ISSUE 37 – APRIL 2018 WWW.MASTERINVESTOR.CO.UK

MAGAZINE

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DEATH OF THE HIGH STREET

WHERE NEXT FOR THE RETAIL SECTOR?

PLUS...

TAKE COVER

THE INVESTMENT TRUSTS WITH THE BEST RESERVES

BITCOIN

HAS THE CRYPTOCURRENCY RUN OUT OF STEAM?

CHARLOTTE RANSOM

NETWEALTH FOUNDER & CEO ON FOUR THINGS INVESTORS CAN – AND SHOULD – CONTROL

FOUR HIGH-GROWTH DIVIDEND CHAMPIONS

THE CREAM OF THE CROP FOR DIVIDEND GROWTH

WELCOME

Dear Reader,

Welcome to the April issue of Master Investor Magazine. This month's cover story asks whether there is any future for the High Street and takes a look at how investors should skew their exposure to the retail sector in their portfolios. There are also interviews with Edison founder Fraser Thorne and Auxico President Mark Billings, while Netwealth's Charlotte Ransom explains how investors can take control of the 'controllables' to maximise their investment performance. All this and much more await you in this month's magazine.

It was great to see so many of you at the Master Investor Show last month, especially given that this is our best chance of getting feedback from readers in person. There were many familiar faces but also lots of new ones, which is testament to the success of the show. The day was overwhelmingly judged to be a huge success; however, we're not content to rest on our laurels – plans are already underway to ensure that next year's show is better still, and there might also be a few surprises along the way to boot.

If you missed the show, you can take a peek at our summary video, which will give you an overview of the day's highlights in less than three minutes. If you are more interested in listening to individual speakers, videos from all presentations are now available to watch either on our own site or over on YouTube. Readers will also be glad to know that our speakers' insights, all summarised in neat presentation slides, are available to download here.

Better still, make sure to watch next year's talks in person! Don't miss out on Master Investor Show 2019 – save **6th April 2019** in your calendar. It's also worth making sure you're signed up to our newsletter to make sure you keep up to date with any other Master Investor events taking place throughout the year.

Last but by no means least, I'd like to say congratulations to Monika Gebala, the winner of last year's Master Investor stock picking competition. Monika has very generously pledged to donate 10% of her £10,000 winnings to charity, and she intends to put the rest in her trading account and attempt to double it by this time next year. We wish her the best of luck!

Best regards
James Faulkner
Editor, Master Investor

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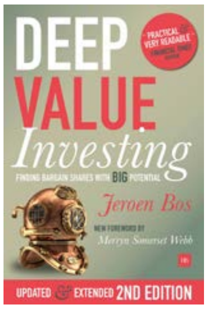

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ALL OTHER TOPICS

BY JIM MELLON

MELLON ON THE MARKETS

Normal service was somewhat delayed by the exigencies of the road trip I have been on for two weeks to Asia and Australia. My colleague Anthony Chow and I have been doing the crossover (i.e. pre-IPO) institutional/UHNW (ultra-high net worth) round for Juvenescence Ltd and the result has been that by the time I get back to London, we should be close to, or at, full subscription.

After all, just about everyone on the planet is a potential client for the longevity products of Juvenescence and the aura is somewhat helped in that the latest company that I was lucky enough to be a partner in, shepherded by the inestimable Dec Doogan, just read out on two successful Phase III trials. This company, **Biohaven (NYSE:BHVN)**, listed on the New York Stock Exchange (and once described as a piffling speculative investment by a notoriously off-target and downright frothy individual), has come up trumps and I am very grateful. $3.5 million to $1 billion in little over three years is pretty miraculous! If that is speculation, give me more!

On my travels, I met some really bright people, including top dogs at the big Chinese internet platforms in Hong Kong. They present a bright contrast to the sorry performance of **Facebook (NASDAQ:FB)**, which is lurching from disaster to disaster. This was my key short at the Master Investor Show this year, and I believe we are looking at carnage in this time wasters' medium, one where the entire business model is now not just redundant but screwed.

I have been coming to Australia for decades, and every time I am increasingly impressed. Like everywhere, Australia has its problems (very fractious politics and an overbearing nanny state, for example) but overall this is one of the great delights of the planet.

My friend Robert Purves is a big advocate of climate change being real – as well as being a disaster – and the unseasonably warm weather here convinces me of that. Even if you don't believe that climate change is man-made, the incontrovertible fact is that electric vehicles are the future, fossil fuel power is the past, and renewables are going to dominate power generation. With that in mind, lithium demand will surpass all expectations, and the relisting of LIFE (AIM) as a lithium company in the near future, neatly recapitalised, and renamed **Bradda Head** is a nap of mine.

The coming cataclysm

I met with an outstanding market commentator, whose views are so widely sought that he can charge vast amounts for them. James D*** (anonymised as he is pretty exclusive) is convinced that we are just at the start of interest rate normalisation, that volatility is too low, and that central banks are now mostly manipulating rates higher and restoring a normal yield curve. He and I agree that wage push inflation, as the precariat demands – and gets – more in the way of wages, will be a factor in making inflation, insidious or benign (as it currently seems), much higher.

This will accelerate the process of the Fed, the Bank of England, and the Bank of Japan etc. shrinking their balance sheets; four hikes this year in the US, and three next year and pretty soon you are looking at distinctly higher interest rate levels. In addition, the Trump tax cuts and the increased spending that every US Senator and Congressman/woman

"BONDS WILL BE CRUSHED. WATCH OUT FOR THIS AS IT WILL BE CATACLYSMIC WHEN IT HAPPENS."

"THIS WAS MY KEY SHORT AT THE MASTER INVESTOR SHOW THIS YEAR, AND I BELIEVE WE ARE LOOKING AT CARNAGE IN THIS TIME WASTERS' MEDIUM."

wants, will put added pressure on US rates.

All sorts of things are conspiring to make me believe that the US dollar has upside potential (sell euro) and that bonds will be crushed. Watch out for this as it will be cataclysmic when it happens. Coupled with the fact that almost all US stock performance (measured by the Nasdaq and S&P 500) has been generated by just a few tech stocks, wildly over-owned and over-priced in the context of their regulatory and business travails, you will see decimation sometime soon.

James D*** called it a reverse parabolic curve; loss of momentum, loss of energy and what looked like a bright day for Silicon Valley people in T-Shirts now looks like an expensive lesson in hubris. My general conclusion is to sell **Amazon (NASDAQ:AMZN)**, Facebook and **Alphabet (NASDAQ:GOOGL)** (the best of the bunch).

What to buy

Biotech, meanwhile, is cheap against the market; and furthermore, it actually does more good than Facebook – a lot more, if you believe that people should

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prioritise health over contact with ephemeral "friends". I would absolutely load up on **Gilead (NASDAQ:GILD)**, **AstraZeneca (LON:AZN)** and **GlaxoSmithKline (LON:GSK)**, as well as **Novartis (VTX:NOVN)**, if you are looking for large cap, undervalued dividend-yielding stocks. In smaller ones, you might want to look at **resTORbio (NASDAQ:TORC)** in the US and **Biotime (NYSE:BTX)** (owner of Age X, which we really like).

On a macro basis, all eyes are on the Donald Trump trade war declaration, which, to be quite honest, I reckon will resolve itself. His action of stirring up hornets' nests seems to be reasonably effective, but the fact is, we are not living in the 1930s and broad scale trade war is unlikely.

I am like a broken record on this, but if you do believe that inflation is being overlooked but is coming back to bite us, you must own gold. Yes, it finds it hard to break above $1,350 an ounce, but that day is coming. Load up on anything halfway decent related to gold and I believe you will be highly rewarded.

So, in summary we have three broad themes to consider: the return of inflation and the breaking of the longstanding bull market in bonds; the relative attractions of biotech stocks to the busted flushes of the social media tin plutocracy; and the likely resurgence of the US dollar for the balance of this year.

As I write the final sentences of this missive, I am looking out at the distant cityscape of Sydney. If in less than 300 years, this land has gone from a wilderness to be the world-beater it is today, just imagine what will happen in the next few decades. It's going to be good!

Happy Hunting!

Jim Mellon

Click here to follow Jim's trades on Twitter

About Jim

Jim is an entrepreneur with a flair for identifying emerging global trends enabling him to build a worldwide business empire. He is amongst the top 10% in the "Sunday Times Rich List" (Britain's equivalent to the Forbes list). He is often described as the British Warren Buffett and he predicted the Credit Crunch of 2007-08 in a book entitled *Wake Up! Survive and Prosper in the Coming Economic Turmoil*. Jim followed this with *The Top 10 Investments for the Next 10 Years* (2008) and subsequently *Cracking the Code* (2012), *Fast Forward* (2014) and, most recently, *Juvenescence* (2017). His monthly "Mellon on the Markets" column in Master Investor Magazine has gained him cult status among investors. He holds a master's degree in Politics, Philosophy and Economics from Oxford University. He is on the Board of Trustees of the Buck Institute in California, a trustee of the Biogerontology Institute, and a Fellow of Oriel College, Oxford.

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BY VICTOR HILL

OPPORTUNITIES IN FOCUS

DEATH OF THE HIGH STREET

WHERE NEXT FOR THE RETAIL SECTOR?

There is a blood bath underway in Britain's high streets – and it's a similar story in the USA. Every week, it seems, another retail brand goes down. Things are changing in the shopping malls too as bricks and mortar retailers respond to the challenge of online shopping. The young are buying lifestyle goods via their smartphones. Families are freshly clicking their five a day from supermarkets. Even the baby boomers book their holidays last-minute online...

The arc of retail history has moved from provincial markets to high streets to out-of-town precincts dominated by big-brand supermarkets to glitzy shopping malls to online shopping...Where does it go from here...?

Do bricks and mortar retailers have any future at all? Is the high street doomed? In fact, is the idea of *shopping* itself dead? Let's call it *spending*. In a prosperous world, people increasingly value experiences over *stuff*. Even supermarkets, a few years ago the stock market darlings, look tainted. It's now time to revaluate our exposure to the retail sector.

That said, as I hope to explain, there is *some* good news for retailers...If people can be persuaded to leave their homes at all in the age of smartphone shopping there is yet hope for bricks and mortar. Therefore, we should not discriminate between retail, eating out and public entertainment. If *spending* is a pleasant and interesting *social* activity, then it could have a future in a digital age...


STORE
CLOSING
store hours

Bonfire of the brands

Toys R Us, Carpetright (LON:CPR), Maplin, New Look, Prezzo... All gone into the dark or tottering on the edge in the first half of March this year. Numerous retailers like **Next (LON:NXT)** have issued profit warnings. An ill wind is blowing down the British High Street and down Main Street in the USA.

Toy tragedy

Toys R Us is a case study in retail failure. After months of agony, the iconic global toy retailer revealed that the game was up. On 14 March Toys R Us announced plans to shut 100 stores in the UK after administrators failed to find a buyer. The next day, after weeks of speculation, the company announced that it will shut or sell all its US stores. The 70-year-old retailer which had shaped the toy industry over recent decades had more than 700 stores and generated about a fifth of all US toy revenues. After filing for bankruptcy in September, the retailer's fate was sealed with a poor Christmas. Stores will not shut immediately, but through an *orderly wind-down*.

The demise of the largest toy retailer in the world marks the end of an era. It will make toymakers in America reliant on **Amazon (NASDAQ:AMZN), Walmart (NYSE:WMT)** and **Target Corporation (NYSE:TGT)** to stock their products. Suppliers had been preparing for the worst in recent weeks, halting shipments after Toys R Us missed payments. **Kohl's (NYSE:KSS), JC Penney (NYSE:JCP)** and **Best Buy (NYSE:BBY)** might pick up some inventory. The liquidation process could also drag down prices, as Toys R Us offers steep discounts to get rid of inventory. Great news for kids, of course...

Toys R Us had been restructuring its debt burden for years, after pulling off a $7.5 billion leveraged buyout in 2005. The company was spending more than $250 million a year servicing its $5 billion in long-term debt. Toys R Us had tried to use its Chapter 11 protection as an opportunity to free itself from the clutches of its venture capital lenders. The company took a $3.1 billion loan to keep stores open and announced plans to raise employee wages and invest in technology...But it was all in vain.

"AN ILL WIND IS BLOWING DOWN THE BRITISH HIGH STREET AND DOWN MAIN STREET IN THE USA."

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What has gone wrong for bricks and mortar retailers?

There are basically four key drivers.

First and foremost, and most obviously, bricks and mortar retailers are losing business to their online rivals. Nothing seems to be able to slow the rise and rise of internet shopping. In this space Amazon continues to sweep all before it. In the USA e-commerce is growing at about 15 percent per annum while sales for bricks and mortar retailers are growing at between one and two percent. The UK figures are of a similar order.

Second, bricks and mortar retailers have been highly leveraged, especially since the financial crisis. For a time they have been able to carry a heavy burden of debt given near-zero interest rates. This has been accentuated by a number of high profile leveraged buyouts in the sector. As interest rates trend back up again, such highly leveraged companies will find it more challenging to service their debt. Refinancing of outstanding debt will also become more difficult.

Third, bricks and mortar retailers have not been able to trim their costs sufficiently. This is partly the fault of government – particularly in the UK where large surface retailers pay exorbitant business rates. (Their customers also usually have to pay to park – another deterrent to physical shopping.) Bricks and mortar retailing is also labour intensive so employee costs are a significant factor. As well as wages, retailers have to pay social charges (NICs in the UK) on those wages and, increasingly, pension contributions as well.

A fourth factor specific to the UK is that a weak pound following the Brexit referendum has increased the prices of imported products, especially food. This has put pressure on margins. Retailers – and indeed restaurants – have to maintain high levels of working capital which means that their cost of capital is much higher than service providers.

"IN 2005 WALMART ACCOUNTED FOR 10 PERCENT OF TOTAL RETAIL SALES IN THE USA. THAT MARKET SHARE HAS NOW FALLEN TO HALF THAT LEVEL."

Table 1: Comparison of Amazon and Walmart

Amazon		Walmart
Jeff Bezos	CEO	Doug McMillon
1994	Founded	1962
$673 billion	Market Capitalisation	$300 billion
$177.9 billion	2017 Sales	$485.14 billion
541,900	Employees	2.3 million
18%	Online Market Share (USA)	9%

Walmart: a case study in surviving digital competition

Walmart (NYSE:WMT), the largest retailer in the world by most metrics, is under huge pressure from Amazon; but the internet giant is not going to have everything its own way. The Incredible Hulk of global retailing, which started out with Sam Walton's *Five and Dime* store in Bentonville, Arkansas in 1945[i], has realised that it cannot rely on the older, rural demographic which powered its growth for decades. It knows that it has to attract younger, more affluent customers.

In 2005 Walmart accounted for 10 percent of total retail sales in the USA. That market share has now fallen to half that level. But while Walmart has closed many less well performing physical stores, it has beefed up its online presence and now accounts for about nine percent of all online sales in the US as against Amazon's 18 percent. At the same time the giant has set out to buy up fashion brands such as the men's fashion retailer Bonobos and premium fashion brand Lord & Taylor. Such brands are now available on Walmart's online portal which seeks to offer a *specialised and premium shopping experience*.

Walmart is entering the e-book market in alliance with the Japanese company **Rakuten (TYO:4755)**. Its e-readers will soon be available both at its physical stores and online. Another joint venture with Rakuten will roll out an online grocery delivery service in Japan.

Caught in the crossfire between Amazon and Walmart is another venerable American retailer – **Target Corp. (NYSE:TGT)**, founded in Minneapolis in 1903. The perception is that the company has stopped innovating and its e-commerce platform is well behind Walmart's. Moreover, it is not controlling costs as effectively as Walmart.

The core Walmart strategy of *Always Low Prices* may yet win out against the threat posed by Amazon. Walmart fans

"THE CORE WALMART STRATEGY OF *ALWAYS LOW PRICES* MAY YET WIN OUT AGAINST THE THREAT POSED BY AMAZON. WALMART FANS WILL TELL YOU THAT MANY OF THEIR PRICES ARE BETTER THAN AMAZON'S FOR CONSUMER GOODS."

will tell you that many of their prices are better than Amazon's for consumer goods.

New trends in retail technology

One of the least pleasurable parts of a customer's shopping experience is queuing at the checkout. Many retailers, not least the leading UK supermarket chains, have been working on this. Amazon even opened a bricks and mortar supermarket in Seattle which had no checkouts – not even automated ones. Instead, shoppers download an app on their smartphones that, assisted by cameras in the ceiling and sensors on the shelves, tracks customers as they load up their trollies or baskets. Their credit cards are billed automatically as they walk out of the store. Walmart has something called *Scan and Go*. Customers offer their smartphone to a shop assistant who scans it and takes payment for what they have purchased.

Walmart has even delved into the world of virtual reality by buying start-up **Spatialand** in order to build VR products. The ultimate goal is to create virtual stores where customers, equipped at home with VR headsets, can enter virtual stores to do their (virtual?) shopping. Presumably, real goods get delivered thereafter...

We are now pretty familiar in the UK with automated checkouts, which have been installed by all the major supermarket chains. The technology seems

E-commerce's Achilles Heel – logistics

The rise and rise of internet shopping has been facilitated in Europe and America by the availability of cost-effective logistics operators which deliver products from the e-retailers' warehouses to customers' homes. The issue is, however, that while the e-retailers are all thrusting private enterprises, many of the delivery companies who facilitate their existence are often poorly run state-owned and highly unionised bureaucracies, many of which are losing money.

This is certainly true in America. In December President Trump sent an angry tweet (not for the first or last time). His target this time: Amazon – because the US Postal Service, which delivers most of its parcels, according to the President, doesn't charge enough for their service. *Should be charging much more*, the President opined. He has a point: the US Postal Service is losing billions but is underwritten by the American taxpayer.

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Malaysia: Too many malls

Shopping malls in and around Kuala Lumpur are struggling despite overall rising consumer demand in this fast-growing Asian economy[ii]. KL is famous for its many gleaming malls where international fashion brands compete for business. Malls are especially favoured in tropical countries like Malaysia where they offer respite from the oppressive heat outside. But there are now too many of them – and new ones are finding it hard to attract tenants.

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to be getting better – though human help is often required!

America: "An abundance of empty storefronts"

The chairman of **Starbucks (NASDAQ:SBUX)**, Howard Schultz, painted a worrying picture last month of the "abundance of empty storefronts" spreading across US cities, even in "prime A1 locations"[iii]. Property owners now face a structural shift in demand for shops in malls and retail precincts. For Starbucks, which has 14,000 outlets, this could be a chance to secure lower rents for its iconic cafés.

In a memo to staff reported by the *Financial Times*, Mr Schultz said the coffee chain was "at a major inflection point" where landlords across the country would be forced "sooner than later" to lower rents as a result of the shift away from traditional bricks and mortar retailing to e-commerce.

This is bad news for the US retail property sector, which has already been hit by a wave of retail bankruptcies and restructurings. Investor sentiment with regard to this sector is reflected in the wave of investors shorting the shares of listed shop owners in the expectation that they will fall.

Short demand for the top US retail REITs – real estate investment trusts that own retail properties – is more than 8 per cent, according to IHS Markit. In companies such as **CBL & Associates (NYSE:CBL), Pennsylvania REIT (NYSE:PEI)** and **Tanger Factory Outlet Centers Inc. (NYSE:KT)**, more than a fifth of shares have been borrowed to sell short. According to consultancy CBRE, US retail property was the only major asset class to see a fall in value last year owing to fears that internet-based retailers were taking market share.

The shift from physical retailing to e-commerce is not the only problem facing the sector, according to some analysts. REITs which invest in malls have another problem – the saturation in the mid-range casual dining market.

Analysts and agents describe a polarising of the US retail property market. The best located malls continue to prosper but ones in less affluent areas struggle. The economic backdrop is at least supportive, with consumer confidence rising in the US thanks to President Donald Trump's tax reforms. CBRE reports that owners of less attractive malls are devising new features to attract consumers such as pop-up shops, short-term leases and co-working *pods*.

Likewise, consultancy Jones Lang LaSalle says that retailers are "adapting and re-evaluating" their physical retailing space in response to the challenge from e-commerce. Property owners, too, are investing "to create attractive mixed-use destinations for a new kind of consumer".

Prezzo: why branded restaurants are in retreat

For some years **Prezzo**, before it was snapped up by equity house TPG Capi-

A growth sector: gym kit and sports gear

In mid-February the ONS revealed that sales of sports equipment spiked in January, noting "an increased uptake in gym wear". No doubt this had something to do with New Years' resolutions to slim or at least to shed the effects of Christmas excesses. Sales of sports equipment were up nearly eleven percent on a year earlier while food sales were down by nearly one percent. This could be good news for the likes of **Sports Direct (LON:SPD)** and **JD Sports (LON:JD)**. Overall, total retail sales in the UK rose by 1.6 percent in January on the same month of the previous year.

"PEOPLE ARE GOING TO SHOPPING MALLS LIKE BLUEWATER NOT JUST TO SHOP (WHICH THEY CAN DO ONLINE AT HOME) BUT ALSO TO BE ENTERTAINED (IN WAYS THEY CANNOT BE AT HOME)."

tal in 2014 for £300 million, was a solid stock market performer. It was a case study in clever branded restaurant design, offering popular Italian favourites to a trendy younger demographic. In early March it was revealed that it owes banks and suppliers almost £220 million (not least £600,000 to British Gas) and was pleading with landlords to reduce its rents so that it could keep on trading. It announced that it was planning to close 94 of its 300 or so restaurants.

