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MAGAZINE

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SPRING CLEAN YOUR FINANCES

PLUS...

INVESTING DOWN UNDER

OPPORTUNITIES ABOUND IN AUSTRALIA AND NEW ZEALAND

BREXIT BRITAIN

WHY FILIPE R. COSTA IS BULLISH ON THE FTSE

ACTIVE OR PASSIVE?

WHICH STRATEGY WORKS BEST?

MELLON ON THE MARKETS

THE MASTER INVESTOR REPORTS FROM THE MILKEN INSTITUTE

WELCOME

Dear Reader,

Welcome to the May issue of Master Investor Magazine. It's a sad fact, but the average pension pot is just £50,000 and one in three retirees will have to rely solely on the state pension in retirement. And with the UK's state pension being one of the least generous in Europe, that's not a great prospect.

So, with the start of a new tax year, what better time to get a grip on your financial future? With that in mind, we've enlisted well-respected IFA Alan Steel of Alan Steel Asset Management to put together an action plan for readers looking to give their financial affairs an overhaul. But for those of you that are already on top of things, there are plenty of exciting investment ideas in the rest of this month's issue.

One area where UK investors as a whole score badly is geographical diversification. So-called home bias is rife in the UK, with many a portfolio overexposed to the domestic market. Given that the UK market has been an underperformer of late versus other developed markets, this means that many UK investors will have seen their portfolios underperform as well.

Historically, one of the reasons that investors favour the UK market is safety – our stock market is supported by a robust legal, economic and political system. But we should remember that there are other countries that share the same characteristics, not least Australia and New Zealand. With that in mind, this month, Victor Hill goes hunting for investment opportunities 'Down-Under'. Turn to page 16 and you'll find that Australasia is under-represented in UK portfolios despite an extraordinary track record of growth.

Meanwhile, closer to home, Filipe R. Costa gets bullish on the FTSE despite the headwinds posed by Brexit; John Kingham investigates why Centrica has such a high yield despite its defensive characteristics; and David Jones asks whether sterling's rally has run out of steam. For the more adventurous investors out there, Richard Gill is revisiting his 'dogs of AIM' theme, to pick out three high-yielders offering tempting prospects on London's junior market.

I hope you enjoy reading the latest issue as much as we enjoyed putting it together.

Best regards,

James Faulkner
Editor

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CONTENTS

ISSUE 38 – MAY 2018

ON THE COVER

FEATURE

ALL OTHER TOPICS

ALL OTHER TOPICS

048 From Acorns to Oak Trees – Dogs of AIM 2018

Richard Gill, CFA, looks at the top ten highest-yielding stocks on AIM and picks out three he believes may be worth a closer look.

056 Chart Navigator – How to profit from a false breakout

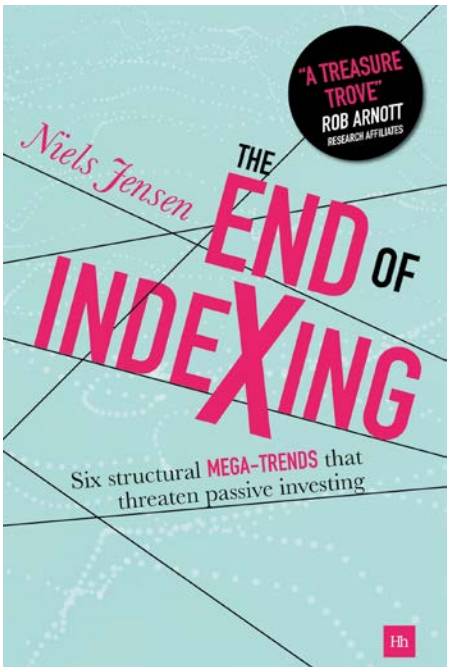
Veteran chartist David Jones take a look at the false breakout – something that can act as a major clue as to the market's next likely move.

062 Forensic Forex – Can sterling's rally continue?

Should we expect the pound's recovery to continue, or is it time to start thinking that maybe it has bounced back far enough for now? Ex-IG chief market strategist David Jones investigates.

066 Book Review – *The End of Indexing*

Richard Gill, CFA, reviews *The End of Indexing,* where author Niels Jensen argues that changes in the economic environment expected over the coming years will be unsuited to index-tracking strategies.



068 The Final Word – Mind games

Some of the latest research about how our minds really work has some profound implications for investors, explains fund manager Tim Price.

072 Investor Events Diary

All the hottest upcoming investor events in May.

074 Markets in Focus

Market data for the month of March.

BY JIM MELLON

MELLON ON THE MARKETS

It's late April in LA, it's raining, and it's time for the annual Milken Institute jamboree. Anthony Chow and I are here, having been relieved of a large sum in order to attend. As with most conferences, the true value is in the networking effect, not so much in what is said at the various sessions. Some of the thoughts expressed by the speakers are really interesting, but all of them are ultimately available online.

So, networking we have been, and there is still a day and a bit to go. After that, it's NYC and a final meeting before heading back to Europe. It's been a full round-the-world trip, since I've been hiking in Japan for ten days prior to that.

This hike took place in the poorest of the main Japanese islands, Shikoku, traipsing around Buddhist temples on what the guide described as a "pilgrimage" – but in reality, was a hard walk to gain as much exposure as possible to the beautiful countryside. Another side of Japan is visibly on display here: not the neon glitz of Tokyo or of Osaka, but the hollowed-out countryside, where there are very few children, where the average age of farmers is north of 70, and where people are mostly (relatively) poor.

Japan: defying the coming bear market

This is the Japan that reflects the grim demographics of the country, a country that is destined, in the ab-

"TAKE MY WORD FOR IT, FACEBOOK IS GOING DOWN, AND IT REPRESENTS THE GREATEST SHORT ON THE MARKET TODAY."

sence of a baby boom/and or immigration to see its population decline from 125 million today to about 50 million by the end of the century.

Japan is a world leader in robotics and in automation generally, and a trip to Shikoku is a brilliant eye-opener as to why it needs both robots and home-service help for its ageing population. There simply aren't enough young people to go around, and unless Japanese attitudes to foreigners change, there never will be.

That doesn't mean that Japanese standards of living have to fall; indeed, it is noticeable that in my thirty or so years of going to Japan, the country seems to have remained prosperous despite stagnant economic growth. This is partly due to the fact that there has been literally no inflation for two decades, as well as the fact that with a shrinking population, the GDP pie is split between fewer people.

It also means that for we foreigners, especially now that the yen is undervalued and relatively weak, Japan is no longer expensive. Sure, if you want to shop in Ginza or stay in the luxurious five-star hotels in Tokyo, you can – and will – pay a lot. But outside of those, the eye watering prices of twenty years ago have become downright reasonable!

I still think Japan is a market that can defy the coming bear market signals emanating from the US, and I still think that the Nikkei will go over 25,000 sometime this year, as the S&P and Dow stall.

D K Grove / Shutterstock.com

Facebook: firmly in the crosshairs

On that subject, my call on **Facebook (NASDAQ:FB)** – a short – looked damn good post-Master Investor, but not quite so clever post their results, which were stellar. Those results are a lagging indicator of Facebook's glory days; it is now a company with the appeal of a tobacco company, and its pariah status is only beginning to become apparent. The FTC could levy a fine of $40,000 per infraction of data protection, and if it did, Facebook would be bankrupt. That is unlikely to happen, but the big pots of money the FANG stocks are sitting on, must be tempting to governments and agencies everywhere.

Apparently, 75 governments have now demanded information from Facebook, and although the latter can afford the best lawyers and is adept at making insincere apologies, this time they are firmly in the crosshairs. Take my word for it, Facebook is going down, and it represents the greatest short on the market today, along with **Tesla (NASDAQ:TSLA)** (a cash crash in the making if there ever was one) and, probably, **Snapchat (NYSE:SNAP)** as well.

Speaking of maniacally crazy valuations, Bitcoin et al have reached the first plateau on their way to oblivion. If you still have any of these crypto things, and you're not a despot, money launderer or otherwise nefarious, it's time to get out. Despite some wild forecasts of vast appreciation to come, these cryptocurrencies are on the way down, possibly to where they started. Don't pay to play here, whatever the hipsters tell you.

Place your bets

Gold and silver keep on banging around in a range, buffeted by the winds of macro change. Those winds are now

"TRUMP IS HERE TO STAY AND HE IS DOING TO IRAN WHAT HE DID TO NORTH KOREA."

beginning to blow in one broad direction – and that is a move to higher inflation (good for precious metals) spurred by capacity constraints in many major economies, as well as incipient wage pressures.

My bet remains on gold and silver, especially in an environment of bond market bearishness. It is only a matter of time before the important US 10-year bond yield goes decisively above 3%, a key psychological indicator. The supply of bonds in the Trump era of tax cuts and deficit spending will be staggering, and as the supply increases and interest rates rise, there will of course be a bigger interest bill to pay, exacerbating those deficits. Not a pretty picture.

The US dollar is strengthening really because of this and because of "Quantitative Tightening" by the Fed. Charles Gave of Gavekal is forecasting a very nasty surprise this year, and I agree with him. Batten down those hatches and get ready for some incoming fire.

Meantime, at the Milken, the key themes appear to be: real estate everywhere is too expensive and in particular retail space is toast (minus 50% coming according to Sam Zell, a grizzled veteran of the industry); and an agricultural revolution is taking place, based around healthier foods, plant proteins and lab-grown meat – the "meatless future". This could indeed be a huge new industry – as much as $10 trillion a year – and should be watched very carefully. I intend to do a lot more investigation in this area and will report back to you on anything I find interesting.


Drop of Light / Shutterstock.com

From a geopolitical point of view, the consensus is that Trump is here to stay and that he is doing to Iran what he did to North Korea – bark hard until there is a retreat. He is doing more or less the same on trade and expect a "deal" with China sometime soon. He obviously doesn't like Merkel, or the EU. This might represent a good opportunity for the UK, if Mrs May can apply a little magnetism to herself and to the forthcoming trip of the great man himself to Britain.

Overall though, the world economy is slowing. Europe has had its "dead cat bounce" and it was short lived. In Europe, the cheapest market is the UK, and **GlaxoSmithKline (LON:GSK)** has caught my eye, along with **BP (LON:BP.)** and **Shell (LON:RDSB)**, which given recently rising oil prices look dirt cheap.

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.

BY ALAN STEEL

COVER FEATURE

HOW TO GIVE YOUR FINANCES A SPRING CLEAN

... Now my advice for those who die
Declare the pennies on your eyes
'Cause I'm the taxman, yeah I'm the taxman
And you're working for no one but me

- The Beatles

Why is it that according to research from Aegon, the average private pension pot for those heading into retirement these days is a measly £50,000, despite the fact that, for most of us, we've lived through the most bountiful sixty-odd years in history? When the average pension income in central London is just shy of £38,000 per annum, why is the national average only £18,400 – and a paltry £12,800 in the Midlands? Over a twenty-year retirement, that makes the total income difference between best and worst a whopping £630,000!

Why do so many folks die without bothering with a Will or any other simple planning, leaving behind heartache, delays, taxes and heavy legal bills for their families? Why do so many 'investors' leave so much money languishing in deposits? Why is it that even those who see the sense of having equity portfolios ignore annual allowances that give extra tax-free income opportunities? Too many whys. We should replace them with "Why nots?" As in why not change old bad habits? Why not aim for excellence? Why not set goals and feel good about achieving them? When's a good time to start? Why not now?

"True happiness is becoming something. This can be done by being committed to lofty goals. We cannot become something without commitment."

- Marvin J. Ashton

When I was just a youngster back in the early 1950s, my memory of this time of year was rather clouded...by dust, lots of it. Yes, this was traditionally the time that mums and grannies took their carpets out into backyards or gardens and gave them a good old-fashioned beating. Remember, this was years before household innovations such as fitted carpets.

If we were lucky, us youngsters escaped this outdoor mayhem but were usually roped-in to scrub-up brasses and polish the family silver. The whole affair was known as "Spring Cleaning". It was an annual event.

When you think of it, it all made sense and copied what nature did. For spring is the time when the days get longer and warmer (only longer in Scotland though). And in our modern world of fitted carpets and artifi-

"ONLY ONE IN TWENTY-FIVE OF US REACH RETIREMENT WITH GENUINE FINANCIAL INDEPENDENCE."

> **“ACCORDING TO RESEARCH FROM AEGON, THE AVERAGE PRIVATE PENSION POT FOR THOSE HEADING INTO RETIREMENT THESE DAYS IS A MEASLY £50,000.”**

cial oak flooring it's a perfect time nowadays to replace the carpet-beating ritual with taking our finances seriously at least once a year and giving them a good going over. For unless we do, how can we be sure about the quality of our financial lives in retirement? Or even worse, what mess will our families inherit when we die?

What have the Romans done for us?

Despite spring moving around from year to year between March and April, "financial experts" tell us the best time to have a go at reassessing our financial plans, if we have any, is right after the new "fiscal year" or "tax year", which begins every year on 6th April. This year it was a Friday.

Now who thought that one up? *The sixth of April?* Not an obvious starting date for anything, is it? Surely, logically, the first of January makes far more sense. And that's the conclusion in loads of countries including the US and Canada. So how come we're different? If you think Pensions legislation is complicated, wait until you hear this.

In the UK the New Year used to start on 25th March because of some weird religious accounting system in medieval times which divided the year into quarters. And for some reason lost in the mists of time, the quarter ending on 25th March was when rents were due, and debts were settled. Over time, that day became the start of the new financial year.

Moving to 6th April started in the sixteenth century with Europe dumping the Julian calendar because somebody noticed (goodness knows how) that the calendar was out by ten days compared to the solar year. Pope Gregory introduced his own calendar which fixed the discrepancy by dumping a few odd days. The UK was unimpressed and ignored it just to spite Europe. But 170 years later we were 11 days out of alignment with the rest of Europe. (Nothing changes there then, eh?) We were brought into line by an Act of Parliament in 1751, which dropped eleven days out of September the following year (no doubt in the process upsetting a few thousand Virgos who missed out on their birthday pressies or parties).

Determined not to lose out on tax collections, the government extended the tax year to 4th April. Then fifty years later added another day for reasons best known to themselves. Just to complicate things further, while our tax year runs from 6th to 5th April, their financial year runs from April Fool's Day to 31st March, as does the Corporation Tax year for businesses. And elsewhere in the world most, countries opt for tax years that run from 1st January.

This may help to explain why so many of us find money and taxes so complicated, and why only one in twenty-five of us reach retirement with genuine financial independence bestowed through ample pension funds and tax effective investments. It is also partly why the vast majority of us leave our families in the lurch financially when we die, thanks to being so disorganised and under-prepared. So why not decide to make this April the time to start putting all that right?

Goals or dreams?

Like losing weight, you can go it alone relying on guidance from online helplines, or if you're like my wife, you'll simply buy slimming magazines every year, admire the pictures, but fall back into the same old habits. It was Einstein who said, "Insanity is doing the same thing over and over again and expecting different results."

But for different and lasting results nothing beats having a coach to map out targets specifically for your circumstances and then keep you on track over time, one way or another. Some of the best advice I received regarding goals was from a coach in the US who said the challenge was to have BHAGs – Big Hairy-Assed Goals. So, let's see what goals you can come up with. First we need to start with some basic questions to establish where you are now and where you want to be. That way, we can establish inefficiencies, shortfalls, and what needs to be done.

First up, do you really want to be financially independent? And by that I mean arrive at a time when you are in control of whether to work or not. When ideally would that be? And if that was now, measured in today's money, what spendable income would you want? Would you want that to keep up with inflation? And if you were to snuff it today, what financial state would your partner or family be in? Happy with that, or not? What are you going to do about it?

Perspectives and actions

Let's look at some perspective. Let's assume you want to be financially independent in 15 years' time and that in today's money that would equate to £3,000 a month after tax. Also, let's assume you want that income inflation-proofed and you also want your partner's income to be protected on your death. Assuming that future inflation is 2% per annum, by simple rule of thumb you'd need to build a fund of £2 million or thereabouts in only 15 years. Ouch!

The earlier you become aware of the enormity of such a target, the better. Now you may begin to understand why Einstein also said, "Compound interest is the 8th wonder of the world. He who understands it, earns it. He who doesn't, pays it."

> **“FIRST WE NEED TO START WITH SOME BASIC QUESTIONS TO ESTABLISH WHERE YOU ARE NOW AND WHERE YOU WANT TO BE.”**

So, your financial "Spring Cleaning" should just start with goals on what you'd specifically want to achieve in real terms (BHAGs) in capital and income for your later years, and what legacy you'd prefer to leave to your family on your death. And now for the hard bit: laying bare your existing situation to the eyes of another.

Any well-designed financial plan starts with the goals, then assesses where you are today. And it should start with protection issues, the potential "what ifs". What if you died tomorrow? What if you became ill tomorrow? Do you have cover for these possibilities? Is it enough? Will any payments go directly without tax and delay to who needs them most? Are your pension plans in trust? Are you sure? Do you have a Will? If so, when was it last reviewed? Have your circumstances changed? If you don't have a Will, go and get one. If you don't know why, go speak to families that have experienced such a nightmare.

