return of seven percent per annum.



“THE LONG-TERM OUTLOOK FOR BANKERS RESEMBLES THAT FOR BLACKSMITHS A HUNDRED AND FIFTY YEARS AGO.”

Banks that emulate Fintechs

To be fair to the bankers, they have realised that investment in new technology is the number one survival strategy. **HSBC (LON:HSBA)** has forged strategic partnerships with technology firms to develop robotics, biometric solutions and facial recognition systems. They have been hiring people from the likes of Google, Facebook and PayPal – technology firms with very different corporate cultures from banks.

And if you can't beat them, join them. A small number of banks have decided that they need to be more like the agile Fintechs. **UBS (VTX:UBSG)** has launched **SmartWealth** which is designed specifically to compete head-on with the robo-advisors.

Other banks are buying up Fintech start-ups. Spanish retail bank **BBVA (BME:BBVA)** has bought the US digital bank **Simple**, the Finnish start-up **Holvi** and a 30 percent stake in **Atom Bank**, the UK's first digital-only bank^{vi}. In fact, **BBVA** sees itself as not just a bank but as a financial services software provider. It bought the Silicon Valley software firm **Spring Studios** in 2015.

NatWest, a subsidiary of **Royal Bank of Scotland (LON:RBS)**, has set up a network of "scouts" based in London, Tel Aviv and Silicon Valley to identify promising Fintech start-ups. The bank has also worked with tech accelerator **RocketSpace**, the London campus of which opened in May 2016, sponsored by **RBS**. Since launching in 2011, **RocketSpace** members have included more than 750 tech start-ups and 16 unicorns including **Uber**, **Blippar**, **SuperCell** and **Spotify**.



The Future

Expect banks to continue to outsource back-office functions further to systems designers like Belgium's **Capco**. At least some banks have woken up to the threat of disruption. Facebook's staff handbook challenges all staff to invent the product that will one day destroy it. Banks need to think like that too – but that will require a change of culture.

In the *MI December* magazine I talked about the [End of Globalisation](#). Part of this story is the end of the *financialisation* of the global economy. That is, the relentless rise of the share of the financial sector in the economy as a whole. That long-term trend now seems to have been reversed. Banks will remain with us for some time to come; but the long-term outlook for bankers resembles that for blacksmiths a hundred and fifty years ago.

Action

Reduce your overall exposure to conventional banks in your portfolio. Those banks which are robustly responding to the challenge of technology and emulating Fintechs (see box) should be preferred. Admittedly, it is difficult to buy into the

future success of Fintech because nearly all these start-ups are privately held, mostly by venture capitalists. However, there are a few open investment funds which are focused on Fintechs. One such is [Propel Venture Partners](#), a US\$250 million venture capital fund launched by BBVA last year.

- i See: <https://www.ft.com/content/21099006-fef9-11e5-99cb-83242733f755>
- ii McKinsey Global Banking Annual Review 2016: A Brave New World for Global Banking. See: <http://www.mckinsey.com/industries/financial-services/our-insights/a-brave-new-world-for-global-banking?cid=soc-web>
- iii Article by William Wright, The Daily telegraph, 10 January 2017, page B2.
- iv See: <http://www.cnbc.com/2015/06/02/retail-bank-branch-is-doomed-and-banks-dont-know-it.html>
- v See: <https://www.theguardian.com/money/blog/2016/sep/17/why-bank-branches-closing>
- vi See: <https://www.theguardian.com/money/2016/apr/08/atom-first-uk-digital-only-bank>

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Personal Investing





BY JAMES FAULKNER

HOPES AND FEARS FOR 2017

JAMES FAULKNER INTERVIEWS CHRIS DARBYSHIRE OF SEVEN INVESTMENT MANAGEMENT

James Faulkner: Hi Chris. Thanks for taking the time to speak with Master Investor today. Could you kick off by giving our readers a brief summary of 7IM and its offering to clients, as well as an overview of your role at the company?

Chris Darbyshire: Hi James. 7IM runs a number of "multi-asset" funds – seeking diversification both by the types of assets invested in and by their geographic location. Each fund has a different level of risk and an expected return commensurate with that risk.

We are very diligent in our estimates of what levels of return investors can expect from the different levels of risk, and we make these estimates available to clients, which helps them to plan their savings strategies. We put a big focus on the types of assets we hold, and often try to invest passively (at minimal cost), believing that asset allocation is the primary driver of investment return rather than active stock-picking or market-timing.

My job as CIO is to manage the investment team, where asset allocation and implementation decisions are agreed collectively.

JF: In your note to clients entitled "The Year Ahead 2017", you say you

feel there are "enough widespread positives" for global growth to continue at a healthy level in 2017. But if we do start to see so-called "emergency" monetary policy measures curtailed and, eventually, reversed, won't markets take fright? Have we become too comfortable with zero interest rates?

**"PROVIDED
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CD: Low rates and unconventional monetary policy have underwritten consumer spending and company balance sheets – in this respect they have helped to stabilise economic conditions and financial markets. Provided central banks switch

to more conventional monetary policy at a time when economic conditions are improving, markets will take things well.

At the end of the day, economic growth and profits drive markets directly, whereas interest rates only have a very indirect effect. As long as those two drivers continue to improve investors will find good stories to focus on.

JF: The biggest known unknown for 2017 is the Trump presidency. The initial market reaction has been positive due to the belief that Trump's policies will be reflationary. But aren't investors being lured into a false sense of security given the threats posed by some of Trump's more outlandish policies?

CD: Absolutely. Stockmarkets are failing to incorporate any kind of risk surrounding Trump's presidency, whether it be bad policies, absence of policies (because he cannot work the Washington machine), incendiary tweets, unnecessary China-bashing, Fed-bashing, scandal and so on.

Stockmarkets have chosen to focus only on the positives but, it has to be said, bond markets are fearing the worst. In fact, the value that has been lost by investors in US government bond markets

is about the same as the value created in stockmarkets – it's as if Trump's policies can accomplish economic growth only by using taxpayers' money.

We're particularly concerned about Trump's policy towards China, which he has been very forthright about. His language towards China has also been highly emotive. Amongst other things, he has accused China of "raping" the US. He has also accused China of inventing the concept of global warming in order to make US manufacturing less competitive! China holds an important Communist Party Congress towards the end of the year so will meet fire with fire. The consequences could be of great significance – what starts as a trade war could escalate into a geopolitical crisis.

JF: Many commentators believe that equity and bond markets are fairly priced or expensive, especially when it comes to the US. What are your current views on asset allocation, both in terms of geography and asset class?

CD: I would agree that the US equity market is fully priced, but whether that turns out to be true depends on the growth in company profits. High valuations can be justified by strong growth in earnings,

and can persist for a long time if investors think earnings are on a rising trajectory. The UK stockmarket also appears fully-valued, though this is largely due to its concentration in certain resource-related companies.

Good expectations for equity returns can still be found in Europe, Japan and Emerging Markets. Bond and fixed income markets generally are richly priced, though we can still find pockets of value. We have preferred to avoid them despite

“GOOD EXPECTATIONS FOR EQUITY RETURNS CAN STILL BE FOUND IN EUROPE, JAPAN AND EMERGING MARKETS.”



the spectacular performance they've had over the past decade – the downside is just too scary, particularly the effect it would have on lower-risk portfolios. Instead we have turned to alternatives and hedging strategies, where reliable returns and protection are available from time to time at very low cost.

JF: All eyes are currently on Trump (shortly due to be sworn in at the time of the interview). But as we move further into 2017, the focus will no doubt shift to Europe, where elections in France and Germany threaten to upset the apple-cart. However, with European growth edging higher of late, do you see the rise in populism losing momentum?

CD: Yes I do. Europe's economy is performing well, and this won't be lost on European voters. "If it ain't broke, don't fix it" should be their mantra. But we just don't know for sure – voters in the UK and the US didn't seem to be aware of the relatively good performance of those economies, and registered their protests even at the risk of upsetting the apple-cart.

It's important to stress that populism in Europe is much less damaging than in the US or UK. It's very unlikely that Le Pen in France would also win a majority in parliament even if she won the Presidential election, so there is a limit to what she could do. Also, most European parliaments are elected by proportional representation, which tends to neuter the ambitions of demagogues.

JF: You have suggested Japan as a potential winner from a Trump trade war. Clearly the Japanese market has been very strong in recent years, not least due to changes in corporate culture and the attitudes of Japanese investors. Does this trend have further mileage in it?

CD: I was thinking that Japan might be able to replace exports from China in the event of a trade war between the US and China, and possibly China's allies as well.

Trump seems to favour nations that have shown him due deference, as the Japanese Prime Minister has done. The changes in Japanese corporate culture have a long way to run – there is still a great deal of cash on Japanese balance sheets that can be deployed in favour of shareholders. And there is always the chance that, eventually, the economy moves into a higher gear as has happened recently in the US. It would be nice if the Japanese stockmarket could shake off the straitjacket of the Japanese currency.

“WE HAVE CONSCIOUSLY AVOIDED BREXIT RISK ON BEHALF OF OUR CLIENTS, WHO HAVE PLENTY OF BREXIT RISK SIMPLY BY LIVING HERE IN THE UK.”

JF: Back here in the UK, a rise in inflation has been widely flagged for 2017. At the same time productivity growth remains below trend and well behind global peers. Is 2017 the year when UK consumers start to feel the Brexit bite?

CD: Yes, I think so. Whether people will feel that bite, though, is a different matter. Inflation can be hard for consumers to detect and, even if it occurs, they may not realise that Brexit is the cause. If they do, and if the Labour Party or the left-wing press are able to connect inflation with Brexit, it could dramatically change the enthusiasm of the electorate for Brexit and for the Tories come the next general election. That could force the government to change its approach in favour of a soft Brexit, something that could cause the pound to rally. Though the probability of this happening is not particularly high, the reaction of capital markets would be

dramatic, with the FTSE 100 plummeting while the pound strengthens.

JF: If inflation rises above the Bank of England's 2% target, can we realistically expect the Monetary Policy Committee to finally begin raising interest rates? Or will Brexit headwinds prevent it from doing so?

CD: I don't think so, because they will see higher inflation as the prelude to an economic slowdown, culminating in a collapse in inflation. So the BoE will see it as a purely temporary phenomenon, and they will look through it.

JF: The UK market has enjoyed a strong performance post-Brexit but much of this has been down to the weak pound and the translation effect from overseas earnings. Given that dividend cover for FTSE 100 stocks is now at its lowest since the Financial Crisis, there are surely some pitfalls out there right now, especially for income investors. What's your current view on the state of UK market?

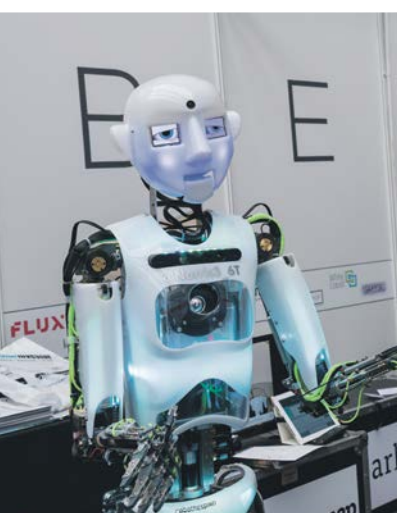
CD: We're avoiding it. It's had a good run, valuations aren't cheap and it is massively sensitive to the ups and downs of sterling. There's also Brexit risk in the 25% of FTSE 100 revenues coming from the UK. We have consciously avoided Brexit risk on behalf of our clients, who have plenty of Brexit risk simply by living here in the UK.

JF: Your very own Justin Urquhart-Stewart will be speaking at the Master Investor show in Islington on Saturday 25th March. I've seen Justin speak a few times in the past and his talks are always engaging and insightful. Can we have a sneak peak of what we can expect to hear from Justin on the day?

CD: I'm not sure yet, but he's one of the most entertaining speakers in the business and still cracks me up, even after working here for 5 years!

Chris Darbyshire – Chief Investment Officer (CIO)

Chris joined the Investment Team in 2012 as Senior Quantitative Portfolio Manager, having spent 8 years working in derivatives, primarily at Goldman Sachs. His career includes 7 years spent with BNP Paribas, where he headed an equity research sector team, as well as 7 years spent in the media industry as the US-based finance director of a division of Viacom. Chris is a graduate of Oxford University.



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BY NICK SUDBURY

FUNDS IN FOCUS

THE RESURGENCE OF VALUE

There were many notable events in 2016, but one of the least heralded was that value stocks outperformed growth stocks by a massive 10%. This represented a remarkable turnaround given the decade of poor relative returns that had gone before, and many believe that the reversal of fortune has a lot further to go.

Value stocks tend to have higher dividend yields and trade on lower price-earnings and price-to-book ratios than their growth counterparts. Those who invest in these sorts of opportunities look for companies that they believe have been unjustifiably written down by the market and where there is likely to be a catalyst that will lead to a positive re-rating.

Until last year, growth had outperformed value pretty consistently ever since the 2007 financial crisis. Over the period from 12th August 2006 to 12th December 2016, the MSCI World Growth index generated a cumulative return that was 33% ahead of the MSCI World Value index.

The dramatic difference in performance is also reflected in the relative valuations, although growth will always be 'more expensive' than value by definition. At the start of the year the MSCI World Growth index had a dividend yield of 1.67% and was trading on a forward PE ratio

of 18.78 and a price to book value of 3.64. By contrast, the MSCI World Value benchmark was yielding 3.24% and had a forward PE ratio of 14.45 and a price to book value of 1.64.

“IT IS POSSIBLE THAT THE RECENT RESURGENCE OF VALUE STOCKS COULD BE DUE TO A SHIFT IN EXPECTATIONS IN FAVOUR OF HIGHER NOMINAL GROWTH.”

It is possible that the recent resurgence of value stocks could be due to a shift in expectations in favour

of higher nominal growth. Periods of healthy economic growth and rising interest rates favour cyclical and the more economically sensitive stocks that tend to fall into the value category.

Those who are comfortable with the idea of value investing and who believe that the rotation in favour of these sorts of stocks will continue could take advantage by investing in a value orientated fund. There are several good quality investment trusts that fall into this category and that provide exposure to different parts of the market.

Strong performer

One of the best known is **Fidelity Special Values (LON:FSV)**, which is managed by Alex Wright who uses a value/contrarian approach to stock selection. Wright looks for companies that have underperformed, but that offer an element of downside protection. The £600m fund was originally managed by Anthony

Bolton and follows the same unconstrained approach, albeit with a mid and small cap bias.

FSV will normally hold between 80 and 120 stocks with up to 20% of the portfolio invested overseas. There will often be large sector bets, with Wright currently overweight industrials and financials, while being underweight in consumer goods. The 10 largest stocks make up 43% of the fund and include the likes of: Shell, Citigroup, Shire, BT and Royal Mail.

The small and mid-cap allocation hurt the performance immediately after the Brexit vote, but the shares have come back strongly. Since Wright took over in September 2012 the fund's NAV is up by twice the 51% increase in its FTSE All-Share benchmark. The shares currently trade at a small discount to NAV of 3% and are yielding 1.6%.