It seems that costs have exploded, not least the wage bill, with many of its staff on the Living Wage (now at £7.83 per hour) and food costs rising due to the weak pound. At the same time, revenues have flat-lined.

Moreover, what seemed like cool design maybe five years ago – dark hardwood tables (no table cloths) upright wooden chairs and benches, spot-lighting, shades of vermillion and terracotta, panelling and maroon hemp walls – now seems gauche. These days you have to either be *authentic* or self-consciously (and wittily) *counterfeit*. There is nothing in-between.

Prezzo's sister Tex-Mex chain **Chimichanga** is also facing the axe. Burger chain **Byron** and **Jamie's Italian** (the food of which is more Essex than Umbria) have also been forced into Company Voluntary Arrangements (CVAs) this year. Restaurants carry huge fixed costs and small changes in taste and sentiment can kill footfall. A recent report[iv] revealed that over 11,000 restaurants in the UK are in "significant financial distress".

That said there is one branded restaurant chain which has established a niche presence very rapidly. Hickory's Smokehouse is a Texas-inspired chain of authentic Southern steakhouses which was founded by Neil McDonnell. It now operates seven themed smokehouses across England's West Midlands inspired by the barbeque shacks of the Lone Star State. It offers no-nonsense tasty American food with good family-friendly service. The chain celebrates good meat – ribs, brisket, steak, chicken and pulled pork – all offered with tangy barbeque sources. The business turns over about £14 million with 650 employees. Watch out for a listing down the road.

Britain's shopping malls – something is afoot

One of the most successful UK shopping malls is **Bluewater** in Kent, famous for its outstanding architecture, design and natural light. Bluewater is owned by Lend Lease Retail Partnership (25%), M&G Real Estate (17.5%), GIC (17.5%), Royal London Asset Management (7.5%), Aberdeen Asset Management (2.5%) and **Land Securities Group (LON:LAND)** (30%). The latter is reckoned to be the largest commercial property company in the UK.

Five years ago, Bluewater sold itself as a designer fashion brands paradise. And the leading fashion brands are still there – **Superdry (LON:SDRY), GAP (NYSE:GPS), H&M (STO:HM), Marks & Spencer (LON:MKS), Laura Ashley (LON:ALY), Zara** (owned by **Inditex SA (BME:ITX)), Topshop (owned by Arcadia Group (private), Ted Baker (LON:TED)** – though some have retreated. But we now seem to be post peak-fashion. People are going to shopping malls like Bluewater not just to shop (which they can do online at home) but also to be entertained (in ways they cannot be at home).

First there is the multiplex **Showcase Cinema** (ten screens); secondly there are trendy coffee shops like **Nespresso** where you can dissect the movie afterwards with friends. Thirdly, there are car showrooms, not least **Tesla (NASDAQ:TSLA)**. If you want to test drive a Tesla you can do so on the spot as they have their own track around the complex. **Hyundai (KRX: 005380)** is also present.

The *halo effect*

The *halo effect* is when stores with a strong physical presence in shopping malls attract visitors who then later purchase at the store online. It is obviously difficult to measure this effect but it is clear that an attractive physical store helps to generate brand awareness. Physical and online shopping are not binary, anyway – an estimated 85 percent of purchases involve a visit to a physical outlet. The **John Lewis Partnership** offers purchasers the chance to buy online and then to collect at the store. Supermarkets also report increasing use of their *click and collect* services.

Now, buying a car is not usually considered "shopping" because it's something we only do infrequently. But you might be surprised (I was). Some analysts think that here in the UK the average person changes his or her car every 24 months – that's actually more frequently than we change our mobile phones![v] This is in part due to the popularity of PCP (Personal Contract Purchase) agreements where punters

A three-way shopping mall takeover battle

Hammerson PLC (LON:HMSO) owns 22 shopping centres across Europe and 15 retail parks, and has sought to create diversified shopping environments where shoppers are offered a range of retail opportunities as well as interesting things to do. As recently as 2015 fashion shops accounted for 40 percent of total lettings but that figure is now down to just one third. **Volkswagen AG (ETR:VOW)** opened its first shopping centre store in [Bullring & Grand Central Shopping Centre](), Birmingham. [Treetop Adventure Golf]() is due to open at the [Highcross Leicester]().

Interestingly, the company reckons that about half of the international visitors to its shopping centres are Chinese. Shopping is a major driver of tourism. At the end of February Hammerson announced profits up by 6.8 percent to £246.3 million with a 98 percent occupancy rate. Footfall rose by 0.4 percent to 675,000 and rents rose by 7 percent to £370.4 million.

The company's shares had been under downward pressure because of fears that its takeover of rival **Intu Properties PLC (LON:INTU)** would expose it further to the risk of losing business to online retailers. However, its shares jumped by 24 percent on 19 March after it revealed that it had received a £4.9 billion takeover offer by French rival **Klépierre SA (EPA:LI)** which operates about 100 shopping centres in 16 countries – though not in Britain. The French offer values the business at 615p a share – they are trading at around 550 pence as I write.

Klépierre is trying to thwart Hammerson's £3.4 billion tie-up with Intu which would create Britain's biggest property company. The deal, announced last December, would bring together Hammerson's Bullring shopping centre in Birmingham and Brent Cross in London with Intu's [Trafford Centre]() in Manchester.

pay a monthly fee, as they would with a mobile phone contract. (The water is muddied because that statistic covers both new and used cars.) But if there are shops selling mobile phones in shopping malls, there should also be shops selling cars. Why should we be forced to drive over to a grotty forecourt on the other side of the by-pass when we can peruse our motoring options in the air-conditioned comfort of a shopping mall like Bluewater?

Increasingly, high-end shopping malls offer *brand showrooms* to well-known service providers, though sometimes for just a few short months before they close again. For example, **Eurostar** sometimes operates a shop in Bluewater to promote services to Europe from nearby Ebbsfleet International.

Glynsimages2013 / Shutterstock.com

How the *war on plastic* could help bricks and mortar retailers

National Treasure Sir David Attenborough's magnificent *Blue Planet II* TV series last year concentrated minds on the awful problem of plastic waste in the world's oceans. In January the UK government announced a crack-down on plastic packaging, extending the compulsory charge for plastic bags to small retailers and encouraging supermarkets to roll out *plastic-free* aisles.

Recently the United Nations passed a resolution calling for all plastic packaging to be recyclable by 2030. Moreover, the easy option of exporting our plastic waste to China for re-processing is no longer available since China banned the import of waste materials. Retailers in the UK and elsewhere are being forced to face up to the plastic problem. Earlier this year, British frozen food retailer **Iceland (private)** was the first supermarket to pledge to eliminate all plastic packaging for its own-brand products within five years.

These are good days therefore for companies that make alternatives to plastic packaging. **[Vegware]()** makes plates, cutlery and even food containers from vegetable, compostable materials. Last year it achieved sales of £20 million. **[James Cropper PLC (LON:CRPR)]()** has developed a wood pulp based rigid material called *Colourform* that can be moulded into any shape.

[Powerhouse Energy Group PLC (LON:PHE)]() has developed a process for turning plastic into gas that can be used to generate electricity or converted into hydrogen and carbon monoxide which both have industrial uses. They convert waste plastic or tyres into granules which are then made into gas

Department stores are also re-inventing themselves

BHS, an iconic department store presence, collapsed in 2016 with the loss of 11,000 jobs. Yet a few stalwart department stores are keeping their heads above water. The **John Lewis Partnership** appears to have the lead over **House of Fraser** (owned by **Nanjing Xinjiekou Department Store Co. (SHA: 600682)**) and **Debenhams (LON:DEB)** according to some analysts. **Fenwicks**, a family owned group with eleven flagship stores, was forced to close its Windsor branch in 2017 blaming "the ravages of online shopping". And yet they managed to open a new 80,000 square foot store in nearly Bracknell, Berkshire. Increasingly, these veteran department store brands in the UK offer add-on activities to keep the customer in the store: Champagne bars, yoga classes, pampering sessions… Once again, the trend is to offer people interesting things to do.

"BRICKS AND MORTAR RETAILERS WITH A STRONG ONLINE PRESENCE SUCH AS WALMART AND JOHN LEWIS ARE FIGHTING BACK."

under high temperatures. It is a *closed cycle process* which creates zero CO2 emissions.

All this puts pressure on high-volume retailers, especially the supermarket chains, to raise their game in recycling. Surely the next step should be that supermarkets provide recycling facilities for both plastic packaging and food waste. The question is of course: who pays? That could be a case for state intervention.

Supermarket blues

I'm not going to analyse the UK supermarkets here because that will be the subject of another article later in the year. Just to say for now that the most successful supermarket in Britain today is a German one – ALDI, of course!

Getting back to basics

Deep in the British psyche there is a classic, perfect high street, brimming with drapers, bakers, fishmongers, butchers, haberdashers, tailors and dressmakers who are all addressed by name...That idyllic high street boasts three or four fine taverns and the nation's much-respected banks are represented by stolid, ornate buildings... That high street now only exists in costume dramas: it is gone – and it is never coming back.

The modern provincial British high street, in contrast, is a dismal place: a motley row of betting shops, nail bars, kebab shops, estate agents, charity shops, the odd convenience store, a Turkish barber and a struggling vape shop. And even they are under threat. In fact, about 15 percent of high street shops are boarded up in Southern England – and it's even worse in Scotland. Pedestrianisation, which seemed such an advance in the 1990s, has only contributed to the sense of bleak decline. (Especially since car ownership in Europe and America is in decline amongst the younger demographic.) And no number of government initiatives, spearheaded by minor TV celebrities, is going to turn this around.

But if you visit the new urban villages – *The Lanes* in Brighton, Winchester town centre, Manchester's *Canal Side*, London's Camden Market – there is the buzz generated by young people on a day or night out and, of course, tourists breathing in a cultural experience.

Historically, shopping was a social activity. Look around the provincial market towns of England, Germany or Italy (where many towns still contain their original market squares). For hundreds of years in Europe people have been going to the weekly market in order to trade, to buy food, to do business, to gossip and to eat together. Attending the market was, and still is, essentially a social activity. The wonderful covered food markets of France and Spain are also places to learn about local produce, to taste and to experiment.

In these days of heightened environmental consciousness there are signs of a revival in the original market concept. Many provincial British towns offer weekly *farmers' markets* where one can buy organic meat, economical vegetables and cheeses one did not know existed...

There are a few remaining business models which cannot be delivered online – hairdressers, nail bars, osteopaths, opticians – though even these services have analogue business models where hairdressers, for example, can visit a client's home. But virtually all services can be delivered through cyberspace: accountancy, travel agencies – even those of funeral directors.

High streets will revert overwhelmingly to residential use while shopping malls are becoming places people go to do much more than just shopping.

Action

The High Street stroke Main Street is dead. Long live the internet. You should certainly have some exposure to Amazon, **eBay (NASDAQ:EBAY), Asos (LON:ASC), Boohoo (LON:BOO)** and the rest – but they won't have it all their own way. As discussed, bricks and mortar retailers with a strong online presence such as Walmart and John Lewis are fighting back. In this category we should also count Argos (owned by **J Sainsbury (LON:SBRY)), Boots (NASDAQ:WBA), Mothercare (LON:MTC), M&S (LON:MKS)** and **Tesco (LON:TSCO)**. Canny commercial property firms with outstanding, well-run shopping malls offering a range of activities such as **Hammerson**'s **(LON:HMSO)** and **Land Securities' (LON:LAND)** should continue to perform even as certain REITs suffer from too much exposure to the retail sector. Finally, for me at least, branded restaurants are off the menu.

About Victor

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

i The store now serves as the Walmart Museum.
ii See: https://www.ft.com/content/aac69526-25dc-11e8-b27e-cc62a39d57a0
iii See: https://www.ft.com/content/12953532-1263-11e8-a765-993b2440bd73
iv Begbies Traynor Red Flag Alert. Available at: https://www.redflagalert.com
v See: https://www.imperialcarsupermarkets.co.uk/blog/317/People-change-their-car-more-often-say-cap-hpi


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BY CHARLOTTE RANSOM, FOUNDER & CEO OF NETWEALTH

CONTROL THE CONTROLLABLES

FOUR THINGS YOU CAN CONTROL WHEN INVESTING

It is natural to spend a considerable amount of effort trying to shape our own and our family's futures – where we will live and work, our children's education, when we would like to retire and how to pay for those later years. Yet many of the factors which shape our life's trajectory are beyond our influence. These include the social and political landscape, the economy, the resilience of companies and the workplace, the evolution of technology and automation and the whims of the housing market.

We face a similar quandary when it comes to our investment strategy; there are things we can control, and those we cannot. One of the key things we emphasise to our clients is to focus on the 'controllables', the factors we can affect with some degree of authority. In addition, we should be mindful of the circumstances where we have less of a say and factor that into our investing behaviour.

Things we can't control

Several aspects over which we have no control will have an impact on the outcome of our investments.

Market performance and volatility

It is impossible to predict with accuracy when shares or bonds will move up or down because the drivers of such potential swings are so numerous and varied.

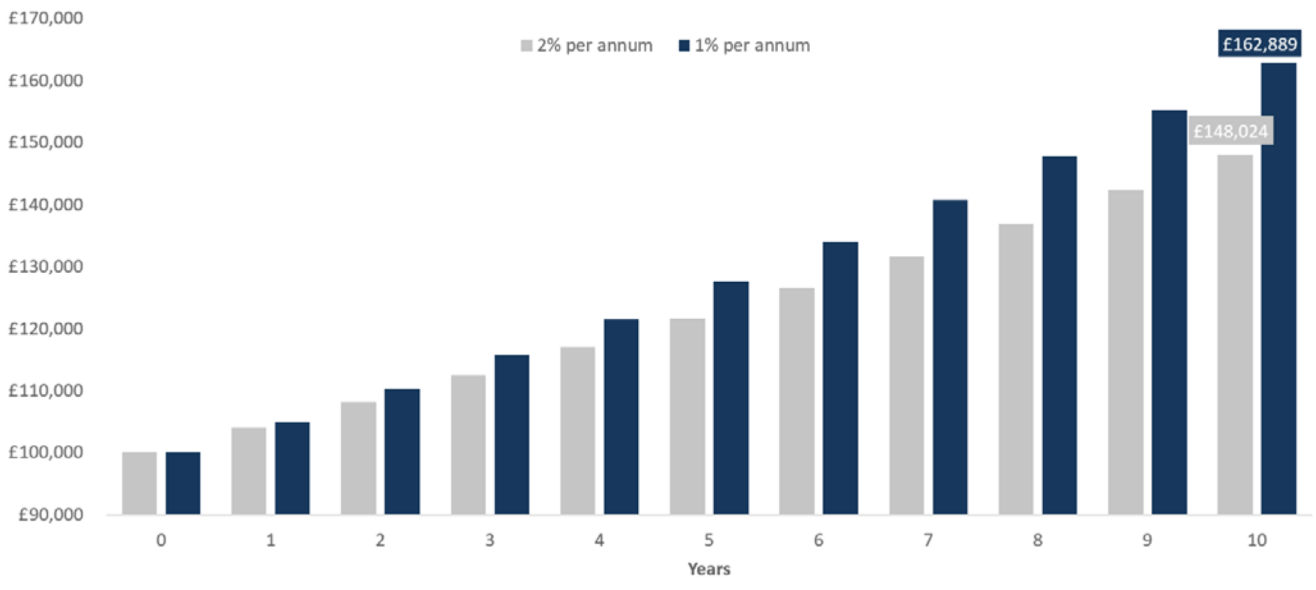
Markets can be affected by shifting economic fundamentals, such as growing or falling GDP, or interest rate decisions. Specific sectors can also act as a catalyst for the market overall, elevating certain companies, or dragging them down as we have recently seen with technology stocks. Sentiment

About Charlotte Ransom

Charlotte founded Netwealth in early 2015. Having started her career at JPMorgan she spent 20 years at Goldman Sachs, serving as a Partner for 10 years. Her leadership roles spanned relationship management, marketing and product development in the Securities Division. From 2006 to 2011, Charlotte was head of Institutional Wealth Management and the Market Solutions Groups for Europe, Middle East and Asia in the Investment Management Division. From 2012, she explored the impact of digital technologies on a variety of industries before founding Netwealth in 2015.

Charlotte is a Vice President of Save the Children and a recipient of the 2015 Mary Lou Carrington Award for her work with Speakers for Schools. She is an active donor and supporter of overseas educational projects, including literacy in Bhutan and early childhood care and school-building in Uganda and Rwanda. Charlotte read modern languages at Bristol University and holds the CISI Private Client Investment Advice and Management qualification.

The Compounding Value of Saving 1% in Fees



Source: Netwealth. Assumes gross investment returns of 6% per annum.

often punches above its weight, too, whether the basis for this feeling is real (the potential for a trade war) or less tangible (the euphoria of a successful IPO).

And we should bear in mind political shocks, armed conflict, so-called black swan events, irascible tweets… the list goes on. So, while we can all agree that markets will be affected by any number of events, trying to forecast them is an overwhelming task.

Inflation

Over time, prices generally rise, as does our spending. But we can't say with any great certainty by how much inflation will increase in a given year or timeframe. What we do know, is that the UK's Retail Price Index has been negative in only one year since 1958.

The rate of inflation can have a meaningful impact on the income or returns we aim to generate from our investments. For example, if we are looking to define future cash flows for our retirement, or we are working out the cost of education for children over a 10 to 15-year period, those future cash flows will rise at a very different pace depending on the level of inflation. The good news, however, is that we can model for the impact of inflation even if we aren't able to control it.

How long we live

We are increasingly living longer. According to the ONS, the average life expectancy of a 30-year old woman in the UK today is 90. They have a 1-in-4 chance of reaching 99. Men lag slightly behind, but the gap is closing. It's likely that many children born in the coming years will be expected to live to 100.

These are general statistics; however, the trend is for greater longevity and we need to plan for it. While we cannot know for certain how long we will live, it is helpful to assess the cost of living for longer and to ascertain whether our investments can cater for those potentially long-term cash flows.

Things we can control

For many top athletes and those driven to succeed, a common mantra is to "control the controllables". This helps them to rigorously concentrate on their key objectives. We can take a similar approach with investment goals. While it is important to understand and to model for the impact of those aspects of investing that are beyond your control, focusing on the things you can influence is a smarter way to invest for the long term.

Minimise fees

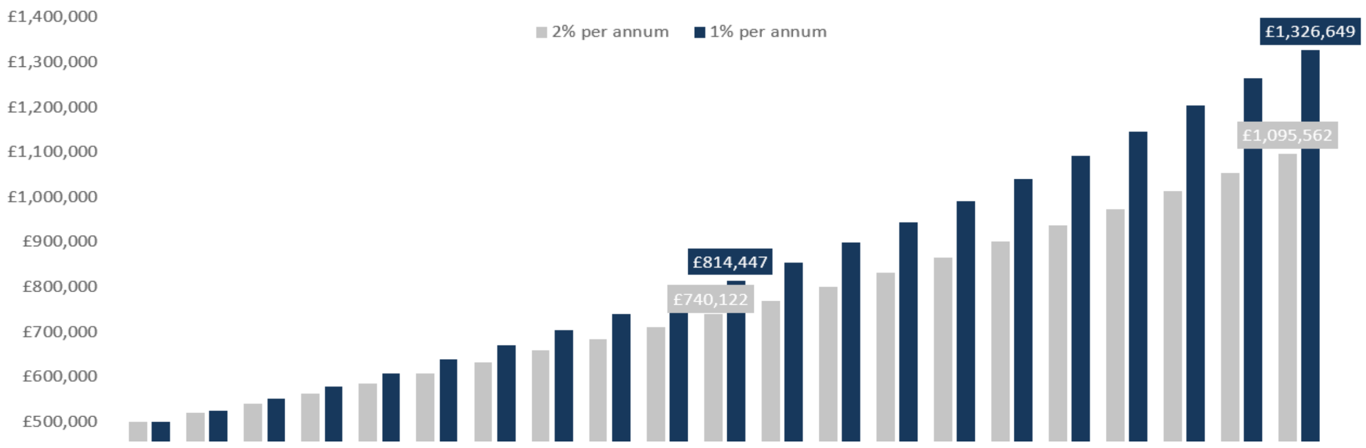
While paying fees to manage your money is unavoidable, these charges are controllable and can make a big impact. At first glance, a low percentage saving in charges may seem negligible to many investors. However, over time, the effect of paying 1% less in fees can make a dramatic difference to an investment pot.

Over 10 years, for example, you could be almost £15,000 better off for every £100,000 invested if you saved 1% in fees by using a more competitive wealth manager such as Netwealth.

Clearly, the impact of this 1% fee saving per year scales up as the amount of investment grows. Below we show the impact on a £500,000 investment over 20 years.