Facing-up to difficult questions

Now let's go through your savings plans in detail. Pensions first. Many of us have been in different jobs or careers, and with pensions legislation being such a dog's dinner, what with over a couple of hundred law changes in the last 20 years, plus so-called "Pensions Simplification" twelve years ago, and bewildering "Freedoms" introduced more recently, there's every chance you've gone off-piste.

Add to that lot the increasing number of different types of plan you may be

"NO MATTER HOW COMPLEX YOU THINK THEY ARE, PENSIONS SHOULD BE THE STARTING POINT OF RETIREMENT PLANNING THANKS TO THEIR STILL-BENIGN TAX STATUS."

stuck with, with their ever-increasing small-print restrictions, and the over-charged and underperforming investments inside, the chances are high that a review can improve your eventual fund size significantly. No matter how complex you think they are, pensions should be the starting point of retirement planning thanks to their still-benign tax status.

Yet another restriction on tax relievable contributions has come along to introduce "tapering rules" which further complicates what is known as "carry forward" rules. There used to be a retrospective chance to catch up on previous years when you didn't make full contributions to your pension plans and pick up tax relief. That's much harder now, especially the more you earn above £150,000, but that now includes dividend income and benefits in kind. The more you earn the less you can contribute and offset against taxes.

Sadly, the whole pensions area is so utterly complex you need a Philadelphia lawyer or preferably an experienced and qualified IFA to guide you through the jungle. But it's well worth it. Few, if any, investment areas are as tax effective, even against Inheritance Tax (IHT). And if you haven't had the treatment of the death benefits checked recently, do so without delay.

Next up list your deposits, collectives (investment trusts, OIECS, investment bonds) and review the performances net of costs. Update your portfolio values. Have you taken advantage of annual tax exemptions? Have you taken advantage of all the opportunities to roll over tax free gains into ISAs which in turn avoid high rate income tax on dividends, as well as giving you freedom from any Capital Gains Tax (CGT)? If not, why not?

Aiming for tax freedoms

Have you thought of shares in the AIM index which don't count when calculating an IHT tax charge? (HMRC in 2016 raised over £5 billion in Inheritance Tax for the first time.) Have you thought of investing in VCTs or EIS investments which, while higher risk, give valuable upfront tax reliefs, and freedom from CGT and Income tax ad infinitum?

Let me remind you that there's no better feeling, when you're my age, than a tax rebate and repeating tax-free cheques from my VCTs. I must admit that my only regret in investment over the years is that I didn't stick more away into VCTs. As I said to a financial journalist pal recently, "Don't complain that your VCTs haven't given you any capital gains, they produce tax free income for life, your partner's life and the tax-free income can pass down the generations."

Finally, are you making full use of all the tax allowances available to you and your partner? Tax planning doesn't just stop at different income tax rates. It should apply to building real wealth over the years by proactive use of all tax planning opportunities, and regular Spring Cleaning of your investments too. And it makes sense to review your attitude to risk. As you age, asset protection usually takes precedence over out and out growth. Especially after a nine-year equity bull market that few saw coming. Now go get that coach!

About Alan

Alan Steel rose to prominence in the financial sector after being the first person to put pen to paper to accuse Equitable Life of rampant mis-selling. A true champion of the ordinary saver/investor, Alan founded Alan Steel Asset Management in 1975, and now has over £1 billion under management. Visit the company website at www.alansteel.com.

This is the personal view of Alan and is not advice. Readers should take personalised independent advice on such matters.

BY VICTOR HILL

OPPORTUNITIES IN FOCUS

INVESTING DOWN-UNDER

AUSTRALIA AND NEW ZEALAND SHOULD BE ON INVESTORS' RADARS

They are non-identical twins on the other side of the world. Despite their shared language and historical DNA they are very different. They are both amongst the most prosperous nations on Earth in GDP-per-capita terms. They both command immense resources (though of different kinds) and benefit from some of the best educated populations. The quality of life in both countries is exceptional. Yet Australia and New Zealand are often off-radar for UK and US investors.

Why? Because they are so far away? In a digital age geographical proximity accounts for less. Besides, air links are improving by leaps and bounds. In March Qantas (ASX:QAN) launched its 17-hour non-stop service between London Heathrow and Perth. They are already talking about the viability of a non-stop service between London and Sydney. The new generation of airliners coming on-stream soon will be able to fly London-Auckland non-stop.

In a globalised world a shared language, legal code, and political and cultural values still count for a lot. Investment in Australian and New Zealand equities is a way by which UK and US investors can diversify into two consistently growing economies while undertaking minimal political, legal and regulatory risk. Currency risk is also manageable. Moreover, opportunities abound down-under...

Young and rich

These two young countries have achieved astonishing levels of well-being in their relatively short histories and have huge future potential. Australia has the 10th highest GDP-per-capita in the world in nominal terms while New Zealand is in 19th place. Australia, the size of the USA minus Alaska, has a population of under 25 million while New Zealand has 4.8 million people (though its population has grown by about 15 percent in the last four years).

True, there is minimal manufacturing in both countries. Ford Australia's engine and vehicle plants closed in October 2016 and the Holden and Toyota Australia factories closed in late 2017 since when all cars are imported. Principal automotive imports are from Japan (**Toyota (TYO:7203), Honda (TYO:7267)** and **Mitsubishi (TYO:8058)**) and Korea **(Hyundai (KRX:005380)** and **Kia (KRX:000270)**). But the service and commodity sectors are booming. If the bedrock of Australia's prosperity is mining, New Zealand's is agriculture.

Australia is a very significant country, financially speaking. The Australian Securities Exchange (ASX, based in Sydney) has nearly 2,200 listings and has a market capitalisation of about US$1.3 trillion making it the eighth largest equity market in the world and the second largest in the Asia-Pacific region. The Australian foreign exchange market is the seventh largest in the world in terms of global turnover, while the Australian dollar is the fifth most traded currency. The Australian Dollar-US Dollar trade is the fourth most traded currency pair worldwide. Partly as a result of its compulsory superannuation system, Australia has the largest pool of funds under management in the Asia-Pacific region, and the fourth largest in the world. Finally, the big four Australian banks – **Westpac (ASX:WBC), Australia New Zealand Banking Group (ASX:ANX), National Australia Bank (ASX:NAB)** and **Commonwealth Bank of Australia (ASX:CBA)** – are truly international universal banks which also dominate New Zealand's banking sector.

"THESE TWO YOUNG COUNTRIES HAVE ACHIEVED ASTONISHING LEVELS OF WELL-BEING IN THEIR RELATIVELY SHORT HISTORIES AND HAVE HUGE FUTURE POTENTIAL."

The New Zealand market is much smaller. The NZX, based in Wellington, has around 300 listings with a market capitalisation of US$99 billion in April. As I discussed in a recent article, there is a worrying tendency for NZ companies to delist from the NZX and to list in Australia, often using so-called back-door listings. Moreover, a number of NZ listed entities have been acquired by foreign purchasers of late. The result is that the NZX has been getting smaller.

Despite a relatively benign economic backdrop the New Zealand stock exchange, the NZX, continues to draw criticism. The NZX is trying to improve liquidity and is consulting with the investment industry on how to channel more trading through the formal market as opposed to off-market trades which obscure price transparency. To this end the NZX is overhauling its price structure and bringing its trading and clearing model into line with global norms.

New Zealand has a somewhat lower standard of living than Australia – though it has a GDP-per-capita comparable with that of Britain. Unlike

Table 1: Australia & New Zealand compared with other Anglophone countries

Country[i]	Land Area	Population 2018	GDP/capita – nominal – PPP
Australia	7,692,024 km^2	24,919,800	$55,707-$49,882
Canada	9,984,670 km^2	34,653,100	$45,077-$48,141
New Zealand	268,021 km^2	4,877,460	$41,593-$38,502
United Kingdom	242,495 km^2	65,648,054	$39,735-$43,620
United States	9,833,520 km^2	327,051,000	$59,501-$59,495

Australia, it enjoys a generous social system with free healthcare provided by the state. The quality of life of both countries, taking into account the absence of pollution and hours worked is amongst the best in the world. Both countries boast very high levels of life expectancy (82.8 years for Australia and 81.6 years for New Zealand).

The Australian economy advanced 0.4 percent in Q4 2017, after an upwardly revised 0.7 percent growth in the previous quarter. It was the weakest growth rate since a contraction in Q3 2016. Overall in 2017 the economy grew by 2.4 percent, slightly below expectations of 2.5 percent growth. GDP Growth Rate on a quarterly basis in Australia averaged 0.85 percent from 1959 until 2017, reaching an all-time high of 4.40 percent in Q1 1976 and a record low of minus 2 percent in Q2 1974. Almost alone amongst Western nations, Australia (and New Zealand) sailed through the Financial Crisis of 2008 unscathed.

New South Wales is still seen as the powerhouse of the Australian economy and considers itself the model for other states. Sydney is the financial and cultural if not the political capital of the country and the home to many of Australia's largest companies.

During April, normally breezily confident Australian leaders expressed grave concern over the prospect of a US-China trade war. Politicians lectured the Aussie public about "the perils of protectionism". On 06 April Labor Trade spokesperson Jason Clare, in a speech to a Perth business breakfast said he found it hard to believe that the world's two largest economies "would be sucked into the vortex of a full-blown trade war". Australia regards itself as a beacon of free trade.

For a nation of just 25 million people, Australia punches above its weight in sport, science and medicine. It is culturally vibrant and is a must-see tourist destination.

On 12 April economic forecaster Infometrics slashed its growth forecast for the New Zealand economy citing short-term headwinds created by government policy. The prediction made by Winston Peters MP, Deputy Prime Minister and Foreign Minister, last year that an economic correction was due appears to have been correct. Infometrics now sees GDP growth slowing to 2.4 percent by the end of 2018 and slipping below 2 percent in 2019 – almost one percent lower than previous forecasts.

Part of this is due to a slowdown in migration and in the housing market – already in train before the new government came to power last October. But Infometrics thinks that the cancellation of numerous road construction projects in favour of rail and public transport initiatives will cost jobs. Supply-side constraints in the construction sector are also a brake on growth.

Infometrics forecasts that net migration will fall from 68,900 in the year to March to below 17,000 by 2021. So long

Some Aussie stars and potential unicorns

Internode is an Adelaide-based internet service provider founded by Simon Hackett (see below) in 1991. It was acquired by iiNet for AU$105 million in 2012.

RedFlow (ASX:RFX) is a Brisbane-based listed entity currently valued at around AU$64 million. Its major shareholder, director and ex-CEO, is serial tech tycoon Simon Hackett. The current Chairman is Brett Johnson, formerly a long-time member of Qantas's general council; the CEO is Tim Harris, the former CEO of Chorus in New Zealand. Former Santos boss David Knox is also an investor. Redflow is a high-tech start-up with proprietary technology in lithium battery production. Mr Hackett sees parallels between the fledgling energy storage market of today and where the internet was in the early 1990s. This is a very speculative stock. The shares are well down on a 12-month basis but went from AU$0.12 to AU$0.14 in April.

Sundance Energy Australia (ASX:SEA) is raising AU$331 million – almost six times its market capitalisation – to fund a AU$221.5 million acquisition of acreage in Texas's Eagle Ford shale basin from Pioneer Natural Resources and its joint venture partners. The company expects to be able to produce up to 22,000 barrels of oil equivalent a day by 2019 generating estimated revenues of US$250 million a year. This deal, if it goes through, will transform Sundance from a low-profile player into a major Australian oil and gas stock. Sundance has been active in the USA since 2006. The only Australian oil group to have cracked the US shale sector previously was Aurora Oil & Gas which sold its Eagle Ford basin position to **Baytex Energy (TSE:BTE & NYSE:BTE)** in early 2014 for US$1.8 billion at the top of the oil market.

BHP Billiton (LON:BLT & ASX:BHP) infamously lost billions in the US shale sector from which it is still trying to extricate itself. Specialist investors who understand the US shale sector might nonetheless wish to be a part of the Sundance deal. Jon Bishop, an analyst at **Euroz (ASX:EZL)**, the joint underwriter of the issue, says that Sundance has picked up "a unique opportunity".

as Australia is growing faster than New Zealand, given freedom of movement between the two countries, young Kiwi talent is likely to head across the Tasman Sea and fewer New Zealanders working in Australia will want to come home.

The Prime Minister since October last year, Jacinda Ardern, is considered to have had a good first hundred days – but there are signs that her government is flagging as she prepares to go on maternity leave. (Yes, New Zealand is right-on socially progressive.)

Ms Ardern, 37 years old, a feminist who once worked in the UK Cabinet Office, became the leader of the Labor Party only seven weeks before last year's election when it was lagging in the polls. Her fresh and outspoken approach benefited Labor. In the election of 23 September Labor's share of the vote went up from 25 percent in the previous election to nearly 37 percent and seats won increased from 32 to 46. In order to gain power, however, Ms Ardern was forced into a surprise coalition with Winston Peters' populist New Zealand First Party (9 seats) and James Shaw's Green Party (8 seats). She therefore leads a government with a majority of only 7 seats over the National Party, now led by Simon Bridges MP.

The National Party (roughly analogue to the Conservative Party in the UK) is still tainted by the revelation that one of its MPs, Jian Yang, who immigrated to New Zealand from China in 1999, covered up the fact that he used to teach at a Chinese spy school.

Airlines: the kangaroo and the silver-backed fern

Qantas (ASX:QAN) is the flag carrier of Australia and its largest airline by fleet size, international flights and international destinations. It is the third oldest airline in the world, after KLM and Avianca, having been founded in November 1920. It began international passenger flights in May 1935 as the "Queensland and Northern Territory Aerial Services" and was nicknamed "The Flying Kangaroo". Qantas is a founding member of the Oneworld airline alliance.

A significant international player with a truly global route network, Qantas is also the owner of Australia's number one budget airline, Jetstar. The CEO of Jetstar since last November is Gareth Evans who was previously CEO of Qantas. The airline has carried more than 250 million passengers since it was set up in 2003. The airline's route network extends across Australia and New Zealand where it has 20 percent of the in-

Australia's retail giants: "The three Ws"

Wesfarmers (ASX:WES) with its HQ in Perth is a massive Australian retailer which owns, amongst other chains, the DIY and hardware chain Bunnings Warehouse and Australia's number one supermarket chain, Coles. But when it comes to success overseas, one of Australia's most outward-bound companies has met with disappointment. Bunnings bought DIY chain Homebase in the UK from **Sainsbury's (LON:SBRY)** in February 2016. Bunnings then sought to rebrand Homebase in its own colours and to focus on barbeque equipment and garden furniture in a country with a much wetter climate than that of Australia. The result was an almost immediate loss of market share. Bunnings, assisted by Lazards, is expected to reinstate the Homebase brand in the UK in due course. Bunnings Warehouse is also the leading DIY superstore chain in New Zealand. Coles has over 100,000 employees and, together with rival Woolworths, accounts for more than 80 per cent of the Australian grocery market. It has over 800 superstores and another 600 convenience stores mainly located in petrol stations, generating revenues of AU$33 billion. Coles Online is the company's online shopping ("click & collect" and home delivery) service. Recently Wesfarmers announced its intention to demerge the Coles business, seeking to retain only a 20 percent stake going forward.

Westfield Corporation (ASX:WFD) & Westfield Group (ASX:WDC). Founded in 1960 by legendary immigrant from Slovakia Frank Lowy – who is often cited as Australia's richest man[ii] – the company owns shopping malls across Australia, the UK and the USA – including London's two largest malls. In June 2014 Westfield split into two listed entities – Westfield Corporation taking the international assets while Westfield Group manages the Australian and New Zealand real estate portfolio. Westfield Corp's shares spiked in December since when they have vacillated.

TK Kurikawa / Shutterstock.com

Woolworth's Group (ASX:WOW). It may come as a surprise to British and American visitors to learn that *Woolworth's is alive and well and living in Australia!* This brand famously died out in the UK in 2009. Woolworths Group, affectionately known as *Woolies*, is a major Australian retailer with high-end supermarkets throughout Australia and New Zealand. It is the second largest company in Australia by revenue, after Wesfarmers, and the second largest in New Zealand. In addition, Woolworths Group is the largest takeaway liquor retailer in Australia and the largest hotel and gaming poker machine operator. With over 200,000 employees the company had revenues of AU$59 billion in 2016 but was narrowly loss-making. The company's shares have traded in the AU$25-28 range over the last 12 months, though in April the share price experienced a pronounced upturn.

ternal airline market. It has a fleet of eight Airbus A320s and five Bombardier Q300 aircraft. It has an order for several Airbus A321NEO airliners to be delivered in mid-2020.

Air New Zealand (NZX:AIR), founded in 1940, is the country's national flag carrier. Based in Auckland, the airline operates scheduled passenger flights to 20 domestic and 31 international destinations in 19 countries around the Pacific Rim and the United Kingdom. The airline has been a member of the Star Alliance since 1999.