Respected manager

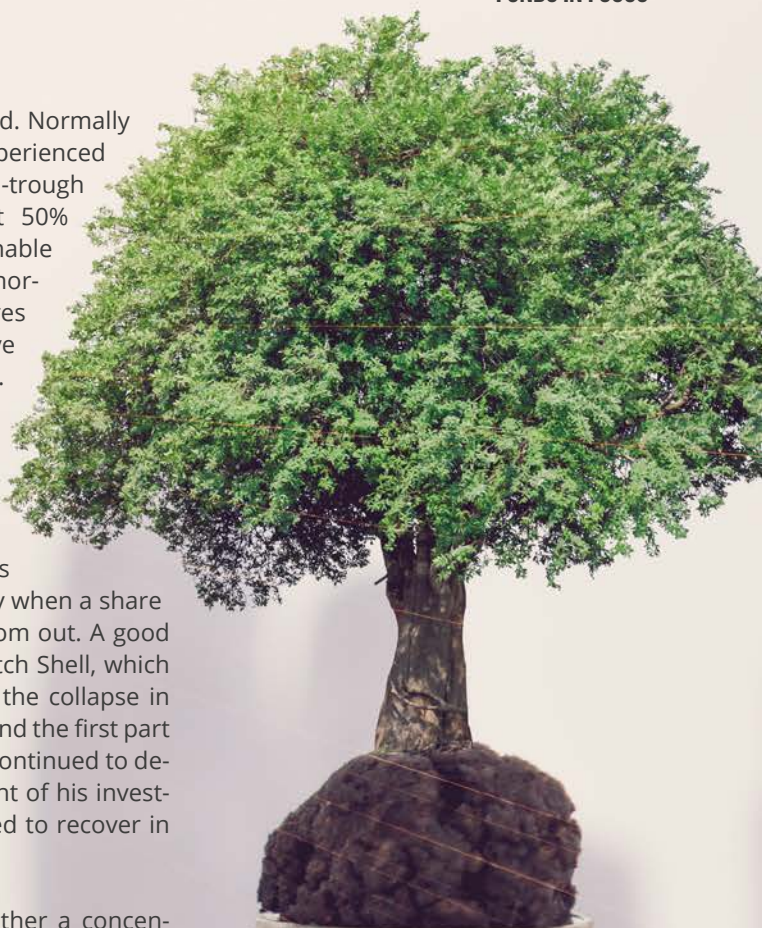
Another respected value manager is Alastair Mundy, who has run the £840m **Temple Bar investment trust (LON:TMPL)** since November 2002. Mundy is a contrarian investor who looks for FTSE 350 stocks that are out of favour and that he consid-

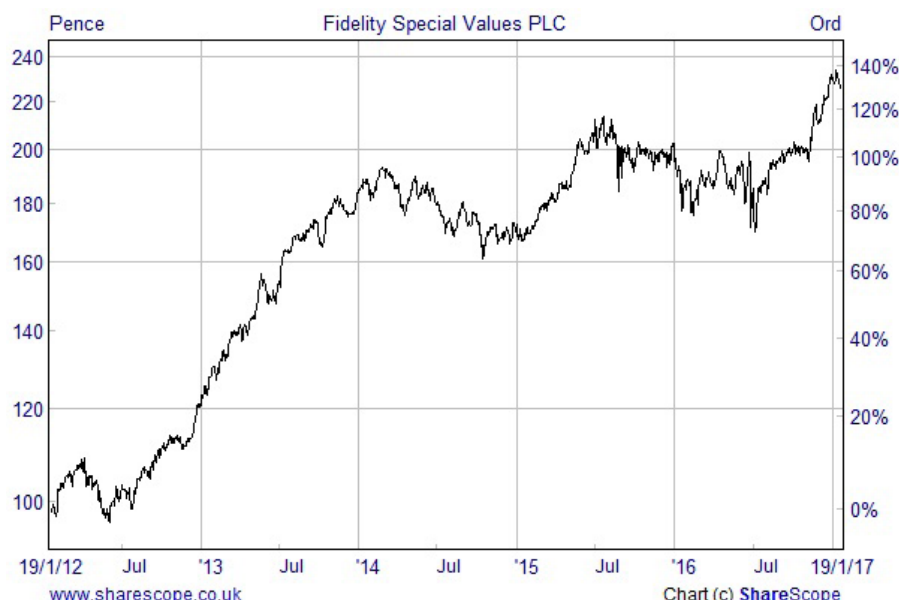
ers to be undervalued. Normally these will have experienced share price peak-to-trough declines of at least 50% and yet have reasonable fundamentals. He normally holds the shares for 4 or 5 years to give them time to recover.

One of the main risks with this approach is that Mundy will often invest too early as it is impossible to identify when a share price will finally bottom out. A good example is Royal Dutch Shell, which he bought following the collapse in the oil price in 2014 and the first part of 2015. The shares continued to decline beyond the point of his investment and only started to recover in January 2016.

Mundy has put together a concentrated portfolio of 45 shares and 4 bonds with the top 10 accounting for just over half of the assets. These include companies such as HSBC, Glaxo, Royal Dutch Shell, BP, Barclays, Lloyds and Tesco.

It is an unusual approach and because of this the holdings will often





differ quite substantially from other UK equity funds, which makes it a useful diversifier. There are times when it will lag behind its FTSE All-Share benchmark as in 2014 and 2015, but over the last 5 years the fund has achieved an 84% increase in NAV compared to the 64% rise in the index.

Income and growth

The **Lowland Investment Company (LON:LWI)** aims to achieve a higher than average income return with growth of both capital and income over the medium to long-term by mainly investing in UK companies. It has been managed by James Henderson of Henderson Global Investors since January 1990.

Henderson is a contrarian, value-driven investor who looks for opportunities amongst the large, mid and small cap areas of the UK market including AIM. He has put together a diversified portfolio of 100 stocks with the 10 largest only accounting for about a quarter of the assets.

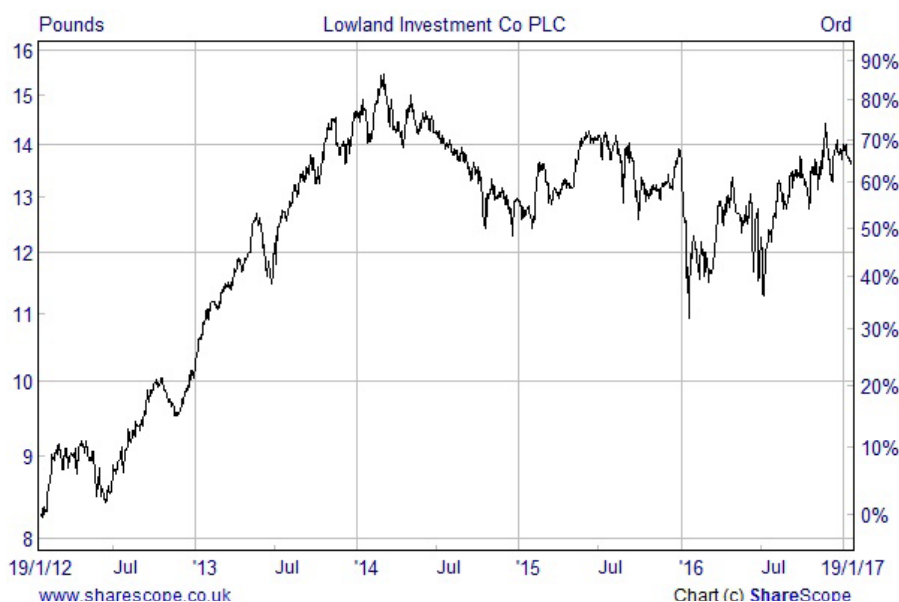
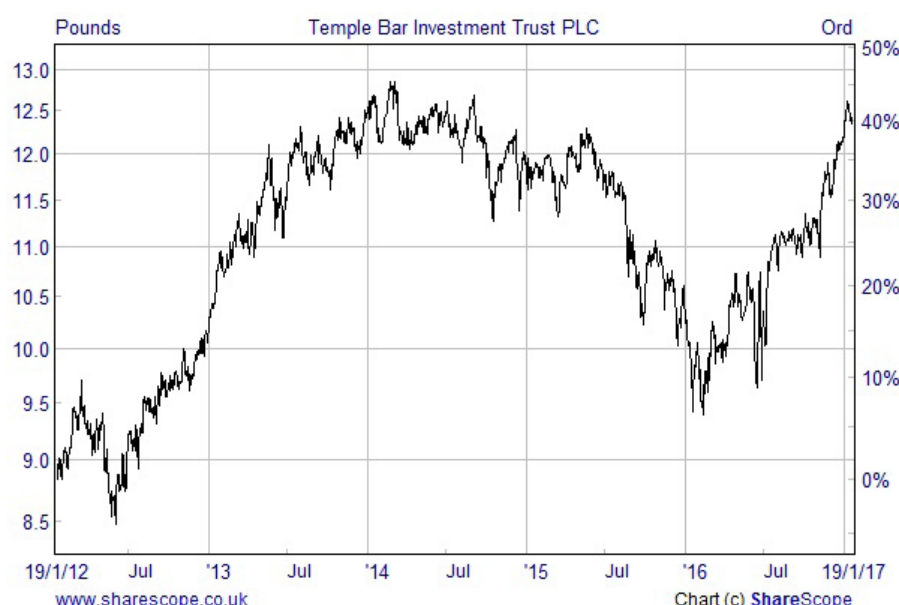
The fund's largest positions include the likes of Royal Dutch Shell, HSBC, Hiscox Insurance, Phoenix Group and Rio Tinto, with the main sector overweights being: Industrials, Basic Materials and Financial Services.

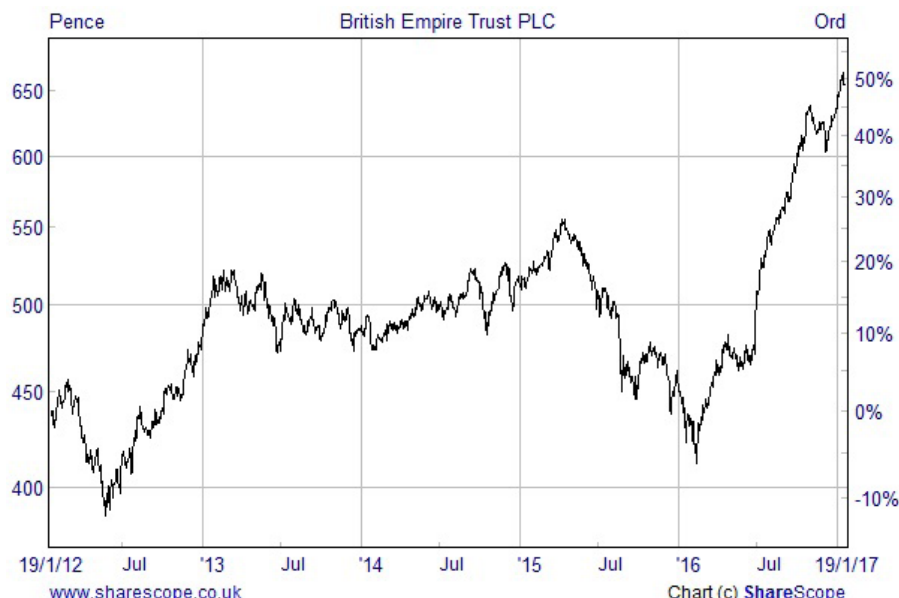
Henderson has built up a decent long-term track record relative to his FTSE All-Share benchmark, but the last 3 years have been more difficult and he has lagged behind. The shares currently trade on an 8.5% discount to NAV and are yielding 3.3% with the dividends paid quarterly.

Global exposure

A more specialist option is the £820m **British Empire Trust (LON:BTEM)**, which aims to generate growth by investing in securities that trade at a discount to their estimated underlying NAV. It is managed by Asset Value Investors, who look for stocks or closed-ended funds with high quality assets that have the potential for capital appreciation and where there is a catalyst for the discount to tighten.

In October 2015 Joe Bauernfreund took over as the lead manager and he has made a significant difference by





Alistair Whyte, the manager, has constructed a reasonably well diversified portfolio of 86 holdings with the top 10 accounting for about a quarter of the assets. The largest positions include stocks such as e2v Technologies, Paragon, Brewin Dolphin and Grainger, with the main sector overweights being Energy and Industrials.

Whyte thinks that there is a reasonable chance of an economic downturn in the UK in 2017 due to a decline in investment and disposable income, but he believes that company balance sheets are better positioned than before the financial crisis and that much of the downside has already been priced in.

The fund is positioned towards the smaller cap end of the universe where he is finding better value, with about a third of the assets invested in companies with a market value of less than £250m.

Aberforth Smaller Companies has had a difficult 12 months with the share price up about 1% and the NAV failing to keep pace with its small cap benchmark. Longer term it has done much better with 5-year share price and NAV returns ahead of its benchmark and sector. The shares currently trade on a 16.5% discount to NAV and are yielding 2.3%.

Fidelity Special Values, Temple Bar and British Empire are all included in the Winterflood investment trust team's model portfolio for 2017.

switching to a higher conviction approach with more emphasis given to the events that could lead to a re-rating. This has contributed to a material increase in the fund's NAV, which is well ahead of its MSCI All Companies World ex US benchmark.

BTEM is now quite concentrated with the top 10 holdings making up about 55% of the portfolio. The investments are divided into 5 main categories: closed-ended funds (45%), European holding companies (24%), property companies (17%), Japanese holding companies (7%), and Asian holding companies (7%).

One example is the Vietnam Phoenix fund, an Irish-listed closed-ended fund that invests in listed and unlisted Vietnamese companies. It has recently approved restructuring proposals that will result in the listed assets being moved into an open-ended fund and the private equity assets being spun-off into a separate realisation vehicle. Vietnam Phoenix has increased by more than 80% in sterling terms since BTEM first invested and there is further upside to come as the remaining discount should more or less disappear once the restructuring has been completed.

Despite the recent strong performance, British Empire shares trade on a 10% discount to NAV and at the end of September the underlying holdings had a weighted average discount to their estimated intrinsic value of 32%. This suggests that the fund still offers significant upside potential.

Small cap value

The **Aberforth Smaller Companies Trust (LON:ASL)** is the largest small cap focused investment trust with a market value of just over £1bn. Its value approach ensures that it offers a different type of exposure to the rest of its peer group and although this has held back its recent performance it still has a good long-term record.

The fund is managed by Aberforth Partners, which is a value house that invests in companies that are trading at less than their intrinsic value. They believe that the small cap universe is ideally suited to this approach because of the greater business volatility that comes from having fewer products or services, the relative lack of liquidity that can affect the valuations and the less abundant information that can result in a mispricing.





BY FILIPE R. COSTA

THE MACRO INVESTOR

CRUNCH TIME FOR THE BANK OF ENGLAND

"I was given nicknames that were variants of my last name which is Carney, so I was called Carnival, or Carnage, or things like that. I like Carnage a little better than Carnival. It seemed a little more manly I guess."

– Mark Carney, Governor of the Bank of England

Brace for impact

While the country was preparing to vote in one of the most important referenda ever conducted, Mark Carney, the Governor of the Bank of England, warned that the UK economy could struggle to grow if the country voted to leave the EU, hinting that the economy appeared to be losing steam already. But while the Bank asserted that the *"risks around the referendum are the biggest risks facing the UK economy"*, it had undertaken *"contingency planning to decrease the potential impacts of uncertainty"*, Carney told a newspaper by the end of April.

Carney's determination to adopt counter measures in case Brexit materialised has been unchallengeable. The same is not true regarding his assessment of the real impact of Brexit. Seven months after the vote, the British economy is doing particularly well in terms of growth, employment, and inflation levels, surprising even the most optimistic of the *Brexiters*. Businesses and consumers

are finding their way and the British economy is heading forward without any real setbacks.

The Brexit process will certainly take time to complete. A recent vote from the UK Supreme Court forcing the government to seek parliamentary

"SEVEN MONTHS AFTER THE VOTE, THE BRITISH ECONOMY IS DOING PARTICULARLY WELL IN TERMS OF GROWTH, EMPLOYMENT, AND INFLATION LEVELS, SURPRISING EVEN THE MOST OPTIMISTIC OF THE BREXITEERS."

approval before triggering Article 50 is proof that the process will take more time than Theresa May would like. A second round of difficulties will be felt at the negotiation table with the EU, where the British PM will face an economic bloc that is more than five times the UK's GDP and a political establishment which is eager to show its members how unfavourable EU detachment may be. Theresa May doesn't possess enough power to bend the EU to her will, particularly if she insists on getting access to the single market without abiding by EU rules. While negotiating with the EU, the British PM will also need to consider that a trade deal with the US, as an alternative to the EU, is now more unsound than ever, particularly given the UK's pursuit of a free market agenda and Trump's support for protectionism.

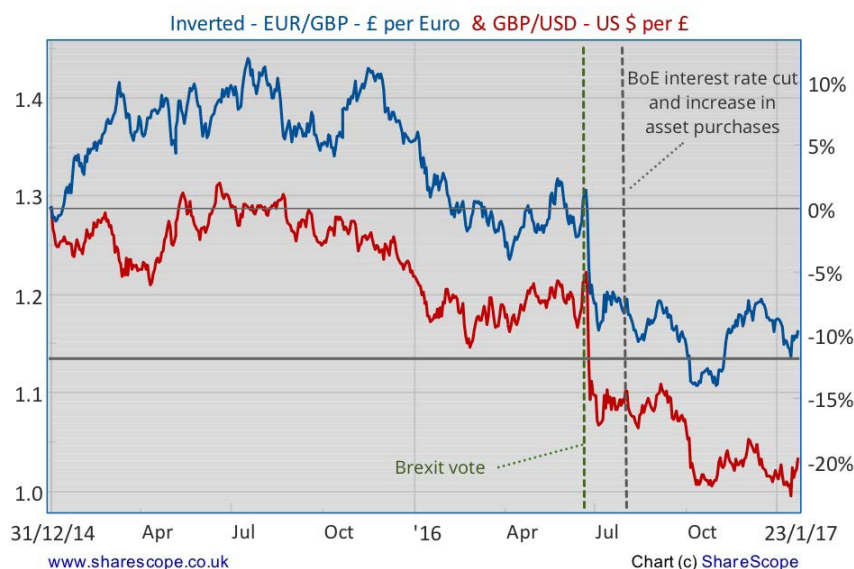
For all this, Theresa May won't be able or willing to push for a complete break with the EU, nor would the EU wish for such a break. Consequently, the process will get underway before long and businesses and



consumers will progressively adapt to new conditions without much disruption. The pound is now softer, which seems to have helped so far, and the economy is growing at a much faster pace than anticipated. The risks are dissipating and investors must prepare for a faster than anticipated change in central bank policy. Many are expecting the BoE to keep rates unchanged at 0.25% until the end of next year while also maintaining the same level of asset purchases. *But what if the BoE's doom and gloom predictions do not materialise? What if inflation stays at its current level?* In that case, the BoE wouldn't have any other option but to withdraw its 'emergency' support for the economy, which I believe will happen later this year rather than in 2018 or 2019.