> **"OVER 10 YEARS YOU COULD BE ALMOST £15,000 BETTER OFF FOR EVERY £100,000 INVESTED IF YOU SAVED 1% IN FEES."**

The projected value of £500,000 invested over 20 years



Source: Netwealth. Assumes gross investment returns of 6% per annum

Make use of tax wrappers

Putting your savings in a tax-free wrapper such as an ISA can greatly improve your net returns. For example, £100,000 invested for 10 years could be worth £127,000 when subject to the higher rate of income and capital gains tax. Yet if this money is invested in an ISA – tax free – it could be worth £153,000, nearly double the total return on investment. (Assumes long-term median expected returns investing in a Netwealth Risk Level 6 portfolio, with marginal tax rates of 40% on income and 20% on capital gains.)

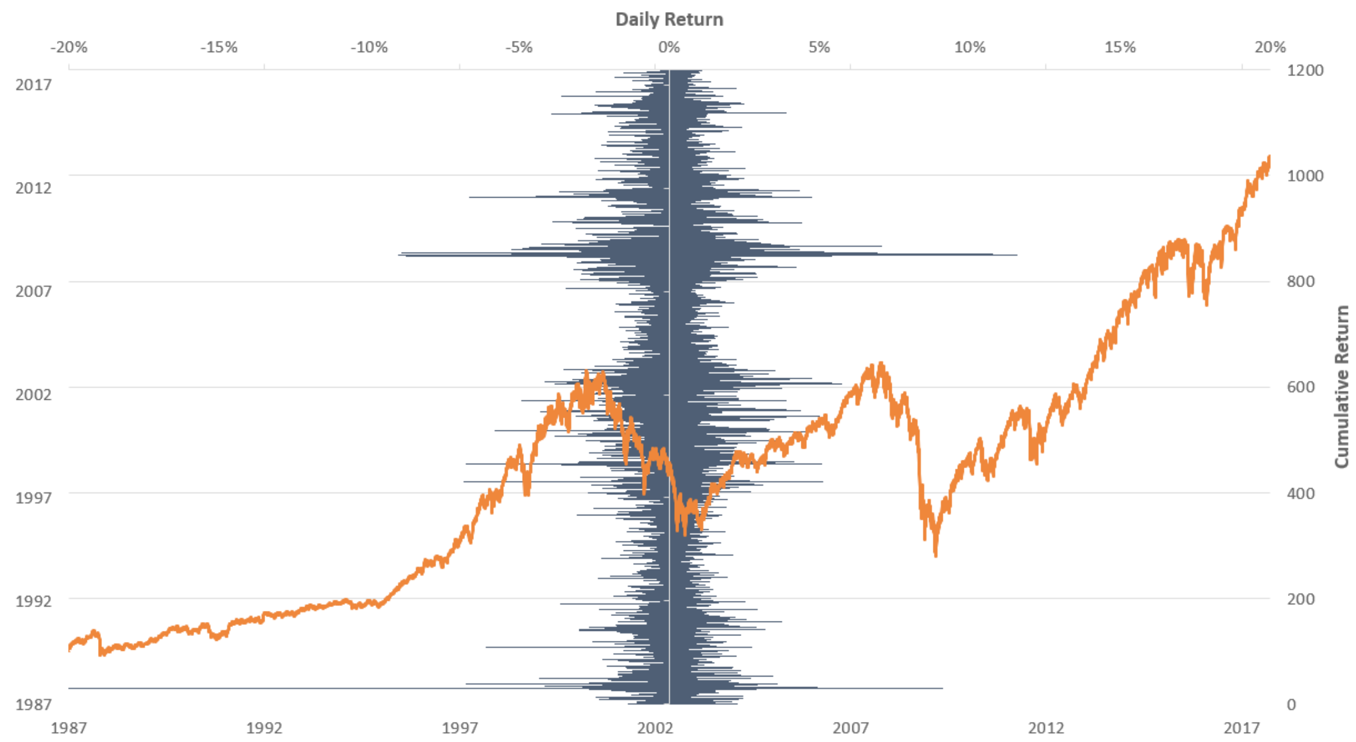
Spend time in the market

Spending time invested and not trying to time the market is another golden rule of investing, for good reason. Market timing is difficult and can be extremely costly. For example, since the start of 1987 the S&P 500 produced total returns in dollars of 933%. Yet if you missed the top 10 trading days over this 30-year period you would be up less than half this amount at 399%.

The chart below clarifies the benefit of staying invested over the long term and the difficulty of timing the market. The orange line represents the long-term performance of US equities, and the central blue bars represent daily moves, highlighting how hard it is to know the right time to react, based on daily changes. We advocate investing for the long term, in a risk level that you are comfortable with, so that you can ride out the day-to-day volatility of markets.

Be suitably diversified

Over time different asset classes deliver different levels of returns – and it's almost impossible to predict reliably which assets will perform well and when. The point of a diversified port-



Source: Bloomberg, Netwealth. Cumulative total returns and daily returns of the S&P500 since 31st December 1986.

Visit Netwealth >

folio is that it reduces extremes and smooths the path of returns. As an individual investor it can be difficult to construct a suitable diversified portfolio cost-effectively, or to find the time to do so, which is why so many look to wealth managers to run diversified portfolios on their behalf. This can be particularly effective if it forms the core of an overall portfolio strategy, allowing for the individual to construct other 'satellite' investments as a complement.

To conclude

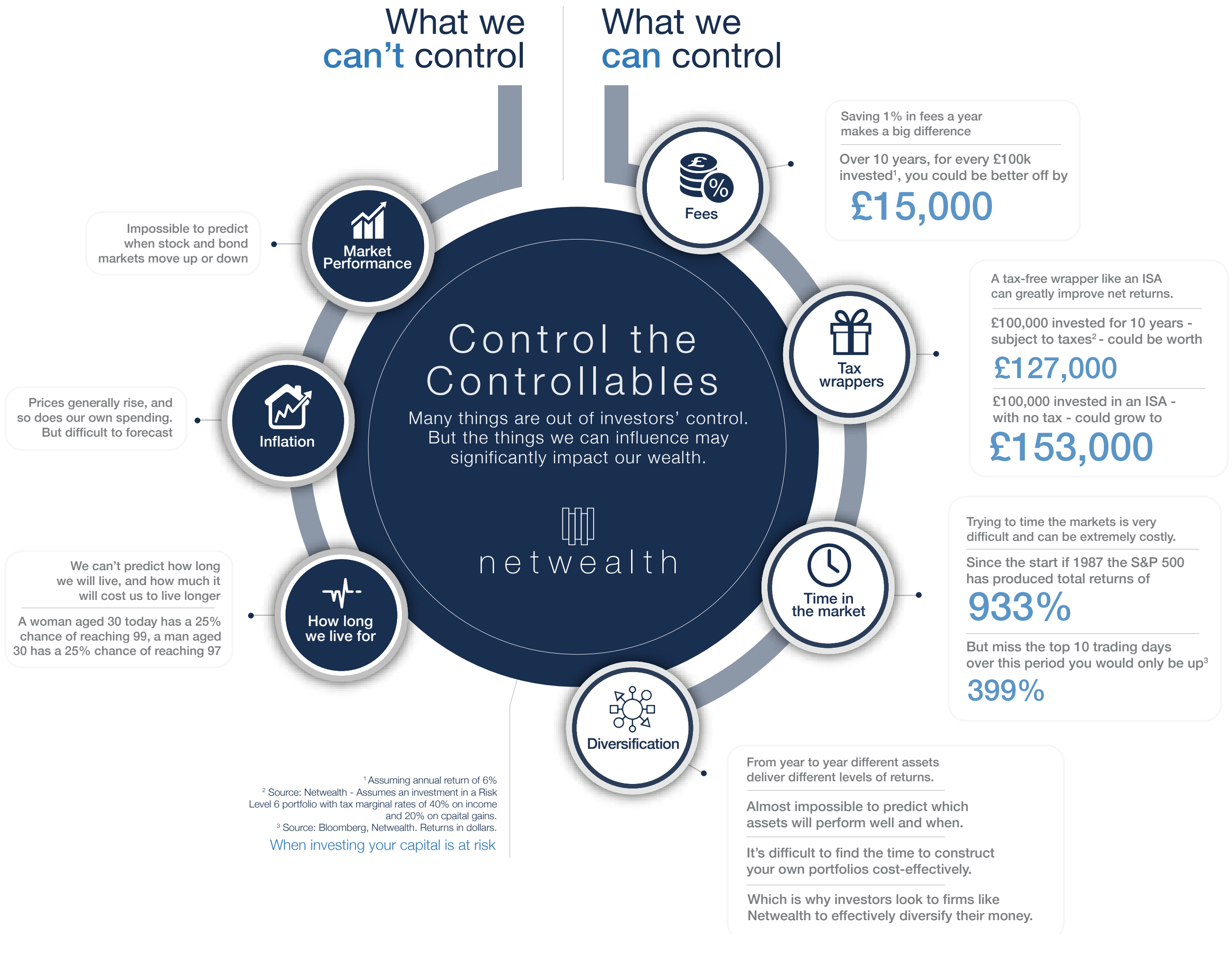
It is only natural for us to want to be in control; its absence can make us feel dislocated and uncomfortable. While we may not be able to control the 'uncontrollables', they can be frequently assessed and stress-tested, so action can be taken where necessary. However, those factors that are very much within our control – fees, tax wrappers, staying invested, being diversified – can have a huge impact on investment outcomes. To focus on these is time well spent. Please remember that when investing your capital is at risk.

What is Netwealth?

Netwealth is a wealth management company that combines the best elements of a superior discretionary service with all the benefits of a technology enhanced approach. The Company has brought together a highly qualified team, a robust investment framework and a comprehensive offering.

Netwealth focuses on the key aspects of investing: the team and process that guide the investments, security of the assets, the costs associated with the service and the technology and transparency underpinning it. By concentrating on these elements, clients have the best chance of achieving their financial goals.

> **"PUTTING YOUR SAVINGS IN A TAX-FREE WRAPPER SUCH AS AN ISA CAN GREATLY IMPROVE YOUR NET RETURNS."**



BY NICK SUDBURY

FUNDS IN FOCUS

TAKE COVER IF YOU WANT YOUR DIVIDENDS TO BE SAFE

Income investors are naturally drawn to the highest yielding shares, but it is the sustainability of the income that will determine whether or not it turns out to be a good investment. This could be a serious problem as the level of dividend cover, which measures the ratio of company earnings to the amount paid out in dividends, is lower than it was at the height of the financial crisis ten years ago.

Research by the broker AJ Bell found that the FTSE 100 companies are forecast to pay a total of £88.5 billion in dividends this year, a 7% increase on the total forecast pay-out for 2017. This gives the shares an attractive average expected yield of 4.3%, although the actual income could turn out to be lower.

If domestic profits come under pressure as a result of Brexit, or there is a slowdown in global growth that affects the money generated from overseas markets, there is not much wriggle room as the average dividend cover is just 1.63 times earnings. Most analysts like to see earnings twice the size of the dividends so that the company can maintain its distribution and continue to invest in the business even during a sudden and unexpected downturn in trading.

Companies that ignore this sort of safety margin run the risk of having to reduce or scrap their dividends when they encounter problems. There have been plenty of recent examples, including the publisher Pearson and the doorstep lender Provident Financial, both of which suffered sharp falls in their share price as a result.

The danger is more acute than it appears as the ten FTSE 100 companies with the highest forecast yields have an average level of dividend cover of just 1.37 times earnings. These include: BP, Direct Line and Centrica. The dividend cover at lower yielders like Vodafone, HSBC, Admiral Group and St. James's Place also looks stretched.

Smooth operators

You can reduce the impact of a dividend cut on your income and capital by investing in a diversified fund, especially if you use an investment trust. Many of these pay quarterly dividends and by combining three

Dividend Cover

Dividend cover is the annual profit a company makes divided by the total dividends paid to its shareholders. A figure of 2 or above is considered ideal as it means the profit is twice the dividend so there is plenty of scope to maintain the distribution in a poor year.

"FTSE 100 COMPANIES ARE FORECAST TO PAY A TOTAL OF £88.5 BILLION IN DIVIDENDS THIS YEAR, A 7% INCREASE ON THE TOTAL FORECAST PAY-OUT FOR 2017."

"INVESTORS WHO WANT A RISING INCOME AND LONG-TERM CAPITAL GROWTH SHOULD PROBABLY START BY LOOKING AT INVESTMENT TRUSTS OPERATING IN THE UK EQUITY INCOME SECTOR."

or more into a portfolio you should be able to achieve a reliable monthly income.

UK domiciled open-ended funds like OEICs and unit trusts are legally required to distribute all of the income that accrues in the portfolio during the course of their accounting year, so if some of their holdings run into problems and reduce their dividends, the total paid out by the fund could be lower than the year before.

Investment trusts have much more flexibility as they are allowed to retain up to 15% of their annual income. This is added to their revenue reserves, which can be used to smooth the annual dividend payments from one year to the next so as to produce a steadily increasing stream of income for their shareholders.

Investors who want a rising income and long-term capital growth should probably start by looking at investment trusts operating in the UK Equity Income sector. Calculations by the AIC using data from Morningstar show that £100,000 invested in the average fund in the sector on 31 December 1997 would have generated an initial annual income of £3,831.

The income would have grown every year over the subsequent 20 years and in 2017 would have been £8,951 bringing the total dividends over the period to £125,122. This represents an average annual increase of 4.6%, which is well ahead of the RPI inflation figure of 2.8%. The capital value would also have doubled to £200,744.

Fifty years and counting

According to data from the AIC, there are now 21 investment trusts that have successfully increased their dividends for at least 20 consecutive years. Four of these have done so for an incredible 50 years or more, including the **City of London Investment Trust (LON:CTY)**, which operates in the UK Equity Income sector.

The £1.4 billion fund has been managed by Job Curtis since July 1991 and he has consistently added to the revenue reserves in good years for dividends and has always paid any special dividends straight into the reserves. Despite this it is one of the tightest in terms of dividend cover with reserves equivalent to 82% of the current year's distribution, although the strategy has still been sufficient to allow him to increase the annual payout in the seven more difficult years when this would otherwise have been impossible.

Curtis concentrates on companies with attractive, sustainable dividends that have enough cash left over to invest in the business to grow the dividends in the future. In the fund's last financial year, he was able to increase the total distribution by 5% and he thinks the outlook for dividends in the portfolio is improving. About 70% of the assets are invested in FTSE 100 companies with the largest positions including the likes of BAT, Unilever, Diageo, Shell, BP, HSBC and Lloyds Bank.

City of London is the largest investment trust in the UK Equity Income sector, but its recent performance has been hindered by the collapse of Provident Financial, which accounted for 1% of the fund's assets at the end of last June. Despite this it was still able to report a 9.5% increase in earnings per share in its half-year accounts to the 31st of December. The shares are currently trading close to their NAV and are yielding an attractive 4.2% with quarterly dividends paid in February, May, August and November.

Another investment trust with an unblemished 50-year record is the £1.5 billion trust **Caledonia (LON:CLDN)**, which operates in the global sector. It has about a third of the portfolio in listed stocks, a third in unquoted or private equity investments and the rest in funds or cash. CLDN aims for both capital growth and income and is yielding just over 2%.

The other two members of the elite 50-year category are **Bankers (LON:BNKR)** and **Alliance Trust (LON:ATST)** with yields of 2.2% and 1.8% respectively.

Dividend heroes

There are several high yielding investment trusts in the UK Equity Income sector that have increased their dividends for more than twenty successive years with one example being the £500 million **Murray Income (LON:MUT)**. It has been managed by Charles Luke since October 2006 and aims to achieve a high and growing income combined with capital growth.

Luke has put together a diversified

FUND OF THE MONTH

Last year was a difficult one for the **Edinburgh Investment Trust (LON:EDIN)**, with the fund generating a share price return of less than 2%, and it remains massively out of favour with the shares trading on a 9% discount to NAV. Its manager, Mark Barnett, who took over from Neil Woodford in January 2014, agrees with his predecessor's view that many domestically-oriented UK stocks have been unjustifiably written down and that this negative sentiment will unwind, although it has unquestionably hurt the short-term performance.

Barnett aims to add significant value by owning businesses that are undervalued by the market and that are able to deliver dividend growth, which ultimately drives positive total returns over the long-term. He is concerned about the valuation of certain parts of the market and has sought to limit the downside risk by investing in "uncorrelated" stocks to protect the portfolio in the difficult market conditions that he thinks may be ahead.

The £1.25 billion fund provides exposure to a concentrated 46-stock portfolio with the largest holdings including the likes of British American Tobacco, BP, Legal & General, BAE Systems and AstraZeneca. Over the last 10 years the shares have returned 131% and they are currently yielding 4.2% with quarterly distributions that are in the process of being evened out.

If Barnett is right and the fears over Brexit are found to have been overdone, the portfolio would be well placed to benefit. In the meantime, investors can continue to enjoy the attractive yield that is backed up by substantial revenue reserves equivalent to 1.44 years of dividends with the downside capital risk limited by the 9% discount to NAV. They can also take comfort from the fact that the fund has increased its annual dividend for 12 consecutive years.

Fund Facts

Name:	Edinburgh (LON:EDIN)
Type:	Investment Trust
Sector:	UK Equity Income
Total Assets:	£1.5 billion
Launch Date:	March 1889
Current Yield:	4.2%
Gearing:	9%
Ongoing Charges:	0.6 %
Website:	www.invescoperpetual.co.uk

62-stock portfolio with none of the holdings accounting for more than 4.4% of the assets. He is cautious about current valuations and favours companies whose market positions, competitive advantages and balance sheets give them the best opportunity to prosper over the longer term. His largest positions include the likes of Unilever, BAT and AstraZeneca.

Murray Income has increased its dividend each year for the last 44 years and is currently yielding 4.3% with quarterly distributions in January, April, July and October. It has revenue reserves sufficient to pay an entire year's dividend with money left over. The fund has returned just under 100% over ten years and the shares are trading on an 8% discount to NAV.

The £520 million **Merchants Trust (LON:MRCH)** is yielding an even more attractive 5.1%, which it achieves by investing in higher yielding UK equities. Its manager, Simon Gergel, who has been in place since June 2006, is a value investor and has been gradually increasing his exposure to undervalued domestically focused stocks that have been written down because of the possible impact of Brexit.

"MURRAY INCOME HAS INCREASED ITS DIVIDEND EACH YEAR FOR THE LAST 44 YEARS AND IS CURRENTLY YIELDING 4.3% WITH QUARTERLY DISTRIBUTIONS IN JANUARY, APRIL, JULY AND OCTOBER."

In recent months he has bought new positions in Barclays, Land Securities and Bovis Homes, whilst also adding to existing allocations to Greene King and Kier. The portfolio is less exposed to the highly rated consumer staples sectors such as tobacco, personal care and food producers, where the manager cannot find sufficient value.

Merchants has increased its dividend every year for 35 years and pays quarterly distributions in February, May, August and November. Its revenue reserves would almost be enough to pay a whole year's dividend. The shares are up 91% over 10 years and are trading on a 5% discount to NAV.

JPMorgan Claverhouse (LON:JCH) takes a different approach and invests in a high conviction portfolio of 60 to 80 UK stocks that includes miners like Rio Tinto, oil majors such as Shell and BP, as well as top growth names like the drinks mixer company Fever-Tree.

Sadly, the fund manager, Sarah Emly, died earlier this year and she has been replaced by Callum Abbot who runs other UK equity funds for the company. He joins William Meadon who has been the co-manager since March 2012.

JPMorgan Claverhouse is yielding 3.8% with quarterly distributions in March, June, September and December. It has extensive revenue reserves equivalent to 1.39 times the annual dividend. The shares have returned 113% over 10 years and are currently trading close to NAV.

About Nick

Nick Sudbury is an experienced financial journalist who has written extensively for a range of investment publications aimed at both private and institutional investors. Before moving into journalism he worked both as a fund manager and as a consultant to the industry. He is a fully qualified accountant and has an MBA with finance specialism.

BY FILIPE R. COSTA

THE MACRO INVESTOR

THE IMPACT OF ROBOTICS

WHAT TO EXPECT FROM THE FOURTH INDUSTRIAL REVOLUTION

"One machine can do the work of fifty ordinary men. No machine can do the work of one extraordinary man."

— Elbert Green Hubbard, 1911

The world as we know it is about to change. In less than a few decades, the streets will be filled with driverless cars, the shelves of grocery stores refilled by robots, and our physical condition evaluated by a stainless-steel health provider. But the trend didn't start today. We are already in the midst of a transitional period which is leading us through a Fourth Industrial Revolution, where a large proportion of daily tasks will be accomplished by the use of artificial intelligence rather than human effort.

The mass adoption of computers was the first step. A single machine can process more information in just one second than a thousand brilliant scientists can over their lifetime. Moreover, these computers are becoming intelligent, and are now able to interact with us at several levels. Cortana, Alexa and Siri can play our favourite music, provide us with weather forecasts, and change cooling, heating and lighting conditions at our homes. Robots are replacing us in daily tasks, saving our time, allowing us to concentrate on something else. But if there's nothing left to do, we may end up depriving people of a job. The great fear is that robots pose just as many challenges as the problems they solve. Companies, individuals, and policy officials will all face transitional difficulties. But it is exactly at times of fear and change that the best opportunities arise.

Time for change

Most of us feel excited when faced with a new technology that is capable of doing something we haven't seen before. We often behave like a kid playing on an Xbox or PlayStation for the first time. The unknown always comes with excitement!