During the week of 16 April AIR cancelled a number of scheduled flights further to the incident in the USA when a Boeing 787-Dreamliner experienced problems with a Rolls Royce Trent 1000 aero-engine. AIR operates 11 such aircraft. This was particularly disruptive as it coincided with the New Zealand school holidays.

New Zealand's film and media industry

One of the things that pushed New Zealand forcefully onto the bucket lists of the world's better heeled tourists was the *Lord of the Rings* film trilogy which, as everyone knows, was filmed there. You can now visit the Hobbiton movie set – it has become a very tasteful theme park in Matamata (not far from Auckland) on the North Island. The great battle scenes were shot in the glorious Southern Alps not far from Queenstown.

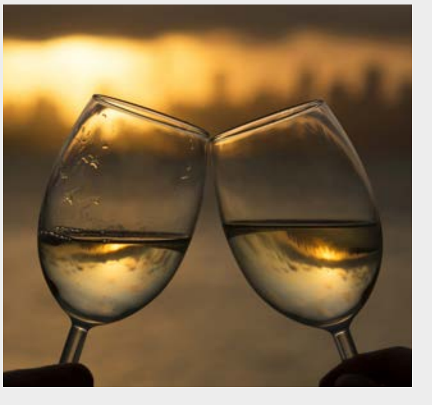
What is not so well known is that New Zealand, despite its small population, has an important movie industry. Wellington, the capital, is the traditional home for movie companies but Auckland is catching up fast. Foreign movie production companies are flocking to New Zealand to make their films thanks to the wonderful scenery combined with excellent infrastructure and technical talent. Shooting recently finished in Otago province for *Mission Impossible: A Wrinkle in Time.*

Annabelle Sheehan, CEO of the New Zealand Film Commission, who was previously CEO of the South Australia Film Commission, said in a recent interview: "Hollywood Studios know our country well and appreciate working here with great crews. But one has to

Wine is money

The Australian wine industry has established itself as a major provider of high quality and varied wines to the world. In April CHAMP Private Equity did a deal to sell Accolade Wines to global buyout firm **The Carlyle Group (NASDAQ:CG)** for reportedly in excess of AU$1 billion. Accolade is the largest producer of Australian wine and its labels include *Hardy's, Leasingham, Grant Burge, St Hallett, Petaluma,* and *Croser*. It ranks in the top wine producers globally with AU$350 million of exports annually to 140 countries. Carlyle bought both CHAMP's 80 percent stake plus the 20 percent stake owned by US liquor company Constellation Wines (a subsidiary of **Constellation Brands (NYSE:STX)**). CHAMP effectively created Accolade in 2011 when it bought Constellation's Australian and European businesses for AU$290 million. Accolade is on track to make an estimated AU$100 million this year. The new owner is expected to accelerate Accolade's Asia strategy – meaning selling more wine to China where the market is growing at about 50 percent per year.

Accolade operates the largest wine bottling, packaging and distribution centre in Europe – Accolade Park in Bristol, UK which employs 500 people. The company is replicating this facility in Berri, South Australia. Accolade was to have been listed on the ASX but according to Australian sources the floatation was pulled due to uncertainty around Brexit. Carlyle reportedly outbid US private equity house TPG and European group PAI Partners.



keep building and maintaining relationships to remain competitive". It is rumoured that Disney's forthcoming blockbuster *Mulan* and James Cameron's planned sequel to *Avatar* will be filmed in New Zealand.

The special effects company Weta Workshop based in Miramar (North Island) has met with international acclaim for its contribution to films such as the blockbuster *Pacific Rim: Uprising.*

The Kiwi hospitality industry is on a roll

New Zealand's providers of accommodation of all kinds achieved a record 39.6 million guest nights in the year to February – up 2.8 percent on the previous year according to Statistics New Zealand[iii]. 44 percent of those guest nights were accounted for by foreign visitors. The upsurge in tourism and hospitality has provoked a flurry of hotel developments.

International guest nights were well up in the South Island with large increases in visitor numbers for Christchurch, Queenstown, Kaikoura, Southland and Dunedin. New Zealand offers the full spectrum of hospitality options from five-star hotels, through motels, holiday parks, campsites, self-catering apartments and backpacker hostels. But the clear trend in New Zealand tourism is towards the higher end: luxury hotel stays are on the rise while the backpacker market seems to be in decline.

The survey found that, overall, hotel occupancy rates increased to an all-time high of 81.8 percent. Some of the world's biggest hotel brands have established themselves in New Zealand. A few, such as **Hyatt (NYSE:H)**, have entered or returned to the market in the last few months and more, including Ritz-Carlton, are rumoured to be on the way.

New Zealand's biggest owner of hotels is CP Group, with 17 hotels and 8 per cent of the country's hotel rooms[iv]. Owned by the Pandey family, CP Group has been both an active developer and owner of hotels. It bought three hotels last year from the exiting Host **Hotels and Resorts Group (NYSE:HST)** and recently converted offices into the 129-room, Sofitel Wellington at a cost of NZ$51 million. It is also converting Auckland's former Reserve Bank building into a Sofitel.

The next biggest player is Singapore's **CDL Hospitality Trusts (SGX:J85)**, which owns 12 hotels representing 6

Outdoor clothing NZ style: Kathmandu Holdings

Outdoor equipment and clothing manufacturer **Kathmandu (NZX:KMD & ASX:KMD)** is a NX brand *born in the mountains* according to its French CEO Xavier Simonet. In March the company acquired US footwear business **Oboz Footwear** for US$60 million which provides a unique distribution channel, retail and wholesale, for the company's products in the USA. Already 10 percent of sales are generated there. Kathmandu employs 2,000 people – 160 at its Christchurch HQ, 60 in Melbourne (where Simonet is based) and more than 1500 throughout its chain of 163 retail stores throughout NZ and Australia – plus one flagship store in London's Kensington. A more extensive UK store network was closed in 2015. The company was given an award for ethical fashion practices last year for its commitment to send zero waste to landfill. It recycles 100 percent of all plastics it uses.

For the six months to 31 January, Kathmandu reported profits of NZ$12.3 million – up 23 percent on the previous year with better margins given lower clearance stock. Sales rose 4.3 percent to NZ$204.8 million. Like-for-like store sales were up by 7 percent in the first six weeks of the current half-year. The company's strategy is to focus on the expansion of online sales in Australasia and internationally.

This is a volatile stock. The retailer's shares hit rock bottom in June 2012 at NZ$1.27 and hit an all-time high in 2014 of NZ$4. It is currently trading at a 12-month high of around NZ$2.60.

Did you hear the one about the Kiwi aerospace industry?

It is common to hear people say *there is no manufacturing in New Zealand* – but that is not quite true. Hamilton-based aircraft manufacturer Pacific Aerospace (private) has been making small civil aircraft since the 1950s and currently employs about 180 people. However, the company is currently in the doldrums. Only one aircraft has been rolled out of the hangar since February last year according to local sources[v]. The CFO and the commercial general manager both left within a month of each another. And, to ice the cake, the company stands accused of sanctions-busting in North Korea. However, the company claims to have firm orders and new models in the pipeline including for the Papua New Guinea Defence Force.

The main product is the multi-purpose 10-seater P-750 XTOL (extreme take-off and landing) aircraft. The planes are thought to sell for about NZ$2 million each. In 2016 a joint-venture was announced with Chinese state-owned aviation giant Beijing Automotive through BAIC International (Hong Kong). The plan was to make up to 40 aircraft per year in Hamilton, half of which would go to China. That is not how things have turned out. According to the *Weekend Herald* a factory in China is now manufacturing P-750s using staff trained in Hamilton.

Currently the company is 50 percent owned by the Chinese and 50 percent by pacific Aerospace Group. The latter is 33 percent owned by PAHL Ltd owned by the Camp brothers and 67 percent by Auckland property and agribusiness investor Nicsha Farac.

percent of the market. CDL's portfolio has not changed in several years. However, it is refurbishing the former Copthorne hotel in Auckland's waterfront, turning it into a five-star, 190-room Millennium Hotel in early 2017. It will also take over the management of the 452-room Rendezvous Hotel in September, renaming it the Grand Millennium Auckland.

France's **Accor SA (EPA:AC)** which owns the Ibis and Novotel brands manages 17 percent of all hotel rooms, followed by Singapore's **Millennium (LON:MLC)** with 8 percent. Australia's **Choice Hotels (NYSE:CHH)** has 5 percent. Heritage (NZ), Rydges, Britain's **Intercontinental (LON:IHG)**, Distinction (NZ) and Australia's TFE Hotels are also significant players.

To reign or not to reign: the future of the monarchy in Australia and NZ

Many visitors arrive in Australia and New Zealand and are amazed to see the face of Queen Elizabeth staring at them from bank notes and coins. The UK monarch is Queen of Australia and Queen of New Zealand.

The Press of New Zealand's South Island reported on 20 April that Prime Minister Ardern had met with Prince Charles – *the man who might be King.* While the monarchy has strong support in both countries, it is fair to say that there is a considerable body of opinion on both sides of the Tasman Sea which favours a move towards a republic after HM The Queen eventually leaves the stage.

There seems to be two strands to republican sentiment. Firstly, there are those who believe that the monarchy – a British monarchy – represents the colonial past and that both countries need to express their identities by having one of their own nationals as head of state. The second strand is agnostic on the issue of a republic but is not comfortable with the Prince of Wales. Some think that Prince Charles does not resonate with the Aussie and Kiwi public – and that Prince William would be a more popular sovereign. Others – the social conservatives who still wield influence despite recent social reforms like same-sex marriage – will never forgive the Prince of Wales for the dissolution of his marriage with Lady Diana...

That said the Prince's visit to Queensland and the Northern Territory to open and then follow the Commonwealth Games in April was deemed a great success by the Australian media. Nevertheless, there is a deep-seated notion amongst many in both countries that they will never be truly independent nations until such time as they have one of their own as head of state. My best guess is that, come the day, the parliaments of both countries will proclaim Prince Charles king – though with loud dissenting voices. There will then be referenda on the issue of the monarchy – which will be finely balanced.

While the monarchy is a potent symbol of Australia's and New Zealand's umbilical link to the Mother Country, the strategic alliances they maintain are more important than any symbol. In London at the Commonwealth Heads of Government Conference (CHOGM) in April, UK Foreign Secretary Boris Johnson and NZ Foreign Minister Winston Peters pledged closer cooperation in the Pacific region. Britain and New Zealand will co-host a forum on climate change in the Pacific in December at Wilton Park.

At the end of the day, the *Five Eyes Agreement* on intelligence sharing (between the UK, the USA, Canada, Australia and New Zealand) is *de facto* the most effective military alliance in the world. On 20 April the NZ Prime Minster, Jacinda Ardern, told the Five Eyes that New Zealand had been hacked by Russia. One is tempted to say: *We are all in this together.*

Australians will tell you that the war in the Pacific during WWII was won by the Americans and that they still look to America for ultimate protection, rather than to Britain. Indeed, Britain's military presence in the Pacific is now negligible. In a more uncertain world, however, the combined military resources of the CANZUK (Canada, Australia, New Zealand and the UK) powers would be formidable. I expect this to climb to the top of the agenda once the current fog surrounding the Brexit negotiations

"IN TEN YEARS' TIME, AUSTRALIA AND NEW ZEALAND WILL LOOM LARGER IN OUR STRATEGIC THINKING THAN THEY DO NOW. AND THEY WILL BE MORE IMPORTANT DESTINATIONS FOR OUR INVESTMENT CAPITAL."

dissolves, as eventually it must. In ten years' time, Australia and New Zealand will loom larger in our strategic thinking than they do now. And they will be more important destinations for our investment capital.

God defend New Zealand!

When New Zealanders sing their national anthem, they pray for God to defend their island nation knowing that their last line of defence is not their armed forces, which are small, but their extraordinary isolation. *Who would want to invade New Zealand?* a Kiwi friend asked me.

New Zealanders harbour a fierce competitiveness with Australia – expressed in the ferocious rivalry between the two nations' rugby and cricket teams – because they know that Australia has been endowed with greater blessings by Mother Nature; and yet they have been able to construct a nation of parallel prosperity and quality of life. New Zealand's strengths are numerous, not least its fertile land and its industrious people; but its greatest weakness is that it is too small. Small nations, which lack economies of scale, tend to be less efficient – and therefore less prosperous – than large ones. That said there are many examples of small nations which have become rich by building up their competitive advantages – think of Switzerland.

The choices that New Zealand makes over the next ten years will set the country's future course for the next century and more. New Zealand needs to establish enduring partnerships with larger nations and groupings, which is why the TPP is considered a no-brainer there. But New Zealand, which is rightly proud of its multi-ethnic character, also needs to decide whether it wishes to remain an English-speaking nation or one largely speaking Mandarin. Time will tell.

Advance, Australia Fair!

You will never meet an Aussie who would not wish to be anything other than Australian – even if the Australians are inveterate travellers, especially when young. Those who spend time working abroad, not least in the UK, normally return in time. The notion that the country is blessed by nature and that it is a country where hard work pays off is implicit in the lyrics of Australia's national anthem. Unrestricted by the social attitudes of the Old World, endowed with the abundant resources of a huge and vibrant young nation, Australians possess the sense of possibility of the Americans, but without their deep anxieties.

Australians all let us rejoice
For we are young and free
We've golden soil and wealth for toil
Our home is girt by sea.

Action

There are a wide number of equity opportunities for clever stock pickers on the Australian stock market; the New Zealand market, however, is smaller, less liquid and more volatile. That said there are numerous NZ stocks worth following, as described above, though many are listed on the Australian market. Since nearly all Australian large cap stocks are heavily invested in New Zealand, the best way to get exposure to these two growing economies is via a diversified Australian equity fund.

The Ellerston Australian Market Neutral Fund is of interest to sophisticated investors but, unfortunately, is currently closed to new subscriptions. Australian equity funds delivered an average return of 12.9 percent in calendar 2017, while the S&P-ASX 300 index returned 11.9 percent over the year, according to the Morningstar Australian Institutional Sector Survey.

Most major London-based investment houses offer Australian funds but amongst locally-domiciled funds some of the star performers over the year have been Platypus Australian Equities Fund and Bennelong Concentrated Australian Equities Fund – which delivered returns of 24.2 percent and 30.8 per cent respectively in 2017.

The team at Platypus applies quantitative screens and fundamentals as the main drivers of its strategy, which results in *a punchy portfolio of 20-40 stocks*, according to Morningstar.

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 Figures from Wikipedia, accessed 17 May 2016.
ii According to The Financial Review Rich List 2017 he is Australia's fourth richest man.
iii Reported in The New Zealand Herald, B2, 13 April 2018.
iv See: https://www.stuff.co.nz/business/property/85164931/hotels--who-are-the-biggest-players
v *Aviation workers waiting for takeoff,* by Andrea Fox, Weekend Herald, page C5, 14 April 2018.

BY NICK SUDBURY

FUNDS IN FOCUS

IS IT BETTER TO BE ACTIVE OR PASSIVE?

There's a lot of talk about the recent sharp increase in volatility creating a stock picker's market after years in which the majority of shares have tended to move in unison. In theory, this sort of environment, where prices behave in radically different ways, should favour active funds over their index tracking counterparts, but it is a big ask to generate long-term outperformance after deducting the higher charges.

The healthy market gains in the last few years, coupled with a greater awareness of the importance of costs on long-term performance, has spawned a huge increase in the popularity of low-cost, passively managed index funds and ETFs.

According to data from the Investment Association, in February 2016 tracker funds accounted for £105.1 billion out of the total open-ended funds under management of £909.5 billion. By February 2018, this figure had risen to £165.5 billion out of £1,205.8 billion. This represents a staggering 57% increase versus an overall rise of just 32.5%.

Passively managed funds provide a low-cost way to track the performance of an index, but those who opt for a well-run active fund could earn a significantly higher return. The main risk is that they could just as easily end up with a duff one that does much worse and it is amazing what a huge difference it can make.

Over the last three years, the 250 actively managed funds operating in the UK All Companies Sector generated an average return of 20.2%. The

best with a gain of 93% was **Chelverton UK Equity Growth**, while the worst was **Old Mutual Woodford Equity Income** with a loss of 7%. Over the same period the FTSE All-Share ETFs typically returned between 17% and 18%.

Some investors believe that the best active funds can consistently outperform and will never use an index tracker, whereas others are sceptical and don't think that an active manager will be able to add value after deducting the additional costs. A more agnostic approach is probably better, but whichever category you opt for you will still need to pick the right funds to get the highest returns.

Both have a role to play

Nick Bamford, a Chartered Financial Planner at Informed Choice, says that they use both active and passive funds for their client portfolios as they believe there is validity for both. "In a mature market like the US or UK where finding an active fund that consistently outperforms the index is more challenging, we might lean in favour of a passive fund."

Informed Choice has developed their own quant screen as a method of reviewing the thousands of active and passive funds available. This looks at 12 points of reference including the long-term performance, volatility and charges, as well as certain technical ratios.