Dark predictions...

As widely predicted, the Brexit vote generated volatility in financial markets, initially leading equities down and smashing the pound. Since the vote, the pound is down 14% against the dollar and 9.5% against the euro, and the numbers have been as extreme as 18.6% and 15.2%, respec-



tively. On the one hand, a weaker pound helps exports; but the flipside is that such weakness makes it more costly to import commodities that are an important component of production costs, which pushes production prices higher and may quickly spread to consumer prices, thus hitting real incomes.

To brace for the Brexit impact, the BoE cut interest rates from 0.50% to 0.25% on 4 August while also extending its asset purchase pro-

gramme from £375 billion to £435 billion. The £60 billion in extra purchases was split between UK government bonds (£50 billion) and UK high quality corporate bonds (£10 billion). In the statement that followed the decision, the BoE expressed its concern about the future of the UK economy. It expected the fall in the pound to push CPI inflation higher in the near term, and for the real economy to weaken, leading to a rise in unemployment and potentially to a recession.



In summary, a weaker pound leads to imported inflation and, as nominal wage growth is unlikely to match it, consumers end up worse off, which leads to a decrease in aggregate demand. With demand declining, spare capacity increases, generating unemployment and eventually ending in a recession. The concern about weaker demand is well expressed in August's BoE statement, to the point where the bank considered the possibility of trading above-average inflation for less unemployment, creating expectations for further interest rate cuts and an extension of its asset purchases. The central bank's view (and in particular Mark Carney's view) about the impact of Brexit has been extremely negative since before the vote and the promised action has been accordingly bold. With the pound declining rapidly, it is debatable whether the best course of action was to cut interest rates or not.

The BoE expressed a concern about the deterioration in real incomes caused by inflation but said it was willing to accept above-target inflation. If inflation were to become a problem, one way of tackling it would be to raise interest rates instead. The action taken was therefore premature and has contributed to the slide in the pound and helped to delay the necessary policy adjustments.

...bright reality

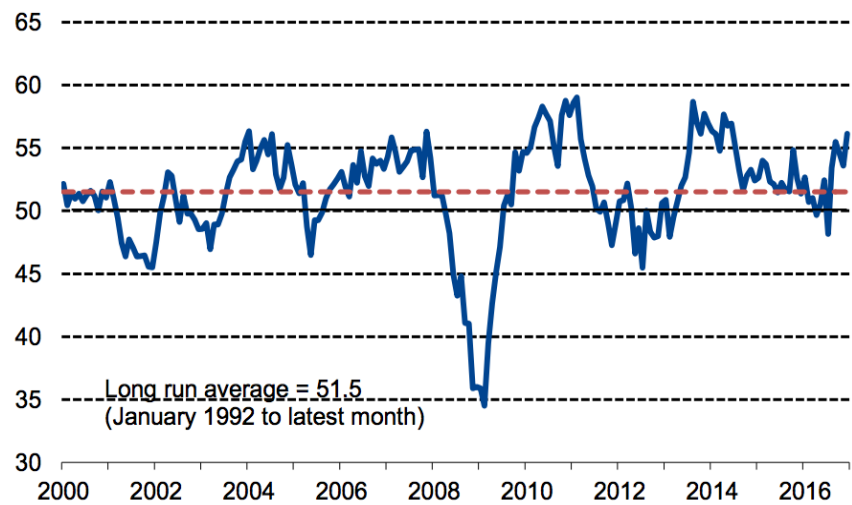
Despite the doom and gloom predictions from the BoE, economists, politicians and analysts, the British economy has not experienced any significant disruption due to the referendum result. In fact, if anything, the UK economy has been *boosted* by the referendum result.

The data coming from manufacturing, services and construction has been

extremely positive. The Markit/CIPS UK Manufacturing PMI rose to 56.1 in December, beating the most optimistic of the forecasts and settling at its highest level for the last 30 months. In addition, the Markit/CIPS UK Services PMI closed 2016 on a very strong footing, showing a reading of 56.2. After contracting in July due to the Brexit vote, the services PMI rose for five straight months. The data coming from the construction sector, which has been marked as highly vulnerable

Markit/CIPS UK Manufacturing PMI

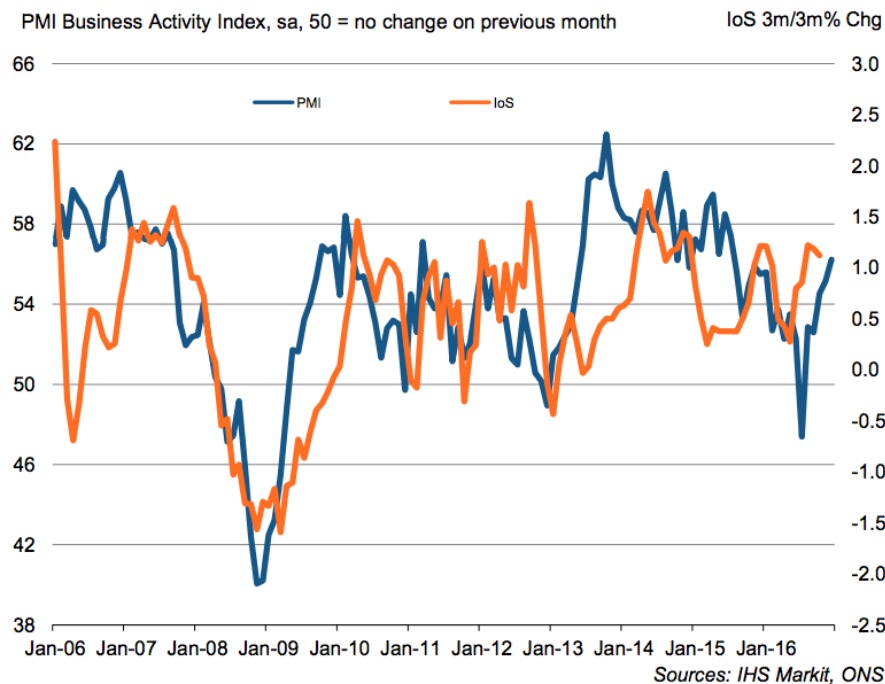
Markit/CIPS Manufacturing PMI® (50 = no change)



Source: IHS Markit



Markit / CIPS UK Services PMI



to the Brexit result, has been remarkably positive too. The Markit/CIPS UK Construction PMI shows a reading of 54.2 for December, the fastest pace of expansion in nine months. At the same time, in all three aforementioned reports, cost pressures are mounting fast.

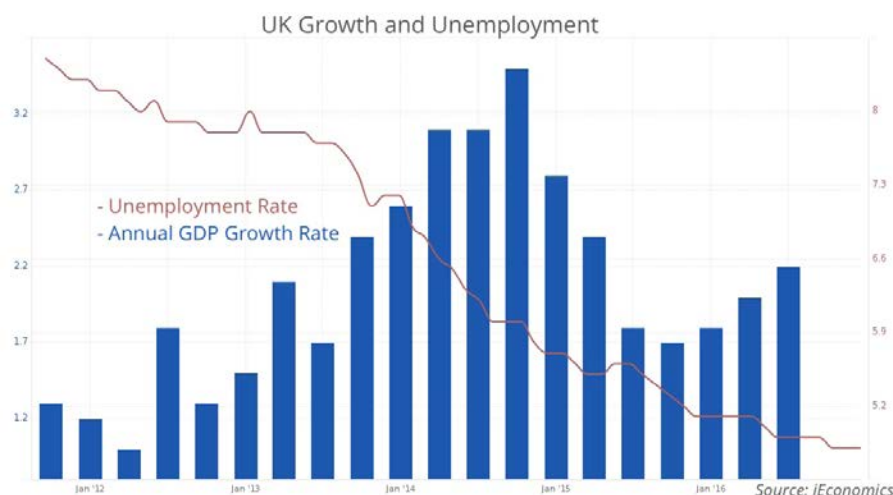
A mix of strong growth with increasing price pressures reflect the inappropriateness of the current monetary stance, which is destined to change sooner rather than later, if the BoE is to pursue its main goals of price stability and confidence in the currency. The data is also encouraging at the broad level. The unemployment rate is at 4.8%, which is comparable to its 1980 level, and GDP grew at a pace of 2.2% during the third quarter of last year, while it didn't show any signs of declining in the fourth.



Before the referendum, Mark Carney had warned that the split from the EU would tip the UK into recession during the second half of 2016, a sentiment that proved to be too pessimistic, as the economy has been growing faster than before Brexit. This realisation forced the BoE to significantly upgrade its projections for the UK economy in November. From an anticipated growth rate of 0.8% (predicted in August), the BoE now expects the economy to grow at a 1.4% pace in 2017. Still, the central bank lowered its 2018 and 2019 growth projections on expectations of higher inflation and reduced business investment.

In terms of financial markets, the decline Carney was expecting, which was behind his decision to extend the BoE asset purchase programme in August, did not materialise either. The FTSE 100 and the FTSE All-Share declined 5.6% and 7.0% respectively between 23-27 June, in the advent of the Brexit result, but both have managed to recover and rise by more than 20% since then.

To some extent, the FTSE 100 gains could be foreseen. The blue-chip index is constituted of multinationals operating mostly outside the UK and earning much of their income in US dollars. With the pound weakening, profits increased when converted back into sterling, thus justifying higher equity prices in the local currency.



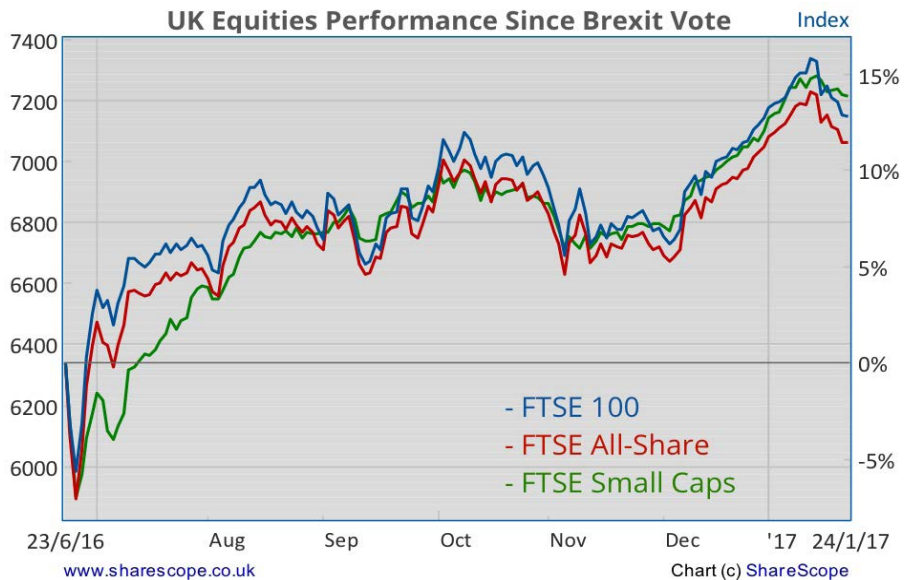
“THE FTSE 100, IN PARTICULAR, MAY BE POISED TO UNDERPERFORM OTHER EQUITY INDICES, WHILE SOME OF THE HEAVY LOSERS FROM BREXIT MAY RECOUP SOME OF THEIR LOSSES.”

However, the upside movement in equities was not a blue-chip phenomenon but rather a broad movement. The FTSE Small-Cap index, which is composed of companies that could be more vulnerable to the Brexit result, managed to rise even more than the FTSE 100, reflecting broad optimism.

Finally, inflation indicators are also rising faster than expected. The Office for National Statistics (ONS) recently reported a 1.6% rise in consumer prices for December, the fastest jump since the summer of 2014 and well above the 1.2% figure reported in the previous month. The pound has been strengthening after the reported data, as every bit of data runs against the current monetary policy stance and may force the BoE to taper its asset purchases in a matter of months. Mark Carney has said he expects inflation to overshoot the BoE target by mid-year, but with producer price data showing a rise of 15.8% last year (the fastest increase since 2011), with prices charged by companies at the factory gate rising at a 2.7% pace (the fastest since March 2012), and with all Markit reports showing cost increases, the BoE may be wrong again about its policy path. Some inflation overshoot may be tolerable, but if that overshoot manifests itself in January or February it would pose severe risks for the current monetary policy and press the BoE towards adopting a more hawkish tone.

Eurozone inflation is rising... finally

The upside trend in inflation and economic recovery is not just a UK phenomenon. In the EU, the latest figures point to the fastest increase in consumer prices in three years. At 1.1%, the average inflation rate for the Eurozone's member countries is well below the ECB's 2.0% target, but in Germany it has already hit 1.7%. The ECB recently (8 December) extended the duration of its asset purchase programme from





March 2017 to December 2017, but trimmed the amount to be purchased during the extended nine months from the current pace of €80 billion/month to €60 billion/month. While Mario Draghi insists that the ECB's monetary policy committee did not discuss tapering and points to the fact that the programme may be further extended beyond December 2017, many commentators are beginning to question the ECB's true intentions.

Just a few days ago, Sabine Lautenschlager, a monetary policy official who currently sits on the ECB's executive board, signalled that the ECB should soon start to wind down its trillion-euro asset purchase programme. Given the connection between the British and Eurozone economies, the pressure on the BoE is growing.

What to expect

All the data, both domestically and internationally, point to a faster recovery, lower unemployment levels, and higher inflation readings. At the same time, seven months having elapsed since the Brexit vote, we have had the opportunity to realise that Brexit isn't the end of the UK. Neither is it the end of the EU. Both blocs will find their way forward and will reach a deal that will most likely end up keeping trade levels more or less unchanged for the medium term. The Supreme Court vote, which forces the UK government to

“I BELIEVE THE POUND HAS LIMITED DOWNSIDE AT THESE LEVELS, AND COULD STAND TO GAIN AS BREXIT IS TURNED INTO A NON-EVENT.”

seek approval from parliament before proceeding with Brexit, was largely expected, as the UK constitution doesn't attribute any binding power to the referendum. However, such a decision is unlikely to stymie the Brexit process.



Investors shouldn't expect any substantial disruption to the UK economy and thus should be prepared for a faster shift in monetary policy than the market currently foresees. A recent survey of 67 economists conducted by Reuters revealed some astounding results (at least to my understanding): the vast majority of economists expect the BoE to leave its key rate and other

stimulus measures unchanged until the end of 2018, and there is only a perceived 20% chance of rates going higher in 2017, which is countered by a 15% chance of them going even lower. Such a view seems skewed to the dovish side of the spectrum. Global risks and Brexit risks have receded significantly, and with governments in the US, Europe and the UK promising more fiscal spending, investors should prepare for monetary tightening rather than easing.

This means that investors should keep clear of long-term bonds, as these are the most vulnerable to unexpected rate hikes. Inflation-protected gilts or short-term bonds are a reasonable option for those willing to keep some cash in bonds. A more aggressive approach would be to sell bonds. At the same time, I believe the pound has limited downside at these levels, and could stand to gain as Brexit is turned into a non-event. That means the FTSE 100, in particular, may be poised to underperform other equity indices, while some of the heavy losers from Brexit may recoup some of their losses.





BY SCOTT GRANT, BUSINESS DIRECTOR AT LSE.CO.UK

SO YOU WANNA BE A TRADER?

The title is a nod to the film *Bugsy Malone*. Fortunately, trading is not as pugilistic as boxing... although some might disagree!

Whether you are a trader or prefer more of an investor's (buy & hold) strategy, and whether you are new to the game or more experienced, I hope this article will be useful to you.

Sir Francis Bacon is credited with the phrase 'knowledge is power' and that is nowhere truer than in the stockmarket. With this in mind, let's explore 5 items to simply get you started or with the loftier aim of buying and selling shares (more) profitably.

All 5 topics are written with the stocks & shares website www.lse.co.uk in mind and outline features that you can access there.

Share Prices

To begin with, we simply need to know the share price of the company.

The vast majority of websites that display share prices will do so on a 15-minute delayed basis. This is okay to begin with. But depending on the share itself and the current economic and stockmarket conditions, a lot can happen in 15 minutes!

For live prices, referred to as 'Level 1' data, you can subscribe to a Live Prices package via lse.co.uk/premium. If you are about to make a buy or sell trade, I'm sure that you would not want to be 15 minutes behind your peers.

People new to the stockmarket are often enticed by the smaller 'penny' shares, as they offer the excitement of a potential journey to a share price many multiples of what it is today! If asked, I always encourage diversification, with smaller shares perhaps forming the minority of a portfolio.

Fundamentals

'Fundamentals' is a grand term for the key financial information about a company. Possibly the most important within this are the profit & loss (P&L) account and the balance sheet.

From the P&L, you can identify the trends in a company's performance before you buy. You might have questions such as:

- Are revenues increasing or declining?
- Is the company profitable?
- Are profits rising or falling?
- What is the earnings per share (EPS) figure?
- Does the company pay a dividend to investors, or does it reinvest funds into the business for more growth?