But we usually fear the unknown at the same time. The unknown breaks

"THE ROBOTISATION OF THE ECONOMY LEADS TO A NEW PARADIGM, WHICH WILL CHANGE THE WAY WE PRODUCE, DISTRIBUTE, CONSUME, AND INTERACT."

with the past and changes routines. It sometimes comes with disruption. The robotisation of the economy leads to a new paradigm, which will change the way we produce, distribute, consume, and interact. It's a whole new way of organising the economy, and therefore amounts to a Fourth Industrial Revolution, rather than just an upgrade to existing conditions. Robots are coming to replace us!

Productivity increase is a key driver for living standards. But the world has been unable to deliver significant increases in productivity during the last few years. Finding a way to boost such an important metric is one of the biggest challenges economists currently face. The mass use of industrial robots saves time and effort, allowing us to produce a lot more than before with existing resources. This should ultimately translate into a big boost to productivity and living standards.

But, as John Maynard Keynes once posited, "In the long run we are all dead"[i]. The mass adoption of industrial robots will lead to a whole new way of organising production. Many tasks will become much more capital-intensive, freeing up labour. Over the long-run we are expected to achieve what we couldn't before. But in the meantime, unemployment may be created in many areas. As robotisation is not a symmetric process, its impact will be deeper for some tasks and less pronounced for others. Some are likely to lose their jobs while others will likely remain unaffected. It is mainly because of the short-run potential disruption that many of us fear the mass adoption of robots.

"AS ROBOTISATION IS NOT A SYMMETRIC PROCESS, ITS IMPACT WILL BE DEEPER FOR SOME TASKS AND LESS PRONOUNCED FOR OTHERS."

GLOBAL ROBOT SALES IN 2016

Country	Robot Sales	Share of Global Sales	Labour Force	Robot Sales per Thousand Workers
China	87,000	29.6%	787,086,139	0.11
South Korea	41,400	14.1%	27,719,429	1.49
Japan	38,600	13.1%	66,844,110	0.58
United States	31,400	10.7%	162,637,713	0.19
Germany	20,039	6.8%	43,462,037	0.46
Total	294,312	100.0%		

Source: World Robotics Report, International Federation of Robotics

Which professions are the most exposed?

Several research studies have attempted to quantify the disruption expected from the robotisation of the economy. One of the most widely known studies was conducted by two Oxford researchers, Carl Frey and Michael Osborne, in 2013[iii]. They examined the susceptibility of US jobs to computerisation, estimating a proba-

BOX 1 – WHAT IS A ROBOT

There is no single agreed definition for what constitutes a robot. In general, a robot is associated with a task that is completed without human intervention. The International Federation of Robotics (IFR)[ii] supports the International Organization for Standardisation (ISO) definition 8373 of a robot, as being:

1. An automatically controlled, reprogrammable, multipurpose manipulator programmable in three or more axes, which may be either fixed in place or mobile for use in industrial automation applications.

    - **Reprogrammable:** whose programmed motions or auxiliary functions may be changed without physical alterations;
    - **Multipurpose:** capable of being adapted to a different application with physical alterations;
    - **Physical alterations:** alteration of the mechanical structure or control system except for changes of programming cassettes, ROMs, etc.;
    - **Axis:** direction used to specify the robot motion in a linear or rotary mode.

2. A service robot is a robot that performs useful tasks for humans or equipment excluding industrial automation application.

3. A personal service robot or a service robot for personal use is a service robot used for a non-commercial task, usually by lay persons. Examples are domestic servant robots, automated wheelchairs, personal mobility assistance robots, and pet exercising robots.

4. A professional service robot or a service robot for professional use is a service robot used for a commercial task, usually operated by a properly trained operator. Examples are cleaning robots for public places, delivery robots in offices or hospitals, fire-fighting robots, rehabilitation robots and surgery robots in hospitals. In this context an operator is a person designated to start, monitor and stop the intended operation of a robot or a robot system.

OCCUPATIONS WITH THE HIGHEST PROBABILITY OF COMPUTERISATION

Rank	Probability of Computerisation	Occupation
702	0.9900	Telemarketers
701	0.9900	Title Examiners, Abstractors, and Searchers
700	0.9900	Sewers, Hand
699	0.9900	Mathematical Technicians
698	0.9900	Insurance Underwriters
697	0.9900	Watch Repairers
696	0.9900	Cargo and Freight Agents
695	0.9900	Tax Preparers
694	0.9900	Photographic Process Workers and Processing Machine Operators
693	0.9900	New Accounts Clerks

Source: Frey & Osborne (2013)

OCCUPATIONS WITH THE LOWEST PROBABILITY OF COMPUTERISATION

Rank	Probability of Computerisation	Occupation
1	0.0028	Recreational Therapists
2	0.0030	First-Line Supervisors of Mechanics, Installers, and Repairers
3	0.0030	Emergency Management Directors
4	0.0031	Mental Health and Substance Abuse Social Workers
5	0.0033	Audiologists
6	0.0035	Occupational Therapists
7	0.0035	Orthotists and Prosthetists
8	0.0035	Healthcare Social Workers
9	0.0036	Oral and Maxillofacial Surgeons
10	0.0036	First-Line Supervisors of Fire Fighting and Prevention Workers

Source: Frey & Osborne (2013)

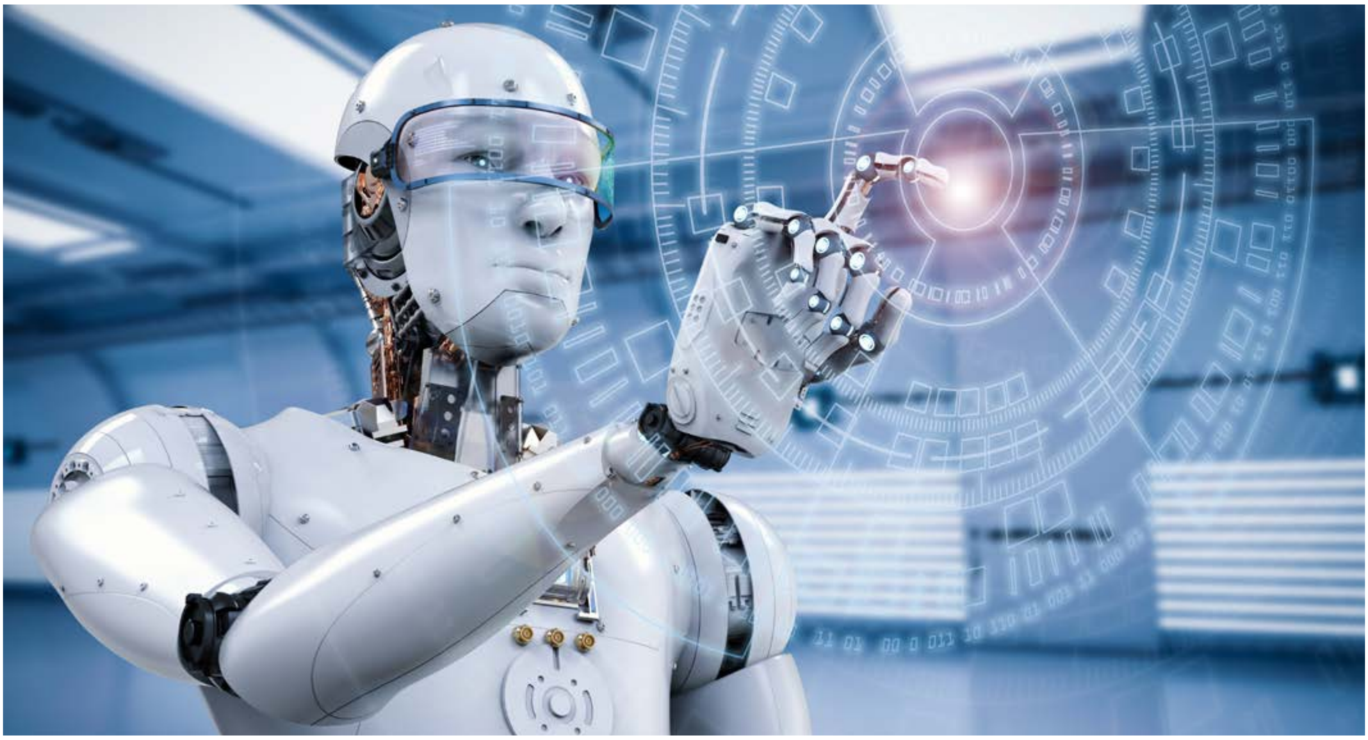
bility of computerisation for 702 occupations. They found that 47 percent of total employment was already at risk. At the same time, they reported that wage and education levels exhibit a negative correlation with the probability of machine replacement. Most of us are replaceable by a machine, but those of us on the highest paid, highest skilled jobs are less likely to be replaced as quickly, if at all.

"Generalist occupations requiring knowledge of human heuristics, and specialist occupations involving the development of novel ideas and artefacts, are the least susceptible to computerisation", according to Frey and Osborne. Social and creative intelligence is hardly replicable by artificial intelligence for now, and therefore professions that rely heavily on such skills will likely be unaffected by computerisation. "Assisting and caring for others", "persuasion", "negotiation", "social perceptiveness", "fine arts", "originality", "manual dexterity", "finger dexterity", and "cramped work space", are the strongest barriers to computerisation.

Are we going to experience disruption and unemployment?

The computerisation of professions and the mass use of robots in production doesn't mean we're going to experience a sudden disruption leading to high unemployment levels and social unrest. The whole process of an industrial revolution takes decades to materialise, as was the case in the past. No corporation adopts a whole new technology overnight. New technologies are more likely to be adopted gradually in order to leave open the possibility of reversion in case something goes wrong. What this usually means is that a corporation starts by reallocating some of its workers to different tasks as they automate processes. They then stop hiring new people for those tasks. The reduction in demand for the newly computerised jobs will lead to a decrease in wages, which is a signal given to the market that there is excess supply for those jobs. The market will adjust accordingly, and future generations will no longer learn the skills for the occupations that were replaced by robots. While this happens, new jobs will be needed. Wages for those jobs will increase to signal to the market the lack of supply and attract more skilled workers. As long as this process is continuous and gradual, the effects of robotisation need not be disruptive in social terms, even in the shorter-term.

A group of German economists studied the impact of rising robot exposure



“AS LONG AS THIS PROCESS IS CONTINUOUS AND GRADUAL, THE EFFECTS OF ROBOTISATION NEED NOT BE DISRUPTIVE IN SOCIAL TERMS, EVEN IN THE SHORTER-TERM.”

on the careers of industrial manufacturing workers in Germany[iv]. They concluded that robots lead to a change in the existing job demand but not necessarily to a decrease in the available number of jobs. Each robot adopted in manufacturing destroys two jobs. This accounts for a decline of 23% of the overall decline in manufacturing employment in Germany during the period 1994-2014, making a total of 275,000 jobs. But the jobs destroyed in manufacturing were offset by the creation of additional jobs in the services sector. The first and second industrial revolutions also destroyed jobs in agriculture. But rather than destroying the total number of jobs, they contributed to a reallocation of jobs throughout the economy.

Another study conducted by two European economists[v] had a positive conclusion in regard to the use of industrial robots. In a study covering 17 countries during the period 1993-2007, the researchers found that industrial robots increase both labour productivity and value added, helping to raise GDP.

Many other studies have attempted to measure the impact of robots on our life. Some focus on the positive impact over time, others on the negative impact on some types of jobs. If the past serves as any indication of the future, then there is a high likelihood of finding driverless cars, robotic doctors, and automated groceries enter the mainstream in the next few years. But the process of change will be gradual. Older jobs will face a reduction in demand and new jobs will be created. The price (wage) will serve as guidance for new generations to reallocate efforts to nascent needs.

Where to invest

If the robotisation of the economy is going to lead us towards a new paradigm, then we should expect some of the most innovative companies to profit from it. While there are many start-up companies dedicated to robotics and automation, many of them will fail, as did most other similar companies during the dot-com bubble. Selectively picking only the best companies while diversifying risk at the same time is a tough task for most investors. A simpler solution is to invest in a speciality ETF.

The Global X Robotics & Artificial Intelligence Thematic ETF (NADAQ:BOTZ) "seeks to invest in companies that potentially stand to benefit from increased adoption and utilization of robotics and artificial intelligence, including those involved with industrial robotics and automation, non-industrial robots, and autonomous vehicles"[vi]. The fund allows investors to access the high growth potential of companies involved in the idealisation, design, creation and application of programmable automated devices that will be part of our future. One important feature is that it invests in several different countries, thus allowing investors to get exposure to the whole investing theme across geographic locations. The fund not only invests in US companies like Nvidia Corp and Intuitive Surgical Inc, but also in Keyence Corp and Fanuc Corp in Japan, ABB Ltd in Switzerland, and Kuka AG in Germany. "BOTZ" currently gets exposure to 29 equities spread across nine countries for a total net asset value of $2.6 billion. Since inception, at 12 September 2016, the fund is up 66% which compares with 28% for the broader market.

"BOTZ" ETF TOP 10 HOLDINGS

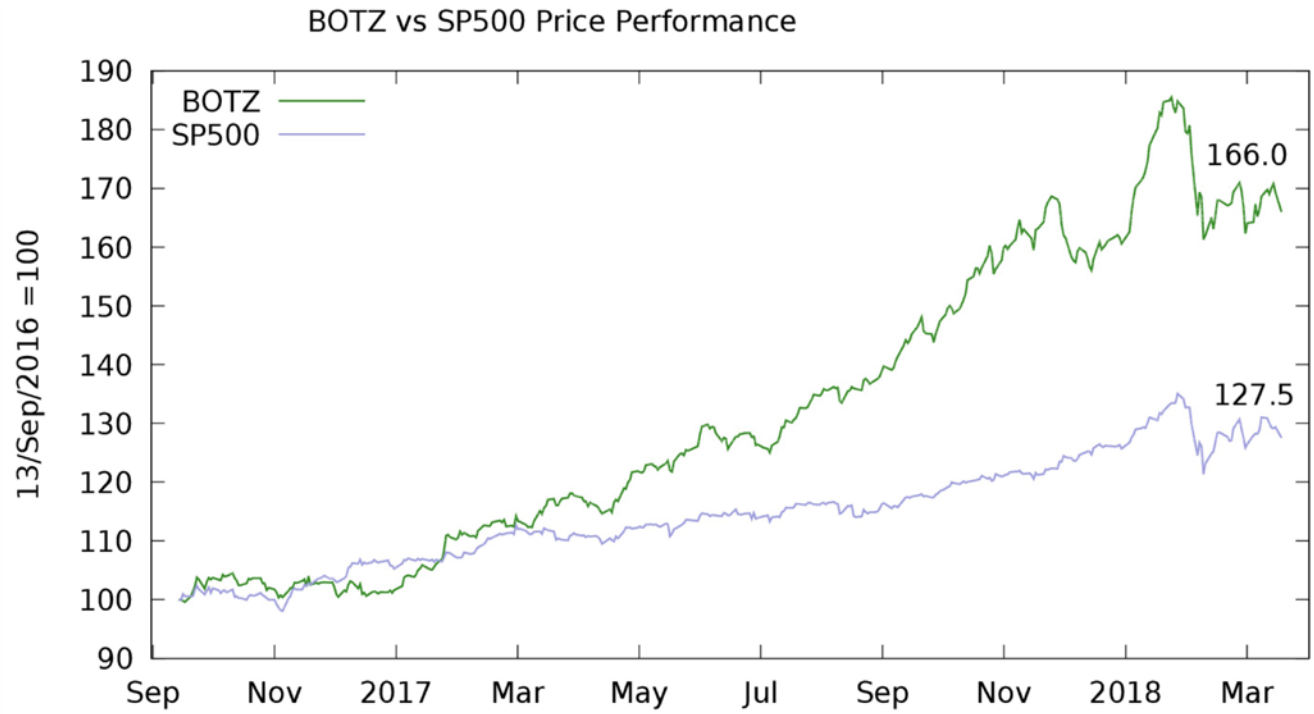
Asset	Holdings (% of Portfolio)
NVIDIA Corp	9.20%
YASKAWA Electric Corp	8.30%
Keyence Corp	8.20%
Intuitive Surgical Inc	8.20%
Fanuc Corp	7.70%
Mitsubishi Electric Corp	6.90%
ABB Ltd	5.60%
Daifuku Co Ltd	5.50%
SMC Corp	5.20%
OMRON Corp	5.10%

Source: Sharepad

For those looking for targeted bets in single stocks, there are a few companies that may be worth looking at. To start with, any of the 29 holdings of the "BOTZ" ETF are potential bets in robotics and automation.

One company that stands out from the crowd and is not held by "BOTZ" is **Teradyne Inc (NYSE:TER)**. Massachusetts based Teradyne designs, develops and manufactures automatic test systems for several industries. Recently it acquired the Danish company Universal Robots, a leading maker of collaborative robots ("cobots"). Cobots are low-cost, easy-to-deploy, and simple-to-program robots that work side-by-side with humans to improve the quality of work and increase manufacturing efficiency. Cobots are an example of teamwork between human and artificial intelligence. Teradyne is a solid, well-established company, offering great upside potential for investors and currently trading at a decent price relative to its earnings growth rate.

Another potential investment within the automation theme is **Amazon.com Inc (NASDAQ:AMZN)**. Jeff Bezos and his team at Amazon.com never sit still or settle for the norm. Amazon is a very innovative company spending a tremendous amount of money and effort trying to make its business more efficient. The company's warehouses are a place of innovation where workers and robots interact to deliver the



best results. Since acquiring the privately-held Kiva Systems in 2012, Amazon has been able to automate the picking and packing process at large warehouses. There's no doubt Amazon will be on the cutting edge of manufacturing improvements and delivering home automation to its customers. But everything has a price and in the particular case of Amazon it seems pretty high right now. Amazon's stock is trading at sky-high price multiples, leaving no safety margin for a potential downturn. While I'm not a buyer at these prices, I still believe this company is worth tracking in a watch list.

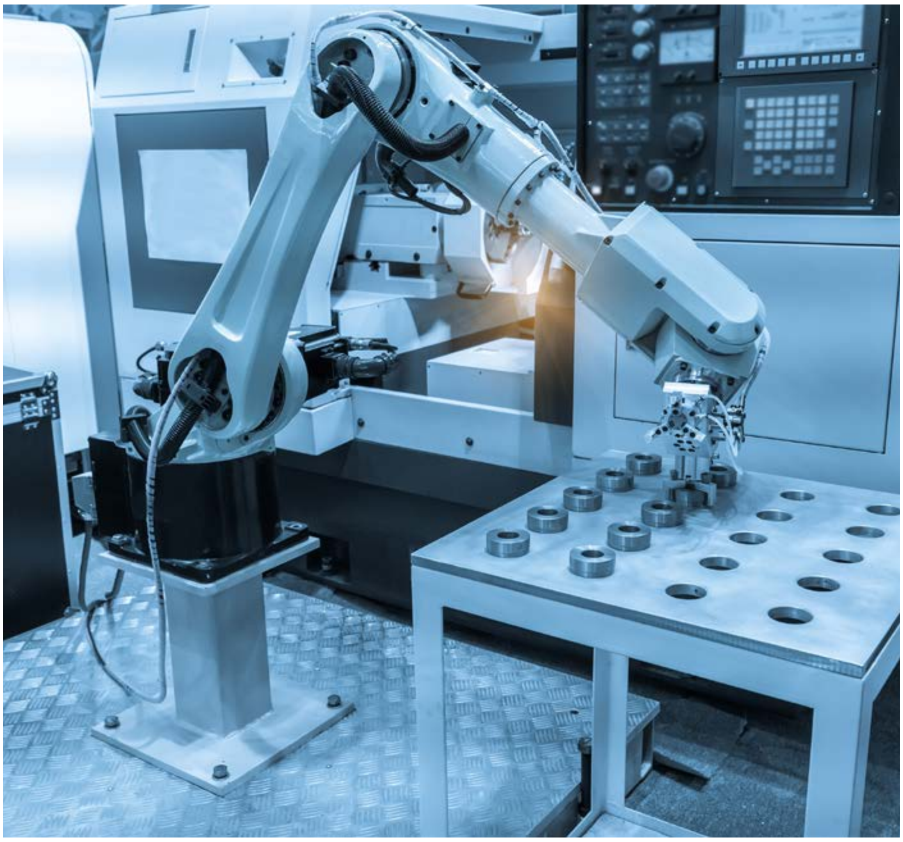
Other potential buys are **iRobot Corp (NADAQ:IRBT), Cognex Corp (NASDAQ:CGNX)** and **Intuitive Surgical Inc (NADDAQ:ISRG)**. All of these are leading companies, well positioned for future automation. Still, they trade at relatively expensive prices regarding the growth experienced to date, which means investors would be paying a high price for the, admittedly positive, future prospects.

A brave new world

While the robotisation of our world will certainly lead to the end of some occupations, we shouldn't be afraid of it. In the end, robots are being created to help us achieve more than we could do otherwise. The disruption they will create is unlikely to lead to mass unemployment and social unrest. Some jobs will be displaced gradually while others will be created. The price adjustment mechanism of the market economy will help reallocate resources. But, in the meantime, those with less skills working on routine repetitive tasks with little abstract thinking and social interaction are at a high risk of losing their jobs or experiencing a decrease in wages. Meanwhile, the high-skilled individuals undertaking complicated tasks that require experience, expertise, autonomy, and abstract thinking will be in high demand.