The aim of the process is to find suitable funds that display consistent risk-adjusted returns combined with low charges. Those that have passed the test include **Rathbone Income** and the passively managed **Fidelity International Index**.

"PASSIVELY MANAGED FUNDS PROVIDE A LOW-COST WAY TO TRACK THE PERFORMANCE OF AN INDEX, BUT THOSE WHO OPT FOR A WELL-RUN ACTIVE FUND COULD EARN A SIGNIFICANTLY HIGHER RETURN."

Rathbone Income aims to achieve above average and maintainable income and is managed by the highly respected Carl Stick. The fund invests in small, mid and large size UK dividend paying companies that are trading at a discount to fair value with the 40-stock portfolio having an attractive historic yield of 4%. Its largest holdings include the likes of Royal Dutch Shell, Unilever, Glaxo, AstraZeneca, BP and British American Tobacco.

Get active

Darius McDermott, MD of Chelsea Financial Services, says that they favour active funds because they think they can identify managers that can consistently do better than the index after charges, so there is the potential for investors to get better returns.

"An active manager can avoid certain stocks and sectors and invest in tomorrow's winners rather than stocks that have already perhaps peaked. We look for a clearly defined and articulated process, with evidence that the manager sticks to this process over the course of a market cycle, and evidence that they can repeatedly add value."

One such that they have identified is **F&C UK Mid-Cap** (see fund of the month below), which gives investors access to a high conviction portfolio of around 30 medium-sized UK companies. "The manager focuses first and foremost on limiting capital loss and he has a good, sensible process of investing in simple businesses at reasonable valuations."

Adrian Lowcock, Investment Director at Architas, likes managers who have conviction in their ideas and believe in their process, but says that this must be accompanied by an ability to critically assess their decisions, especially the ones which went wrong. "Patience is also an important characteristic amongst fund managers as they can often be right, yet the market doesn't agree."

He recommends **Lindsell Train Global Equity**, which he says has a clear process with a focus on the long-term growth of companies that the manager believes have something unique. The businesses it invests in have barriers to entry that competitors cannot easily replicate.

The £4 billion fund provides exposure to a concentrated portfolio in which the 10 largest holdings make up just over 60% of the assets. These include well-known companies such as Unilever, Diageo, Heineken Holdings, Nintendo, the London Stock Exchange and PepsiCo.

Small is beautiful

Patrick Connolly, a Certified Financial Planner at Chase de Vere Independent Financial Advisers, asserts that many active funds should have an advantage over their passive counterparts in the long-term. "Most passive funds are managed on the basis of market capitalisation, which means they will have the largest weightings in the biggest companies, but over time, small and mid-cap stocks should be expected to outperform their larger rivals which might be at the consolidation stage of their development."

He likes **Rathbone Global Opportunities**, which has been managed by James Thomson since 2003 and in that time has established a strong track record. The fund invests predominantly in the US and Europe, with the manager adopting a flexible approach as he searches for under-the-radar and out-of-favour growth companies.

Laith Khalaf, Senior Analyst at Hargreaves Lansdown, believes that the most important factor in choosing an active fund is the manager, whose skills will be a key determinant of returns. "We suggest that investors look for managers who have a long track record of outperformance across a range of different market environments, so normally a performance history of seven years or more."

FUND OF THE MONTH

Tom Wilson, the manager of the F&C UK Mid-Cap fund, aims to identify businesses with a strong competitive advantage, attractive returns and low levels of debt. He then conducts detailed research to make sure that the valuation is attractive relative to the company's perceived prospects.

These sorts of stocks can continue to generate profits irrespective of the state of the wider economy and tend to come out of economic downturns better than when they went in as they can pick up market share from their weaker competitors.

Wilson has put together a concentrated 30-stock portfolio, with the 10 largest holdings including the likes of John Laing Group, Melrose Industries, UBM, National Express Group and Pennon Group. The three main sector exposures are Financials, Industrials and Consumer Services.

McDermott says that he likes the manager's valuation discipline and the bias in favour of companies that can be easily understood. "The fund has continued to perform well during a period when its investment style has been out of favour – outperforming the index in four out of the past five calendar years, with cumulative outperformance of 21% (compared with the FTSE 250) after charges."

F&C UK Mid-Cap provides exposure to a portfolio of value stocks that are largely domestically focused in the UK. This is one of the most unfashionable parts of the market with many of these businesses being written down because of fears about the impact of Brexit. When the growth/tech bubble finally bursts, it will be these sorts of companies that will be positively re-rated.

Fund Facts

Name:	F&C UK Mid-Cap
Type:	UK UCITS
Sector:	UK All Companies
Total Assets:	£42.7m
Launch Date:	31 December 2005
Historic Yield:	1.9%
Ongoing Charges:	0.81 %
Website:	www.bmogam.com

He says that investors might want to consider the **Marlborough UK Micro Cap Growth** fund that invests in some of the smallest companies in the UK stock market. "Such businesses tend to be risky, but often come with good long-term growth prospects. This is an area of the market which enjoys less scrutiny and consequently is a good hunting ground for active fund managers like Giles Hargreave who runs this fund."

The £1.1 billion fund has 55% of its assets invested in micro-cap stocks worth less than £250 million, with a further 26% in the small caps that are valued at £250 million to £1 billion. It is a highly diversified portfolio which is typical of this end of the market with 275 different holdings.

The passive alternative

The main advantage of using trackers is that they are usually much cheaper than actively managed funds. The typical annual charge on an index tracker can be around 0.1% per annum, whereas an active fund might be 0.75% per annum or more. This is a big difference and means that actively managed funds start with a significant disadvantage.

"THE TYPICAL ANNUAL CHARGE ON AN INDEX TRACKER CAN BE AROUND 0.1% PER ANNUM, WHEREAS AN ACTIVE FUND MIGHT BE 0.75% PER ANNUM OR MORE."

"Tracker funds are the perfect option for those who are disillusioned with the higher costs of actively managed funds because they don't believe that they can consistently outperform or for those who want a simple long-term buy and hold option," explains Connolly.

When selecting a tracker fund he looks for those from experienced passive managers that predominantly use full replication to track their target index and have competitive charges. A good example is **HSBC FTSE All Share Index**, which provides a broad exposure to the UK stock market and is very low cost.

Lowcock says that passive funds are more automated, as there isn't a manager deciding which stocks to buy, so the focus is more on the efficiency of the process. "The two main areas which impact on the performance are the tracking error, which measures how much the fund differs from the index, and the costs. The speed and efficiency in allocating new money can also be important as cash weightings could be a drag on the returns."

He recommends **Blackrock US Equity Tracker**, a cheap index fund that provides access to the world's largest equity market. These sorts of funds have been an effective way to get exposure to the US as it is one of the most efficient investment markets available, making it hard for analysts to get a competitive advantage.

Other passive options that are closer to home include the **Legal & General UK Index fund** and the **HSBC FTSE 250 Index fund**, which are simple, low-cost funds for those who prefer this type of exposure.

HSBC FTSE 250 Index was launched in October 1997 and has assets under management of £816 million. The fund has competitive ongoing charges of 0.18% and over the last five years has generated a cumulative return that is within 1% of the index with a tracking error of just 0.07%. It has an historic yield of 2.5%.

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

BREXIT BRITAIN

WHY I'M BULLISH ON THE FTSE

"If you can look into the seeds of time, and say which grain will grow and which will not, speak then unto me."

in *"Macbeth"*, William Shakespeare

At a point when there is just one year left for Brexit to materialise and change the UK's economic role in Europe, it is worth looking back to analyse what has happened so far in order to better understand what may or may not happen in the near future.

The challenges created by the divorce of Britain from Europe are huge and will continue to dictate the path followed by British equities in the near term. But it is not just Brexit that will move the market. We're entering a new period where inflation is higher, unemployment is at historically low levels, the global economy is growing, financial institutions are more regulated, and the construction sector is showing signs of saturation at many levels.

After so many years of rising asset prices, investors need to be a little more careful and selective than before. During the last few years, one of the best investment strategies has been to split funds between a market index and bonds. After taking into account all the fees incurred, an investment manager would have struggled to beat this passive strategy, as central banks have been carefully managing downside risks. Consequently, a large part of the equity market now looks expensive while bonds appear to be nearing a cliff edge. More than ever, investors need to protect portfolios against downside risks, even at the expense of giving up some upside potential. With equity values so stretched, as they are now, a crash may occur suddenly. We have already had a glimpse of how quick volatility can rear its ugly head.

In terms of the British economy, all projections point to a soft 2018, at a time when growth is gathering pace elsewhere. Brexit may be holding back the economy, in particular because business investment has been delayed as a consequence of the uncertainty created. Still, British equities in general and the FTSE 100 in particular seem undervalued when compared with their peers. British equity indexes have struggled in recent months, partly due to an appreciating pound. While battered down by the Leave vote in June 2016, the pound has since managed to recover almost all its losses against the US dollar and a significant portion of them against the euro.

The stronger pound is punishing the FTSE 100. But, as the Brexit *grand finale* approaches and the US economy accelerates, I believe there is potential for another round of sterling depreciation, which may help the dollar-earners on the FTSE 100. The British blue-chip index has the advantage of being very modestly valued, offering some protection against the downside. From this point into the future, Brexit may lead to a further deterioration in the exchange rate, but it would be unlikely to lead to panic selling, as most of the downside appears to be accounted for. Therefore, if there is potential for surprises, I believe it is tilted to the upside. There is also an

additional point in favour of the FTSE 100 – the prospects for rising inflation. The many commodity stocks that are part of the FTSE 100 may offer a hedge against that possibility. A global pick-up in demand is also very favourable to commodities in general.

Extreme predictions rarely materialise

When we approach a point in our life where a significant change is expected to happen, we're usually afraid of it. We fear the unknown, even when it represents a chance for improvement. When we were nearing the year 2000, many stories and theses about the end of the world were put forward. But eighteen years after, the sun is still shining, and we are better off than before. After all, the passage from one millennium to another was much smoother than predicted.

Analogously, many feared the worst and predicted the UK economy would enter a long-lasting recession, just before the Brexit vote. I myself believed its effects would be worse than they have turned out to be so far. Not even the Bank of England resisted the gloomy outlook, pointing to a stagnation for the second half of 2016 while Mark Carney warned of a possible "technical recession".

> **"THE BRITISH BLUE-CHIP INDEX HAS THE ADVANTAGE OF BEING VERY MODESTLY VALUED."**

Fortunately, the gloomy predictions didn't materialise, and the UK did better than many other developed economies. The depreciation of sterling helped the exporters and many of the dollar-earning FTSE 100 companies, which saw profits increase in sterling terms. From the date of the vote until the end of 2016, the FTSE 100 rose 13% while the S&P 500 rose just 7%. Retailers had less luck at the beginning, as the rising import prices squeezed their margins. But as the pound later stabilised and they were able to transfer some of the higher costs to the final consumer, the scenario improved for them.

However, if the worst of the gloomy predictions failed to materialise, the UK economy is hardly booming. While it is far from the "technical recession" scenario depicted by the Bank of England, growth is falling short of other developed economies. The British economy grew 1.6% in 2017, which is below its peers. Growth in France, the US and Germany for the same period was 1.8%, 2.3% and 2.5% respectively. At a time when growth is gathering pace elsewhere, it seems it is losing momentum in the UK, which may be a sign that most of the positive effects felt over the last two years were mainly due to a global pick-up in economic activity rather than being a result of Brexit.

There was no instant recession due to the Brexit vote, but some negative effects may still materialise over the coming years. The IMF expects the UK to grow 1.6% in 2018, which is significantly behind the European Union (2.5%), and the US (2.9%). In the G7 group as a whole, the UK is struggling, being placed just above Japan (1.2%) and Italy (1.5%).

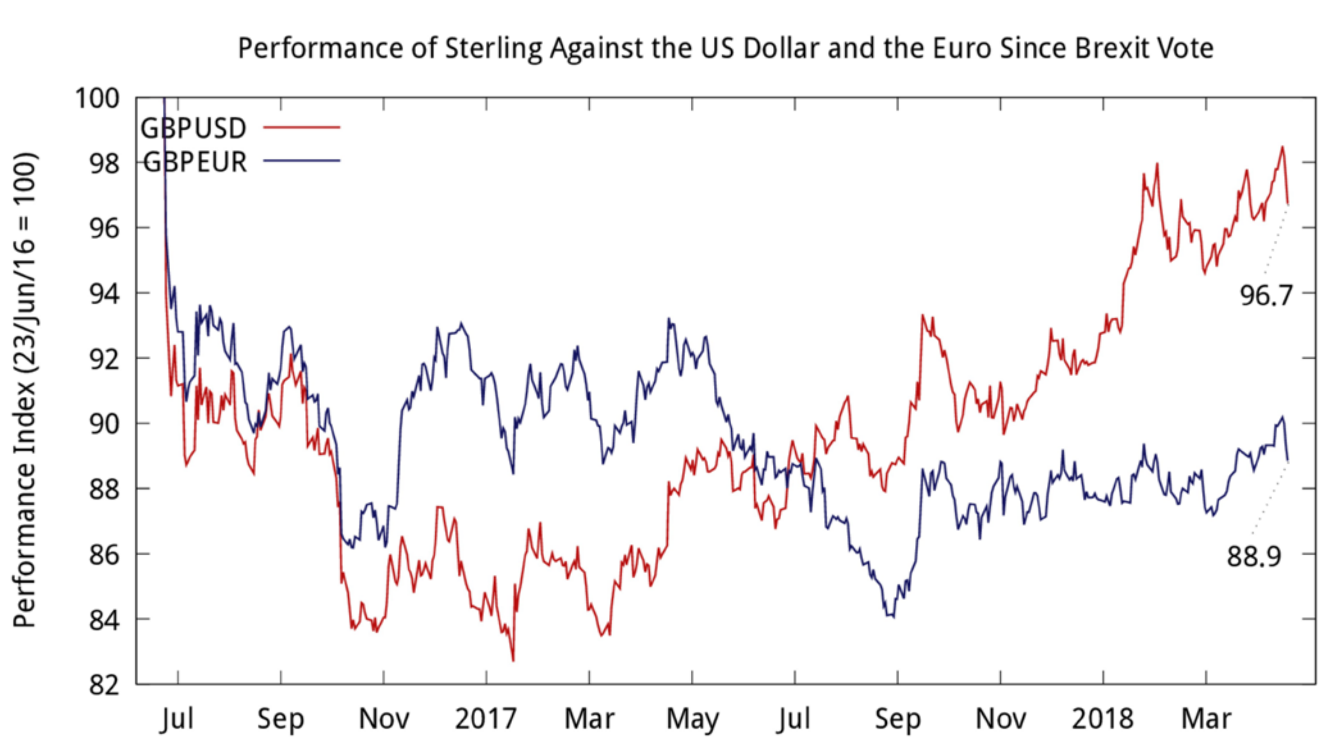
GDP Growth Projections

Country/Region	Expected Growth 2018
Euro Area	2.4
European Union	2.5
UK	**1.6**
France	2.1
Germany	2.5
US	2.9
Canada	2.1
Japan	1.2
Italy	1.5

Source: IMF, World Economic Outlook (April 2018)

Sterling: From slump to recovery

The immediate reaction from currency traders to the Leave vote was to sell sterling. On the day after the vote, the currency declined 9.8% against the US dollar, from 1.4660 to 1.3228. The trend continued over time as investors adjusted to the new conditions. By 16 January 2017, one pound was worth 1.2040 US dollars, or 17.9% less than before the Brexit vote. On the positive side, such depreciation means that a British company profiting to the tune of $500 million overseas would now



convert this to £388 million instead of £341 million. The pound's fall against the dollar was one of the main reasons why the FTSE 100 rose so much in the aftermath of the Brexit vote.

The pound also lost ground against the then troubled euro. One pound bought 1.2841 euros on 23 June but just 1.2302 one day later, a 4.2% decline. The depreciation continued and by 25 August 2017 the pound was worth 1.08 euros, accumulating a loss north of 16%.

The pound's depreciation was more severe against the dollar than the euro. In 2016 the eurozone economy was struggling while the US economy was already improving fast. Later, the pound ended up recovering much of its losses against the dollar, but it is still significantly depreciated against the euro. As of today, the accumulated loss is 3.3% against the dollar and 11.1% against the euro.