LONDON SOUTH EAST

Vodafone Market Data



TIDM	VOD
Ticker Code	VOD.L
ISIN	GB00BH4HKS39
Currency	GBX
Issue Country	GB
Sector Ticker	NMX6570
Year End	31-Mar-17

Shares in Issue	26,618m
Market Cap.	£54,860m
Market Size	10,000
PE Ratio	-12.79
Earnings	-15.08p
Dividend	11.30p
Yield	5.86%

# of Trades	10,109
Vol Sold	17,586,814
Vol Bought	33,417,277
52 Week High	240.10p
52 Week High Date	15-Aug-16
52 Week Low	188.85p
52 Week Low Date	02-Dec-16

VOD Fundamentals - IFRS

	£ Millions	£ Millions	£ Millions	£ Millions	£ Millions
Income Statement	31 Mar '15	31 Mar '14	31 Mar '13	31 Mar '12	31 Mar '11
Revenue	42,227.00	38,346.00	38,041.00	46,417.00	45,884.00
Operating Profit / Loss	2,030.00	(4,191.00)	(2,777.00)	6,224.00	537.00
Net Interest	(853.00)	(1,208.00)	(1,291.00)	(1,476.00)	880.00
Pre tax Profit	1,095.00	(5,270.00)	(3,483.00)	9,549.00	9,498.00
Post tax Profit	5,860.00	11,312.00	(3,959.00)	7,003.00	7,870.00
Profit for the Period	5,917.00	59,420.00	657.00	7,003.00	7,870.00
Equity Holders of Parent Company	5,761.00	59,254.00	413.00	6,957.00	7,968.00
Minority Interests	156.00	166.00	244.00	46.00	(98.00)
Continuing EPS					
Earnings per Share (Basic)	21.53p	42.10p	(15.66p)	13.74p	15.20p
Earnings per Share (Diluted)	21.42p	41.77p	(15.66p)	13.65p	15.11p
Earnings per Share (Adjusted)	5.55p	7.69p	20.12p	14.91p	16.75p
Continuing and Discontinued EPS					
Earnings per Share (Basic)	21.75p	223.84p	1.54p	13.74p	15.20p
Earnings per Share (Diluted)	21.63p	222.07p	1.54p	13.65p	15.11p
Earnings per Share (Adjusted)	5.55p	7.69p	20.12p	14.91p	16.75p
Dividend per Share	11.22p	11.00p	10.19p	13.52p	8.90p

VOD Alliance News		VOD Reuters News		VOD ShareCast News		VOD Regulatory News		VOD Pro News			
Categories:		All				Date:		<input type="text"/>		<input type="button" value="Show"/>	
1	2	3	4	5	6	7	8	9	10	11	
Date	Source	Headline					Category				
18-Jan-17 07:00	RNS-R	NEW PARTNER AGREEMENT WITH TELE2					Company Announcement - General				
18-Jan-17 07:00	RNS-R	RENEWAL OF PARTNERSHIP AGREEMENT WITH TDC GROUP					Company Announcement - General				
16-Jan-17 10:22	RNS	DirectorPDMR Shareholding					Company Announcement - General				
03-Jan-17 13:55	RNS	Total Voting Rights					Holding(s) in Company				
03-Jan-17 07:00	RNS	Liberty Global and Vodafone complete Dutch JV					Company Announcement - General				
16-Dec-16 16:16	RNS	Publication of a Prospectus					Company Announcement - General				
16-Dec-16 08:30	RNS	Completion of sale of Vodafone Thuis					Mergers, Acquisitions and Disposals				
14-Dec-16 13:57	RNS	DirectorPDMR Shareholding					Company Announcement - General				
08-Dec-16 15:40	RNS	DirectorPDMR Shareholding					Company Announcement - General				
07-Dec-16 15:22	RNS	Repurchase of Floating Rate Notes by Verizon					Company Announcement - General				
06-Dec-16 08:00	RNS	APPOINTMENT OF GROUP ENTERPRISE DIRECTOR					Company Announcement - General				
01-Dec-16 15:23	RNS	Total Voting Rights					Holding(s) in Company				
30-Nov-16 07:00	RNS-R	VODAFONE STARHUB RENEW PARTNERSHIP AGREEMENT					Company Announcement - General				
23-Nov-16 12:35	RNS	DirectorPDMR Shareholding					Company Announcement - General				
21-Nov-16 11:35	RNS	DirectorPDMR Shareholding					Company Announcement - General				
16-Nov-16 16:26	RNS	Publication of SupplProspts					Company Announcement - General				
15-Nov-16 17:54	RNS	DirectorPDMR Shareholding					Company Announcement - General				
15-Nov-16 07:00	RNS	Halfyear Report					Results and Trading Reports				
11-Nov-16 15:18	RNS	DirectorPDMR Shareholding					Company Announcement - General				

The balance sheet can provide a snapshot of the company's financial position. Some investors prefer the relative safety of a company with little debt and decent cash balances, such that future provisions are well catered for.

Ise.co.uk displays the last 5 declared years of financial information, regardless of whether you are a site member.

RNS

Regulatory News Service (RNS) announcements are keenly anticipated by traders and investors alike. Depending on their hue, they can have the power to move a share price dramatically.

Of particular note are such announcements as a new product launch, a new drug or natural resource discovery, or the bonanza of a takeover bid. More prosaic announcements might include a director selling just a few shares or a Notice of AGM (annual general meeting).

Ise.co.uk provides free, live RNS announcements to all site visitors.

Level 2

For the more sophisticated trader, access to 'Level 2' (L2) data can be vital, especially if you are moving in and out of a share in reasonably short timeframes, or looking to exploit certain triggers you have defined.

L2 data can be a wide and complicated topic. Broadly, it provides a look 'under the bonnet' of the current market in the share under consideration. It shows the depth of the market – buy and sell orders waiting to be fulfilled at different price levels and by different market makers (broker firms).

L2 can provide an useful indication of what direction the share is likely to move in. If there are several orders getting filled on the buy side, this can mean that the share is heading lower since sellers are rushing to off-load shares at lower prices. The opposite can imply that the stock is heading higher.

Much as the aforementioned Level 1 (Live Prices) data is a step forward and a tool in a trader or investor's armoury, L2 takes the concept further still. You



“FOR THE MORE SOPHISTICATED TRADER, ACCESS TO ‘LEVEL 2’ (L2) DATA CAN BE VITAL.”

VOD.XLON	VODAFONE GROUP PLC ORD USD0.20 20/21					Close 192.5 (26-JAN-2017)			GBX
Segment	SET0	Sector	FE00	EMS	10,000	LAT	192.75	0.25 (0.13%)	15:36:41
Trade Hi	193.5	Auto Vol	30,440,960	PE Ratio	-12.7818	LAT Hi	193.5	1 (0.52%)	08:00:11
Trade Lo	191.033	VWAP	192.3292			LAT Lo	191.05	-1.45 (-0.75%)	09:50:44
Trade Count	10,716	Cum Vol	57,058,432			Year Hi	240.1	15-AUG-2016	
Auction	191.1					Year Lo	188.85	02-DEC-2016	
11	28,488	192.7	-	192.75	13,518	5	VOD Live Trades		
						Time	Trade Price	Volume	≈ Value
Depth 380						356 Depth			
15:37	1,482	192.7	192.75	6,000	15:37	15:37:13	192.75	14,000	26.99k A
15:36	3,819	192.7	192.75	772	15:37	15:37:13	192.75	2,202	4,244 A
15:36	2,780	192.7	192.75	1,200	15:37	15:37:13	192.75	1,024	1,974 A
15:36	2,700	192.7	192.75	1,508	15:37	15:37:13	192.75	1,750	3,373 A
15:36	2,700	192.7	192.75	4,038	15:37	15:37:13	192.75	6,000	11.57k A
15:36	2,916	192.7	192.8	4,000	15:34	15:37:13	192.75	2,700	5,204 A
15:36	2,916	192.7	192.8	2,260	15:34	15:37:13	192.75	4,000	7,710 A
15:36	4,000	192.7	192.8	2,916	15:34	15:37:13	192.75	2,700	5,204 A
15:36	2,700	192.7	192.8	2,916	15:34	15:37:13	192.75	1,414	2,725 A
15:37	1,403	192.7	192.8	3,649	15:34	15:37:13	192.75	734	1,415 A
15:37	1,072	192.7	192.8	1,988	15:36	15:37:13	192.75	1,207	2,326 A
15:36	2,700	192.65	192.8	1,561	15:36	15:36:47	192.75	4,000	7,710
15:36	2,700	192.65	192.8	9,772	15:37	15:36:43	192.75	1,555	2,997
15:36	4,000	192.65	192.8	1,316	15:37	15:36:41	192.75	4,011	7,731
15:36	2,700	192.65	192.8	9,595	15:37	15:36:41	192.75	11,252	21.69k
15:36	3,400	192.65	192.8	2,600	15:37	15:36:41	192.75	5,038	9,711
15:36	2,916	192.65	192.85	2,138	15:32	15:36:41	192.75	3,710	7,151
15:36	2,916	192.65	192.85	2,700	15:32	15:36:25	192.725	7,040	13.57k

can subscribe to an L2 package via lse.co.uk/premium.

Chat forums

Ok, OK... chat forums don't have the best reputation! However, I see two real benefits of chat forums in relation to shares.

The first is the social aspect. It can be hard if you are the only person in your office or family who trades relatively seriously and with commitment; it can be even lonelier if you are trying to make a living from trading and doing it alone at home. A chat forum can provide a degree of sociability.

Secondly, there are some diamonds in the dirt. By this, I mean that you can find some well-informed individuals with good facts, worthy opinions, and bags of experience on chat forums. But be careful and DYOR (do your own research)!

lse.co.uk can boast the UK's largest share chat forum. Not only that, but it is quite possibly the only moderated

jackdawson		RE: Add 191.93 - to VOD buy 199.82	Today 14:39
Posts: 2,656			
Observation			
Opinion: Buy			
Price: 192.15			
		Hi Carrington,	
		Best of luck! Looks like it may be close to bottoming out fairly soon, mindful that in December we saw 188+. Either way, I'm reasonably content with all my positions here & in BT. Most quality stocks recover after huge falls. But even if one has to sit longer, we've a VG divi income for holding. - Regards & GL.	
		Reply Recommend Report	
Gerry557		RE: Downgrade	Today 13:32
Posts: 2,865			
Observation			
Opinion: No Opinion			
Price: 192.10			
		Toff, most people know they won't win and the stats show it's almost impossible. Then again you're just wasting a quid for that slim chance to have a life-changing amount. I might suggest premium bonds would be a better option unless £77m is really what you need. Nobody ever suggests that its fixed or the wrong balls are being used or any other type of finger prints in the wrong place	
		With shares you need a bigger capital outlay, unless fees eat up any winnings so minimum £1k and all the risks of those manipulators to boot. Still let them keep going I could do with some 7% yield.	
		Reply Recommend Report	

board out there. Over 7,000 posts were made in relation to just one share alone in the preceding week to my penning this article.

Moderation by humans – alongside the sensible precautions that can be automated such as swearing filters – seeks to bring a balance and sense of fair play to what can be heated exchanges. After all, investors sometimes get too wedded to their holdings!

You can set up a free Member Account

and join in with the conversations via www.lse.co.uk/share-chat.asp.

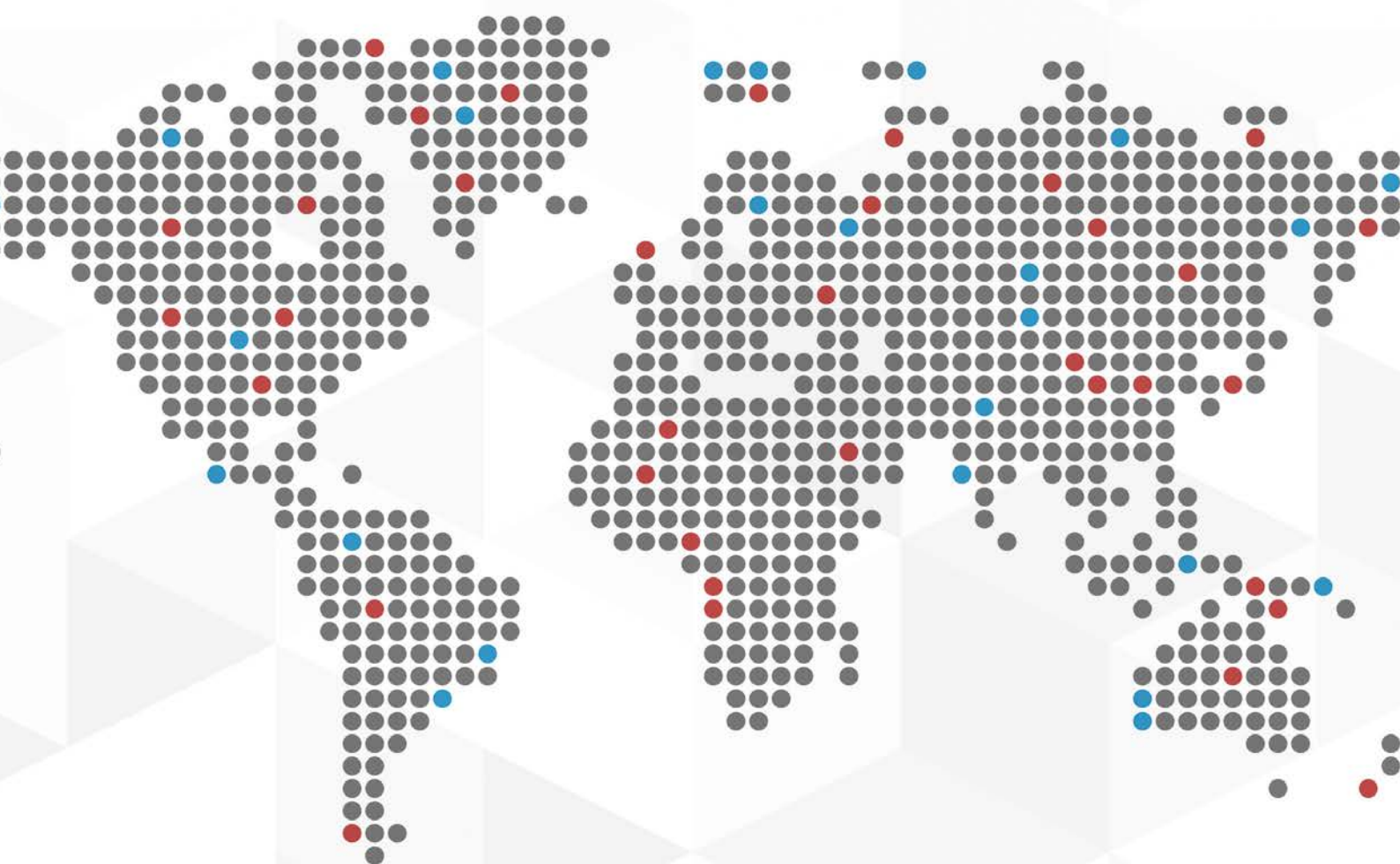
Back to where I started with *Bugsy* and the Boxer song, "Can you move in a whirl like a humming bird's wing / If you need to (oh, that's fast) / Can you bob? Can you weave?"*

Hopefully, the stockmarket won't make you bob or weave too much! Good luck with your trading and/or investing.

* Songwriter: Paul Williams.

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BY RICHARD GILL, CFA

FROM ACORNS TO OAK TREES

SEARCHING FOR GROWTH AMONGST AIM'S NEW ISSUES

As I discussed in last month's edition of *Master Investor Magazine*, AIM shares had a good year in 2016, with the FTSE AIM All Share Index rising by an impressive 14.2%. However, investors who got involved in AIM's new issues did even better - although the two sets of performance statistics aren't comparable directly due to timing differences associated with the newly listed companies.

Sifting through the stats, I count 43 new companies which listed on AIM in 2016 (excluding those which re-listed or moved from other markets). Investors who managed to get on board these new issues at their IPO price, and invested in every company, would have seen a superb average gain per share of 38.3%. The typical retail punter, who

most likely wouldn't have had access to the IPO fundraisings, could also have made decent gains, with the average rise of the 43 companies between close on the first day of dealings and the end of the year being 17.8%.

Big winners

The best performing IPO of 2016 by far was **Blue Prism Group (PRSM)**. The shares surged by a whopping 470.5% after the robotic process automation

software business upped its trading expectations three times in a row. Also doing well was **Franchise Brands (FRAN)**, the owner of former AIM listed cleaning business Myhome, which I tipped on the [Master Investor blog](#) last August at 41.5p. The shares rose to 66p by the year end, double the IPO price of 33p. Close behind with a gain of almost 95% was upmarket chocolatier **Hotel Chocolat (HOTC)**, the shares rising to 288.5p, up from my tip at 189p in last June's edition of the magazine.