At the country level, some important shifts are going to occur, as the reliance on cheap labour may decrease over time. Companies that once fragmented their production all over the world to benefit from cost efficiencies may opt to move their manufacturing activities closer to home and consolidate production, as the use of robots replaces cheap labour. On that front, developed countries may benefit over labour-intensive emerging economies.

The Fourth Industrial Revolution is already on its way. Leading companies with strong balance sheets can deliver sustained profits over the years to come. Many of these companies aren't located in the US or in the UK but are spread all over the world with a special emphasis on Asia. The best way to get a share of the market is through an ETF like the Global X Robotics & Artificial Intelligence Thematic ETF.



About Filipe

Filipe has been a contributor to Master Investor since the earliest years. His specialisation is monetary policy, macro issues and behavioural finance where he allies the practical experience of several years of trading with academic credentials. Filipe in fact teaches courses on Financial Markets and Monetary Economics at the University of Oporto Faculty of Economics, helping traders maximise profits and better manage risk.

i Keynes, J. M. (1923). A tract on monetary reform. Macmillan.
ii International Federation of Robotics (2017). The Impact of Robots on Productivity, Employment and Jobs.
iii Frey, C. B., & Osborne, M. (2013). The future of employment. How susceptible are jobs to computerisation.
iv Dauth, W., Findeisen, S., Südekum, J., & Woessner, N. (2017). German robots-the impact of industrial robots on workers.
v Graetz, G., & Michaels, G. (2015). Robots at work.
vi Check https://www.globalxfunds.com/funds/botz for more information.

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TOY PASSPORT

BY SWEN LORENZ

10 QUESTIONS FOR...

FRASER THORNE

EDISON: SHINING A LIGHT ON LISTED COMPANIES FROM AROUND THE WORLD

Fraser Thorne is founder and CEO of Edison Group, which runs Edison Investment Research and Edison Avisors. Since its inception in 2003, Edison has grown into one of the world's leading providers of investment research, investor relations services, and strategic consulting for public companies.

The company's extensive research covering hundreds of public companies in the UK and elsewhere is available for free on the web. Why does Edison provide this seemingly altruistic service? How can private investors best make use of it? And what are the important changes that the "MiFID II" regulations will bring for anyone with an interest in publicly listed equities?

We had a chance to pick Fraser's brain on all of the above, and more.

Swen Lorenz: Edison Research has been a long-standing supporter of (and exhibitor at) our annual Master Investor Show. Yet, not every one of our readers will be familiar with your company and its services. Please give us a brief overview of what you deliver that is useful and relevant for our private investor audience.

Fraser Thorne: *Since our inception in 2003 we have led the field in providing free-to-view equity research. Our research is carefully written such that it adds value to the most experienced investor right across to someone who is new to the stock market. As our research is commissioned by companies, we can make it available to all investors on a free-to-view basis. We also organise investor meetings and are keen to expand our offering to private investors.*

SL: To cut to the chase, many an investor will wonder if research that has been paid for by the company that it covers, is by definition too biased in favour of the company. He who pays the piper calls the tune, right?

FT: *Yes and No. Investors are right to ask the question of any equity research that they read, "Why have they written this?" Companies work with Edison to get access to as wide an audience of investors as possible. We work with companies across a wide range of sectors, market caps and geographies who are looking to find the right kind of investors for their companies rather than those who might be influenced by a buy or sell recommendation. All our research is written on a flat-fee, subscription basis – i.e. unlike a broker we do not make more or less money if a stock goes up or down. Our job is to introduce our client companies to an audience of sophisticated investors. In order to gain the investor's trust we produce research that is "true, fair and not misleading". We work to a tight code of ethics and research principles that have helped us to build a strong bond with the investor community and we are not going to put that at risk by writing a one sided piece of "PR puff".*

SL: The financial media has recently been brimming with articles about

"UNLIKE A BROKER WE DO NOT MAKE MORE OR LESS MONEY IF A STOCK GOES UP OR DOWN."

"MiFID II". I am the first to admit that the entire subject of this new regulatory framework is so complex that my mind shuts off as soon as I see the acronym. Can you distil the essence for us please? Why is this something that private investors should take note of?

FT: *MiFID II is a massively complex set of rules that covers the whole range of financial instruments, not just equities. With regard to the investors and the brokers it is looking to take more costs out of the system whilst giving the difference back to the underlying funds. That is good news for all private investors who own a unit trust or fund.*

SL: Obviously, you cannot issue specific investment advice. But surely in your years of building your company to the impressive size that it is today, you will have developed some ideas on how to find the most promising investment opportunities amidst the hundreds of research reports your firm publishes every year? Or do we have to read them all to separate the wheat from the chaff?

FT: *I would hope you will read them all! How you use equity research will vary by your investment style and in this age of free information the quality of editorial and a trusted brand is of paramount importance. However, we also now operate in an age of immediate consumption and we have designed our research notes to provide investors with as much key information as possible on the front page so they can scan key points such as: market capitalisation, nationality, sector and an investment summary. We also expand this with more notes and company news on each company page of our website. Readers can set their own preferences so they only receive the research they want to see, and our new website will also feature advanced search tools and industry oversights to further improve the investor experience.*

"THE PRIVATE INVESTOR COMMUNITY IS NOW VERY MUCH SEEN AS A KEY MARKET AREA FOR COMPANIES TO ENGAGE WITH."

SL: Have you spotted any trends in recent years relating to private investors engaging with the stock market? Are more of them investing in public equities? Do they make better use of the various research resources now open to them? And could they become a bigger factor for public companies planning their Investor Relations strategy? Or are they a dying breed that gets fleeced by the finance industry's big boys?

FT: *We have seen a fantastic uplift in private investor engagement and direct investment over the last few years. We see this with our readership statistics and the explosive growth of platforms such as Hargreaves Lansdown. This means the private investor community is now very much seen as a key market area for companies to engage with, and that is something we are very keen to support.*

SL: Your company is providing research for public companies from around the world. All of it is in English – i.e. its content is easily accessible for our British audience. Yet, most private investors in this country shun equity opportunities from abroad. Are they missing out? And if so, why?

FT: *Investing in international equities was historically much harder and therefore perceived as higher risk than buying local stocks. Some of this was down to language, currency, settlement, access to information or access to a broker who could take your trade, but the internet has changed so much of this. We are very lucky as English is still the international language of business and companies looking to tap international markets, especially the US, will make a real effort to provide translation facilities on their websites, so the information gap has closed.*

More online brokers also now provide the facilities to trade international stocks. It is widely recognised that an international portfolio will provide more

About Fraser Thorne, Founder & Chief Executive

Fraser founded Edison in 2003. Before that, he ran Newton Investment Management's UK smaller company fund – a top decile performer. Fraser has broad experience in equities markets working closely with Edison's operations in Asia-Pacific, Germany as well as the UK. He holds an MBA, is a member of the CFA Institute and is on the board of the Investor Relations Society.

About Edison

Edison is an investment research and advisory company, with offices in North America, Europe, the Middle East and Asia-Pacific. The heart of Edison is our world-renowned equity research platform and deep multi-sector expertise. At Edison Investment Research, our research is widely read by international investors, advisors and stakeholders. Edison Advisors leverages our core research platform to provide differentiated services including investor relations and strategic consulting.

diversity and hence a smoother performance over time. Some of the most exciting and fastest growing companies are based in the US or China and international investing can provide you with exposure to tech companies, for example, that are just not available on the local market.

SL: **Specifically, I wanted to ask you about the Tel Aviv Stock Exchange. Israel is a serious hub for technology and life science companies. Many a fortune was made by Israeli entrepreneurs, and often enough, there was the opportunity for anyone with a brokerage account to buy into these growth stories early on. Your firm is now providing research about the companies listed in Tel Aviv. Have you visited firms down there in recent years and what is your impression of Israel as an investment destination?**

FT: *Israel is a very exciting and fast developing economy and it is looking to build a capital markets infrastructure that can provide the capital to support this growth. We are delighted to be part of this community, working with the Tel Aviv Stock Exchange (TASE), who run a research scheme designed to highlight fast growing and developing tech and healthcare companies. I was in Israel earlier this year and it is easy to see why it is now recognised as one of the most important markets for venture capital investors. Every major international tech company has a presence in Tel Aviv, looking to tap into the hard working, entrepreneurial culture. There is no doubt that Israel is a real and growing investment destination with strong areas of expertise in tech, healthcare and agriculture. Many don't make it to the equity markets as they are bought up by private equity, but this will change as the local market becomes more sophisticated.*

SL: **Will we be hearing about Edison expanding its research into asset classes other than listed equities? In our conversations with private investors, we often hear of a desire to read research about crowdfunding opportunities as well as privately held companies that have an off-exchange free float and exotic subjects such as cryptocurrencies.**

FT: *Most of our research is on listed equities but we do also write on private companies, though this often remains private, for the consumption of the company's management, its private backers and advisers. We are talking to many of the crowd funding sites and are very excited about the prospect of working alongside them to help build investor knowledge of the opportunity. We hope to be able to test the market with something later this year.*

SL: **What do you yourself read to keep abreast of financial markets, trends and opportunities? Are there any websites, e-letters or portals that you'd recommend private investors take a look at?**

FT: *There are so many it is difficult to name a few. The Edison website is obviously a key source of information as are the annual outlooks written by the big fund management houses. These can provide you with a very good sense of ideas and trends that the fund and market are looking at. They will be distilling information from multiple sources and give you pointers of what investment themes are coming in the next twelve months. The major financial papers are also a key source of market intelligence; the FT, Wall Street Journal and the Economist are great for a quick review of international business. If I am looking at a particular sector in more detail, then I will also refer to the leading industry publications to get a closer feel for what is going on and to see if that correlates with what a company is saying.*

"COMPANIES ARE REAL, LIVING ENTITIES – NOT JUST A TICKER SYMBOL."

SL: **I noticed that your CEO desk is right in the centre of your open-plan office. All your employees can see you and, in turn, you can keep an eye on anyone who comes out of the elevator and approaches the reception. Evidently, you love the buzz and excitement of running an innovative, growing business. What does Fraser do to relax?**

FT: *I am very passionate about investing. Having started my career working alongside the industry guru Stewart Newton, I was instilled with the discipline of undertaking detailed company research, but also to remember that companies are real, living entities – not just a ticker symbol. Shares often move for reasons that fundamental research cannot predict – and that is what makes it so exciting. My work is a passion and so it can be hard to switch off, but playing or watching sport is a very good distraction – though perhaps not golf as that can give you too much time to think (or maybe I'm just not very good at it!).*

About Swen

Swen Lorenz regularly serves as an advisor and board member to public and private companies. His work has been featured in publications like the Financial Times, Private Eye, and the Economist. He welcomes readers connecting with him on LinkedIn.

BY THE ISLE OF MAN DEPARTMENT FOR ENTERPRISE

THE ISLE OF MAN

A THRIVING HUB FOR ENTREPRENEURIALISM AND INNOVATION

The Isle of Man is home to a wildly diverse spectrum of businesses across all sectors, spanning well-established traditional finance and professional services, to emerging sectors such as e-business, fintech, crowdfunding and biomed, and just about everything in between, including world class aerospace manufacturing, digital media, world renowned aircraft and ship registries and a raft of artisanal food and drink producers.

This combination of diversity and quality has allowed the island's economy to remain stable and sustain economic growth despite testing times elsewhere.

So how has a small island managed to sustain economic success, produce so many world class offerings that can compete in the global marketplace and establish itself as a leading International Business Centre of choice?

A supportive business environment

The Manx Government are committed to encouraging and nurturing entrepreneurship and innovation in the island by creating a business friendly ecosystem with a range of support and assistance including grants, equity, loans and mentoring.

Economic growth and innovation are enabled by a unique combination of

"IN THE LATEST BUSINESS CONFIDENCE SURVEY, 92% OF RESPONDENTS SAID THAT THEY WOULD RECOMMEND THE ISLE OF MAN TO OTHERS AS A GOOD PLACE TO DO BUSINESS."

progressive business-centric legislation that paves the way for enhanced exploration and development of cutting edge ideas and new products, whilst robust regulation provides added security and protection.

This positions the island as an incubation hub for entrepreneurialism and innovative start-ups, giving Isle of Man based businesses an edge over their competitors.

Working in partnership with private companies & £50m fund managers, SPARK Impact

The Department launched the £50 million Enterprise Development Scheme (EDS) in May 2016 to invest in businesses that seek to create jobs on the island.

One such business, Cortech Healthcare Ltd. joined representatives from the Isle of Man's Department for Enterprise at this year's Master Investor Show after having recently secured investment through the EDS. This support enabled Cortech to relocate its manufacturing and operations to the island from the UK. Cortech now plan to go into full production of their electronic commode – showcased at the 2018 Master Investor Show – into IOM, UK and European healthcare markets. Spark Impact, who manage the EDS, also joined the Department at the Show. SPARK Impact is an active investor that proactively assists existing Isle of Man businesses and companies seeking investment that want to locate to the island access the fund, Government advisors and concierge service.

A unique and beautiful location

As well as being a thriving start-up and scale-up business incubation hub, with easy access to the UK, Ireland and further afield, the Isle of Man is also the only entire jurisdiction in the world to be awarded UNESCO Biosphere Reserve status. Residents enjoy breath-taking countryside and beaches idyllic for outdoor pursuits and leisure and family activities, all within easy travelling distance, allowing families to enjoy an enhanced quality of life, more valuable personal time and thrive both personally as well as professionally.

The natural environment provides the relaxation, inspiration and space necessary for allowing creative ideas to evolve and flourish. This may explain why we see such a concentration of innovators, artists and creatives that choose to call the Isle of Man home.

The island offers residents a high quality of life with one of the lowest crime rates in Europe, a friendly welcoming community, free property market and excellent schools and facilities, all contributing to providing the peace of mind that frees up businesses and individuals to focus on what really matters to them.

In the latest Business Confidence Survey, 92% of respondents said that they would recommend the Isle of Man to others as a good place to do business with 31% stating the business environment and community as the greatest advantage.

With such a unique and supportive offering, it's not a surprise that so many enterprising businesses and individuals choose the Isle of Man as the place to live and establish or relocate business operations, enjoying success and a high-quality lifestyle on the island.

DEPARTMENT FOR ENTERPRISE im

ISLEXPO 2018 – Exploring the Isle of Man as a unique business location

For the last two years the Department for Enterprise has hosted their flagship business event ISLEXPO to inspire new start-ups and further support established entrepreneurs and businesses to grow and succeed with a range of keynote speakers, advisory panels, skills-based workshops, networking opportunities, one-to-ones with Government representatives and much more. Now in its third year, ISLEXPO 2018 will address challenges that many businesses face such as attracting and retaining talent, future-proofing the workplace, employer brand and initiatives with keynotes from Dan Germain, Group Head of Brand and Creative at Innocent; Emma Gannon, Author and Broadcaster; Thimon De Jong, Trend Forecaster & Futurist; and Matt Alder, Talent Acquisition and Innovation Consultant.

ISLEXPO is free to attend and will take place on Wednesday 16th May at the Villa Marina, Douglas with further information and discounted travel packages starting from £130 available at www.islexpo.com.

To find out more about relocating or starting a business on the Isle of Man and the range of business support schemes available, please visit www.whereyoucan.com, contact paul.maddocks@gov.im or visit www.islexpo.com to register for ISLEXPO 2018.

BY JOHN KINGHAM

DIVIDEND HUNTER

4 HIGH GROWTH DIVIDEND CHAMPIONS

Over the last few months I've mostly written about high yield stocks and the occasional high-profile disaster. That sort of thing isn't to everyone's taste, so this month I'll be looking at something completely different. More specifically, I'll be looking at four high growth "dividend champions", companies that have grown quickly whilst raising their dividend every year for at least the last decade or so. The high growth requirement adds a bit of spice and makes this list a little different from most dividend champion lists, as those tend to focus on large stalwarts such as Unilever and Shell.

This list, on the other hand, starts off with a couple of very high growth, market-leading internet stocks:

Moneysupermarket.com Group PLC

- **Index: FTSE 250**
- **Share price: 287p**
- **10Yr Growth rate: 23%**
- **Dividend yield: 3.6%**

Moneysupermarket.com (LON:MONY) is the UK's leading comparison website. It enables millions of people to compare prices on car insurance, home insurance, energy providers, credit cards and more. And what a success it has been, with a ten-year growth rate of 23% and a dividend that has tripled over that period.

The dividend yield is surprisingly high for a company with such a high historic growth rate, although as you might expect, its growth has gradually slowed as the company became ever larger. Last year for example, the dividend grew by "just" 6%, although that's still pretty good for a company with a near-4% yield.

Money Super Market com

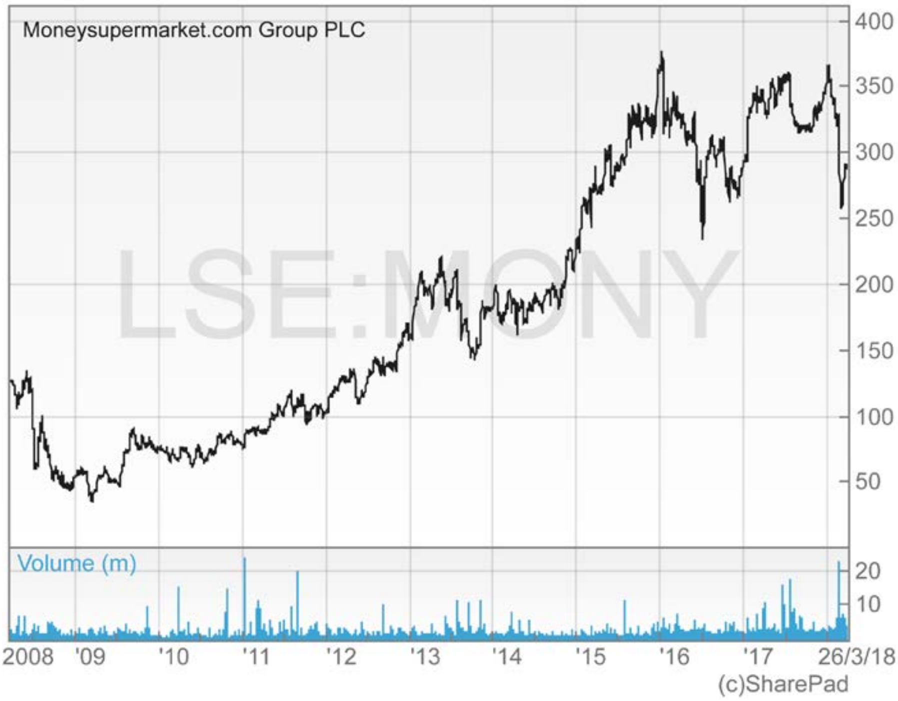
On the plus side the company has no debt and, as an internet business, it doesn't need to invest heavily in plant and machinery which gives it a somewhat low capex to profit ratio of 40% (most companies fall into the 50% to 100% range). Average return on capital employed is also good at just over 15% and the company has a 100% track record of increasing revenues, profits and dividends over the last decade.

That's the good news. The bad news is that the price relative to the company's ten-year average earnings (the PE10 ratio) is a bit on the high side. To be honest this is what I'd expect to see given the company's high growth rate. Still, at 37 the PE10 ratio is above my usual cut-off point of 30.

However, that ratio could be misleading. After all, the dividend yield is almost 4% which suggests the shares are not expensive. Also, the PD10 ratio (price to ten-year average dividend) is only 40, some way short of my cut-off point for that ratio of 60.

With a PE10 ratio of 37 and a PD10 ratio of 40, it's clear that the compa-

"THE DIVIDEND YIELD IS SURPRISINGLY HIGH FOR A COMPANY WITH SUCH A HIGH HISTORIC GROWTH RATE."



ny's earnings aren't much higher than its dividend. In fact, Moneysupermarket.com's dividend cover has averaged just 1.1 over the last decade, largely because (I suspect) it has little need for all the cash it throws off, so it sends the cash to investors instead. And that's why the high PE10 ratio might not be a problem.

In summary then, this is a company I'd like to look at more closely, especially if the share price dropped by another 20% to 220p or less. At that price the valuation ratios would be acceptable to me and I might be willing to buy (assuming no unforeseen skeletons in the closet).

Rightmove PLC

- **Index: FTSE 250**
- **Share price: 4,193p**
- **10Yr Growth rate: 22%**
- **Dividend yield: 1.4%**

Second on this list of high growth dividend champions is **Rightmove (LON:RMV)**, the UK's leading property portal. Like Moneysupermarket.com, Rightmove is an internet business with a ten-year growth rate of more than 20% (22% to be precise). Rightmove has achieved this impressive rate of growth primarily because it's the eBay of UK property. And that's a good thing because both eBay and Rightmove benefit enormously from something known as the network effect.

The network effect is an extremely powerful competitive advantage; a virtuous circle that can quickly lead to total market domination. For Rightmove it works like this: Rightmove has the largest inventory of UK property for sale or rent listed on its website. This makes it attractive to people who want to buy or rent, and that's why its website attracts more people interested in buying or renting property than any other UK website. And because it attracts the largest number of buyers and renters it's a very attractive place to advertise property for sale or rent. And that's why it has the largest inventory of UK property on its website. And on and on the virtuous circle goes.