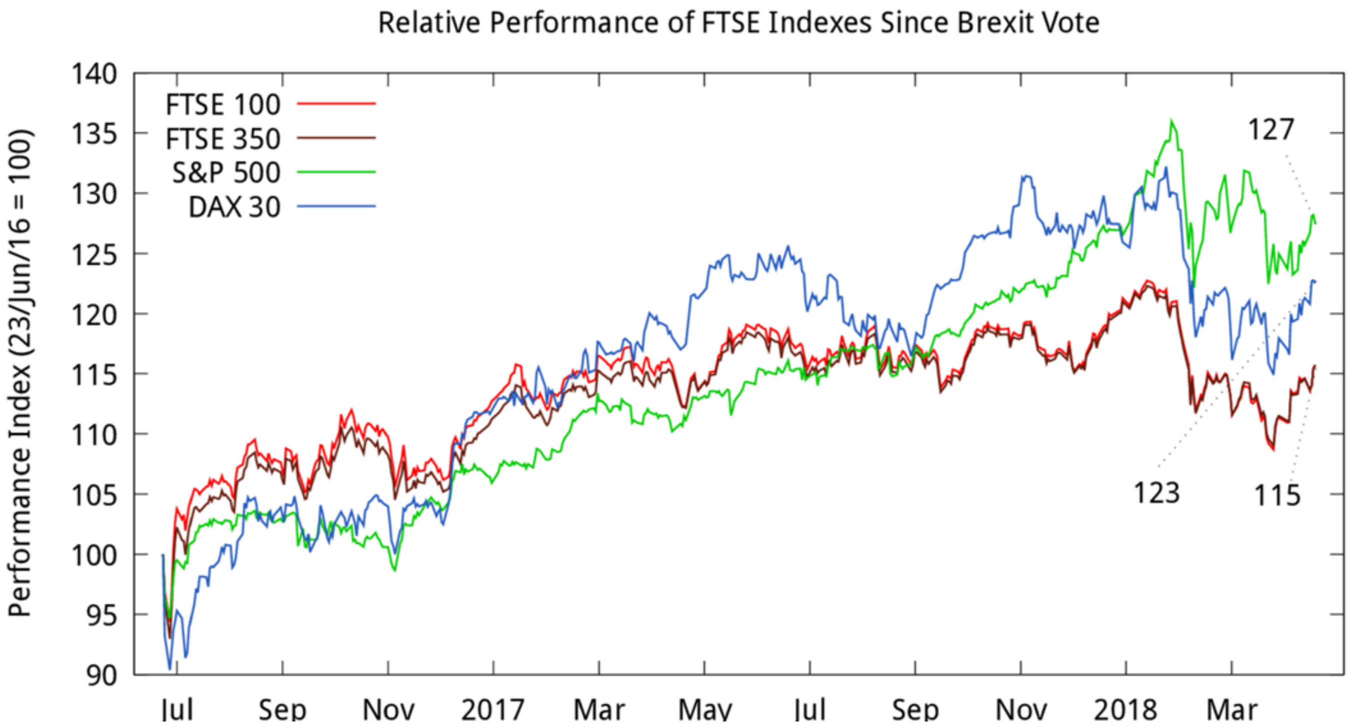
In the near term, as the Brexit divorce date approaches, one should expect further sterling weakness. The Bank of England is expected to hike its key rate two times during the year, but there could be some dovish surprises as the central bank will be at pains to avoid a recession should the Brexit negotiations take a turn for the worse. Given the fact that the UK trade deficit is large and that there is some likelihood of a softer monetary policy stance than predicted, I believe the pound will once again retreat against both the euro and the dollar, which will boost the FTSE 100. One way of getting a long position in the US dollar and short in the pound is through the **ETFS Short British Pound Long US Dollar ETC (LON:USD2)**. While I am confident of further sterling weakness, I would avoid any leveraged ETF offering two or three times the daily change in the pound relative to the dollar, as no one is able to predict the behaviour of these instruments with precision. In many cases, an investor ends up guessing correctly with regard to direction but loses money on these leveraged ETFs, as they are equivalent to a strategy of buying more of what rises and selling what declines.

"I BELIEVE THE POUND WILL ONCE AGAIN RETREAT AGAINST BOTH THE EURO AND THE DOLLAR, WHICH WILL BOOST THE FTSE 100."

Inflation in the UK rose faster with sterling's fall. From below 0.5% before the Brexit vote, consumer prices rose to a pace of change of 3% per year. But, as sterling reverses its losses, inflation is losing steam again. While inflation is now less pronounced than a year ago, we should always keep in mind that the unemployment rate currently sits at 4.3%, a 40-year low. Wage pressures will quickly mount and start pressing prices again. If that happens, I believe the central bank will lag behind, allowing the pound to decline, in particular at a time when it has already recovered from the initial Brexit vote losses.

British equities look cheap

While the FTSE 100 rose faster than its peers during the first few months of the aftermath of the Brexit vote, it has lagged behind over time. Since the Brexit vote, the S&P 500 has risen 27%, the DAX 23% and the FTSE 100 a more modest 15%. The British index has been underperfoming its peers for a long period of time, particularly because it has a large share of raw materials (an underperforming sector) and a lack of technology stocks (an outperforming sector). Still, raw materials have been in heavy demand lately, with oil now trading above $70. Iron ore, which has been a drag on FTSE profits, is also on better footing. Mining companies in the FTSE 100 look attractive and well positioned for the



pick-up in global growth. Companies like **Rio Tinto (LON:RIO), BHP Billiton (LON:BLT), Fresnillo (LON:FRES), Glencore (LON:GLEN), Anglo American (LON:AAL)** are worth an investment as a group.

"MINING COMPANIES IN THE FTSE 100 LOOK ATTRACTIVE AND WELL POSITIONED FOR THE PICK-UP IN GLOBAL GROWTH."

While the FTSE 100 seems undervalued, there are a few companies that may be badly positioned for the current economic situation. That is particularly the case with bond-like equities. At a time when bonds are struggling, stocks like **Centrica (LON:CNA), National Grid (LON:NG), Severn Trent (LON:SVT), United Utilities Group (LON:UU), and SSE (LON:SSE)** may follow suit. I would rather not own them.

Willy Barton / Shutterstock.com

The construction sector is another area that may see some difficulties. On the one hand, the government is easing back on austerity and is willing to spend more money in infrastructure, which should help the construction sector. But on the other hand, business investment in general has been weak and house prices are showing signs of a top, particularly in London.

While Brexit is certainly a huge blow for the European project, we now know it won't be extreme in political and economic terms. The British economy will go through different periods of adjustment but will likely remain closely linked to the European Union, which is (and will continue to be) its main trading partner. The initial downfall of the pound helped a few dollar-earners in the FTSE 100 which lifted the market, but the trend was later reversed as the dollar weakened. The stronger pound weighed negatively on the FTSE 100, leading the British index to lag behind its peers. Still, the index is undervalued and offers good opportunities in a world where stocks may be approaching the exhaustion point in terms of appreciation. Besides, as Brexit looms near, further pound weakness is expected, which may help boost the FTSE again. Basic materials, financials, industrials, and technology all look attractive industries, while utilities and some consumer-related stocks may encounter some difficulties in the meantime.

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.

BY BARNEY WHITER

CAN YOU INVEST YOUR WAY TO FINANCIAL INDEPENDENCE?

What does financial independence mean?

I quit my corporate job aged 43 when I realised I probably had enough to never need to work again. In other words, I discovered that I was financially independent (FI). Most people assume this is impossible unless you are a lottery winner, successful entrepreneur or hedge fund manager. But I did it as an accountant with an office job (and supporting a family with three children!). So yes, it's possible. But to get to FI, you are probably going to have to make some changes. Otherwise, our actions and attitudes to money can hold us prisoner.

On my blog I use the analogy of escaping from a prison camp. If you are in debt or working a job you don't like, then you are a prisoner. Freedom and happiness are a lot easier to achieve if you are financially independent. Financial independence means you've escaped: you are allowed to keep on working if you want, but you can politely decline the less reasonable requests of your boss or, even better, be your own boss.

"The Aggregation of Marginal Gains"

Getting rich may seem like a daunting task at first, but a journey of 1,000 miles starts with a single footstep. Over time, small gains in your everyday life add up to big money. I call this "The Aggregation of Marginal Gains", a concept I borrowed from Dave Brailsford, the Team GB and Sky Cycling director and arguably the most successful sports coach of his generation.

It's a cliché in personal finance to write about how cutting out that daily trip to Starbucks can save you a fortune in lattes over the course of a couple of decades. But the reason things become clichés is that they are truths that get repeated frequently. Getting to financial independence requires you to look for improvements in all areas of your spending, earning and investing. Every little helps.

The 4 elements of financial independence

Some smart investors have a bit of a blind spot when it comes to wealth accumulation. They become obsessed about the details of individual shares or funds. They miss the wood for the trees.

> **“MOST PEOPLE TREAT THEIR MONEY LIKE IT’S WATER IN A BUCKET FULL OF HOLES. I SUGGEST YOU THINK OF IT LIKE YOUR BLOOD.”**

The truth is that your investment returns are only one factor in how long it takes to get to financial independence. And not the most important factor either. So, lets break it down into the four elements needed to reach FI:

1. Earn more

The primary driver of the time it takes to get to financial independence is your savings rate (the percentage of your income you can save and invest). And, let's be honest, it's easier to save more of your income when you're on a higher income. There are five main ways you can earn more money in your career:

- Work harder
- Take more career risk
- Do something that others can't (or won't) do
- Negotiate better
- Get a side hustle

Yes, I know this is common sense. But I've come to realise over the years that common sense isn't that common.

2. Spend Less

Most people waste vast amounts of money on debt interest, pointless consumer spending and status goods. There are lots of reasons why we do this, encouraged by the advertising and marketing industries.

We all have a money blueprint in our minds that we developed growing up. We were taught attitudes by parents, other family, teachers, advertisers and bosses. Some of these attitudes are true, but on examination many turn out to be half-truths or just plain wrong. One example is the widely-held belief that more spending brings more happiness. But academic studies show that, above a certain level, additional spending (particularly on "stuff") brings no additional happiness.

Most people treat their money like it's water in a bucket full of holes. I suggest you think of it like your blood. It's not something you want leaking out of you unless there's a really good reason. When it comes to your spending, you need to track your spending to be able to answer the question: *Where does it all go?*

Before you can repay debts and learn to invest, you need to save. You should target a savings rate of 50+% of your (net) pay. No, that is not a typo. If you can save 50% of your earnings, then it should take you about 19 years to go from broke to the point where you are financially independent and probably never need to work again. And if you can save an amazing 75% of your earnings (I didn't manage this, but I know some that do) it only takes seven or eight years to go from broke to financially independent.

"MONEY IS NOT FOR SHOWING OFF OR SPENDING ON CONSUMER NONSENSE, IT IS FOR MAKING YOU MORE MONEY TO BUY FREEDOM AND HAPPINESS."

These savings rates are obviously easier for higher earners. But only if you don't allow your spending to creep up unseen via lifestyle inflation. And if you are a not a high earner, then being frugal is even more important. Remember – money is not for showing off or spending on consumer nonsense, it is for making you more money to buy freedom and happiness.

3. Invest wisely

Given where this article is appearing, I'm guessing you've already realised the importance of this one. With interest rates close to zero on cash, we're not going to be able to build enough wealth by just saving in a bank account. One of the foundations of financial independence is learning to think long term and accept the inevitable volatility of equity markets along the way. For the long-term investor, equity market crashes are rich sources of opportunity that allow us to buy assets cheaply.

As we all (should) know, compound interest is the most powerful force in the universe over longer periods of time. At 12% per year, your money doubles every 6 years. This can seem quite boring for the first few years. After that, as the snowball gathers size, it stops being boring and becomes really very interesting.

Unfortunately, many people are paying far too much in fees and expenses on their pension plans, ISAs and other investment vehicles. The best way to avoid this is to take charge and manage your own investments.

There are many different investment styles and strategies out there. Of those many options, there are two that I use. Firstly, the best option for many (most?) people is to keep things as simple as possible and just invest via low cost index trackers. People who don't want to spend their life focussing on company accounts, analyst research and share price graphs can unlock the power of the stock market to build significant wealth. Vanguard has been a gift from God in this respect.

Secondly, I manage my own concentrated portfolio of high quality shares, focussing on global businesses with enduring franchises that allow them to

"THE BEST OPTION FOR MANY (MOST?) PEOPLE IS TO KEEP THINGS AS SIMPLE AS POSSIBLE AND JUST INVEST VIA LOW COST INDEX TRACKERS."

earn high cash returns on capital and to re-invest and compound those cash returns over time. This is comparable to the strategy adopted by Fundsmith and Lindsell Train.

In my career, I worked in corporate finance. I specialised in valuing companies. This gave me an ideal vantage point from which to hone my stock-picking. Not only did I get good at valuation analysis (such as multiple analysis of comparable companies, of prices paid in M&A transactions, discounted cashflow etc.) but I also got to see which companies endured and which tended to blow up. This taught me the wisdom of tilting towards quality when stock-picking.

4. Know when you have enough

Here's a true story from the classic investing book *Winning the Loser's Game.*

Two writers were at a party held on a billionaire's island. The first was Kurt Vonnegut, the second Joseph Heller, author of *Catch 22*. Kurt turned to Joe and said: *"How does it make you feel to know that our host only yesterday may have made more money than your novel Catch 22 has earned in its entire history?"*

Joe: *"Ah, but I've got something he can never have"*

Kurt: *"What on earth could that be, Joe?"*

Joe: *"The knowledge that I've got enough"*.

These stories illustrate a fundamental truth about financial independence. It's often harder than you think to realise when you have enough.

There is a helpful simplifying concept here: the idea of a 4% safe withdrawal rate. The 4% "rule" is a simplification. It is based on a number of studies, the most widely cited of which is the Trinity Study. The Trinity Study showed how, over a range of time periods and market conditions, how portfolios reacted to differing levels of withdrawals.

In the Trinity Study, portfolio success was defined as not running out of money within a 30-year retirement period. And, under that definition, with a 75% equities/25% fixed income portfolio and 4% inflation adjusted withdrawals, the portfolio success rate was 100%.

This 4% "rule" means that the maths is the easy bit. All you need do to get to financial freedom is cut your spending and save enough so that your investment portfolio is worth more than 25x your annual spending. That will probably be enough.

Achieving FI not only entails the discipline to accumulate wealth for a number of years but then also having the self-awareness of your own emotional flaws and biases to know what's enough.

Conclusion

If you're new to these concepts, be aware that the stuff I've covered is only the tip of the iceberg. There's a huge amount of high quality free information out there. The weird thing is that what for me started just as an attempt to get better with money, turned into a broader journey of self-development.

I wish you all the best on your journey.

If you would like more on this subject, you can check out Barney's blog at www.theescapeartist.me.

About Barney

Barney read economics at university before qualifying as a chartered accountant. He then worked as a corporate finance adviser for almost 20 years, specialising in valuing companies and providing mergers and acquisitions and restructuring advice to companies, creditors and equity investors. He resigned from his job in 2014 and now writes a personal finance blog at www.theescapeartist.me. Barney is married with three children and lives in Surrey.

BY JOHN KINGHAM

DIVIDEND HUNTER

CENTRICA'S 8% YIELD MEANS IT'S PRICED FOR ENERGY ARMAGEDDON

Most of the time, when you're looking for very high yield stocks you end up finding companies which are either small, young or highly cyclical. Sometimes though, you'll find the exact opposite, and that's what we have today with Centrica. It's a large, mature business operating in what should be a very defensive sector, and yet it has a dividend yield of more than 8%. At first glance, this seems odd. Why would a company with such an entrenched market position, operating in such a defensive market have such a high yield? Let's find out.

In the beginning, energy companies were privatised, and it was good

After the energy sector was privatised in the 1980s and '90s, energy utilities were about the most boring and defensive stocks you could imagine. For the most part they sucked fossil fuels out of the ground, processed them and sent the end result out to homes and businesses through the national grid. For many years it was a very attractive business to be in. Competition was sparse, demand was almost entirely unaffected by the economic cycle and customers had little or no interest in hunting around for the best deal. And governments largely kept out of the way because they wanted to show that the re-privatisation of the industry had been a success.