Company	Float date	IPO price (£)	Price end 2016 (£)	Sector	% change
Blue Prism Group	18/03/2016	0.78	4.45	Software	470.51%
Franchise Brands	05/08/2016	0.33	0.66	General Retailers	100.00%
Maxcyte	29/03/2016	0.7	1.375	Pharmaceuticals	96.43%
Hotel Chocolat Group	10/05/2016	1.48	2.885	Food Producers	94.93%
SDX Energy	20/05/2016	0.18	0.33	Oil & Gas	83.33%

Table: Top 5 best performing AIM IPOs in 2016

Few losers

There were only seven companies which listed on AIM during 2016 that saw their share price lower by the end of the year. The worst performer by some distance was low carbon energy business **Cogenpower (CGP)**.

The shares fell by almost 44% after the firm withdrew from its utility retail business and posted an interim loss of €0.93 million. I personally got it wrong with Italian public relations business **SEC SpA (SECG)** which I implied was worth a punt last year. The shares lost almost 14% in value as they remained

thinly traded despite a steady performance from the business itself. But I got it right with events media business **Time Out Group (TMO)** which fell by 7% after a lacklustre start to life on the markets – I advised avoiding the shares last September after pointing out that, *"Time Out's accounts are absolutely dire"*.



Name	Float date	IPO price (£)	Price end 2016 (£)	Sector	% change
Cogenpower	12/02/2016	0.2	0.1125	Alternative Energy	-43.75%
SEC SpA	26/07/2016	1.51	1.3	Media	-13.91%
Osirium Technologies	15/04/2016	1.56	1.35	Software	-13.46%
Time Out Group	14/06/2016	1.5	1.395	Media	-7.00%
Oxford BioDynamics	06/12/2016	1.58	1.515	Pharmaceuticals	-4.11%

Table: Top 5 worst performing AIM IPOs in 2016

Despite the good share price performance from many of 2016's new market additions I believe that there are still good opportunities out there. Here are three of them:

Accrol Group

Established in Blackburn, Lancashire in 1993, **Accrol Group (ACRL)** is a UK market leader in the manufacture of toilet rolls, kitchen rolls, facial tissues and other tissue products. The company listed on AIM in June last year, raising a net £41.4 million for itself, along with £20.2 million for selling shareholders. The funds were mainly used to pay down debt, with the company refinancing its banking facilities at the same time.

Operating from a 350,000 sq. ft. manufacturing, storage and distribution facility, Accrol currently has 15 converting lines in operation which give it the capacity to produce around 118,000 tonnes of finished tissue products every year. Customers include a range of independent and multiple retailers, including the likes of Tesco and ASDA, with the firm having a particularly strong share of the discount retail sector (c.50% at last count).

On a roll

Accrol has made a number of impressive operational advances since listing on the market. In July last year the group announced a significant contract win with a "major global retailer", which was subsequently revealed to be discount supermarket giant Lidl, to supply toilet paper, kitchen rolls and facial tissues. Revenues under the contract were initially forecast to be c.£10 million, per annum, representing 10% of sales on an annual basis. But since the range was launched in October it has become apparent that sales will be more than originally expected.

Accrol came to market with a strong track record, revenues growing by

a compound annual rate (CAGR) of 16.2% in the three financial years to April 2015, with EBITDA up by a CAGR of 13.7%. The first set of results as a public company showed further growth, with revenues up by a further 17% to £118 million for 2016 and adjusted EBITDA growing by 22% to £15 million. While the interims showed more modest revenue growth of 8.8%, a maiden dividend was announced and full year expectations are forecast to be met.



In preparation for further growth, Accrol has agreed a lease with Lancashire County Council to move into a new 168,000 sq. ft. manufacturing facility at Leyland near Blackburn. The unit will house two high speed tissue converting lines already purchased by the company, with potential to add two further lines, and provide finished goods warehousing space. This will add additional capacity of 25,000 tonnes per annum, with the fit out said to be progressing well and production expected to begin at the end of Janu-



“THE YIELD IS JUST OVER 4% AND SHOULD INCREASE OVER TIME GIVEN THE COMPANY’S PROGRESSIVE POLICY.”

ary. Following this, annualised capacity will be 143,000 tonnes per annum, sufficient to support between c.£160 million to £180 million of annual sales.

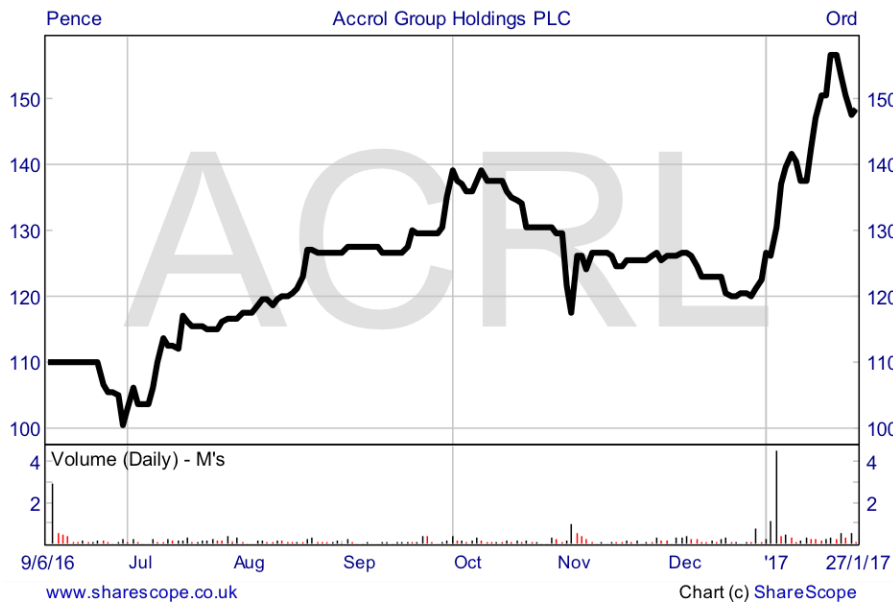
Lancashire hot stock?

Shares in Accrol Group have performed well since IPO, currently trading 48.5% higher at 14.5p per share. That capitalises the business at £138 million and values the shares at 11 times adjusted earnings forecasts for the current financial year. As the new capacity comes on line earnings are forecast by the market to grow by 11% in 2018, with the multiple falling to just below 10 times.

At the time of IPO Accrol stated that it was looking to pay a dividend for the 2017 financial year which equated to a 6% yield at the IPO price of 100p. So far we have had a 2p payment at the interim stage, implying an additional 4p payment for the full year. So at the current share price the yield is just over 4% and should increase over time given the company's progressive policy.

Key risks here include exposure to forex movements, although these have been managed successfully recently,





the company shrewdly hedging against a fall in Sterling before the EU referendum vote. We also have to consider that the top four customers made up 56% of revenues in the last financial year and an exposure to changes in pulp and paper reel prices. On the balance sheet, net debt of £19.9 million as at 31st October is manageable, with interest costs for the first half covered almost 9 times by adjusted EBITDA.

Overall, Accrol looks like a modestly valued growth play with the attraction of a decent income. Investors

could do worse than to follow the lead of CEO Stephen Crossley, who bought 100,000 shares in September last year.

Watkin Jones

Based in Bangor, Wales, **Watkin Jones (WJG)** is a fast growing business which has operated over four different centuries, being founded in 1791 as a joinery manufacturer and undertaker. As of today the company is a developer and constructor of multi-occupancy property assets, with a main focus on pur-

pose built student accommodation. Since completing its first student accommodation project in 1999 the company has delivered over 31,800 beds across 98 sites, taking advantage of a surge in demand for quality accommodation from both UK and international students.

Unlike other listed student accommodation specialists such as Unite Group and Empiric Student Property, Watkin Jones does not own the property it develops, instead delivering the projects for its institutional client base. To reduce risk, and the need to take on debt, a forward sales model is employed, with clients paying a regular cashflow as Watkin Jones meets certain obligations and milestones over the life of the development. Elsewhere in the business, the firm has delivered more than 50 residential developments and runs the asset management specialist Fresh Student Living.

Watkin Jones' IPO in March last year was the largest listing seen on AIM for two years, the company raising £131.3



Watkin Jones student development: Source: Company presentation

“ANY UNCERTAINTY OVER BREXIT IS EXPECTED TO HAVE A MINIMAL IMPACT ON THE BUSINESS.”



million in the process and being valued at an initial £255 million. Selling shareholders banked £45.9 million, with the remaining £85.4 million being used to acquire certain businesses as part of a structural reorganisation. The company is headed up by CEO Mark Watkin Jones, the ninth generation of the family to run the business, with revenues having grown almost 16-fold since he joined in 1990.

Building profits

Results for the year to September 2016 impressed the markets with some decent numbers and also helped to allay investor fears that demand could be hampered by the UK's upcoming exit from the European Union. At the top line, revenues grew by 9.3% to £267 million, with operating profits adjusted for IPO expenses growing by 16.7% to a record £37.9 million. While net cash fell by 18% (mainly due to the IPO restructuring expenses) it remained solid at £32.2 million.

Driving the results was a strong showing from the core student accommodation development business, with ten schemes completed during the year (all on schedule) comprising 3,819 beds. Private residential sales grew from 69 to 127 and the Fresh Student

Living business grew beds under management by 48% to 12,337, with there being contracts in place to increase this number to 18,636 by 2020.

Providing good earnings visibility, Watkin Jones had 27 development sites under offer and in the pipeline at the period end (representing 9,469 beds) with a combined appraised development value of approximately £800 million. Into the next few years, any uncertainty over Brexit is expected to have a minimal impact on the business given that UK university places remain oversubscribed (2016 saw a record number of applications), with only 7% of students coming from the EU. Elsewhere, a key part of the company's strategy is to grow in the private rented sector, with a 322 apartment development in Leeds having been forward sold to an institutional investor and due for completion in the first half of 2017.

Valuation

Trading at 128.75p as I write, Watkin Jones shares have risen by 28.75% since IPO. But despite the rise I believe that the shares still look cheap. They trade on a multiple of 9.5 times forecast earnings for the current financial year, which falls to just 8.6 times if we strip out the net cash of 12.6p

per share as at 30th September. **For a growth company with excellent short to mid-term earnings visibility and piles of cash on the balance sheet, that looks excellent value to me.**

Just like Accrol above, Watkins Jones guided in its admission document that it would be looking to pay an annual dividend yield (pro-forma) of 6% for 2016 with reference to the IPO price of 100p. Building on its maiden payment, broker Zeus is looking for a 6.3p dividend for the year to September 2017, which equates to a tasty yield of 4.89% at the current share price.

Draper Esprit

Finally, we end with an investment which is a little more speculative but provides the opportunity for stellar returns.

Draper Esprit, which has the aspirational EPIC code of **(GROW)**, is a venture capital investor focussed on high growth technology businesses operating in the UK, Ireland and Europe, mainly in the area of digital technologies. The business model has three main elements, with investing in companies via its primary portfolio being the core activity, supported by the management of six EIS funds and three legacy venture capital funds which are in run-off. As well as providing capital to investee companies, Draper Esprit provides management support to accelerate their growth and development. The focus here is on patient long-term capital, with short-term gains being shunned in favour of the potential for more substantial returns at a later date.

In June last year Draper Esprit took the slightly unconventional step (for a venture capital firm) of becoming a public company, dual listing on both AIM and the Enterprise Securities Market in Ireland (VC companies usually have a limited partnership structure). Total funds of £74.2 million were raised

draper esprit

across both markets at flotation in order to acquire an initial portfolio of 24 primary investments from a separate entity and to provide capital for further investments.



The team behind the company has significant industry experience, having been involved in investing over \$1 billion in more than 200 technology businesses prior to Draper Esprit's formation in 2006. They have a highly selective investment process – in 2014 having reviewed over 1,800 opportunities, with only around 40 ending up being considered by the Investment Committee.

A portfolio with potential

Within the digital technology sector Draper Esprit's investments are mainly spread over the areas of consumer technology, enterprise technology, hardware and health & wellness. Some of the firm's largest investments include:

Graze – the retailer and manufacturer of healthier snacks, operating in the UK and the US, which has seen great success via its online subscription model and has recently moved into retail products. A total investment of £3.7 million by the company is now valued at £9.6 million.

Trustpilot – the global community review website where consumers can

leave positive or negative reviews about an online merchant. Revenues are earned via a Software as a Service model. Draper Esprit invested £5.5 million in the business between 2013 and 2015 (valued at £9.4 million as at 30th September), with it doubling its investment in January this year.

Lyst – the online fashion marketplace that lets people shop across over 11,500 different online stores using a single check-out. A total of £2.4 million invested to date was valued at £8.5 million as at 30th September.

Draper Esprit's most recent results, covering the six months to September 2016, reported a total investment portfolio value of £106.9 million. This was up by £28.1 million since IPO and, excluding new investments of £6.8 million, represented an impressive 27% increase in value over just three months. Demonstrating the progress of the portfolio constituents as a whole, the cumulative revenue of portfolio companies for 2016 was forecast to be over \$710 million, up by 28% compared to 2015.

Worth a venture?

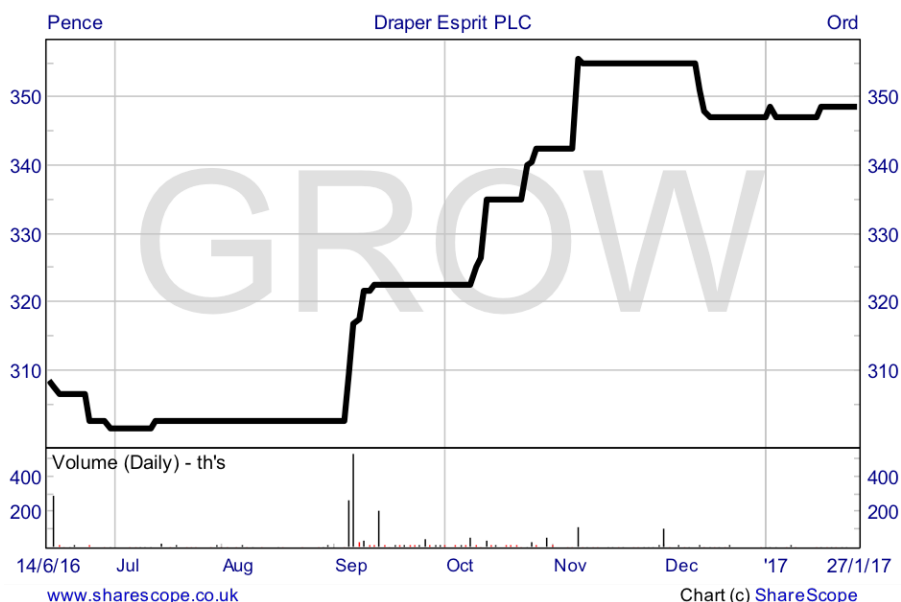
Draper Esprit shares are a unique proposition, offering retail investors an indirect opportunity to put their money

into a variety of early stage and fast growing technology driven companies. Given the high risk nature of many of these investments, the shares may not be for everyone. But for those with a sense of adventure the shares look ideal for adding a bit of excitement to a portfolio.

It is difficult to provide forecasts for the company given the variety of moving parts. But providing solid backing to the valuation, the shares (now at 348.5p) trade at a modest 1% discount to the last stated NAV of 352p per share (as at 30th September 2016).

In terms of income, the company has not dismissed the payment of a dividend but has suggested that any income received from its investee companies, along with the proceeds from realisations, will be reinvested back into the portfolio. This seems entirely sensible given its modus operandi.

**“THE SHARES
LOOK IDEAL FOR
ADDING A BIT OF
EXCITEMENT TO A
PORTFOLIO.”**





BY SAMUEL RAE

FORENSIC FOREX

WHAT PROTECTIONISM MEANS FOR THE DOLLAR

Nothing is attracting more financial media attention right now than American politics. The implications of a Trump presidency for global equities markets, currency valuations and general economics are unclear, and the response looks to be one of uncertainty-driven risk aversion. For currency traders, it can be tough to know how to approach the markets with things as they are. Even for me, with a strategy that is 95% technically driven, and into which fundamental economics only factors as secondary, things seem a little more unpredictable than before.

Scratch the surface, however, and all this uncertainty seems a little overkill. Yes, political and, especially, social tensions are high right now both domestically in the US and internationally; but the economics of the Trump term are nothing new, and we can predict with a degree of confidence how his policies will play out – assuming he sticks to his word and carries them into reality.

It all comes down to protectionism. With trade agreements likely to fall fast, and tariffs almost certainly set to follow, the US is very quickly going to become a protectionist economy. Many will scoff at protectionism, writing it off as an arcane and outdated economic policy. Skip back to the 1600s, however, and protectionism (or mercantilism, as it was then known) essentially fueled European economic expansion and underpinned the economies of the then-global superpowers.

Since the advent and popularisation of the economics of Adam Smith and

“UNCERTAINTY IS DRIVING GREENBACK STRENGTH, AS MARKETS RUSH TO SAFE HAVEN ASSETS. NEAR TERM, THEREFORE, MY US DOLLAR BIAS IS BULLISH.”

his seminal *Wealth of Nations*, Mercantilism has become something of an economic whipping boy. I believe it has its place, however, and while not a perfect solution in an ideal world, in certain economic conditions it can be beneficial. Sure, free trade is great, but it is an ideology. In many areas of the US economy, free-trade is having a negative impact, and it is this that drove many

US citizens to vote Republican in the latest election in the first place. Protectionism isn't going to solve all of the problems free-trade stirs up, and no doubt it is going to bring about a number of problems of its own, but it's also not going to be the end of global economics as we know it, as many news media outlets are suggesting.