> **"THIS POSITIVE FEEDBACK LOOP IS ALMOST IMPOSSIBLE TO BREAK, WHICH MAKES RIGHTMOVE A VERY ATTRACTIVE PROPOSITION, AT THE RIGHT PRICE OF COURSE."**

This positive feedback loop is almost impossible to break, which makes Rightmove a very attractive proposition, at the right price of course.

rightmove

As with Moneysupermarket.com, Rightmove has no debt and an extremely low capex ratio of just 2%. In other words, it has almost no capital assets whatsoever and therefore almost no need for capital expenses. This lack of capital assets shows up in the company's completely ridiculous return on capital employed ratio, which has averaged more than 800% over the last decade. The downside is that the company invests very little into capital assets, but when it does it gets an 800% annual return.

As you might expect with such a dominant high growth company, the share price is high and the dividend yield is low. Having said that, the latest dividend increase was 14%, so a sub-2% yield might still be enough to produce high returns for investors, as long as that kind of growth rate can be sustained. Personally though, I think the price is too high. Yes, Rightmove is likely to continue to dominate its market and may well have many more years of growth ahead of it, but then again, it might not. And with PE10 and PD10 ratios of 52 and 138, it's far too expensive for me.

As for what the right price might be, something like 2,000p or less would spark my interest. That's a big drop from its current share price, but in the stock market surprising things happen all the time.

"SOMEWHAT SURPRISINGLY FOR AN ENGINEERING COMPANY, DIPLOMA HAS RELATIVELY LOW CAPITAL EXPENSES."

Diploma PLC

- **Index: FTSE 250**
- **Share price: 1,068p**
- **10Yr Growth rate: 14%**
- **Dividend yield: 2.1%**

Diploma's (LON:DPLM) revenues are split fairly evenly across three businesses: Life sciences, Seals and Controls. The Life Sciences business supplies diagnostic instruments, surgical devices and other related products and services to the healthcare industry. The Seals business supplies seals, filters and other products to the heavy mobile machinery market (think JCB diggers) and the general industrial market. The Controls business supplies wiring and fasteners as well as temperature, pressure and fluid control systems to various markets including aerospace, motorsport and catering.

Diploma has been very successful over a long period of time and, like the two companies above, it has a 100% track record of revenue, earnings and dividend growth over the last decade. Also, like Rightmove and Moneysupermarket.com, Diploma has almost no debt.

DIPLOMA PLC

Somewhat surprisingly for an engineering company, Diploma has relatively low capital expenses. That strikes me as odd since the company has factories, machinery and other capital assets which are required to run a manufacturing business. But the numbers don't seem to lie; the company has £23 million of tangible capital assets which require about £3-£4 million of capital investment each year for replacement and expansion. That may sound like a lot, but it isn't compared to the company's post tax profits, which have averaged around £50 million over the last few years.

However, Diploma also has almost £180 million of intangible assets on its balance sheet, an amount which dwarfs its £23 million of tangible assets. These intangible assets are mostly goodwill from acquisitions. I'm not a fan of acquisitions, but some companies are able to turn acquiring and developing companies into a core competence, and Diploma may be one of those. The acquire, build and grow model is a key part of the company's strategy and it runs these acquired companies as independent operations, aided and supported by both the "head office" business and rest of its subsidiary network. What I like most about Diploma's acquisition strategy is that it has been carried out almost entirely without the use of borrowed money, which suggests to me that these acquisitions really are well thought out, rather than just a desperate attempt buy growth rather than build it.

The main downside once again is price, although this time the price is almost right, at least for me. At 1,068p the company has a dividend yield of 2.1%, which isn't bad for a double-digit growth company. It also has PE10 and PD10 ratios of 35 and 70 respectively, which are only just above my upper limits of 30 and 60 respectively.

For me to be happy with Diploma's price, it would have to drop below 900p, which is a pretty small decline in the big scheme of things. Of course, I would have to look at the company in more detail first; but following this quick overview Diploma looks like a company I'd be happy to invest in at the right price.

Dunelm Group PLC

- **Index: FTSE 250**
- **Share price: 549p**
- **10Yr Growth rate: 13%**
- **Dividend yield: 4.7%**

Dunelm (LON:DNLM) is the UK's leading homewares retailer, selling curtains, cushions and other home furnishings through its network of over 160 out-of-town superstores, as well as an increasingly important website.

Unlike the previous three companies, Dunelm misses out on a 100% track record of revenue, earnings and dividend growth over the last decade. Instead it scores a still very impressive 96%, only let down by a small decline in normalised EPS in 2017. As you might expect, the market is not happy with declining earnings so another difference between Dunelm and the other companies is that it has low valuation multiples and a market-beating dividend yield.

As well as these differences, there are similarities. Dunelm uses some debt, but less than most companies. Its bor-

“THERE ARE ALMOST ALWAYS PROBLEMS ASSOCIATED WITH LOW VALUATION MULTIPLES AND HIGH YIELDS, AND DUNELM IS NO EXCEPTION.”

rowings are just 1.5-times recent average profits and by my estimations that's a very prudent policy (the average debt-to-profit ratio on my stock screen is 4). It also has relatively little need for capital expenses, with capex averaging just 46% of profits over the last decade. That's less than the market average capex to profit ratio, which is about 66%. Excessively large acquisitions are not a problem either and the dividend has typically been covered about twice over by free cash flows.

At first glance then, Dunelm looks like a company I'd be happy to invest in, except this time the price is attractively low as well. Unfortunately though, Mr Market doesn't offer low prices for no reason. There are almost always problems associated with low valuation multiples and high yields, and Dunelm is no exception.

Dunelm

In this case there are three main problems as I see it: Brexit, stalled like-for-like growth and a slower store rollout programme. Brexit is an obvious uncertainty for UK-focused retailers, even though we don't yet know for sure whether the long-term impact will be good or bad. Either way, uncertainty is a risk and Mr Market demands a higher potential return from higher risk investments, and in this case that means a lower share price and a higher dividend yield. As for like-for-like growth, it has barely kept up with inflation over the last few years and actually declined in 2017, so this doesn't look like a source of attractive growth for the company. That leaves new store openings as the main growth driver, but even there the news is not good.

New openings have fallen from around 10 per year for most of the last decade to an average of six per year over the last two years. As the total number of stores increases, that lower number of new stores looks even worse as a percentage of the total. For example, annual new store openings have fallen from about 12% of total stores a few years ago to just 4% or so today.

This combination of weak like-for-like growth and slower new store openings has decreased the company's "expected" annual growth rate (equal to like-for-like growth plus new store growth) from more than 10% in recent years to just 5% in the last couple of years. 5% is still a reasonable growth rate, but if investors are to get a decent return then a high yield will be required to make up the difference, and that's largely why Dunelm's yield is around 5%.

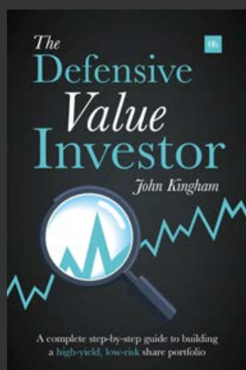
Nobody can know whether Dunelm will thrive or stagnate, but of these four high growth dividend champions Dunelm is the only one I'm currently invested in. However, at first glance the other three also look like companies I'd be happy to own, but only if the price contains a reasonable margin of safety.

About John

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

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

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



BY RICHARD GILL, CFA

FROM ACORNS TO OAK TREES

CASH IS KING

BOOST YOUR RETURNS WITH THESE CASH-RICH SMALL CAPS

It goes without saying that cash is an incredibly important part of running a business – "cash is king" as the saying goes. You can't do anything without cash – pay the bills, invest in growth, acquire other companies and so on. Of course, a company could take on debt to do these things, but as we have seen in the recent case of Conviviality (LON:CVR), when the cash isn't flowing and the (sometimes unexpected) bills need paying, debt can be a very dangerous thing.

However, cash by itself isn't necessarily a sign of a good investment. While cash resources provide a company with the means to carry out its day-to-day operations and expand the business, what's more important in picking out good investments is how well they use that cash. In addition, investors don't want too much cash being built up as that might be a sign of a company running out of new ideas.

The following three companies are all strongly cash generative, have a decent amount of cash on the balance sheet and look like they have good opportunities to put their dough to good work.

COSTAIN

Some investors may be wary of getting involved with construction companies given the recent demise of Carillion. But, unlike this next company, Carillion severely overstretched itself on risky contracts and ultimately went under due to having built up an unsustainable debt pile of almost £1 billion, not to mention a pension deficit of £587 million.

Founded in 1865 by Richard Costain as a building firm, **Costain (LON:COST)** is a well-known engineering and construction business which now describes itself as a "smart infrastructure solutions" company, deploying technology-led programmes to meet urgent national needs across the UK's energy, water and transportation sectors. Under its "One Costain" operating model the company has two core operating divisions, Infrastructure and Natural Resources, both of which concentrate on building up relationships with blue-chip clients for long-term growth.

The core Infrastructure division, which made up 80% of revenues in the last financial year, operates in the highways, rail and nuclear markets. Some key recent contracts and work include the Crossrail project in London (Costain is the largest supplier to Network Rail); Highway England's largest ever contract, the A14 upgrade; and the provision of a project controls managed service to portfolios and programmes of work across all of EDF Energy's eight UK nuclear power stations.

In the smaller Natural Resources division Costain operates in the water, power and oil and gas markets. Key deals include those with Thames Water, Severn Trent and Southern Water for improving and maintain-

"'CASH IS KING' AS THE SAYING GOES."

"NET CASH FLOW FROM OPERATIONS WAS PARTICULARLY GOOD."

ing water quality standards and supply resilience; with National Grid to provide project services to deliver the replacement of the Humber Estuary Crossing; and with Total to deliver a Hydrochloric Acid Dosing Plant Construction Contract and Condensate Mercury Removal System for the oil giant's Edradour-Glenlivet facility 100km north west of the Shetland Islands.

Building growth

Early last year shares in Costain returned to levels not seen since 2007, a time when the company was beginning to see the early effects of the financial crisis and had to launch a £60 million rights issue. Things have improved significantly since a decade ago, however, evidenced by a strong set of results which have just been published for the year to December 2017.

Headline figures for the year showed revenues up by 7% at £1.68 billion, underlying pre-tax profits up by 16% at £43.4 million and underlying earnings per share up by 10% at 34.8p. Net cash flow from operations was particularly good, with a net £51.6 million inflow, well above the reported net profit of £32.6 million. As a result of the good performance the total dividend for the year was hiked by 10% to 14p per share.

Costain has consistently maintained a solid cash position over the years, with net cash standing at £177.7 million at the period end. Of course, this is only a snapshot as at the balance sheet date, with Costain often having large movements due to the high value of its contracts. Nevertheless, the average month-end net cash during the year was also high at £96.7 million. To support further growth Costain has in place banking facilities of £191 million. Together, the cash and debt facilities go to show potential clients that the company has significant financial resources and is unlikely to go the way of Carillion.

The outlook looks positive for Costain, with the current year said to have started well and the forward order book standing strong at £3.9 billion, with a preferred bidder position of c.£400 million. In addition, over £1.1 billion of revenue has already been secured for 2018.

Engineering a buy

At the current price of 465p per share Costain is valued at £493 million. That puts the shares on a modest historic earnings multiple of 13.4 times, with a dividend yield of 2.73%. If we strip out the average month end net cash for 2017 then the multiple fall to 10.8 times, a figure which looks good value for a solid, cash rich company with growth opportunities across a number of sectors.

On the downside, net margins are very thin at around 2%, with there also being a modest (but manageable) pension deficit of £23.9 million. However, the order book is very strong, representing over two years of revenues on a historic basis and Costain has an excellent reputation within a number of industries – over 90% of the order book comprises repeat business.

"CAMBIAN REMAINS CASH RICH, AND CASH GENERATIVE."

CAMBIAN GROUP

With a history going back to 2004, when it initially owned three mental health rehabilitation hospitals, **Cambian Group (LON:CMBN)** has undergone a number of changes over the years to now be one of the UK's leading children's specialist education and behavioural health service providers. With the UK public sector being its major customer, Cambian currently looks after 1,920 children and young people and employs over 4,500 people across a portfolio of 222 residential facilities, specialist schools and fostering offices in England and Wales.

Since its beginnings, the company has been backed by private equity investor GI Partners. As a partial exit for GI, Cambian listed on the Main Market of the LSE in April 2014, raising c. £168 million for selling shareholders at the time. Another major deal in the company's recent history came in December 2016 when the company decided to dispose of its adult services business to Cygnet Health Care for a cash sum of £377 million. This was a welcome injection of capital for a company which had breached its banking covenants and issued two profit warnings during the year. The proceeds were mainly used to pay back £275 million of borrowings, with an additional special dividend of £50 million being distributed to shareholders. Following a further review of its capital requirements, another £15 million was returned to shareholders in February this year. Yet, Cambian remains cash rich, and cash generative.

Some readers may be more familiar with Cambian following an ITV documentary *Who Cares? Children's Homes Undercover* broadcast in December 2017, which alleged inadequate levels of care and education for children at three Cambian operated facilities. Following a review by regulator Ofsted, two of these facilities had their registrations initially suspended for up to three months. However, that seems to have been the extent of the damage, with the company saying there was no material impact upon the 2017 results and the shares quickly bouncing back after a brief dip. What's more, at the 2017 year-end 80% of the company's services were rated "Good" or "Outstanding" with Ofsted or the Care Quality Commission (CQC).

Healthy figures

Following the disposal of the adult services business Cambian is now solely focussed on children's services. The first financial year following the disposal (to December 2017) saw steady growth, with revenues up by 8% at £196 million and adjusted EBITDA up by 15% at £18.7 million.

Some investors may question the dubious nature of "adjusted" EBITDA as a performance measure, but in Cambian's case it does look justified given it was backed by a strong cash flow performance. While the company reported a statutory net loss of £9 million for the year from continuing operations, the net cash inflow from operations was an impressive £29.88 million. Major non-cash items added back included £11.1 million of depreciation and £9.4 million of amortisation and impairment charges. What's more, there was a £19.7 million fall in receivables, a sign of good cash collection from customers. After the £50 million special distribution (but before the £15 million payment) net cash stood at £82.8 million at the year end.

While 2018 is expected to be a year of consolidation, Cambian will continue to focus on its strategy of providing higher severity services, an area in which it holds a market leading position, where average fee levels are higher than the industry average and which is estimated to have a target market of 88,000 children.

In terms of financials, the strategy is to increase revenues by a compound annual growth rate of more than 5% and increase the adjusted EBITDA margin to more than 16% over the medium-term. With this margin being just 9.5% in 2017 there is plenty of room here for profit growth. Cambian is also looking to invest around £85 million over the next three years in capital expenditure in order to increase capacity, upgrade existing facilities, and invest in other infrastructure.

At the current share price of 181.6p Cambian is capitalised at £335 million. Strip out the cash (less the £15 million special dividend) and the enterprise value is £267.2 million. Should EBITDA margins rise towards 16% in the medium term as expected (without any revenue growth) then the shares could be trading on an EV/EBITDA multiple of just 8.5 times, which looks cheap for a well funded business with growth opportunities.

KAPE TECHNOLOGIES

Finally, we have a company which has been sitting on a large pile of cash for several years, but is only now starting to put it to good use.

Kape Technologies (LON:KAPE) is a consumer security software business which recently changed its name from Crossrider in order to reflect a shift in strategic focus. Crossrider listed on AIM in September 2014 raising $75 million, the original business being a next generation digital advertising group specialising in monetising web and mobile media through the use of big data. But following the appointment of CEO Ido Erlichman in May 2016 the company refocused to operate as a digital distribution and product hub, still using its existing technology and intellectual property. In particular, the new strategy identified the consumer cyber security space as presenting a significant growth opportunity.

As of today, Kape develops and distributes a variety of digital products in the online security space, offering products which provide online security, privacy and an optimal online experience. The core division is App Distribution, which comprises the app distribution product hub and where revenues are generated from end users purchasing products online. Key products include CyberGhost, an online privacy application; Reimage PC/Mac, which can fix a PC or Mac and restore peak performance via the internet with 24/7 support; and Driver Agent, which scans computers for outdated drivers.

The second core division is Media, which includes the firm's marketing technology platforms and ad network activities, with income earned via revenue sharing arrangements with media partners. Ajilion is the company's white-label B2B mobile media management platform whose ad exchange brings together buyers and sellers. Definiti is an advertising network that uses the Ajillion hub.

Kape crusading

The strategic move towards consumer security software seems to have paid off for the company, with results for the year to December 2017 showing revenues up by 17.4% at $66.4 million. That was driven by a 26% rise in revenues in the App Distribution division to $48.23 million which came following the addition of the DriverAgent and CyberGhost software products, along with organic growth. CyberGhost was acquired in March 2017, with the acquisition successfully integrated by June and making a positive net profit contribution of $1.5 million for the year. Notably, the division has strong operating margins, which rose from 29.5% to 35.7% for the year.

Elsewhere, in Media, revenues were up by 14.5% at $15.78 million, with the now dormant Web Apps and License division seeing $2.38 million of final revenues from a software agreement which expired in September.

Kape is another company which reports adjusted EBIDTA, with the figure for the year up by 29% at $8.3 million. Like Cambian, a good cash flow performance followed, with there being a

$7.64 million inflow before exceptional items. At the year end there was net cash of $69.5 million on the balance sheet, most of this coming from the proceeds of the IPO completed over three years earlier. Along with the good performance during the year, this led the company to declare a special dividend equivalent to 3.55p per share, with the ex-dividend date being 24th May.

Secure a share

Kape is a cash rich company operating in a fast-growing industry. In 2004, the global cyber security market was worth $3.5 billion and in 2017 it was worth over $120 billion, with the addressable market for personal digital safety in 2018 estimated to be $10 billion. While the company has arguably not fully taken advantage of its vast cash resources to date, $7.4 million was spent on acquisitive growth in 2017, with further deals said to be being looked at with a view to expanding the product offering. Furthermore, Kape is gradually transitioning to a fully SaaS (Software as a Service) based model, which is expected to improve both the visibility and quality of earnings.

With Kape shares currently trading at 86.5p, investors buying now will receive the special dividend, which yields 4.1%. On the historic numbers the EV/EBITDA multiple is 12.3 times, which looks good value should the company put its war chest to good use.

“KAPE IS A CASH RICH COMPANY OPERATING IN A FAST-GROWING INDUSTRY.”

About Richard

Richard Gill is an investment analyst with over a decade's experience of analysing small/mid cap equities. He is the Head of Research at Align Research. Richard qualified with the Chartered Financial Analyst (CFA) designation in 2012 and was awarded PLUS Markets Financial Writer of the Year at the 2008 PLUS Awards. He has been a judge at the Small Cap Awards from 2013 to 2017.

BY JAMES FAULKNER

AN INTERVIEW WITH

AUXICO RESOURCES

ZAMORA: A NEW MINING DISTRICT IN THE MAKING?

Auxico Resources Canada Inc. (CNSX:AUAG) is a Canadian company which holds a 100% interest in the Zamora Property in Mexico. The Zamora Mineral District (ZMD) is host to over 15 historical mines and workings, which stretch along a 6-kilometre trending structure. Sampling to date has been highly encouraging and Zamora bears many similarities to Zamora's neighbour, Hecla Mining's lucrative San Sebastien mine. We caught up with their President, Mark Billings, to find out more about this exciting prospect.

James Faulkner: Your principal focus is the Zamora gold/silver property in Mexico, which comprises several historical mines and was recently reopened with sampling yielding initial grades of 15 kg/t of silver and 20 g/t of gold. What progress has Auxico made at the property since listing on the TSX last year?