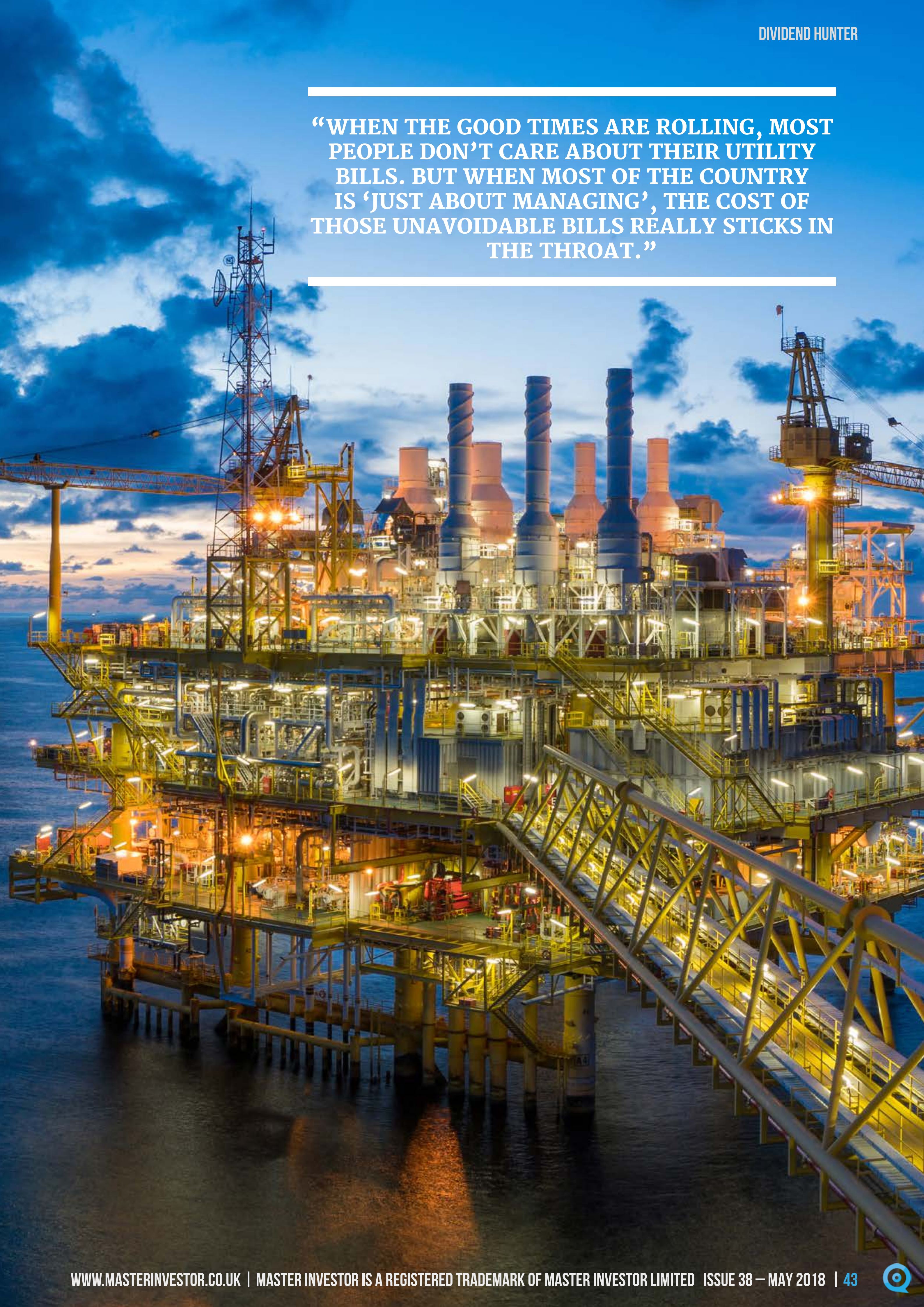
Today this situation has changed dramatically, largely because of the financial crisis and its secondary effects. Most important among those effects are: a) the tough economic environment of the last decade; b) an increased distrust of capitalism; and c) government's desire to appear tough on "fat cat" and "rip off" businesses. I'll take each of those in turn:

Nobody really wants to buy gas or electricity

When times are tough, the cost of gas and electricity matters. After all, when was the last time you heard somebody say, "I'm going to run up a massive electricity bill this week because I'm worth it!"? My guess is never. That's because nobody actually *wants* to buy what Centrica is selling. They *have* to buy it, and there's a big difference. In that sense gas and electricity are like car insurance. But it's worse than that. At least with car insurance you can reduce your car insurance costs by buying a smaller car, or not having a car at all. With gas and electricity there's pretty much no way to avoid them unless you want to live like a caveman.

When the good times are rolling, most people don't care about their utility bills. But when most of the country is "just about managing", the cost of those unavoidable bills really sticks in the throat.

"WHEN THE GOOD TIMES ARE ROLLING, MOST PEOPLE DON'T CARE ABOUT THEIR UTILITY BILLS. BUT WHEN MOST OF THE COUNTRY IS 'JUST ABOUT MANAGING', THE COST OF THOSE UNAVOIDABLE BILLS REALLY STICKS IN THE THROAT."



"OVER THE LAST DECADE, CENTRICA'S POST-TAX ROCE HAS AVERAGED 11%. THAT DOES NOT LOOK LIKE A COMPANY RIPPING OFF THE MAJORITY (OR EVEN A SIGNIFICANT MINORITY) OF ITS CUSTOMERS TO ME."

Evil capitalists are out to rip you off

I think capitalism is awesome. Yes, it isn't perfect; far from it. But its ability to efficiently allocate human and physical capital towards activities that society values is astonishing. But, as I said, it's far from perfect. In the run up to the financial crisis, regulators thought that financial markets worked best when left alone, and the result was a large number of "bankers" pocketing vast amounts of money at the expense of the rest of us. Quite rightly, ordinary people were not overly impressed with this, especially when it created an illusory boom and an all too real bust. But quite wrongly, that distrust of "bankers" has grown into a general distrust of big business and even capitalism itself.

Unfortunately for Centrica and the other big energy utilities, they sit right in the crosshairs of this distrust, largely because they're big businesses, they're well-known and nobody wants to buy their product, but everybody has to.

"Rip-off" energy companies are an easy target for politicians

Given this backdrop of falling real wages, dead-end zero-hour contract jobs and a growing distrust of big business, it's no surprise that political parties want to show they're standing up for the common folk by squaring up to and facing down those evil big businesses. To a large extent that's going on with the government versus Facebook, Amazon, Google and Starbucks (to name a few).

As for Centrica and the other big energy utilities, both of the UK's major political parties have come up with market interventions which are largely responsible for the high yields these companies offer (for example, SSE also has a yield of more than 7%). So what are those market interventions?

The Conservative plan revolves around a price cap on the standard variable tariff which would, in my opinion, be a bad idea. Hopefully this price cap idea is more of a big stick which politicians can use to look tough and cajole energy companies into somehow lowering their prices. However, it could be implemented and if it is, the impact on Centrica and the other big energy utilities would probably be negative.

Compared to the Conservatives, Labour's market intervention is on to an entirely different scale. Labour's plan is to nationalise the sector, either just the transmission and distribution network (think National Grid) or perhaps all the big energy suppliers as well, including Centrica. I think a programme of mass nationalisations is both a) likely to be inefficient and lead to worse service and significant subsidies from the taxpayer and b) a very real risk to shareholders.

A misguided regulatory sledgehammer to crack a relatively small nut

Both the price cap and nationalisation ideas are attempts to fix a broken market. And if the energy market was seriously broken, then perhaps a reasonable argument could be made for such extreme measures. But I just don't see any evidence of widespread market abuse.

If, for example, Centrica was systematically ripping off the majority or even a substantial minority of its customers, then it would show up in its accounts. Centrica would be consistently earning excess profits beyond those possible in a reasonably competitive market.

My preferred measure of profitability is return on capital employed (ROCE), which shows how much profit a company makes from its fixed capital assets (e.g. oil and gas infrastructure) and its working capital (e.g. cash in the bank or oil and gas in storage). On average, companies on my stock screen (which covers about 200 dividend-paying FTSE All-Share companies) produce post-tax returns on capital employed of about 10% per year. Weak and uncompetitive companies produce returns on capital employed as low as 5% (if they produce any returns at all) and companies with strong competitive advantages can produce consistent returns on capital employed of 20% or more. So where does Centrica fit into this spectrum of profitability and competitiveness?

Over the last decade, Centrica's post-tax ROCE has averaged 11%. That does not look like a company ripping off the majority (or even a significant minority) of its customers to me. It looks like the returns of a reasonably competitive company in a reasonably competitive industry. If Centrica is ripping people off left right and centre, where exactly is it hiding the profits?

I'm not saying Centrica or the other big energy utilities don't overcharge some vulnerable customers who are not capable, for whatever reason, of constantly switching to the cheapest supplier. And I'm not saying the energy market couldn't be improved. What I am saying is that there's no obvious evidence I can see that a large percentage of Centrica's customers are being ripped off.

That's why I think the solutions offered by both political parties are way over the top, especially the idea that nationalisation will somehow lead to better outcomes. Remember British Leyland cars? Ah, those were the days (of rust and constant break-downs). As far as I can see, these proposed interventions are largely driven by vote chasing rather than a real concern for the effectiveness of the energy market and outcomes for those who are "just about managing".

> **"CENTRICA FACES POTENTIALLY SERIOUS AND LARGELY UNQUANTIFIABLE REGULATORY RISKS."**

And they won't work anyway. Not in any meaningful way. That's because energy utility profit margins are about 5%. So even if the energy utilities made zero profit, your energy bill would only fall by about 5%. Big deal. A better solution would be to remove green and social "taxes" from our energy bills and move them onto our income tax bills. That would reduce energy bills by about 10% and make those green and social costs progressive rather than regressive.

In summary then, Centrica faces potentially serious and largely unquantifiable regulatory risks. That will put many investors off completely. However, I'll assume you're not one of them, so let's carry on and look at what Centrica is doing in this tough and uncertain environment.

Centrica's response is to refocus on its customer-facing business

Following weak results in the years leading up to 2015, Centrica carried out a major business review and concluded that it needed to focus much more on efficiency and its customer-facing businesses, and less on fossil fuel exploration and production.

Its multi-year plan is currently about half-way through the first stage, which runs to 2020. On the efficiency side, some 6,000 jobs are expected to go by 2020. Along with many other changes, this will hopefully lower costs by around £750 million each year. The company's focus is also materially moving towards its customer-facing business, with some £900 million being realised from exploration and production disposals, which is helping to finance an investment of up to £1.5 billion into customer-facing activities.

How all this will affect the company's results is yet to be seen, but Centrica had to do something. Over the last decade the company has pretty much gone nowhere, with earnings and dividends more or less unchanged since the financial crisis. Once inflation is factored into the equation, Centrica has actually shrunk quite a bit over the last decade.

Historically, another potential sticking point has been Centrica's relatively high capital intensity. In other words, extracting, refining, storing and burning fossil fuels takes a lot of capital assets such as oil rigs and refineries. If Centrica wanted to expand its exploration and production business, it would have to invest huge sums up-front in these assets before it could generate a penny of revenue or profit. This makes growth much more expensive and much more difficult, although one upside is that high capital intensity puts off would-be competitors from entering the market.

This is now changing as Centrica moves away from that sort of capital intensive exploration and production activity. In the last few years its capex ratio (the ratio of capital expenses to net profits) has fallen from a relatively high 100% or more (i.e. the company spent more on capital assets than it made in profits) to a much more typical 60% or so. That's because customer-facing activities like supplying energy and fixing boilers is much less capital intensive than extracting oil or gas.

So capital intensity is no longer such a problem, but its debts and pension obligations are. This does seem to be a recurring theme at the moment, largely because extraordinarily low interest rates have seduced companies into taking on more debt whilst also inflating the size of their pension obligations. In Centrica's case, it has debts of more than £6 billion, which are more than four-times its recent average profits. That's high, but it doesn't break one of my investment rules:

INVESTMENT RULE: Don't invest in a defensive company if its debts are more than five-times its recent average profits

As well as fairly high debts, the company has considerable retirement obligations as well. Currently these run to just over £9 billion, or 6.6-times recent average profits. The pension scheme also has a deficit of almost £1 billion which is effectively a debt to the pension scheme which must be repaid. With borrowings of £6 billion and a pension deficit of £1 billion, Centrica does indeed start to look uncomfortably indebted, with a debt ratio of five once the pension deficit is included, and that's right on the limit of what I would call an acceptable level of debt. But it gets worse. I have another investment rule relating to pension obligations:

INVESTMENT RULE: Don't invest in a company if its combined debt and pension obligations exceed ten-times its recent average profits.

With borrowings of £6 billion (excluding the £1 billion pension deficit) and total pension obligations of £9 billion, Centrica's combined debt and pension obligations of £15 billion are about 11-times its recent average profits of £1.4 billion. That takes it above and beyond the level I'm comfortable with.

The verdict

Overall then I would describe Centrica as a mature, well-known business operating in what should be a very defensive sector. Unfortunately, mature also means low growth in this instance. Add to that low growth the external risks of populist regulatory changes and the internal risks of large financial obligations and it's easy to see why the company has a dividend yield over 8%. Because of these various problems, I would not buy Centrica today. I think there are other stocks which offer a better risk-adjusted reward, although I must admit I do find that 8% yield enticing.

Somewhat contradictorily, I actually own shares in Centrica. I've owned them since 2012, which means the investment is about 50% underwater. Some investors would say I should sell the company if I'm not willing to buy more shares today, but I disagree. Yes, the investment has not gone well, at least so far. And yes, I would not buy shares in Centrica because of the regulatory risks and its large financial obligations. However, that doesn't mean I have to sell. The future is a very uncertain place and nobody knows what it will bring, especially where investments are concerned.

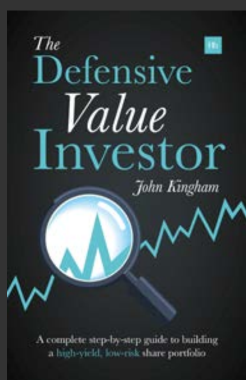
Perhaps there will be no nationalisation programme and perhaps the price cap will either never happen or will be watered down and temporary. Perhaps Centrica can turn things around and return to modest growth by concentrating on customer-facing activities. If the dividend is maintained for long enough then investors are likely to become less pessimistic. If that happens, the dividend yield is likely to return to a more normal 4% or 5%, which would mean a significant increase in today's share price. Obviously, I'm not saying that will happen, but it could. And since I'm here already and Centrica is about 1% of my portfolio, I might as well wait to see what happens.

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

THE DOGS OF AIM 2018

PROFIT FROM THESE HIGH YIELDING SMALL CAPS

Just over one year ago I launched my "Dogs of AIM" portfolio. This was based on the popular "Dogs of the Dow" method, the investment strategy that sees investors put equal amounts of money into ten individual companies, otherwise known as "dogs", which are constituents of the blue-chip focussed Dow Jones Industrial Average index. The term "dogs" in this context specifically refers to the companies with the highest historic dividend yields. However, instead of the Dow, my strategy applied the same approach to the Alternative Investment Market, using the FTSE AIM 100 index to ensure that constituents were of a decent size and sufficient quality.

Diamond dogs

I am pleased to report that the initial portfolio has performed remarkably well, showing that the strategy is not barking mad.

The average capital return of the ten holdings over the period was 44.8%, significantly higher than the 20.9% return delivered by the FTSE AIM 100 Index. Eight out of the ten companies rose in value, with **Manx Telecom (LON:MANX)** only down by 2.8% and the one major loser being miner **Pan African Resources (LON:PAF)** which fell in value by 51.6%.

"THE INITIAL PORTFOLIO HAS PERFORMED REMARKABLY WELL."

At the top of the table was trading platform provider **Plus500 (LON:PLUS)** which soared by 222.8% after investors shrugged off regulatory concerns and as net profits grew by 70% for the 2017 financial year. Also doing well was digital performance marketing services company **XLMedia (LON:XLM)**, shares in


THE UNITED STATES OF AMERICA

Name	Price (p) 28/03/2017	Price (p) 27/04/2018	% Change	Dividend (p)	Total Return
Andrews Sykes	440	537	22.0%	23.8	27.45%
Central Asia Metals	210	282.5	34.5%	16.5	42.38%
Manx Telecom	196.5	191	-2.8%	11.1	2.85%
Numis Corporation	255	398.5	56.3%	12	60.98%
Pan African Resources	15.5	7.5	-51.6%	0.88	-45.94%
Plus500	435.5	1406	222.8%	123	251.09%
Polar Capital Holdings	347	526	51.6%	25.5	58.93%
Redde	150.5	174	15.6%	16.1	26.31%
SafeCharge International	255	324	27.1%	13.47	32.34%
XLMedia	108	186	72.2%	5.63	77.44%
			44.78%	AVERAGE	53.38%

Data source: Sharescope

which rose by 77.4% after it continued its acquisitive expansion and grew pre-tax profts by 27% in 2017.

The portfolio returns get even better when we include dividends, with the *total* portfolio return being 53.4% (assuming dividends were held as cash and not reinvested). That compares to a 22.7% rise in the FTSE AIM 100 Total Return Index. Plus500 was a notable contributor to the dividend payments, the company paying out over $190 million to shareholders for 2017 and further boosting returns via share buybacks.

Different dogs?

Under the original Dow strategy the dogs portfolio is periodically rebalanced, typically annually, with the previous year's holdings replaced with a revised, but again equally weighted, selection based on the same criteria. Looking at the current top-ten highest-yielding AIM 100 stocks reveals many familiar faces, with only two new entrants to the portfolio.

Exiting the portfolio are Pan African Resources, which has fallen out of the AIM 100, and financier Numis, whose rising share price has reduced its yield to just 3%. The new entrants are Russian miner **Highland Gold Mining (LON:HGM)** and a company which I covered in the March edition of Master Investor Magazine, **Eddie Stobart Logistics (LON:ESL)**.

For those investors who don't have the capital to invest in all ten companies, or who want to invest in a few stocks only, here are three of the most interesting:

HIGHLAND GOLD MINING

There aren't many AIM listed mining companies which make a profit. Even fewer pay a dividend. According to my research, out of a total of 99 mining companies listed on the junior market only four currently make a distribution to shareholders. Among those, the highest yielding miner is Russia based Highland Gold Mining.