It may – and please don't hate me for saying this – help to reestablish a stronger middle class in America. Yes, it's probably going to make certain things more expensive. The idea of countries like China and Mexico accepting tariffs without retaliating is ridiculous, and the US relies on both nations for a large portion of its imports. I believe that US consumers, however, will be willing to accept some degree of price hike for certain goods if they know and understand that this hike has come about on the back of the goods being produced in the US, and the production of these goods is contributing to the maintenance of internal dollar circulation.

Anyway, this is a currency piece, so what does all this have to do with foreign exchange? Well, we can use this political uncertainty to form both a long- and a short-term bias in the US dollar, and, in turn, apply this bias to the major dollar crosses in our currency operations.

Let's start with the short term. As mentioned in the introduction to

this piece, uncertainty is driving sentiment, and sentiment right now is overwhelmingly "risk off". Yes, the equities markets may be deriving some collateral benefit from a seemingly business-centric United States Chief, but there exists an underlying uncertainty as to what happens next. This uncertainty is driving greenback strength, as markets rush to safe haven assets. Near term, therefore, my

US dollar bias is bullish. Short cable, long dollar-yen, short EURUSD.

Looking to the longer term, however, things are a little different. Protectionism is going to have two primary, and compounding, effects on the US economy. The first is that goods are likely to become more expensive, and – by proxy – inflation will rise. The second – and more people will



likely disagree with this one, but I believe it to be true – is that the nation's economic output will increase quite dramatically.

There is an argument that over the very long-term, an increase in the price of goods will eventually result in private industry being unable to support itself, and this is potentially catastrophic for the US. Looking only to the long term, however, a price increase is likely to result in a lower rate of savings for the average American. This is by way of a chain of economic factors, but all boils down to the fact that even with more jobs, wages cannot rise at too fast a rate, and so disposable incomes will fall. This will pressure retail banks into increasing their rate offerings on savings accounts, in an attempt to lure savers.

An increased retail savings rate, however, should draw capital from con-

“MY LONGER-TERM VIEW IS SHORT US DOLLAR, ONCE THE PROTECTIONISM DERIVED INFLATION STARTS TO TAKE HOLD AND IS SUBSEQUENTLY STEMMED BY RETAIL BANK INTERVENTION.”

sumer expenditure, and put a dampener on industrial capex. This, in turn, will cap inflation (the retail banks are essentially playing the part of a central bank in this system) and stem growth. In an attempt to balance the equation, the Fed will lower its base rate, thus normalising retail rates, and – as a natural implication of a reduced base rate – devalue the US dollar.

Essentially, we've got a quick run to inflation, but then an even quicker cap placed on this inflation and a return to

stimulus policy from the nation's central bank. Therefore, my longer-term view is short US dollar, once the protectionism derived inflation starts to take hold and is subsequently stemmed by retail bank intervention. Long cable, short dollar-yen, long EURUSD.

Economic theory, of course, is never quite this cut and dry, which is why the majority of my strategy is risk driven.

Let's see how it all plays out...



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BY DAVID JONES

CHART NAVIGATOR

HOW TO UNDERSTAND MOVING AVERAGES

There are plenty of investors out there who would rather not look at the chart of a share before making a decision to buy or sell. It's a view I have a lot of sympathy with – there are a few too many technical analyst evangelists who think of charts as some sort of all-seeing crystal ball.

That is a view that's clearly misinformed – but charts can help us see what has been the path of least resistance for the share price. Are we buying into a multi-year slide so should be braced for some more pain – or is the company showing the first signs of turning the corner?

So I think even for the most committed of non-believers, charts can add some value to the decision mak-

ing process. The chances are if you have ever looked at a price chart of a share, index, commodity or forex pair you would have come into contact with the *moving average*. It's been a while since I read it but even many of the charts in the Financial Times had a moving average plotted. Much is made at certain times when the FTSE 100 or S&P or Dow crosses above a certain number of days moving average – but what do these

things actually show and can they help with the investment process?

Let's start off with the idea of a 200 day moving average. The chart shown below is the FTSE 100 index over the past couple of years. The blue line is the 200 day moving average. At the time of writing, the market had closed at 7198 and the 200 day moving average was sitting at 6687.



“SOME CHART FANS WILL USE THE PRICE MOVING THROUGH THE MOVING AVERAGE AS BUY OR SELL SIGNALS.”



The calculation of this moving average is straightforward enough. It takes the closing price (you can also use the high, or the low, or the open etc. but the close tends to be the most popular) of each of the last 200 days, adds them up and divides by 200. This way we end up with an average price for the last 200 days for the FTSE 100. Simple enough. This is a *moving* average because at tomorrow's close the process is repeated

and the latest value plotted on the chart – the average moves from day to day. In a rising market the moving average will be following the market higher – and in a sliding market it will be getting dragged lower as prices drop.

So what exactly is the point of the moving average? Initially, one way it is used is to try and "smooth out" what the price is doing – to take some of

the day to day noise out of the market and give you a clearer idea of a trend. But in addition to this, some chart fans will use the price moving through the moving average as buy or sell signals. There is some merit to this – at least as a possible indicator of a change in sentiment and trend. If the price is above the moving average in an uptrend, and below the moving average in a downtrend, when the trend changes the price





and moving average have to crossover. This crossover is one signal to buy or sell. As usual a picture paints a thousand words so back to the FTSE chart.

Last summer, the FTSE 100 crossed above its 200 day moving average and closed above it. This was the last signal generated and the moving average back then was sitting around 6150. By the middle of January the FTSE had breached the 7300 mark. So, the 200 day moving average worked well here – it sounds like a great trading system for the FTSE, right?

One of the problems of basing decisions on moving average crossovers is when the market doesn't actually get into an uptrend or downtrend after the crossover. I am sure plenty of us know that, for an awful lot of the time, share prices just chop around up one day then down the next without actually making that much progress. It is this sort of chop that can be the downfall of the moving average system – if the price and moving average are close together it will produce frequent signals, regularly reversing the position and not making money. Here's another FTSE example from 2011 and 2012 where the market traded in a broad sideways range and where using the 200 day moving average would have been fruitless.

So as usual it's important to understand that no technical approach to trading or investing is a silver bullet. A moving average approach works well in a trending market – it's just that we can't be sure whether a real trend is going to get underway when the buy or sell signal is given.

Bearing that in mind, here are a couple of shares that could be worth watch-

ing, to see if their moving average crossovers are going to result in a new trend.

The first of these is **Lloyds Banking Group (LON:LLOY)**. It has not had the best couple of years, sliding from the

2015 highs just shy of the 90p mark to briefly sub-50p last year. Since last July we have seen a recovery – albeit an erratic one – for the price of Lloyds. During December 2016 the price managed to move back above its 200 day moving average – another plus if we are looking to build the case for a turnaround in its medium-term fortunes.

The break below the 200 day moving average in August 2015 did a good job of warning that there were bad times ahead – but there have been a couple of false signals on the way down that would have had investors betting on a turnaround in the share's fortunes. It is just something to bear in mind for this particular signal – but the move so far has proved a little more sustainable than some of the previous rallies over the last couple of years.



“THE BREAK BELOW THE 200 DAY MOVING AVERAGE IN AUGUST 2015 DID DO A GOOD JOB OF WARNING THAT THERE WERE BAD TIMES AHEAD.”





The second company is the FTSE 250 retailer **Dixons Carphone (LON:DC.)**. Now, we are a bit premature on this one as the crossover has not actually happened yet. Like Lloyds, it's another company that hasn't had the best time recently with its share trading down around 30% from where it was a year ago. There are signs of some stability coming back in following the early summer 2016 nosedive – those lows have not been taken out so can add to the hopes of a recovery.

At the time of writing, the 200 day moving average was above the price of Dixons Carphone, signifying a downtrend. To change this trend the price needs to move back above the moving average line. Currently the moving average value (the average price for the last 200 days) is 266p. Let's round that up and say that if Dixons Carphone moves to 270p, it has crossed through the moving average suggesting this could be the start of a longer term recovery. One to watch.

There are various ways moving averages can be "tweaked" in the search for a better or more reliable approach to using them. One obvious method

is to change the number of days used in the calculation. If, for example, you used a 20 day moving average rather than 200, it would track the price more closely. The advantage here is that it will be quicker to get you into changes of trend. But the disadvantage (there are always drawbacks with any strategy!) is that because it is closer to the price, a lot more "false" signals will be generated.

Another option is to use two moving averages together. For example, let's say you choose to stick with the 200 day moving average and use a 50 day moving average in addition. When us-

ing this approach, investors and traders typically look for the moving averages to crossover for the signal to buy or sell – and not the price. When the market turns from a downtrend to an uptrend, the 50 day (shorter moving average in this case) will cross above the the 200 day (longer average). This is the signal to buy. When the 50 falls below the 200 that's a sell.

Here's a chart of the S&P 500 with the 200 and 50 day moving averages displayed – the last signal was in April last year when the 50 (shown in red) crossed above the blue line of the 200 day average.

There are many other variations as chartists have tried to come up with a better approach. But the reality is that when using technical methods nothing is going to work all the time – but it can certainly tilt the probabilities in our favour. Once you are aware of the drawbacks with moving averages, they can still be useful in helping you with the big picture view of a particular market or share. They can still be, for some investors, an important part of the filtering process for flagging up potentially interesting opportunities.





BY FILIPE R. COSTA

HOW TO INVEST LIKE...

PHILIP L. CARRET

"The business man who can devote the necessary time to the control of his personal finances will find speculative investment a fascinating undertaking keeping him constantly in touch with the material progress of the world. He will take an intelligent interest in economic history in the making."

— Philip L. Carret,
"The Art of Speculation", 1930

A long life

Some say that the activity of managing investments leads to premature ageing and an early death due to its time-consuming, stressful and sometimes dramatic nature. This month we profile an investor who is most certainly an exception to that rule. Besides possessing one of the longest track records in the investment industry and having started employing the main principles advocated by Benjamin Graham a few years before the widely acclaimed "Security Analysis" book was published in 1934, Philip L. Carret is also proof that investment need not be detrimental to one's health, as he died at the ripe old age of 101. Carret was a lifelong value investor, having worked right up until a few months prior to his death. His long and impressive investment track

record spanning over 80 years and covering many very different periods in modern history makes him no less important a figure than the greatest names in value investing, such as Benjamin Graham (issue 13 – April 2016) and John Templeton (issue 16 – July 2016). He also served as a source of inspiration to none other than Warren Buffett (issue 14 – May 2016) himself.

**"CARRET'S CAREER
AS AN INVESTOR IS
ONE OF THE LONGEST
EVER SEEN, SPANNING
OVER EIGHT DECADES
AND SEVERAL
MARKET CYCLES."**

This month, we're going to take a look at the man who funded the Mutual Trust investment pool in 1928, at a time when nobody else was engaging in this kind of investment, and managed it for 55 years with huge success. 88 years after its inception, the fund is still alive and kicking.

The longest career in investment

Philip Lord Carret was born on 29 November 1896 in Massachusetts and died in New York on 28 May 1998, aged a respectable, if not enviable, 101 years. The son of a lawyer (father) and of a social worker (mother), he graduated from Harvard College in 1917 with a degree in chemistry. During World War I he was trained to fly the Sopwith Camel airplane but (luckily for the in-

vestment world) when he was sent to France to fight, the war was already over. Unlike his stint in the military, Carret's career as an investor is one of the longest ever seen, spanning over eight decades and several market cycles. In total, he went through 31 bull markets, 30 bear markets, and 20 recessions.

Carret started out managing money for family and friends until, at the age of 31, he launched the Mutual Trust, which later evolved into the well known Pioneer Investments. The fund was one of the first mutual funds to be created and it still exists today under the name of the Pioneer Fund. The idea to create an investment pool came while

he was working as a reporter at the Boston News Bureau, where he met Clarence W. Barron, who later gave his name to the well known financial publication Barron's.

At the inception of the Mutual Trust, Carret had \$25,000 under management, which, adjusted for inflation,



How Much Was \$10,000 Invested in 1934 Worth in 1988 ?



“THE SAGE OF OMAHA OFTEN TOLD BERKSHIRE’S SHAREHOLDERS THAT THEY WOULD LEARN MORE FROM SPEAKING FOR 15 MINUTES WITH CARRET THAN FROM SPENDING THE WHOLE DAY WATCHING BERKSHIRE’S ANNUAL PRESENTATION.”

corresponds to around \$345,000 today. During his 55-year tenure at the helm of the Pioneer Fund, he would turn \$100,000 into \$80,000,000, corresponding to an annual compound growth rate of 12.9%. During the same period, the S&P 500 would turn \$100,000 into a more modest \$10,660,000, as its annual compound growth rate amounted to 8.86%.

Later in life, Carret sold the controlling stake in the company that managed the Pioneer Fund and founded Carret & Company to manage funds for wealthy individuals and institutions. While selling his stake in this firm in 1988, he continued working there without a salary until his death. The Pioneer Fund is now part of the Pioneer Investments asset management company, which has grown to employ over 2,000 people and manages more than €200 billion. As of today, the company is a subsidiary of Amundi. Carret & Company is also still in business, now under the name of Carret Asset Management.

While often disregarded by investors in favour of other big names in value investing like Benjamin Graham and

David Dodd, Carret is still an important point of reference in the investment world and one of the most important inspirations behind Warren Buffett's investment success. To survive the markets for so many years and so many market cycles, the investment style followed by Carret can only be described as a guiding light of value investing. But, unlike today where such a strategy is well defined and easily identified, when Carret started out he was making it up as he went along. The Mutual Trust was started six years before Ben Graham's famous "Security Analysis" book on value investing was published.

Even though the strategy was rarely referred to as value investing, Carret was always a fierce advocate of buying shares from companies with consistent earnings growth, strong business fundamentals, manageable debt, solid cash flow and managers who were strongly aligned to the same goals as common shareholders through a hefty stake in the company's shares. After going through these checks he only invested if he thought there was the potential to double his money. These are the foundations of value investing.

Value is time independent

In the mid-1940s Carret purchased shares in the barrel maker Greif Brothers Corporation at around 68 cents per share. Prior to his death, the Carret & Company still owned a 4pc stake in the stock, by then trading at around \$36.50. After his death, in May 1998, Greif's stock has still done rather well, having risen by another 190%, which compares with 117% for the Dow Jones index. When properly researched, companies with value tend to do well for very prolonged periods of time.

Interestingly, the initial tip that prompted Carret into researching the stock was given by Howard Buffett, the father of the legendary investor Warren Buffett. Carret would later turn into a longstanding shareholder of Berkshire Hathaway, the investment holding company owned by Warren Buffett. He usually travelled to Omaha to attend Berkshire's annual shareholder meeting and became an inspirational figure for Buffett. The Sage of Omaha often told Berkshire's shareholders that they would learn more from speaking for 15 minutes with Carret than from spending the whole day watching Berkshire's annual presentation.

The roots of value investing

Carret wrote many articles while a journalist at Barron's, some of which were compiled into books. In 1930, his most prominent work was published – "The Art of Speculation". The book is a serious manual into the world of value investing, even if the name may suggest a pursuit of short-term profits. Carret viewed speculation merely as a natural attempt by an investor to exploit the difference between observed prices and expected future prices. In his view, every business has a part that is filled with speculation, to some extent. "The successful manufacturer of cotton textiles must then be to a considerable degree a successful speculator in raw cotton. If he buys at the wrong time or fails to buy it at the right time, his profits will be small, or non-existent".

Any long-term investment involves speculation in prices. What is really important is the attitude towards such speculation. While both speculators

Greif Inc. Vs. Dow Jones



and investors buy on the "expectation" of future price rises, gamblers buy on the "hope" of future price rises. The main goal of Carret's book is to train the speculator's judgement, and this way push speculation towards its frontier with investment, as opposed to its frontier with gambling.

“CARRET VIEWED SPECULATION MERELY AS A NATURAL ATTEMPT BY AN INVESTOR TO EXPLOIT THE DIFFERENCE BETWEEN OBSERVED PRICES AND EXPECTED FUTURE PRICES.”

12 Commandments for investment success

Carret was a hard working man who always spent a lot of time reading through annual reports, particularly the footnotes, which others mostly ignored. In his view, there is no shortcut or mechanical formulas that can avoid the hard work needed to uncover

value. As he writes in the very first paragraph of the preface to "The Art of Speculation",

"The man who looks upon speculation as a possible means of avoiding work will get little benefit from this book. It is written rather for the man who is fascinated by the complexity of the forces which produce the ceaseless ebb and flow of security prices, who wishes to get a better understanding of them"

Carret suggests 12 precepts he believes investors can follow in order to achieve consistent profits over time. Nevertheless, he always mentions that such rules need to be flexible enough to adapt to exceptions that will always exist instead of being followed blindly.