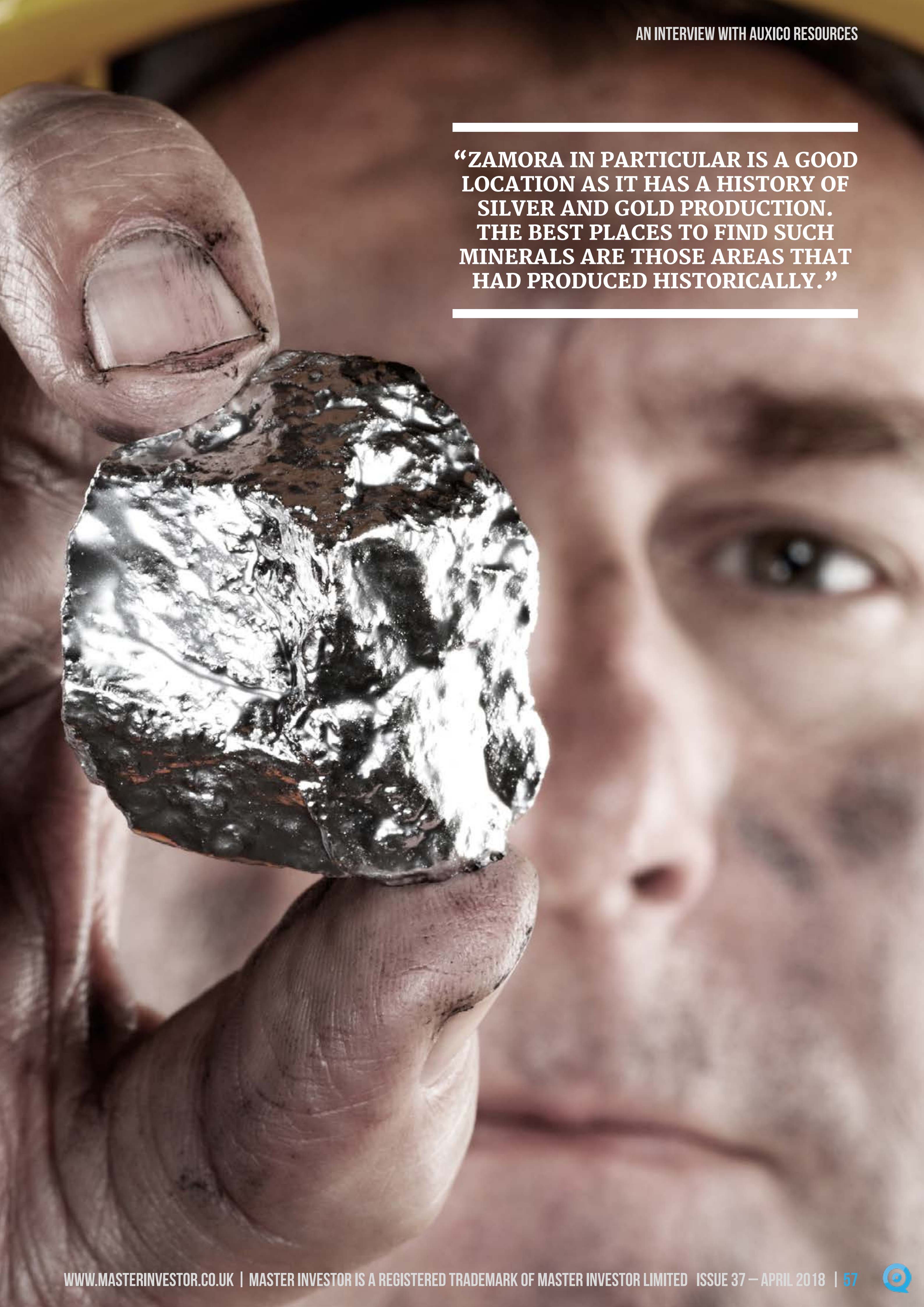
Mark Billings: *We listed on the Canadian Securities Exchange in October 2017. Since then, we have conducted a trenching and channel sampling campaign on two previous mines – Aguamas 1 & 2. We believe that we have identified another parallel structure on the property that is primarily a gold-hosting formation. Samples taken on surface were giving us half an ounce to an ounce of gold and the trenching between Aguamas 1 & 2 demonstrated gold on surface. This is a signature that there should be gold on this section of the Zamora Property.*

JF: Historical workings on the Zamora Mineral District date back to the 1800s and the remaining infrastructure was partially restored in the 1980s by the Mexican Mineral Resource Board, who evaluated the mineral potential and confirmed the district's potential to host high grade precious metal deposits. What are the attractions of working in a region with historical pedigree with regards to mining?

MB: *Mexico is a great place in which to do mining. It is a friendly jurisdiction and has a very good history of silver and gold production, as the mining laws were recently updated. The best places to find gold and silver are those areas. Zamora in particular is a good location as it has a history of silver and gold production. The best places to find such minerals are those areas that had produced historically. At Zamora, the ore was so rich, that is was shipped directly to a nearby mill for processing. The former tenants simply followed the veins into the earth to harvest that ore. We have discovered that those veins are hosted in a system that produces silver and gold that is just as rich. A lot of material was left behind – material that we hope to process.*

JF: Hecla Mining, the largest silver producer in the US, own a high-grade silver project in the neighbouring state which is producing to the tune of $97 million in free cashflow. What similarities does Zamora share to the Heckler property?

MB: *I think there are definite similarities between Zamora and the San Sebastien mine of Hecla. They are both high-grade silver, with gold as well. They have a 500 tonne per day mill that, funny enough, was built by our geologist Joel Scodnick in the 1990s. They have been able to generate such high cash flow because*



"ZAMORA IN PARTICULAR IS A GOOD LOCATION AS IT HAS A HISTORY OF SILVER AND GOLD PRODUCTION. THE BEST PLACES TO FIND SUCH MINERALS ARE THOSE AREAS THAT HAD PRODUCED HISTORICALLY."

the grade – and hence revenues – is high and the operating costs are low. Their average grade of silver must be between 700 and 800 grams per tonne, with gold credits as well. (Their actual cost of producing silver is negative when you take into account such credits!) We would like to follow their example and start a small operation on site that would process high-grade silver as well. We have identified areas of the property that have generated grades of over 1 kg of silver, with gold as well. If so, we can start to generate cash flow for our company. Hecla's San Sebastien mine is a good case study for what we hope to do at Zamora.

JF: With grades of over 1kg Ag, this sounds like a miner's dream come true! How come Zamora remained under the radar for so long?

MB: *There was never any history of exploration on the property, which was mined artisanally by local Mexicans. The ore was so rich that they bypassed exploration to go right to production. In our industry, companies typically explore, find an economic mine and put it into production. This is our opportunity. By applying a more scientific approach to Zamora, we hope to uncover what we believe to be a huge opportunity.*

JF: How close is Auxico to first production and ultimately generating cash flow for shareholders?

MB: *We have to order a mini mill and get it shipped to the property. This costs about $500,000. Before that, we would like to do a small exploration campaign on some of the higher-grade areas of the property to test the grade. We plan to get all of this underway in 2018.*

JF: Earlier this year Auxico acquired 13 gold and cobalt prospects in Colombia. Can you provide an insight into the logic of this acquisition?

MB: *We just announced the acquisition of these prospects in Colombia (the Metalor Property). This country is very rich geologically but was ignored by the mining and investment community because of the situation between the government and the FARC rebels. That is no longer an issue. We decided to look at Colombia because we have very good connections in this country. Our geologist visited the Metalor property and took some samples, which generated substantial results, which we published recently. Of the six samples, we had an average of 1,300 grams of scandium and 21 grams of gold over a 480m x 480m area. The gold results are very high grade. The scandium results are very interesting. This is a rare earth element that sell for $4,000 to $15,000 per kilogram. It is used in aluminium alloys and the supply is very scarce. If Metalor has significant scandium, this could be quite*

About Mark

Mark Billings has an MBA from the Harvard Business School and he is a Chartered Financial Analyst. He has been an investment banker, having raised hundreds of millions of dollars for small-cap companies, including several junior mining companies. Mr Billings also founded and managed companies in the junior resource sector, in addition to being CEO, CFO or a director of a number of publicly traded resource companies in Canada and abroad.

“BY APPLYING A MORE SCIENTIFIC APPROACH TO ZAMORA, WE HOPE TO UNCOVER WHAT WE BELIEVE TO BE A HUGE OPPORTUNITY.”

valuable to Auxico. Plus, the gold is high-grade. We decided to stake these claims in Colombia as this is an opportunity for us and did not want to let it slip by.

JF: **I'd like to talk a bit about the prospects for silver if we may. Silver is often mentioned in the same vein as gold when it comes to precious metals, yet it exhibits its own particular characteristics. This is primarily due to the fact that silver has a much greater variety of industrial applications, which account for around 50% of global demand for the metal. What are the attractions of owning silver at this point in the cycle, and in particular what are the benefits of doing so through a mining company like Auxico?**

MB: *I am surprised that silver has not moved up in price. I personally expect this to happen for a number of reasons. Silver and silver powders are being used in key sectors of the new economy, such as solar panels, as well as being increasingly used in automotive and other applications. The gold to silver ratio is also quite high. Historically, the ratio was about 50. It is now about 80, which means gold is either overvalued (which I do not think so) or silver is undervalued (which I believe to be the case). Given the price at about $17 per oz, I think silver is affordable and should be in one's portfolio. The advantage of owning silver through a company such as Auxico is that, once the company produces silver and assuming an upward move in silver prices (even into the $20 range), that would increase significantly the profitability of our operations.*

JF: **What are some of the nascent applications of silver that our readers might not be aware of?**

MB: *It is one of the most fascinating elements. We know it is used as a currency. It has antimicrobial qualities and is used in lab coats, for example. It is used in medicines and food garnishings. It is used to purify water and is present in laundry detergents. It is used in batteries and engines, as well as stained glass. In addition, I mentioned its use in solar panels as it is the element with the highest electrical and thermal conductivity. It is also increasingly used in 3D printing.*

JF: **What about the prospects for silver as a store of monetary value? As interest rates look set to rise around the world, the opportunity cost of holding bullion will increase. Won't this act as a drag on demand for the metal, notwithstanding the very bullish industrial outlook?**

"HECLA'S SAN SEBASTIEN MINE IS A GOOD CASE STUDY FOR WHAT WE HOPE TO DO AT ZAMORA."

MB: *This could, you are correct. In recent years, gold and silver have played against the stock market. As the markets go up, people invest less in these stores of value and more in the stock market. However, I think that the increasingly important industrial applications of silver will increase demand for this metal in sectors in which it was not previously present (e.g. 3D printing).*

JF: **Finally, what catalysts should investors be looking out for in future?**

MB: *The catalysts include exploratory work at Zamora and the acquisition of a mill for production. We will also focus on our Metalor Property in Colombia with additional sampling and geological work. If any of the geological work returns high grades of silver, gold, scandium or cobalt, this could have a significant impact on our company.*

About James

Our Editorial Director, James Faulkner, began investing in the stock market in his early teens. With over a decade of experience covering the stock market under his belt, he has also been a judge at the Small Cap Awards, and is an Associate of the Chartered Institute for Securities & Investment.

BY DAVID JONES

CHART NAVIGATOR

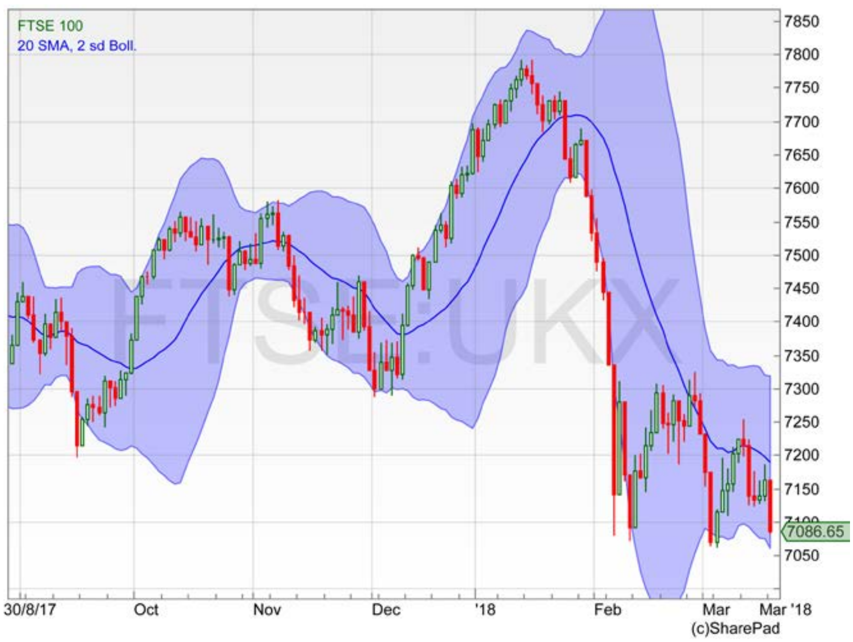
HOW TO INTERPRET BOLLINGER BANDS

I thought this time around we would take a look at a popular technical indicator and how it can be used to help improve timing for trades and investments – and also could actually serve as a warning that a major move is coming.

The problem with Technical Analysis

This paragraph is maybe an odd one to have in an article on charting and technical analysis. I might be guilty of grumpy old man syndrome here, but the problem these days is that software and trading platforms make technical analysis a little bit too easy – on the surface anyway. Before you know it, you can have multiple moving averages, Fibonacci lines, stochastics all overlaid on your chart. All very pretty – but also quite a distraction from what is actually going on with the price.

And there's the problem. Far too many people new to markets – and shorter-term trading in particular – think that the secret to unlocking unlimited profits from the markets lies in getting the values on a particular indicator *just right* – and then that is it – the free money starts pouring in.



Whilst these indicators have their uses from time to time, they are no Holy Grail, which is why I try not to fill every monthly article with a different one. But, given some of the increased volatility we have seen in stock markets in recent weeks, I thought a technical indicator that tried to help quantify volatility could be of some use. But it is definitely not a Holy Grail!

The theory behind Bollinger Bands

Bollinger Bands were developed by John Bollinger, so no prizes for guessing where the name comes from. Let's take a look at them on a chart and then explain how this technical indicator is made up.

Very pretty, I am sure you will agree. The candlesticks on the chart are the

"ONE WAY TO USE THE BOLLINGER BANDS IS AS A FORM OF FLOATING SUPPORT AND RESISTANCE, WRAPPED AROUND A 20-DAY MOVING AVERAGE."

FTSE100 index – this is a daily chart. What we are concerned with here first of all is the line that is loosely following the direction of the market, and the two bands above and below this line.

The line is a 20-day simple moving average. All this shows is the average price of the last 20 days. Clearly, as a new day finishes this line will change in value. Traditionally, moving averages can be used to give their own buy and sell signals. For example, when the price of the market moves above the line, this is considered a buy signal – and vice versa when it drops below the line. But we are not concerned with that approach here. In this example, the moving average is simply acting as a basis for the Bollinger Bands.

These two bands are based on a mathematical calculation. They are placed *two standard deviations* above the moving average, and the same amount below the price. By using two standard deviations, it is expected that approximately 90% of the price movement of the market being analysed will occur within those bands. As volatility decreases the bands will move closer to the moving average – as volatility increases then the bands will widen and move further away from the moving average.

“SOME TRADERS WOULD USE TIGHT BOLLINGER BANDS AS A SIGN THERE IS A SIGNIFICANT MOVE JUST AROUND THE CORNER FOR THAT MARKET.”

Generating signals

There are a couple of ways Bollinger Bands can be used. One way is as a form of support and resistance. It helps if we think of the price of a market as being like an elastic band and getting stretched above and below its "true"

“THE INTERPRETATION OF BOLLINGER BANDS IS MORE ART THAN SCIENCE BUT THAT DOES NOT MEAN THEY DON’T HAVE THEIR USES.”

value point. When it gets stretched so far in one direction, a return to the median would normally be expected. This is a technique that plenty of other oscillators use when talking about the idea of overbought or oversold markets.

With Bollinger Bands, when it moves to the lower band, one view is that this should act as a support zone and the market should rotate back towards the upper band. I think there is a reasonable example of that happening in December last year on the FTSE. Here's the chart.

There are three days at the beginning of December where the FTSE trades around the 6,700 mark, right on the extreme of the lower Bollinger Band – and actually probing through during the day. Now, if the bands are meant to catch 90% of price action, then the expectation at the moment is that the price is at the lower extreme and chances are for a swing back upwards. This did happen as can be seen from the right side of the chart with the market gaining around 300 points, or 5% in fairly short order.

But – and this is a big but, and links back to the problem with technical analysis mentioned at the beginning – one swallow does not make a summer: don't think this example shows that Bollingers are a great way to trade the FTSE. I don't think these sorts of indicators should be used in isolation. Adding weight to the "buy the FTSE" argument was the fact that the FTSE was also trading near an important prior low on the chart. The November previous low came in around 6,675, so that was extra confirmation (and arguably more important than the Bollinger Band signal) that perhaps the FTSE slide had gone far enough for now.

So, it is clear that one way to use the Bollinger Bands is as a form of floating support and resistance, wrapped around a 20-day moving average. But another way is to observe the behaviour of these bands. When they narrow, for example, and start moving closer to the central moving average, it is a sign that volatility is dropping off – the swings in the markets are calming down. These bands tend not to stay close together for long – so some traders would use tight Bollinger Bands as a sign there is a significant move just around the corner for that market.

Here is an example from FTSE100 oil giant **Royal Dutch Shell (LON:RDSB)**. We can see that in July last year the price was drifting lower, but with very little in the way of volatility. As you can see on the chart, the bands get really narrow (relative to where they had been) recently. Fans of Bollingers would see this as a suggestion that the market was about to experience a large move – but the bands don't really forecast which way this will be. Technically all we can expect is an explosive move. As we can see, during August the price of Shell did go on to rally by approximately 10%, and the Bollinger Bands quickly widened to take into account this increase in volatility. When the bands go relatively wide, the expectation is for volatility to start to drop off and for the trend to stop – but it is notoriously difficult to predict the end of trends so personally I prefer to use the approach of the bands tightening to warn of an explosive mood. When this happens, it is easier to control risk by setting stop losses the other side of the tighter range.

I think the interpretation of Bollinger Bands is more art than science but that does not mean they don't have their uses. I don't think it's an approach that should be used in isolation, but with other classic chart formations such as support and resistance and trend, they can help "take the temperature" of the market and give you an easy insight as to how volatile it currently is, compared to where it has been, and the chances of that changing.

About David

David Jones qualified as a technical analyst in 1995 and started his City career as a currency analyst. He then went on to work for trading companies CMC Markets and IG Group as Chief Market Strategist. Since leaving the industry in 2013 he has been a presenter on BBC Radio 5 Live's Wake up to Money programme and the Chartist for Shares magazine. He is an active trader and private investor.

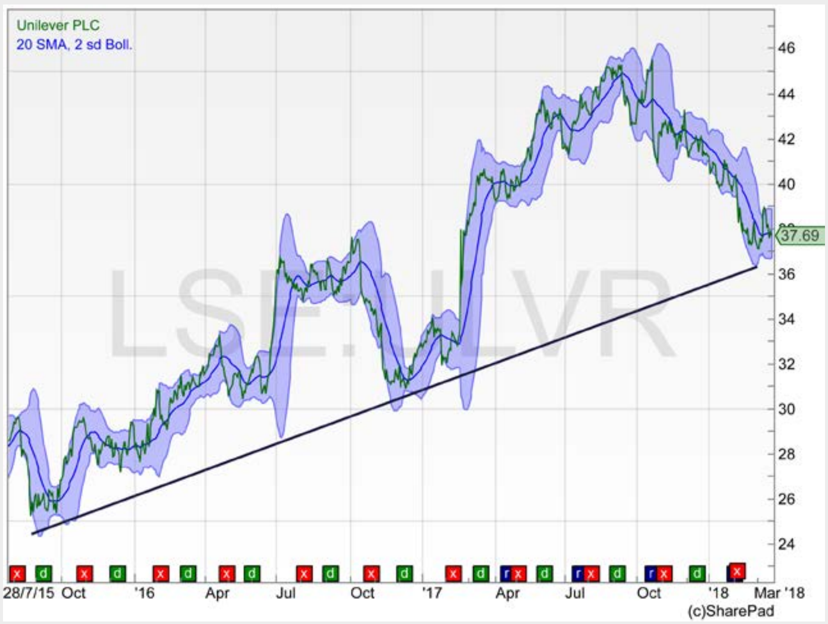
Chart of the Month – Unilever

Sticking with the theme of Bollinger Bands makes FTSE100 company **Unilever (LON:ULVR)** an interesting set-up at the moment. Here's the chart with the now familiar bands overlaid.

First of all, the bands were fairly wide apart during February as volatility was on the up, but they have narrowed since. The daily gyrations have reduced but this could be a suggestion that a bigger move could be coming. So that is one reason to think there could be an opportunity here. Let's take a look at the bigger picture.

Although the Bollinger Bands are on this bigger picture view, it is not the important consideration here. For me it's the longer-term trend that has been in place for almost three years. The drop in the price from the 4,600p area down to 3,800p has brought the price back to this longer-term trend support. In a nutshell, if the price is going to recover from anywhere then this is the place.

So, in this example – as with others – the Bollingers are not forecasting that the price is going to recover. But they are signalling that an increase in volatility could be just around the corner. Given the prior trend in this share price, the expectation would be that a move upwards is the more probable outcome here.



BY DAVID JONES

FORENSIC FOREX

BITCOIN: THE FUTURE OF CURRENCY?

This month, I have finally succumbed. After years of commenting on, and trading actual real currencies, I thought it was time to dip my toe in and write about the virtual world of the cryptocurrencies. Unless you have been living "off the grid" over the past six months, you will have heard plenty about the likes of Bitcoin, Ripple, Ethereum and the many other members of the cryptocurrency family. And maybe like me you have actually traded them a bit as well. It's a timely moment I think to take a sensible, no-hype look at what has been going on – and what the future may hold. We will focus on Bitcoin – but much of what has happened in recent months is equally applicable to the others.

What is Bitcoin?

Bitcoin is a digital asset, a virtual currency – call it what you will – designed to work as a form of payment. It works without the need for a central bank (like the Bank of England, US Federal Reserve etc.). Transactions get recorded in a public ledger called a blockchain. These blocks are linked – once recorded this data cannot be changed without changing all the blocks after it. This gives the blockchain an apparent high level of security and goes some way to explaining the appeal of a cryptocurrency for financial transactions.

Why has there been so much hype?