The company was founded and listed on AIM in 2002 with the strategy of acquiring, consolidating and developing a portfolio of quality gold mining projects in the Russian Federation with good growth potential. Since then those aims have been achieved, with it

Company	EPIC	Capital (£m)	Yield (%)	Sector
Highland Gold Mining	HGM	493	6.86	Mining
Redde	REDD	528.9	6.09	Financial Services
Manx Telecom	MANX	217.4	5.97	Fixed Line Telecoms
Central Asia Metals	CAML	497.2	5.84	Mining
Plus500	PLUS	1601.5	5.61	Financial Services
Polar Capital Holdings	POLR	491.3	4.75	Financial Services
Andrews Sykes Group	ASY	227.2	4.43	Support Services
Eddie Stobart Logistics	ESL	508.2	4.08	Support Services
SafeCharge International	SCH	479.1	3.83	Support Services
XLMedia	XLM	409.9	3.66	Media

Data source: Sharescope – as at 27/4/2018. Plus500 excludes special dividend

"HIGHLAND'S PRODUCTION PROFILE PUTS IT WELL INTO MID-TIER MINING TERRITORY."

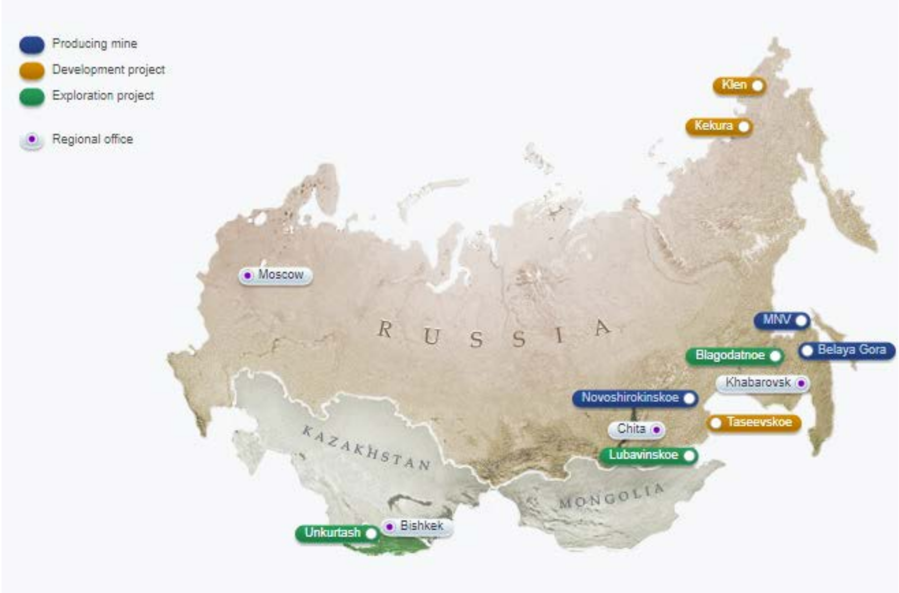
having built up a trio of core operating mines (the catchily named Mnogovershinnoye, Belaya Gora and Novoshirokinskoye) which in the last financial year produced over 270,000 ounces of gold and gold equivalent.

Highland's production profile puts it well into mid-tier mining territory, as do its resources. At the end of 2017, the firm's proven and probable ore reserves amounted to 5.1 million ounces (Moz) of gold and gold equivalent. This was up from 3.3 Moz a year earlier following updated estimates for each of its producing assets and main development project, Kekura. Additionally, mineral resources (measured, indicated and inferred) were 17.2 Moz at the period end, providing significant long-term production potential.

Further long-term opportunities come from another two development projects in Russia, along with three exploration properties, one of which is in Kazakhstan. Adding to this, Highland has recently announced the addition of a fourth producing mine to add to its portfolio. For a total of $91 million the company is buying Valunisty, an operating gold mine and processing plant in the region of Chukotka, also home to the Kekura development project. The Valunisty mine brings with it historic annual production of 31,000 oz, reserves of c.520,000 oz of gold and gold equivalents and resources of 1.15 Moz, along with two additional licence areas. The deal is expected to be accretive on several key financial and operational metrics on a pro forma basis including adjusted earnings and NAV per share, cash return to shareholders and gold production.

Golden numbers

The 2017 financial year saw record levels of production at Highland, with 272,274 ounces of gold and gold

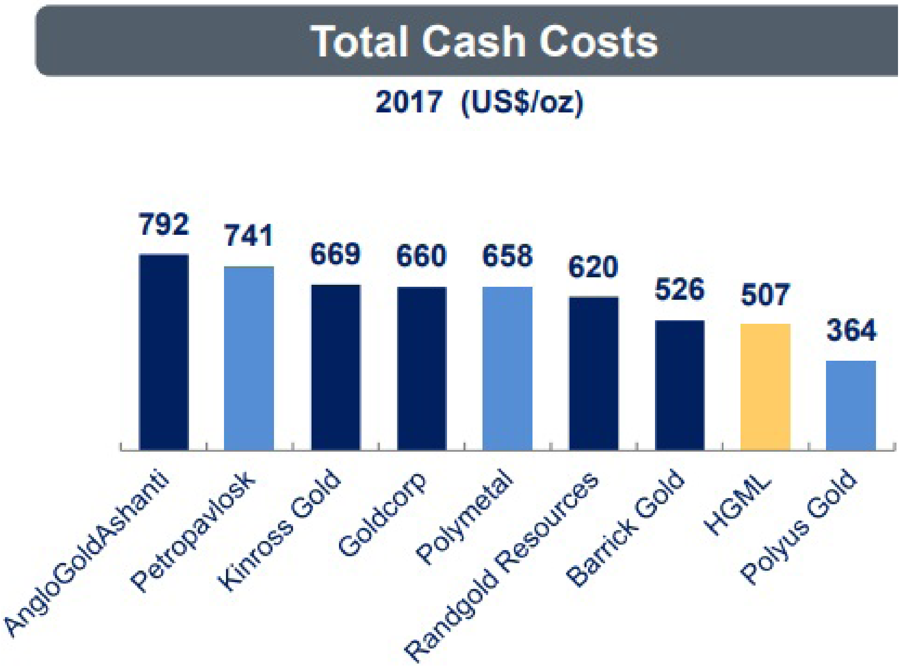


equivalent produced, up 4.3% compared to 2016. With the average realised gold price edging up by $26 to $1,162 an ounce, revenues for the year were $316.7 million. On the downside, a strong Russian rouble saw total cash costs rise by 11.7% to $507 per oz. Nevertheless, this provides high margins at current gold prices and remains at the lower end of a range of the company's peers, as per the chart below.

At the bottom line, net profits grew by 37% to $65.9 million, with the cash inflow from operating activities down by 6% but still impressive at $131 million. That helped to trim net debt down by c.$7 million to $198.3 million and allow the company to pay a 10.4p dividend for the year. While debt is relatively high, interest payments for the year were covered 38 times by operating profits, a figure which is very comfortable.

The most recent news is that in the three months to March 2018 total production was down by 9% at 59,311 oz as technical issues resulted in reduced processing plant capacity. However, these issues have now been solved, with full-year forecasts for 265,000-275,000 oz gold and gold equivalent confirmed. The average realised gold price during the quarter was $1,329 per ounce, up from $1,222 in Q1 2017.

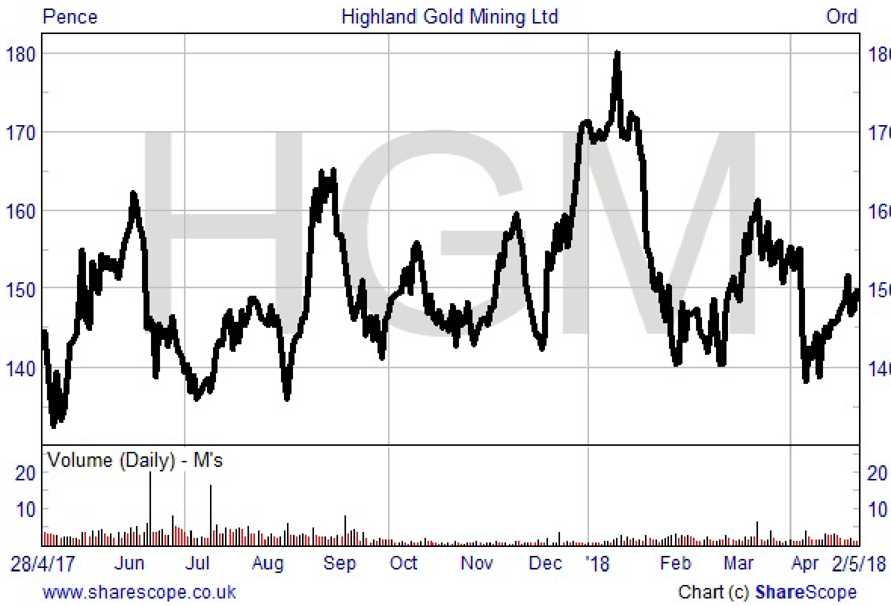
The strategy now is to balance a steady rate of production from the existing operating mines with progression of the key development and exploration projects. The recent Valunisty acquisition is expected to increase production by c.11% on an annual basis, with a recent Definitive Feasibility Study for the Kekura project estimating a start date of 2021 with a total mine life of 16 years. Highland is targeting average annual gold production of 172,000 oz for the first eight years at Kekura and 46,000 oz thereafter, with average total cash costs of $511.



Golden opportunity?

While based in a politically sensitive region, Highland Gold is a relatively stable business in terms of gold production and looks to have some good growth opportunities across its various assets over the next few years. It has low operating costs and despite the gold price having risen by c.14% since the start of 2017 its shares are only up by 8%, despite the obvious potential for operational gearing.

At the current price of 151.5p Highland Gold is capitalised at £493 million, making it the second largest AIM listed miner behind **Central Asia Metals (LON:CAML)**. As mentioned previously, the company is a good dividend payer, with the policy being to pay out 20% of net cash flow from operating activities. Highland has also highlighted that it could pay special dividends should such funds not be required for capital expenditure or debt repayment. The historic yield is 6.86%, which makes Highland the highest yielding AIM 100 share. In addition, Broker Numis has a 210p target price, which suggests 39% upside from here.



PLUS500

The story of Plus500 is one of the most eventful of the small cap markets over the past few years. Founded in 2008 by alumni of the Israel Institute of Technology, the company has come from nowhere to become one of the largest on AIM and one of the leading CFD (contracts for difference) trading platforms. But it hasn't all been smooth sailing.

As of today, Plus500 provides customers with an online CFD trading platform on which they can trade CFDs internationally over more than 2,200 different underlying global financial instruments including equities, indices, commodities, options, ETFs, cryptocurrencies and foreign exchange. Unlike other more belligerent brokers, Plus500 customers can not run into negative balances, there are no commissions on trades, the company does not use cold calling techniques and does not offer risky binary options. It is regulated by the FCA in the UK and also in Australia, Cyprus, Israel, New Zealand, South Africa and Singapore.

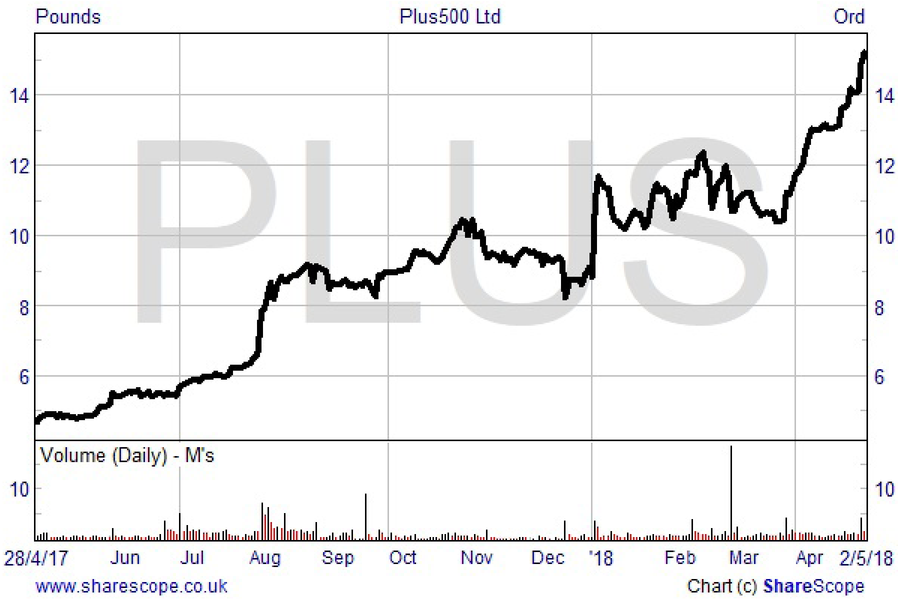
"RECORD FIGURES WERE SEEN FOR THE PERIOD, WITH REVENUES UP BY 285% TO $297.3 MILLION."

Having enjoyed a more than six fold increase in its share price between listing on AIM in July 2013 and May 2015, the shares went on to lose two-thirds of their value in a week. This came after the FCA stopped the firm's UK business from taking on transactions for existing customers and taking on any new clients until new anti-money laundering procedures had been implemented. The company has gone on to fully recover from these issues, with investors even seeing the shares surpass the value of a £460 million agreed bid from Playtech after the gaming software firm failed to achieve regulatory approval for the deal.

Adding investors

On May Day this year Plus500 cheered the markets by announcing a cracking trading update for the three months

to March 2018. Record figures were seen for the period, with revenues up by 285% to $297.3 million, resulting in EBITDA of $237.3 million. Those figures were driven by active customer numbers growing by 204% to 218,187, with 72,960 new customers added over the period.



Plus500 is a big spender on marketing, as it seeks to add new customers, and during the quarter the average new user acquisition cost fell by 45% to $502 as spending efficiency improved. Crucially, average revenues per active customer were well ahead of this figure, rising by 26% to $1,363. It should be noted that the period benefited from relatively volatile markets and high levels of interest in the company's cryptocurrency CFDs offering, with such an exceptional performance not expected to be repeated in the remainder of the year.

This trading update followed a superb set of figures for the year to December 2017 which showed revenues up by 33% at $437.2 million and net profits up by 70% at $199.7 million. However, the clear highlight of the numbers was the cashflow performance, with a net $212 million inflow from operations. As a result, the company made the decision to distribute all its net profits back to shareholders for the year, with $192.1 million being paid in the form of traditional and special dividends and $7.5 million also being spent on share buybacks.

Further growth to come?

Some investors are very cautious of Plus500, being concerned over a number of factors including the sustainability of its remarkably high profitability, potential for customer churn, high marketing costs and regulatory issues.

On the last point, the company will shortly be hit by new rules designed to protect retail investors from the European authorities which will see, amongst other things, leverage limits on the opening of a position by a retail client and a restriction on the incentives offered to trade CFDs. In response, Plus500 has stated that it already operates in compliance with most of the regulatory changes and there will be a limited impact on the 2018 numbers. Additionally, the company points towards a highly flexible business model, low cost base and global diversification as being positive for its future prospects.

Despite the concerns, the shares currently trade at a record high of 1,490p, capitalising the business at just under £1.7 billion. At that price Plus500 trades on a historic earnings multiple of 11.7 times, with the historic yield (including the special payment) being 8.2%. Taking a bullish stance, those figures do not look too demanding, especially if the company can continue to deliver the growth that has been seen over the past few years.

XLMEDIA

Despite blockchain and cryptocurrencies being the flavour of the moment, there are still some "old economy" internet stocks out there with interesting investment propositions. One of those is XLMedia, a provider of digital performance marketing services.

The company listed on AIM in March 2014, raising $69.5 million in a significantly oversubscribed placing in order to grow the business via acquisitions and invest in its IT systems. The original business model focussed strongly on the provision of marketing services to online gambling operators. Its job was to attract players by using online marketing techniques and direct them to gambling operator clients in return for a share of the gambler's ongoing revenue or for a fixed fee. While gambling still accounted for 64% of group revenues in the last financial year, the decision to diversify into additional sectors has reduced its exposure over the past four years and made the business more attractive for investors.

"THE COMPANY OWNS OVER 2,300 WEBSITES IN 18 LANGUAGES."

XLMedia currently operates three divisions. In Publishing the company owns over 2,300 websites in 18 languages which refer potential customers to its online focussed clients. Content on these sites is written by professional writers and designed to attract online traffic which is then directed to clients to earn fee income. The Media division acquires online advertising targeted at potential online traffic with the objective of referring potential users to the group's customers' or its own websites. Finally, the smaller Partners Network business manages marketing partners, whose role is to direct online traffic to customers for which XLMedia receives revenues.

XLent figures

The company's latest annual results presentation reports that since 2010

XLMEDIA

revenues have grown by a very impressive compound annual rate (CAGR) of 43% up to 2017, with EBITDA up by a CAGR of 42%. The 2017 results themselves reported revenues up by 33% at $137.6 million and adjusted EBITDA up by 36% at $47.1 million. I have commented before that the adjusted EBITDA measure of profits can be controversial, but if it closely matches or exceeds operating cashflow then it should be taken notice of. In XLMedia's case net cash from operations was $41 million for the year, 29% higher than reported net profits.