(1) Never hold fewer than 10 different securities covering five different fields of business

Investors should always diversify. Diversification should accomplish three important goals: minimise the factor of chance, allow for an occasional error of judgement and reduce the importance of the unknown factor. The central tenet is that external uncontrollable factors may affect equities in different ways. Diversification should provide a safety net, as some external factors impacting an asset negatively may not impact all others in the same way. The second goal is related to the fact that

not even the best analyst is immune to an error of judgement.

The third goal is related to idiosyncratic risk – the specificities of each stock – which can be eradicated by diversification. "By sufficient diversification these unknown factors affecting individual securities cancel each other. The loss which is due to the unknown factor in one case will be counterbalanced by an unexpectedly large profit in another", he claims. This perception forms the basis of the Modern Portfolio Theory which was developed 20 years after Carret first mentioned it in his book.

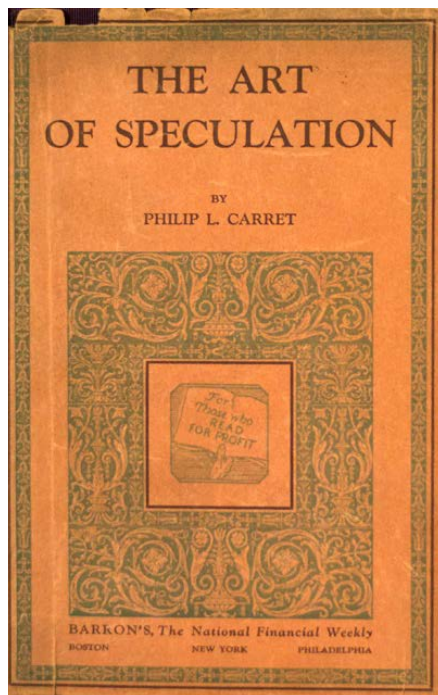
(2) At least once every six months re-appraise every security held

It is not only about calculating paper profits/losses; it is also about re-assessing prospects from time to time. This is a difficult task given the vested interest an investor has in the security. An investor should be able to detach himself from the money already committed and ask the question: *If I had money to invest at this point, would I?*

(3) Keep at least half the total fund in income producing securities

These are of higher grade and the risk of a severe loss is relatively small. Of course, the potential profit is also smaller but that is necessary "for the speculator not to venture too far from





the shore in his operations". These income producing issues can much better weather out any storms and sustain the investor through market cycles.

(4) Consider yield the least important factor in analysing any stock

It is not the yield but rather the prospects that matter. Investors should invest primarily in dividend-paying stocks of high grade and non-dividend paying stocks of companies which are making progress in strength and earnings power and are headed towards the dividend ranks. In the first case the dividend yield is low and in the second it is non-existent. In many cases, high yields come from low-grade dividend-paying stocks, which exhibit high yields because their dividends are in doubt and their future outlook is uncertain.

(5) Be quick to take losses, reluctant to take profits

Investors should hold on to holdings for a long period of time if a stock is doing well, which is confirmation of good management and strong earnings power. But, when losses appear, the best course of action is to cut them rather quickly, because they may reflect poor management which isn't going to change over time.

(6) Never put more than 25% of a given fund into securities about

"DURING THE HIS 55-YEAR TENURE AT THE HELM OF THE PIONEER FUND, HE WOULD TURN \$100,000 INTO \$80,000,000, CORRESPONDING TO AN ANNUAL COMPOUND GROWTH RATE OF 12.9%."

which detailed information is not readily and regularly available

Because that would raise the importance of the "unknown" in overall performance, which bears more resemblance to gambling.

(7) Avoid "inside information" as you would the plague

By the time you know a rumour, you're probably the thousandth person to hear it.

(8) Seek facts diligently, advice never

No one can attain a fortune by just seeking advice from others. Investors should diligently seek out facts and information but they need to take the decision by themselves alone.

(9) Ignore mechanical formulas for value in securities

While it would be great to automate the investment process, the best that such formulas can offer is a source of potential candidates for further research.

(10) When stocks are high, money rates are rising, and business is prosperous, at least half a given fund should be placed in short-term bonds

Even when individual prospects are good for the long term, investors cannot ignore market trends.

(11) Borrow money sparingly and only when stocks are low, money rates low and falling, and business depressed

Borrowing too much and after a strong and long-lasting bull market is dangerous and risks major losses. Anyone

would survive falling from the ground floor, and most from the first floor, but none from the 10th.

(12) Set aside a moderate proportion of available funds for the purchase of long-term options on stocks in promising companies whenever available

Carret always sought out future opportunities and often used options as a way of getting exposure.

A few final words

It is difficult to distinguish between investment and speculation and between speculation and gambling. To some extent "the average man who opens an account with \$1000 has at least subconsciously the idea that if he doesn't double his money in a year he will be disappointed". But in real life, "as he grows older his natural tendency probably will be to take fewer and smaller risks, to become more an investor than a speculator".

Some time before Graham created the "Mr Market" allegory resembling the irrational short-term behaviour driving equity prices, Carret had already expressed his concern with short-term movements. "For practical purposes the occurrence of ripples and waves in the price movement is unpredictable", he claimed in his 1930s book. "To attempt to trade on such movements is mere gambling with the odds against the trader by a considerable margin", he added. Investors should seek out long-term value by deeply researching potential investments and patiently waiting for value to be unlocked. Nevertheless, many are those who prefer to seek out short-term gains. "It is astounding that thousands of otherwise intelligent persons persist in trying to make money in this way", he observes.

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JANUARY 2017

BEST OF THE BLOG

Our picks for 2017

Happy New Year! As if 2016 wasn't tumultuous enough, 2017 promises to hold many more surprises. Here's a selection of our best ideas from some of our favourite commentators...

Alphabet Inc. (Google) – Victor Hill

During 2016 I wrote more about Alphabet/Google (NASDAQ: GOOGL) than any other company. Reading around, I came to understand that Google is much more than an internet search engine which generates massive revenues from targeting ads with pin-point accuracy. It is a technology powerhouse at the centre of new convergent technologies which will very soon change the world.

Self-driving cars, data mining in healthcare, artificial intelligence, quantum computing... Google, uniquely, is at the forefront of all these mind-blowing technologies and will maintain its lead for the foreseeable future.

In May I wrote a piece entitled [*The Fly in Alphabet's Soup*](#). Back on 20 April the European Competition Commission charged Google with abusing its dominance of



**“SOMETIME DURING 2017
THE MARKET IS GOING TO
REALISE THAT GOOGLE HAS
A POTENTIALLY MASSIVE
NEW REVENUE STREAM HERE
AND ITS SHARE PRICE WILL
RESPOND ACCORDINGLY.”**

the Android operating system.

Android is the world's most-used mobile phone operating system, powering about 1.8 billion devices. If the Commission could prove that Google has broken European competition law then it has the power to fine the company up to 10 percent of its global revenues.

The EU dismissed Google's petitions on 14 July and even submitted ad-

ditional charges – including one of evading taxes in Italy. This dispute is likely to run on for years but the markets seem to have shrugged off initial concerns about its impact on revenues. By the time the case is resolved the technology will have changed anyway.

In June I considered the amazing potential of [data mining in healthcare](#) – a field in which Google has developed an important niche market

through its UK subsidiary, DeepMind Technologies.

By Master Investor



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“THE CONTRARIAN IN ME IS OPTIMISTIC FOR CONTINUED OUTPERFORMANCE FROM THE MINERS IN 2017.”

There's more to come from the miners in 2017

The recovery in mining stocks took many by surprise in 2016. However, despite the renaissance, there is still a heavy weight of opinion against the mining sector. With this in mind, the contrarian in me is optimistic for continued outperformance from the miners in 2017.

I know my writing here is too intermittent to update readers on investment timing (I warned as much in one of my blogs) so I missed suggesting taking profits when my various recommendations reached their peaks throughout 2016. Not that I'm claiming to call the tops. Except for the highest conviction stocks I hold, I usually take at least partial profits when I see a spike.

24 out of my 29 recommendations went the way I forecast; but one, **Ariana Resources (LON:AAU)** (on which I provide an update below) went spectacularly the other way; one, **Metminco (LON:MNC)** hasn't delivered yet; and one, **Caledonia Mining (LON:CMCL)**, initially went far beyond the price I thought irrational momentum would take it to – before crashing back down a bit later than I thought it would.

My worst bet, **Paragon Diamonds (LON:PRG)** was suspended – with last news in July when it was still hoping to secure finance for its Botswana diamond project. Since then: nothing.

But the table shows the successes well outweighing the few failures, with most picks, even if down from their peaks, still showing a healthy profit.

By John Cornford



Index of 2015-6 reccs by JC		Mkt cap	date	Recc	mid price	2016	Price	Performance	
		now £m	mentioned		p	high	end '16	to high	to end '16
BUYS									
Atlantis Resources	ARL	60	5 April '16	LT Buy	62.5	84.0	49.5	34.4%	-20.8%
Berkeley Energia	BKY	147	13 Jan '16	Buy	24.0	54.5	54.5	127.1%	127.1%
Dalradian Resources	DALR	152	16 Feb '16	Buy	42.0	92.0	70.5	119.0%	67.9%
Franco Nevada	FNV:US	1,140	6 Jan '16	Buy	67.0	104.0	59.8	55.2%	-10.8%
Hornby	HRN	25	19 Feb '16	Buy	35.0	40.5	29.0	15.7%	-17.1%
Hummingbird Resources	HUM	67	Dec '15	Buy	17.0	28.5	18.3	67.6%	7.4%
Kefi Minerals	KEFI	12	5 Feb '16	Buy	0.3	0.6	0.3	106.7%	6.7%
Kibo	KIBO	23	Nov '15	LT Buy	4.5	9.8	6.8	116.7%	50.0%
Lydian International	LYD:CA	231	15 Dec '16	Buy	0.3	0.5	0.3	88.9%	22.2%
Metminco	MNC	6	12 May '16	LT Buy	0.3	0.3	0.1	0.0%	-56.7%
Ncondezi Power	NCCL	13	Nov '15	Buy	1.9	6.8	5.3	255.3%	176.3%
Oracle Coalfields	ORCP	26	Nov '15	Buy	2.8	3.6	2.9	28.6%	1.8%
Pan African Resources	PAF	296	21 Jan '16	Buy	9.0	24.0	15.5	166.7%	72.2%
Royal Gold	RGLD:US	3,310	6 Jan '16	Buy	37.7	84.5	63.4	124.1%	68.0%
Sandstorm Gold	SAND	642	6 Jan '16	Buy	2.7	8.4	3.9	212.3%	45.0%
Shanta Gold	SHG	53	April	Buy	7.4	13.0	9.4	75.7%	26.7%
Silver Wheaton	SLW:US	916	6 Jan '16	Buy	17.4	39.7	19.3	128.2%	11.0%
Solomon Gold	SOLG	336	15 Mar '16	Buy	3.6	29.3	23.9	713.9%	563.2%
AVOID									
Stanley Gibbons Intl	SGI	23	12 Jun '16	Avoid	13.5	15.4	12.4	14.1%	-8.3%
WEAK HOLD									
Photo-Me	PHTM	617	21 Jun '16	Hold	135.0	164.0	164.0	21.5%	21.5%
SELLS									
Ariana Resources	AAU	14	9 sept '15	Sell	0.9	2.1	1.8	133.3%	97.2%
Aureus Mining	ASO	80	29 feb '16	Sell	5.0	5.2	1.5	4.0%	-70.0%
Avocet	AVM	113	5 May '16	Sell	88.0	122.0	54.3	38.6%	-38.4%
Caledonia Mining	CMCL	44	12 Aug '16	Sell	90.5	147.0	90.5	62.4%	0.0%
Kibo	KIBO	23	23 Oct '15	Sell	9.0	9.8	6.8	8.3%	-24.4%
Scotgold Resources	SGZ	8	22 Oct '15	Sell	0.7	1.0	0.5	35.7%	-28.6%
Sirius Minerals	SXX	833	31 Aug '16	Sell	45.0	45.0	19.3	0.0%	-57.2%
SUSPENDED									
Paragon Diamonds	PRG		Oct '15	Buy	5.3		-		

Bargains still to be had in the small cap market

As discussed in [my article for January's edition of Master Investor Magazine](#), 2016 was a great year for small cap shares. The AIM All-Share rose by an impressive 14.3%, the FTSE Small Cap Index surged by 11%

and dozens of individual stocks grew in value by more than 100%. Three stocks even finished the year up by an eye watering 1,000% or more!

With some small cap indices reaching all-time highs and a raft of shares now hitting topmy valuations, it's becoming increasingly dif-



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difficult for investors to pick out value stocks. But, as ever, there are still a number of companies trading at bargain prices. Here follows three companies listed on the FTSE Small Cap Index which I believe offer good value.

Trinity Mirror

I last covered newspaper owner **Trinity Mirror (LON:TNI)** on the Master Investor blog [HERE](#) in August last year. Since then the shares have risen by a decent 10%, with a 2.1p interim dividend taking the total return to 12.3%. Nevertheless, the company remains one of the lowest valued on the whole of the London markets. To re-cap, here's why.

- **Huge pension deficit.** Trinity's pension deficit, at £426 million, is even larger than Bob Maxwell's stomach. A related funding plan is sucking cash out of the business.
- **Phone hacking costs.** For its part in the phone hacking scandal Trinity has made a total provision of £52.5 million to cover damages and victims' legal costs. Damages for over 80% of claims have now been settled but the market remains wary of further cost increases.
- **Decline in the print industry.** Trinity has struggled to adapt its business model to take advantage of the shift from print to digital media/advertising over the past decade.

Despite these issues the company does have certain attractions.

"2016 WAS A GREAT YEAR FOR SMALL CAP SHARES."

Following the 2015 acquisition of Local World Trinity is the largest regional news publisher in the UK, with substantial scale synergies set to be enjoyed as the two businesses become fully integrated in the coming months. Digital revenues are now starting to show good momentum across the business and operational cashflow remains very strong across the group, even after considering the large payments into the pension scheme.

By Richard Gill, CFA



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full article**

Why 2017 could be BP's year

BP is entering a new phase in its history, with it having drawn a line under the costly oil spill of 2010. Its valuation and yield have appeal in my view within a sector that remains generally undervalued. Therefore, I feel that now is the right time to buy BP and that 2017 could be another

strong year for the company.

Even the most optimistic of oil bulls is unlikely to have accurately predicted the performance of oil in 2016. At its lowest ebb, oil traded at \$28 per barrel in January, but yet ended the year at over \$56 per barrel. That's a 100% gain in less than a year, which seemed unlikely given the persistent glut of supply.

However, with OPEC agreeing to a production cut, the outlook for oil is now much more positive. This has been followed by a cut in production from non-OPEC members.

With Donald Trump less concerned about the environment and on regulations concerning fossil fuels than his predecessor, demand for oil in the US could remain high for longer than previously thought.



Emerging-market demand could also push the price of oil higher in my view, while reduced exploration and capex spending across the industry could help demand and supply to move back into line.

All of this bodes well for **BP (LON:BP)**. Alongside its improving financial position following the 2010 oil spill, a high yield and an appealing valuation, this makes it a sound long-term buy in my opinion.

By Robert Stephens, CFA



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full article**





BY RICHARD GILL, CFA

READ TO SUCCEED

INVESTING THROUGH THE LOOKING GLASS

A RATIONAL GUIDE TO IRRATIONAL FINANCIAL MARKETS

BY TIM PRICE

"We're all mad here..."

The Cheshire Cat, Alice in Wonderland

A Mad T(-Bill) Party

The basic premise of *Investing Through the Looking Glass* is that, following the financial crisis of 2008/09, and the resulting bank bail outs, quantitative easing, bond bubble, zero interest rate policies, explosion in government debt and so on, the financial markets have become unbalanced and flooded with delusional behaviour.

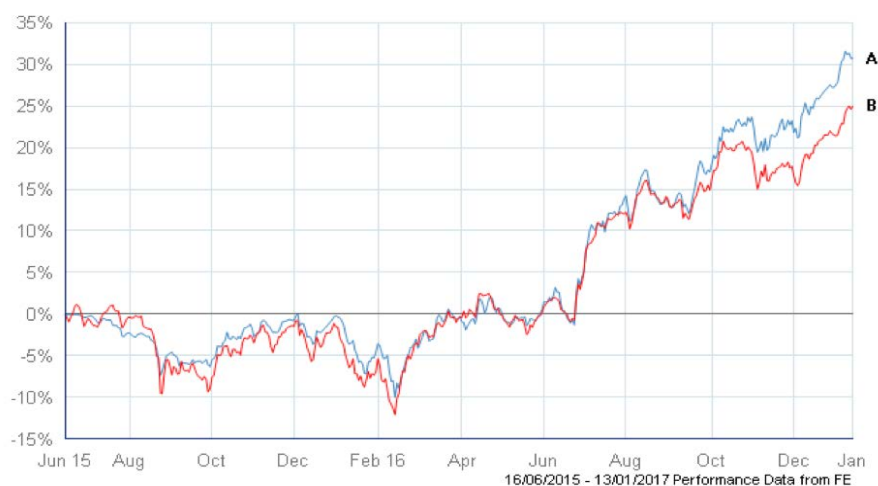
Just like Alice experienced in her journeys into Wonderland, the world doesn't appear to be how it should be. And while there are always people to guide investors along the way, such as fund managers, financial journalists and other 'experts', their advice can often turn out to be as useful as the Mad Hatter's.