There are a couple of reasons for this. First of all, some fans of Bitcoin and the wider idea of cryptocurrencies are almost evangelical in their conviction that this is the future of currencies. Did someone say, "the cult of the crypto"? Bitcoin has been around for years but what has happened over the past 12 months or so has emboldened the early (and not so early) adopters of the idea of cryptocurrencies. Which brings us to the second point. At the beginning of 2017 one Bitcoin was worth around $1,000. Less than a year later, it had almost reached $20,000. There's nothing like a meteoric rise in an asset to bring it to the attention of the media and then, of course, the wider public.

Driving the rise was an increasing belief amongst a few, then some more, then many more, that actually, maybe the crypto fans could be onto something here. Suddenly, every man and his dog (or K-9, as we are in the virtual world here, for older fans of Dr. Who) seemed to want a slice of the action. When buyers are chasing a market, whether that is the price of gold, tulip bulbs or late-1990s technology stocks, there is only one way that price is going to go. And it can often go parabolic, which is what we saw from Bitcoin.

The late 1990s technology stock comparison is an interesting one. Plenty of people (me included) felt that the Bitcoin move in the last few months of 2017 had a close resemblance to the fever we saw during the dot-com days. People wanted in at any price and suddenly those who had never invested or traded before wanted to be Bitcoin buyers. This sort of fever only ever ends one way – badly – but market tops are notoriously difficult to predict. But the top came, and this is what we have seen since that mythical $20,000 level was almost reached.

Well, colour me surprised. The price has come back down to earth with a bump. It's always the way of course with market manias – all the way back to the tulip bulb bubble in the 1600s. And plenty of late Bitcoin buyers would have no strategy for either taking profits or minimising losses so will have sat through the 60% decline from the highs.

What's next?

I think this is where it could get interesting again. We have been through the "just get me in at any price" phase – with plenty assuming it was going to the moon. Perhaps now we will see it trade more like a "traditional" currency pair. Although with cryptocurrencies that is all relative. With daily volatil-

> **"THE $6,000 AREA FOR BITCOIN REMAINS AN INTERESTING LEVEL TO WATCH."**

ity still often in the range of around 10%, the likes of Bitcoin still move a lot more than your typical currency pair or most listed company shares. But we have seen a lot of froth leave the crypto-arena in recent months as prices have come back down to earth with a bump.

From a charting point of view, at the time of writing, the $6,000 area for Bitcoin remains an interesting level to watch. Back in November 2017, although prices were rising, this does represent the lows before Bitcoin went truly stratospheric. It was also a major turning point during February of this year, setting up a near doubling of the price, before falling back once more. So, to use the term "value" loosely, $6,000 has been seen as an area of value for the cryptocurrency in recent months and it is well worth keeping an eye on this level to see if the same thing happens next time around.

From a more fundamental point of view, I think the bigger question does link back once again to those dot-com boom days. Yes, the internet changed the world and was here to stay. But plenty of the companies that were around at that time failed to make it too far into the 21st century when the mania died away. Blockchain technology and cryptocurrencies do look like at least a part of our financial future – but does whatever is destined to be the widely accepted crypto in 15 years' time even exist today? Will the early pioneers go the way of Ask Jeeves and My Space, to be replaced by the new Googles and Facebooks?

It is going to be fascinating. And from a short to medium term point of view there is no reason at all not to get involved in trading in the daily gyrations – just make sure to manage the downside risk of these volatile markets. And remember – as many new entrants have learnt to their cost – a profit isn't a profit till it is booked.

About David

David Jones qualified as a technical analyst in 1995 and started his City career as a currency analyst. He then went on to work for trading companies CMC Markets and IG Group as Chief Market Strategist. Since leaving the industry in 2013 he has been a presenter on BBC Radio 5 Live's Wake up to Money programme and the Chartist for Shares magazine. He is an active trader and private investor.

BY RICHARD GILL, CFA

BOOK REVIEW

DEEP VALUE INVESTING 2ND EDITION

FINDING BARGAIN SHARES WITH BIG POTENTIAL

BY JEROEN BOS

Economists, stock analysts, fund managers and the like spend an awful lot of time trying to predict the future. Some are very good at it and go on to use that information to make money in the markets. But, on the whole, financial forecasters are known for being a pretty useless bunch.

James Montier, the value investor and author, is a particular critic of forecasting. In his book *Value Investing* he found that when analysts applied discounted cash flow models, such as those used in forecasts, then the average 24-month forecast error was 95% and the average 12-month forecast error 43%. He concludes, *"frankly the three blind mice have more credibility than any macro-forecaster at seeing what is coming"*.

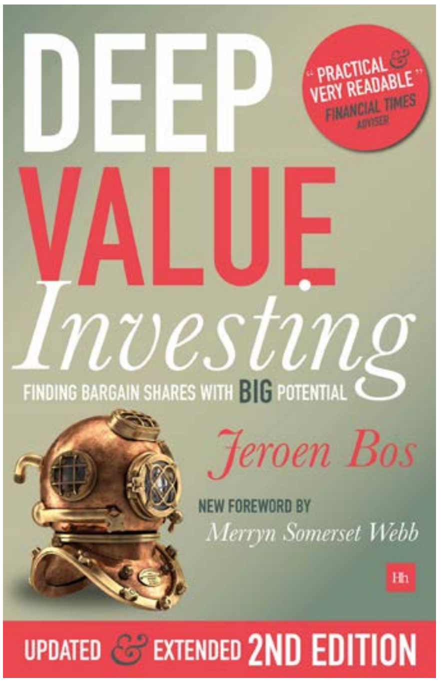
Given its dubious rate of success, it is surprising the amount of time equity analysts spend on forecasting. This is especially so when the history of investing shows us that it is possible to make money from stocks without having to bother with trying to predict the future at all. Instead, all an investor has to do is look at a share's current price, compare it with historic earnings or net assets to determine whether it is cheap or not, and buy accordingly – an approach otherwise known as value investing.

"IT IS POSSIBLE TO MAKE MONEY FROM STOCKS WITHOUT HAVING TO BOTHER WITH TRYING TO PREDICT THE FUTURE."

Many studies have shown the rewards of value investing. In his book *What Works on Wall Street* James O'Shaughnessy suggests that if you had put $10,000 into stocks with a high P/E ratio at the start of the 52 years leading up to 2003 you would have had $793,558 at the end of it – a compound annual growth rate (CAGR) of 8.8%. Yet, the same amount put into low P/E stocks would have resulted in an $8,189,182 fortune – a CAGR of 13.8%.

This approach is not quite so simple however, as investors need patience to eventually realise returns in out-of-favour value stocks. Exactly when the markets eventually will reflect their true "intrinsic" value is unknown. On a psychological basis too it is hard to invest in companies the rest of the market finds unfashionable. And of course, just because an investment is cheap doesn't mean it is a good one.

In *Deep Value Investing*, author Jerome Bos goes one step beyond the value investing philosophy and introduces the "deep" value investing concept. Bos is a fund manager at Church House Investment Management where he looks after the CH Deep Value Investments Fund. He has worked his entire career in the financial services industry, mainly in the City of London, where he worked for many years at stockbroker Panmure Gordon & Co. and developed an interest in value investing. This process accelerated after the October 1987 stock market crash, during which



time he took inspiration from the classic *The Intelligent Investor* by Benjamin Graham.

Buying a tenner for a fiver

The first part of the book covers the philosophy of deep value investing. Put simply, the approach focusses on buying stocks which trade at a discount to their assets, with assets on the balance sheet being concentrated on rather than uncertain and volatile earnings. Going one step further, the approach ignores fixed assets, which are hard to liquidate, and focuses on the more liquid current assets such as inventories, debtors and cash.

Companies which are trading at a discount to their current assets less their total liabilities are known as "net-net" or "bargain stocks". In other words, these stocks are trading at less than the value of the relatively liquid assets on their balance sheet. For example, a net-net stock might have current assets that are £10 million higher than its total liabilities, with a market cap of just £5 million. So in effect, investors have the opportunity to buy a tenner for the price of a fiver. Therefore, in theory, even in a worst case scenario investors will not lose money as even if the company is liquidated the value of the current assets will be higher than the liabilities. Any fixed assets are also thrown in for free.

Part Two of the book looks at some deep value successes which Bos has enjoyed over his career. These mainly include service companies, such as recruitment firms, financial services companies, consultants and housebuilders, whose price movements tend to be cyclical, providing opportunities to buy them cheaply at some point. To give one example, Bos invested in financial services recruiter Spring Group in December 2008 at 22p. Then trading at a substantial net-net discount, he exited just ten months later at 62p per share after the company was taken over.

This is the second edition of a book which was originally published in 2013. While the core deep value investment philosophy has not changed since then, the book updates on the performance of investments flagged in the first edition, providing several additional case studies of new deep value investment opportunities. One great success of the first edition was housebuilder Barratt Developments, where Bos's fund sold its final holding at 652p in 2016, up from an original purchase price of 90p.

Of course, not every investment approach is totally infallible, with Part Three looking at several deep value failures, warning investors which characteristics to look out for in potential dogs. Finally, Part Four offers five companies which Bos believes could be the deep value shares of tomorrow.

Time to go hunting for value?

This is a great book for investors already familiar with the workings of the stock market and also a perfect primer for those looking for a potential low risk/high return strategy as they start to manage their own investments. It is refreshingly free of financial jargon and easily understood by anyone with only a basic knowledge of finance.

What's more, this could be an opportune time to get into deep value investing. As an investment approach, the wider value investing philosophy has fallen out of favour somewhat over the past few years. According to data from Morningstar/Schroders, around 40% of UK fund managers swayed towards value investing ten years ago but that has now fallen to around 14%. So with markets tending to revert to the mean, deep value investors could be looking at some good returns over the coming years.

In addition, the implications of the recent MiFID II regulations should provide an increased opportunity for deep value investors. Under the new EU rules, brokers are forced to charge clients separately for their research, making it increasingly uneconomic to cover small caps. Thus, fewer investors will be made aware of deep value opportunities. Those investors wanting assistance from a top fund manager in identifying those opportunities should buy this book.

About Richard

Richard Gill is an investment analyst with over a decade's experience of analysing small/mid cap equities. He is the Head of Research at Align Research. Richard qualified with the Chartered Financial Analyst (CFA) designation in 2012 and was awarded PLUS Markets Financial Writer of the Year at the 2008 PLUS Awards. He has been a judge at the Small Cap Awards from 2013 to 2017.

BY TIM PRICE

THE FINAL WORD

THE PROBLEM WITH GROWTH

One of the most influential things I have ever seen is a presentation on YouTube. Its formal title is *Arithmetic, Population and Energy* but it is described, for once, I think, without too much exaggeration, as *The most important video you'll ever see.* You can judge for yourself and watch it here.

The presenter is the late Dr Albert Bartlett, an emeritus professor of physics at the University of Colorado at Boulder. He is believed to have given this presentation over 1,700 times during the course of his career. Without giving too much away, Dr Bartlett makes two key points. One of them is that, as humans, our biggest frailty is our inability to understand the power of the exponential function – that is, something growing at a steady rate over time. It is also known as the miracle of compounding, something that Einstein allegedly referred to as the eighth wonder of the world. The second point, related to the first, can be summarised in his quote: "For any entity beyond maturity, further growth is either obesity, or cancer".

All very interesting, you might say; but what does this have to do with the financial markets?

Plenty. We live in a physical world constrained by finite limits. No matter how ingenious humanity gets, we

"IF YOU WANT TO KNOW WHO PUBLIC ENEMY NO.1 IS IN THE CONTEXT OF THE RISING WEALTH INEQUALITY THAT WE HAVE EXPERIENCED OVER THE PAST DECADE LOOK NO FURTHER THAN OUR CENTRAL BANKS."

cannot conjure up an infinite amount of food or energy (at least, not yet). But the world of finance seems to operate as if there were no constraints on anything. Our appetite for credit alone appears utterly boundless.

We can indeed make an argument that the world of finance now requires constant growth, simply in order to service the debt pile amassed by governments, households and corporations. Without constant economic growth, the bond market is reduced to a house of cards.

Perhaps the most shocking financial statistic was the one revealed by the consultants McKinsey back in early 2015. Contrary, perhaps, to the understanding of some, austerity never happened. In the years since the Global Financial Crisis that ignited in 2007, global debt levels did not contract. They grew. No major economy managed to reduce its debt-to-GDP ratio since 2007. Global debt, in fact, grew by some $57 trillion. Yes, that's *trillion* with a 't'.

Squaring the debt circle

We can plausibly argue that Quantitative Easing (QE) was all about tackling this monstrous debt pile. If you accept my thesis that Finance World is facing a possibly existential crisis over an unmanageable mountain of debt, you should probably accept my suggestion that there can only be three ways of resolving the problem.

One is for the major governments of the world to engineer enough economic growth to keep the debt serviced. The demographics of the eurozone alone suggest that such 'permagrowth' is unlikely there. The second is to default on the debt. If you prefer, you can sugar-coat the outcome with the words 'debt jubilee' or 'restructuring,' but it amounts to the same thing. A broad-based default would also instantaneously bankrupt the global banking and pension fund industries, as the largest holders of said debt. So, what's in Box Number 3? What's in Box Number 3 happens to be what all governments throughout history have resorted to when they get desperately out of their depth in debt: *inflation*.

So, it's entirely plausible that QE was created to square the debt circle. Default on the debt in such a way that most people barely recognise what's going on. Stealth default, if you like. It happens to be the crowning irony of monetary policy that QE never managed to deliver the inflation its governments wanted, to help them out of the debt quagmire. But it did manage to create inflation in the prices of financial assets, bonds, stocks, property and rich boys' toys. So if you want to know who Public Enemy No.1 is in the context of the rising wealth inequality that we have experienced over the past decade ("For whosoever hath, to him shall be given, and he shall have more abundance: but whosoever hath not, from him shall be taken away even that he hath") look no further than our central banks.

So now we face an intriguing challenge. The debt pile has simply got bigger – and it was already unsustainably high a decade ago. Monetary policy rates (short term interest rates) are now rising in the US and the UK. There is one iron law in finance, and it suggests that if interest rates go up, bond prices go down. This is because bonds' coupon payments, being in most instances fixed, become comparatively less attractive when deposit rates rise, so the price of those bonds falls in order to compensate their investors.

"Riskless" assets?

Whether you can even call bondholders 'investors' at this point in time is something of a moot point. The great value investor Benjamin Graham offered a definition of investing in his seminal work *Security Analysis* of 1934, co-authored with David Dodd: "An investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculative."

10-year UK government bonds, or Gilts, at the time of writing offered a nominal yield of roughly 1.5%. Given that UK inflation currently stands at approximately 3% (put to one side whether that's an accurate reflection of our real rate of inflation), and assuming that it doesn't change over the next decade, that effectively means that Gilt 'investors' today are locking in a guaranteed 1.5% real terms loss. Safety of principal? Satisfactory return? That makes bonds today look somewhat speculative, in my view.

So, it is rather awkward that the financial regulator, and by extension most wealth managers, regard government bonds as the only thing approximating to riskless assets within a balanced portfolio. Riskless? A Gilt investor in 1973 subsequently incurred a real term loss of over 35% of his capital. He did not make any positive return from his Gilt portfolio until 1985. That's a 12-year period of no real returns. Gilt yields today are far lower than they were in the 1970s. The capacity of the Gilt market to deliver shocking returns for 'investors' today should not be underestimated.

For all of these reasons we have pretty much eliminated bonds from our client portfolios. But given that both bond and stock markets are trading at levels that could fairly be described as elevated, there are clearly other risks to be faced.

The Power of Gold

When Ben Graham referred to "safety of principal" it's not clear whether he was referring to the 'store of value' properties of money itself. Given that the pound sterling has lost roughly 98% of its purchasing power over the last century, it's useful to consider ways in which we might try to protect our own purchasing power, as savers and investors, in the years to come. It's for this reason that we see especial merit in having an allocation of personal capital to a form of money that can't simply be printed on demand out of thin air. That form of money is, of course, precious metal: the likes of gold and silver.

Gold remains, in my view, one of the most misunderstood assets in the world. Like the topic of Brexit, it tends to provoke strong emotional responses and passionately polarised opinions. I particularly like this anecdote from Peter L. Bernstein's book on the subject, *The Power of Gold:*

> *About one hundred years ago, John Ruskin told the story of a man who boarded a ship carrying his entire wealth in a large bag of gold coins. A terrible storm came up a few days into the voyage and the alarm went off to abandon ship. Strapping the bag around his waist, the man went up on deck, jumped overboard, and promptly sank to the bottom of the sea. Asks Ruskin: 'Now, as he was sinking, had he the gold? Or had the gold him?'*

When we discuss gold with clients, we invariably get asked at what price point we intend to take profits and liquidate our holdings. But this skirts over the question of why we elect to hold gold in the first place. We hold gold because we anticipate a perhaps disorderly breakdown in the global monetary system – on the back of that unsustainable mountain of debt. It's entirely plausible that the 'resolution' of the debt crisis could bring in its wake either a messy inflation, or a troubling deflation, or perhaps even both. Fiat currency in any event looks like a poor potential store of value. No unbacked paper currency has ever lasted. Gold, on the other hand, has been a useful and defensible store of value across thousands of years.

The problem with growth is that sooner or later it comes to an end. Now that we can add the threat of trade wars to the other problems facing the world economy, it seems increasingly likely that 2018 will reward strategies offering the prospect of capital preservation as opposed to those seeking growth at any cost.

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About Tim

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MARKETS IN FOCUS

MARCH 2018

GLOBAL EQUITIES

Index	Last Month %	YTD%	Proximity to 52w High*
Euronext 100	-1.6	-2.8	
Bovespa	-1.7	11.7	
FTSE 100	-2.4	-8.8	
Hang Seng	-2.4	-0.9	
IBEX 35	-2.4	-4.9	
S&P 500	-2.7	-2.2	
DAX Xetra	-2.7	-7.9	
Nikkei 225	-2.8	-6.4	
CAC 40	-2.9	-3.3	
Russian TSI	-3.4	7.3	
Dow Jones	-3.7	-2.8	
NASDAQ 100	-4.0	1.0	
S&P/ASX 200	-4.3	-5.2	

COMMODITIES

Commodity	Last Month %	YTD%	Proximity to 52w High*
Cocoa	15.0	45.7	
Crude oil (Brent)	6.4	1.8	
Crude oil (Light Sweet)	5.0	5.1	
Natural Gas	29.0	-8.5	
Gold	0.2	1.9	
Silver	-1.6	-4.5	
Cotton	-1.0	7.5	
Coffee	-2.4	-3.3	
Platinum	-6.1	-1.0	
Sugar (No. 11)	-4.0	-8.4	
Copper	-4.4	-7.5	
Palladium	-8.7	-12.6	
Iron Ore	-17.0	-2.7	

FOREX

Pair/Cross	Last Month %	YTD%	Proximity to 52w High*
GBP/AUD	3.1	6.2	
EUR/CHF	2.0	0.7	
GBP/USD	1.6	4.3	
USD/CHF	1.1	-1.8	
EUR/USD	0.9	2.5	
USD/CAD	0.7	1.8	
EUR/JPY	0.5	-3.4	
USD/JPY	-0.4	-5.7	
EUR/GBP	-0.6	-1.8	
AUD/USD	-1.5	-1.7	

CENTRAL BANKS - RATES & MEETINGS

Central Bank	Key Rate	Next	After
BOE	0.50%	May 10	Jun 21
ECB	0.00%	Apr 26	Jun 14
FED	1.75%	May 02	Jun 13
BOJ	-0.10%	Apr 27	Jun 15
SNB	-0.75%	Jun 21	Sep 20
BOC	1.25%	Apr 18	May 30
RBA	1.50%	May 01	Jun 05
RBNZ	1.75%	May 10	Jun 28
BOS	-0.50%	Apr 25	Jul 02
BON	0.50%	May 03	Jun 21

FTSE 350 TOP

Sector	Last Month %	YTD%	Proximity to 52w High*
NEX Group PLC	46.0	59.3	
Hikma Pharma PLC	40.0	8.6	
Hammerson PLC	20.0	-2.2	
FDM Group Holdings PLC	18.0	11.3	
TBC Bank Group PLC	18.0	2.8	

FTSE 350 BOTTOM

Sector	Last Month %	YTD%	Proximity to 52w High*
Micro Focus Int. PLC	-52.0	-60.8	
Aveva Group PLC	-34.0	-31.6	
Greencore Group PLC	-25.0	-43.1	
Inmarsat PLC	-23.0	-30.8	
Ferrexpo PLC	-22.0	-16.5	

FTSE 350 SECTORS TOP

Sector	Last Month %	YTD%	Proximity to 52w High*
Pharma & Biotech	6.7	-1.4	
Gas, Water & Mult	6.5	-9.1	
Personal Goods	5.6	-5.9	
Automobiles & Parts	5.4	34.0	
Real Estate Inv. Trusts	4.4	-4.7	

FTSE 350 SECTORS BOTTOM

Sector	Last Month %	YTD%	Proximity to 52w High*
Soft. & Computer Serv.	-23.0	-30.6	
General Retailers	-8.7	-10.3	
Food Producers	-7.1	-17.4	
Banks	-6.6	-10.0	
Mining	-6.4	-8.7