So to help investors find their bearings in this strange new world author Tim Price lays to rest a number of investment myths, combining his contrarian mind-set and alternative way of think-

ing to explain exactly what is going on. Price is a well-known investment commentator and fund manager with over 20 years' experience in the markets. He worked at various investment firms, including Paribas Capital Markets and Merrill Lynch International, before moving to Union Bancaire Privée where he was chief investment officer, global strategies, managing over \$1 billion in an absolute return programme

for institutional clients. He currently works as director of investment at PFP Wealth Management and is also the manager of the VT Price Value Portfolio, a value focussed fund which invests in the style of Benjamin Graham.

As the chart below shows, the fund has done well since launch in June 2015, growing in value by over 30% and outperforming the data vendor's bench-



mark by a decent margin – the fund itself does not compare its own performance against an index. Admirably, (and I have not been paid to say this) the fund has no entry fee, no performance fees and a management fee of just 0.75%.

Read me

After a brief introduction on how the financial markets got into their current senseless state, the core text of the book comes in two parts.

“VALUE STOCKS CURRENTLY OFFER UNUSUAL APPEAL.”

The first part, which further grows Price's reputation for being a bit of a doom monger, covers the problems facing today's investors. Over seven chapters he examines questions such as: are bonds low risk assets to be held for the long-term; does the financial media exist to help investors make sense of the markets; and can fund managers deliver an edge in the markets and deliver the best return for investors?

Each "problem" which is the basis for discussion in part one's chapters is framed as a "delusion". These are written as a simple one paragraph statement, a statement which in recent times has often been considered as a fundamental fact of the financial world. For example, we kick off chapter one with, *"commercial banks are an essential part of the modern economy"*, a proclamation that many economists would have been supportive of over the course of history. Then Price brings in the "reality", in this case arguing that commercial banks have grown greedy and that, while banking itself is essential to a financial system, banks themselves are not indispensable, especially as new technologies are developed and take hold.

My favourite chapter, and perhaps the one most interesting to equity investors, looks at the delusion that stock markets always rise over the long-term. Price argues that returns from equities over time are a lot more variable and

modest than you might think. He illustrates this with some interesting data which show that annualised 20-year returns for the UK stock market, going back to the year 1700, have averaged round about.... zero!

Good value

The second part of the book focusses on the solutions to the problems faced by investors today, with Price providing practical guidance to readers via three detailed chapters so they can preserve and grow their capital in what he calls, *"one of the most challenging investment environments that anyone has ever seen"*.

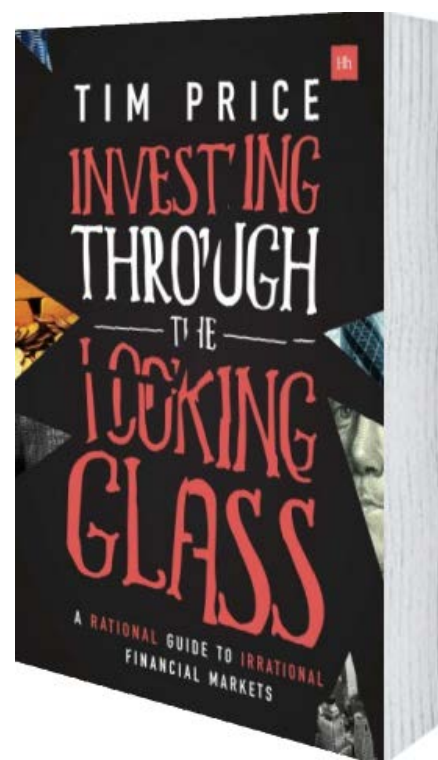
Unsurprising given his background, Price's first solution is value investing. He debunks the myth that the investment style favoured by legends such as Benjamin Graham and Warren Buffet is out of date in the modern world and argues that value stocks currently offer unusual appeal. However, given asset inflation caused by quantitative easing, investors may have to look farther afield to find such stocks – perhaps as far as Asia, and Japan in particular.

Price is also a fan of gold, arguing that the precious metal, seen by many as being a barbarous investment relic, is important for preserving purchasing power. Fiat currencies – including those such as the pound and dollar – (which are declared by governments to be legal tender and are unbacked by a physical commodity) have plunged in value over time. The US dollar for example has lost over 98% of its purchasing power over the last 100 years. But gold has been seen to hold its value over thousands of years. Overall, Price sees gold as an insurance policy against breakdowns in the current financial system, with both physical and gold focussed equities recommended.

The book finishes with a useful appendix named the Modern Investor's Manifesto, a list of 99 statements and observations which the author believes describe the state of the current financial system and the challenges facing investors.

The Price is right

In *Investing Through the Looking Glass* Tim Price has produced a thought provoking and entertaining guide for anyone concerned about their financial future. It is highly relevant to today's market where investors need to stand up for themselves in light of the irrational actions of central banks, governments, regulators and all those other parties who are supposed to be looking after their best interests. Written in an informative and educational style, and packed with stock market history and anecdotes, this is an essential addition to any investor's library.



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BY TIM PRICE

THE FINAL WORD

REASONS TO BE CHEERFUL?

For investors of a certain persuasion – that is to say, bearish – SocGen's annual investment conference plays an iconic role. Its popularity can often be regarded as a contra-indicator: the greater the number of attendees, the higher the likelihood that the market will rally. Last year's conference was packed to the rafters, and the FTSE, along with many other stock markets, ended up having a terrific year. This year, the conference was well attended but hardly bursting at the seams. In the words of technical analyst David McCreadie of Hobart Capital Markets, "That nicely sums up the stage of acceptance the market has reached with current equity levels."



As a reminder, the Kübler-Ross model incorporates five stages of grief: denial, anger, bargaining, depression and acceptance. Without sounding overly fanciful, one can plausibly overlay these onto phases of the stock market following the 2008 Crash: refusal to accept reality; anger at losses incurred; coming to terms with the new market environment (and chasing it higher); regret at having to pay ever higher prices; finally, there is acceptance of the longevity of the rally. If this year's SocGen conference had been a standing room only affair, one could be forgiven for adopting a particularly bullish perspective for the year to come. As it was only tolerably full, we should probably fear the worst for 2017.

SocGen's 'perma-bear' team is now sadly depleted – again, a reflection of just how long in the tooth the equity market rally has become. It originally consisted of Albert Edwards, behavioural economist James Montier, and strategist Dylan Grice. Now

only Albert remains. Montier has gone off to work for fund managers GMO, and Grice has gone off to work for a Swiss family office.

But Albert's 'Ice Age' thesis still stands. On his analysis, the world's central banks in their increasingly desperate efforts to reflate the world economy have only deferred the inevitable day of reckoning and have essentially captured the world financial markets in a giant Ponzi scheme. He anticipates that the West will ultimately follow the experience of Japan and its two-decade slide into deflation and depression. In the new 'Ice Age', stock markets will re-rate (downwards) both in absolute terms and relative to bonds. He may well be right, albeit his bearish stance

on equities will have been costly to many investors since he first developed this thesis 20 years ago. Having said that, his call to favour longer duration bonds instead has worked like a charm. He still believes that US 10 year Treasury yields can trade below 2% and stay there for a decade.



House of cards

In his defence, stock markets across the world now seem somewhat over-valued, none more so than those of the US itself. We know that Robert Shiller's cyclically adjusted p/e ratio for the S&P 500 index stands at a historically expensive 28 times (you can track it on a daily basis [here](#)). As his SocGen colleague Andrew Lapthorne points out, however, it is EV/EBITDA (enterprise value versus earnings) that really looks shockingly rich. The last time US EV/EBITDA was above its current level of 13 times was 2001. The ratio then suffered a long decline that didn't stop until the end of 2008 when it hit just 6 times. The prognosis for US stock markets today is not exactly encouraging as a result.

Enterprise value is a more useful measure of company worth than simply market capitalisation because it also includes the value of corporate debt. One of the problems with the US stock market is that US corporates have been on a gigantic borrowing binge. The Fed's QE has exacerbated the problem, which Lapthorne also highlights. The Fed's purchases of Treasuries has depressed the level of US government bond yields. Depressed bond yields have led to an increased demand on the part of fixed income investors for higher yielding corporate debt instead. If the ducks are quacking, feed them – and US companies have been happy to do the feeding. So US companies have issued more debt, and have used that debt to buy back their own stock in the process, boosting corporate earnings per share. Higher EPS, together with net buying from corporate America, has boosted the price level of equities. US capital markets, in other words, are now badly distorted – and US companies are now heavily overleveraged as a result. QE has consequences. We may see some of those consequences play out in US markets this year.

Whether expressed in terms of debt to equity or as debt to total assets, US companies have never been more heavily indebted than they are today. US company earnings as defined as EBITDA (earnings before interest, taxation, depreciation and amortisation) have roughly doubled since the height of the financial crisis. But net debt has



“NOW WOULD BE AN AWKWARD TIME FOR CREDIT CONDITIONS TO DETERIORATE IN NORTH AMERICA – OR, FOR THAT MATTER, FOR A FED TIGHTENING CYCLE TO BEGIN.”

risen over four-fold. And it was arguably debt that was the proximate cause of the crisis to begin with. It's a strange crisis that can be resolved by terrific amounts more of the very thing that caused it.

We are often told that US companies are rolling in cash, much of it held overseas and just waiting to be repatriated. That may hold true for the largest 25 companies in the US. But as Andrew Lapthorne also points out, the remaining 99% of US companies barely have any – cash ratios for almost all of the rest of the market are at historic lows. Now would be an awkward time for credit conditions to deteriorate in North America – or, for that matter, for a Fed tightening cycle to begin.

There is a similar inequality with regard to profits in the US. While the biggest five companies per sector are enjoying relatively high returns on equity, the remaining 2500 US stocks have seen their own return on equity trend sharply downwards for the past two decades. If President Trump is to turn around the corporate profits cycle, he has his work cut out.

"There's always something to do"

Andrew Lapthorne alludes, in passing, to the extent to which Asia (in particular China) is starting to flex its market and economic muscles. For the first time ever, there are now more listed equities in China and Hong Kong than there are in the US.

While there is little for US investors to cheer in SocGen's analysis, there is some good news for Asian investors. What I found striking about Andrew Lapthorne's presentation was the revelation that the average dividend yield in Japan is now above the average dividend yield in the US. As Lapthorne quips, he has waited 25 years for Japan to become an equity income story – and now it's happened.

The late, great Canadian value investor Peter Cundill got a name check in last month's column for one of his aphorisms about taking a global attitude to stock market investing: "there's always something to do". And there is always something worth investing in. Today, while the US market increasingly feels

like an accident waiting to happen (and Donald Trump could yet be that accident), there is a standout value opportunity waiting to be rediscovered, in the form of Japan.

Yes, the Japanese stock market has been a disaster ever since it peaked in 1989. But it's worth reflecting on just how much pain Japan has now incurred. The Nikkei 225 index peaked in 1989 at a level of 38,916. Some 28 years later, it now stands at half that level. To say it has room to play catch-up with the rest of the world may be the understatement of the century.

And yes, Japan has been a graveyard of lost hopes for the entire duration of my career (which began, as a bond salesman at a Japanese bank, back in 1991). The difference this time is two-fold. On one hand, the valuation arguments in favour of Japan are truly compelling. Over 40% of the entire Topix index trades on a price / book ratio of less than one. Having suffered from bouts of deflation for over 20 years, Japanese companies now have the strongest balance sheets in the world. There are plenty of companies quietly making record profits in Japan. You just haven't heard about them yet, because the perma-bear narrative that has be-

set the market for over 20 years has yet to change.

**“HAVING
SUFFERED
FROM BOUTS
OF DEFLATION
FOR OVER 20
YEARS, JAPANESE
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NOW HAVE THE
STRONGEST
BALANCE SHEETS
IN THE WORLD.”**

On the other hand, the Japanese market now has strong domestic support for the first time in years. This is, effectively, a capital flow argument on top. As I mentioned in last month's column, John Seagrim of CLSA points out the existence of what he terms a new "high roller" club in Japan. To qualify for membership, you need to be buying at least ¥4 trillion worth of stock a year. The Bank of Japan is a founder member – they bought ¥6 trillion last

year. Japanese companies bought back roughly ¥6 trillion in stock in 2016. The Government Pension Investment Fund, the GPIF – the largest pension fund in the world – has raised its target equity weight to 25%, which is consistent with them investing ¥5 trillion in the stock market this year. And Japanese private investors, not least through their NISA accounts (the equivalent of our ISAs), were on course to buy an annualised ¥4 trillion of stock for 2016. That totals ¥21 trillion – or over 5% of the entire Topix free float. I repeat these figures this month because they are utterly remarkable, especially in the context of the third largest economy in the world.

The one wild card in Japan is the yen. The Bank of Japan has also pledged to keep 10 year interest rates at zero for the indefinite future. That is likely to keep the yen weak. But that is itself also likely to give stocks a boost. So if you do see merit in the Japanese story (I certainly do – it accounts for roughly 40% of the investments in my own fund), you probably want to hedge at least part of your yen exposure.

So it promises to be an interesting 2017. But in relation to the US market, at least, a degree of caution is probably warranted. Happy New Year!



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.



MARKETS IN FOCUS

JANUARY 2017

GLOBAL EQUITIES

Index	Last Month %	YTD %	Proximity to 52w High*
Bovespa	7.4	7.4	
NASDAQ 100	5.2	5.2	
Russian Trading System	1.8	1.8	
S&P 500	1.8	1.8	
Dow Jones	0.5	0.5	
DAX Xetra	0.5	0.5	
Hang Seng	6.2	6.2	
S&P/ASX 200	-0.1	-0.1	
Nikkei 225	-0.4	-0.4	
IBEX 35	-0.4	-0.4	
FTSE 100	-0.6	-0.6	
Euronext 100	-1.8	-1.8	
CAC 40	-2.3	-2.3	

COMMODITIES

Commodity	Last Month %	YTD %	Proximity to 52w High*
Palladium	11.8	11.8	
Coffee	10.4	10.4	
Platinum	10.3	10.3	
Silver	10.1	10.1	
Copper	9.8	9.8	
Iron Ore	6.4	6.4	
Gold	5.3	5.3	
Sugar (No. 11)	4.9	4.9	
Soybean	1.9	1.9	
Crude oil (Light Sweet)	-2.0	-2.0	
Crude oil (Brent)	-2.4	-2.4	
Cocoa	-2.9	-2.9	
Natural Gas	-16.8	-16.8	

FOREX

Pair/Cross	Last Month %	YTD %	Proximity to 52w High*
AUD/USD	5.2	5.2	
EUR/USD	2.7	2.7	
GBP/USD	1.9	1.9	
EUR/GBP	0.7	0.7	
EUR/CHF	-0.3	-0.3	
EUR/JPY	-1.0	-1.0	
USD/CHF	-2.9	-2.9	
USD/CAD	-2.9	-2.9	
GBP/AUD	-3.0	-3.0	
USD/JPY	-3.6	-3.6	

CENTRAL BANKS - RATES & MEETINGS

Central Bank	Key Rate	Next	After
BOE	0.25%	Feb 02	Mar 16
ECB	0.00%	Mar 09	Apr 27
FED	0.75%	Feb 01	Mar 15
BOJ	-0.10%	Mar 16	Apr 27
SNB	-0.75%	Mar 16	Jun 15
BOC	0.50%	Mar 01	Apr 12
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 %	YTD %	Proximity to 52w High*
KAZ Minerals PLC	31.7	31.7	
Antofagasta PLC	23.7	23.7	
NEX Group PLC	23.7	23.7	
Nostrum Oil & Gas PLC	22.2	22.2	
Vesuvius PLC	19.5	19.5	

FTSE 350 BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Pearson PLC	-24.4	-24.4	
Next PLC	-23.1	-23.1	
Inmarsat PLC	-19.1	-19.1	
Cobham PLC	-17.2	-17.2	
BT Group PLC	-17.2	-17.2	

FTSE 350 SECTORS TOP

Sector	Last Month %	YTD %	Proximity to 52w High*
Mining	13.2	13.2	
General Industrials	7.2	7.2	
Industrial Engineering	6.0	6.0	
Tobacco	5.4	5.4	
Forestry & Paper	5.1	5.1	

FTSE 350 SECTORS BOTTOM

Sector	Last Month %	YTD %	Proximity to 52w High*
Fixed Line Telecom	-16.5	-16.5	
Food Producers	-9.3	-9.3	
General Retailers	-6.6	-6.6	
Industrial Transportation	-5.7	-5.7	
Oil & Gas Producers	-5.5	-5.5	



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