The company spent just over $21 million during 2017 acquiring businesses, domain names and websites, expanding in the areas of personal finance, mobile apps, cyber security, as well as into further geographical markets. Nevertheless, net cash plus short-term investments stood at $38.3 million at the period end, with the strong position meaning that $16 million of dividends were declared for the full year.

In order to provide further funds for its acquisition-led strategy, in January this year XLMedia raised a total of £31.7 million in an equity placing at 198p per share. The company commented that it has identified a strong pipeline of acquisition opportunities which are at various stages of due diligence. Since the placing, one further deal has been completed, that of WhichBingo.co.uk, an online informational portal and comparison sites for online bingo games in the UK. This adds to the (up to) €15 million acquisition of a number of leading Finnish gambling-related informational websites in January this year which are expected to be immediately earnings-enhancing.

Valuation

XLMedia looks to be a great growth business with a superb track record of rising profits and plenty of cash in the bank to invest in further organic and acquisitive expansion. At the current price of 178.5p the company is valued at £393 million and trades on a historic earnings multiple of 13 times. That's looks good value given the historic growth rates, cash in the bank and expected growth in 2018 from the variety of recently completed deals. The historic yield is a reasonable 3.2%, with analysts at Berenberg Bank having a target price of 290p for the shares, suggesting 62% upside.

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.

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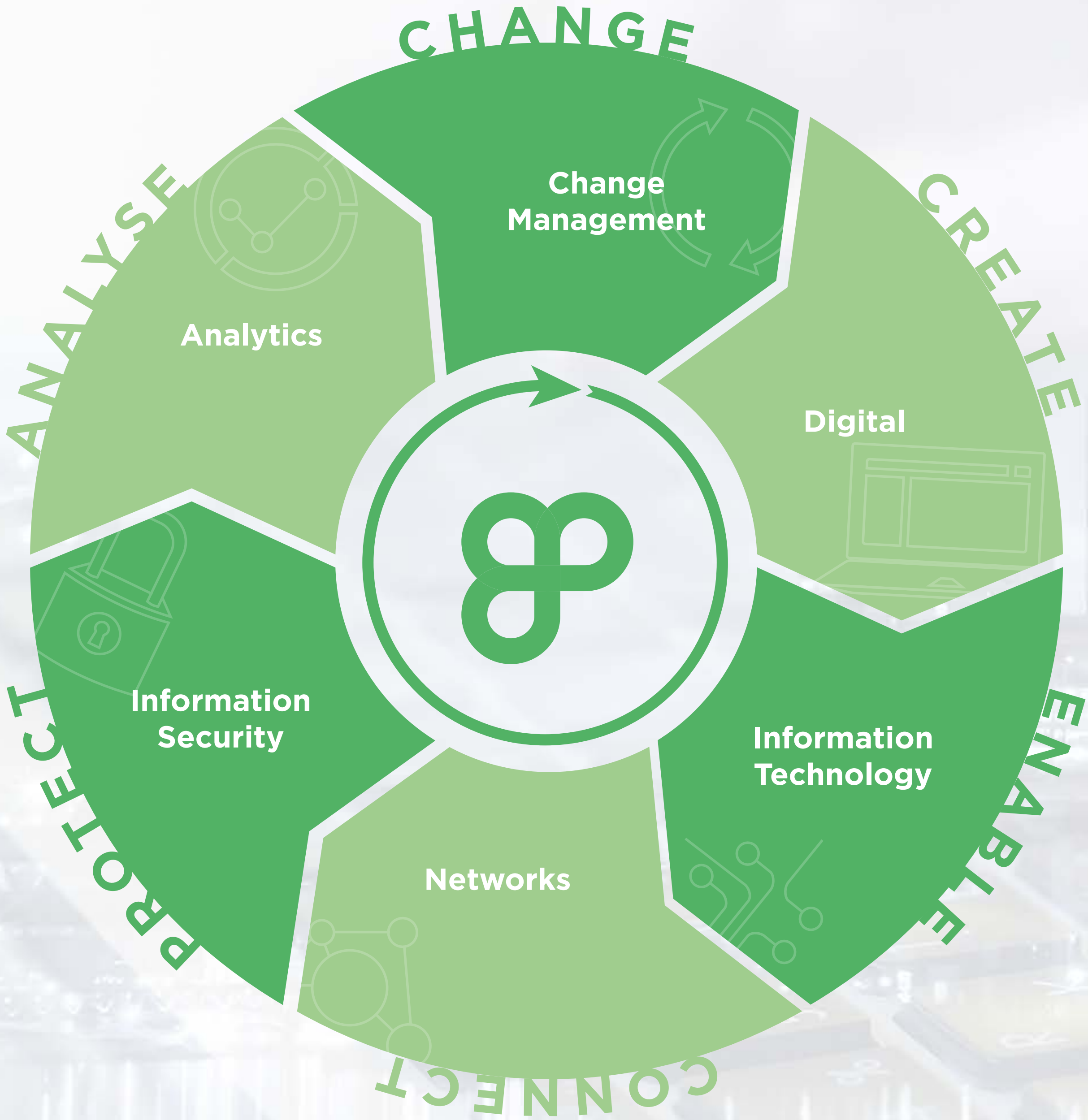

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BY DAVID JONES

CHART NAVIGATOR

HOW TO PROFIT FROM A FALSE BREAKOUT

Not many articles on charting start with a quote from a Sherlock Holmes novel. I am about to rectify that by lifting an extract from *Silver Blaze*.

Gregory (Scotland Yard detective): "Is there any other point to which you would wish to draw my attention?"
Holmes: "To the curious incident of the dog in the night-time."
Gregory: "The dog did *nothing* in the night-time."
Holmes: "*That* was the curious incident."

It centres around a racehorse that was stolen in the night. A dog at the stables did not bark – which you would normally expect – but the fact that it remained silent pointed to it being someone that the dog knew. So, the dog doing the opposite of what was expected was a major clue.

This tenuous introduction brings us to the subject of the false breakout – admittedly perhaps not as gripping to most as a Sherlock Holmes mystery – but something that can act as a major clue as to the market's next likely move. First of all, let's go back to the basics.

The breakout trade

Traditionally, if a market breaks a major level – usually a significant previous high or low – it is taken as a sign that a new trend could be under way. A breakout upwards suggests strength and further gains; a breakout below suggests weakness and steeper drops. Here are two reasonable text book examples to illustrate this simple charting principle.

FTSE250 mining business **KAZ Minerals (LON:KAZ)** is a good example of how it is meant to work. For five months from February to July 2017 it could not get past the 550p/600p a share zone. This had turned into an area of *resistance* on the chart. But as July went on this changed and the price managed to push through – the classic "chart breakout" pattern. The resistance had been overcome and the expectation was for further gains – this one duly delivered.

The second example is **Tate & Lyle (LON:TATE)**. From September 2017

"THE *FALSE BREAKOUT* DROPS LOTS OF HINTS. IT CAN END UP PRESENTING BETTER TRADING OR INVESTING OPPORTUNITIES THAN THE TEXT BOOK PATTERN EVER COULD."

through to February 2018, whenever the price sold off it found buyers ahead of the 620p area. But in February this eventually changed – a *support* zone that had stopped any weakness was broken. And in this example, the share price of Tate & Lyle played by the rules and sold off further after the break.

So far, these have worked as the text books say they should. But of course, nothing works every time, all the time. And, like the dog that didn't bark in the night, the *false breakout* drops lots of hints. It can end up presenting better trading or investing opportunities than the text book pattern ever could.

That's a bold statement, so let's walk through the details of a false breakout.

The three steps of a false breakout – and how to profit from it

Step number one is straightforward enough of course. If we are going to see a breakout, we need a definite area in the market that the market has struggled to get through. So, a previous support or resistance level is the first requirement. The FTSE250 housebuilder **Countryside Properties (LON:CSP)** is a good example of a share showing a clear level of support.

> **"I USE THESE A LOT – PARTICULARLY ON SHORTER-TERM CHARTS."**

It can be seen that in June and September of 2017 the price slipped back towards the 310p level. On both occasions the buyers stepped back in and caused the share price to rally, creating a support level. At the far right of the chart, at the end of January 2018, the price was once again back at this support level. So, step one is identifying the support and then waiting to see what happens next.

Step two in this example is the breakout. The level that had been a place where price turned around in the past isn't acting the same any more. We

"WITH POTENTIAL REWARDS A MULTIPLE OF THE INITIAL RISK, IT DOESN'T EVEN NEED TO WORK HALF THE TIME TO MAKE MONEY."

have a breakout (or breakdown – the terminology is unimportant).

Now, it is all about what happens next. Remember – the text book approach to breaks through a big level are that it could signify a major shift in sentiment and the start of a new trend. The market is meant to follow through in the direction of the break. So, in this example, the expectation is for further weakness following the break in support.

When looking for the *false breakout*, let's refer back to the Sherlock Holmes story at the start. We are waiting for the dog that doesn't bark – in this example, the market fails to follow through in the direction of the break. Because our chart is a daily chart in this example it is not something we need to be glued to second by second. We can note the break and come back in a few days' time to see what happened. Let's jump forward in time with Countryside Properties.

What's interesting here is that after the sharp fall over a couple of days following the break, the share price rallies. This is not an unusual reaction to a sharp move – but what happens next is the potential "non-barking dog" set up. The price slips back into March but you can see a couple of days where the price rallies ahead of the low immediately following the breakout. This is the signal that this could well be a false break and it's time to buy.

The strategy here would be to be a buyer around the 310p level, with a stop loss below that low following the first break – i.e. around 290p. By definition, if the share price goes lower than that initial breakout low, it's not a false breakout! It is doing what the text book says it should and we should exit for a loss.

What are the advantages of trading false breakouts?

I use these a lot – particularly on shorter-term charts where the approach is exactly the same as on a daily chart in this example. The big advantage is one of risk versus reward. If you get it wrong and get stopped out, it's a small manageable loss. But, if it does end up being a false breakout, you are getting in right at the extreme of what

Chart of the Month – Wood Group (John) (LON:WG.)

Given this week's topic is all about spotting false breakouts, I thought it made sense to pick up on one to watch along similar lines. It's actually quite difficult to find false breakouts over recent weeks, as the stock market has bounced back, but I came up with an interesting one, I believe, in the shape of oil & gas business John Wood Group.

Take a look on the chart at what we saw happening in March of this year. The 550p level had been good support in September 2017 – it ended up being the turning point for a rally to 750p. Since then the price has turned back down and sailed through those previous 550p lows. But, this didn't see everyone heading for the exits and further selling – after a couple of days of drops the price stabilised and found support ahead of 510p.

The question now is what next? If the price drops back, and those 510p lows hold, it looks like a false breakout and an opportunity to buy with a stop loss somewhere below those lows (personally, I would suggest the other side of 500p) and looking to see if once again the share price can stage a recovery back up to the old 700p-plus levels. It will be interesting to see how this one pans out.

is hopefully a significant move against the direction of that first break. So, your potential reward should be many times what your initial risk is. Here's what happened next with Countryside Properties.

In this example, the distance to the stop loss from 310p was 20p. That break did end up being a false one and, so far at least, the price has recovered as high as 370p. That represents a profit potential of 60p per share – three times that initial risk based on the stop loss. As usual, it should be stressed that this false breakout approach doesn't work all the time – far from it. But with potential rewards a multiple of the initial risk, it doesn't even need to work half the time to make money – if you are making, for example, 50p for a risk of 20p, you can be wrong more than you are right and still have a profitable strategy. As mentioned above, this is an approach I have used on shorter term charts, such as hourly and 10-minute charges, on both foreign exchange and index markets with success over recent months, and the main attraction is that healthy balance between risk and reward.

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 DAVID JONES

FORENSIC FOREX

CAN STERLING'S RALLY CONTINUE?

Given the progress seen by the pound in recent months, I thought it was worth revisiting what the rest of the year could hold in store, given the backdrop of expected base rate rises and the ongoing Brexit negotiations. During April, the pound/US dollar exchange rate (GBP/USD) hit its highest level in more than 18 months, albeit briefly. So, should we extrapolate this trend and expect even dizzier heights to be hit this year – or is it time to start thinking that maybe the pound has bounced back far enough for now?

The story so far

I am sure we are all familiar with the story following the EU Referendum vote – the early morning of 24 June 2016 saw the pound fall off a cliff. The shock result to leave the EU saw levels of short term volatility that were unprecedented in living memory. But – and this is an important *but* – the story of the past 15 months or so has been one of a recovery for GBP/USD, with the currency pair moving from around 1.23 at the beginning of 2017 to almost 1.44 more recently. This is an appreciation by the pound of 17%, which is no mean feat for a currency. In fact, for the year to date, the pound is the best performing currency out of the G10 group of nations. Well done us...

There have been a few reasons helping the pound to recover. Last year was a terrible one for the US dollar, losing ground against many major currencies. This dollar weakness lifts other currencies, so that was a factor. In addition, perhaps the outlook post the EU referendum was too bleak – we certainly have not seen the economy hit as hard as some of the more gloomier forecasters would have had us believe. Plus, of course, last November saw the central bank, the Bank of England, raise rates for the first time in ten years – this was seen as symbolic and the sign of further rises to come. Add into the mix the usual market trends argument – rising markets attract more buyers and discourage short sellers, and we have a collection of reasons why the pound has powered higher for more than a year.

> **"FOR THE YEAR TO DATE, THE POUND IS THE BEST PERFORMING CURRENCY OUT OF THE G10 GROUP OF NATIONS."**

What next?

Even a dyed-in-the-wool trend following chartist like me recognises that trends do not last forever. In the short-term at least, there are signs that some market participants are starting to get a little nervous about the levels reached.

For example, UK inflation last month came in slightly lower than expected. Now, a lower than expected cost

of living is a good thing of course for most of us – but not if you are betting on the Bank of England raising rates. One way of combatting inflation is to put the base rate up – but if inflation starts to decelerate it can make the argument for raising rates a little weaker, reducing the attraction of a particular currency. This, combined with a recent speech from the Bank of England Governor Mark Carney trying to slightly play down expectations of a May rate rise, was enough to knock the GBP/USD back quite considerably in the third week of April. Whether it happens or not, keep an eye on those monthly inflation numbers to get a feel for the frequency of future rate rises and what that could mean for the pound.

"THERE ARE SIGNS THAT SOME MARKET PARTICIPANTS ARE STARTING TO GET A LITTLE NERVOUS ABOUT THE LEVELS REACHED."

Brexit negotiations are the great unknown. At the moment, the market's interpretation has been broadly positive with March's announcement of a draft treaty getting closer being widely welcomed – and pushing the pound higher. But if there is one area that can deliver surprises then it is these ongoing negotiations. It seems very likely there are going to be stumbling blocks along the way – the severity of these could have a major impact on the pound's recovery.

So how about that trend?

To many, of course, charts are just hocus-pocus tea-leaf gazing – but just simply looking at how price reacts to major announcements can give a very good handle on broader market sentiment. Without getting too bogged down in the esoterica of technical analysis, let's just take a look at that price recovery in a bit more detail.

The chart shows the solid progress made since the beginning of 2017. There have been setbacks along the way, but the price has managed to push ever higher. Arguably, that has started to change with that latest lower-than-expected inflation data. The price made a brief move to a new high for the trend but, at the time of writing, we have not had the follow through here. Is this the sign that the market thinks the rise we have seen has gone far enough?

I think there is a good case for that. This doesn't mean we are going to see the currency plunge, but perhaps it is due something of a pause in the rate of recovery. As the UK gets deeper into the Brexit negotiations, and ever nearer our actual exit, there is likely to be more caution in the foreign exchange market as to what the implications for the economy will be. On top of that, there is always a chance of a bounce back for the US dollar. Last year was the worst performance for the greenback in more than a decade. This sort of pessimism only lasts so long and despite a poor start to the year, the second half story could be one of a resurgence in sentiment for the US currency.

And back to that chart. At the moment, GBP/USD is a reasonable distance away from that longer-term trend line. Even if the rate was to drop 10c (1,000 points) from here, back to the 1.3000 level, the trend would still be up, and it would just mean that the price has returned to a more normalised value. This could be an opportunity for those who want to buy the pound – just not at current levels. So perhaps the months ahead will see just a slight cooling of the euphoria that the pound has enjoyed this year and give a more favourable entry level to be positioned for any stronger recovery.

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

THE END OF INDEXING

SIX STRUCTURAL MEGA-TRENDS THAT THREATEN PASSIVE INVESTING

BY NIELS JENSEN

Given the poor ability of active fund managers to do their job (see multiple previous book reviews) it's no surprise that index tracking has grown significantly in popularity over recent years. This form of passive investing provides a low cost and hassle free way of following the performance of a range of indices around the world by putting money into a structured fund such as an ETF (exchange traded fund). The indices followed can be major ones such as the FTSE 100 and S&P 500, along with more exotic ones focussed on niche areas of expected growth – there is even a US fund looking to benefit from obesity trends.

> "90% OF NET FUND FLOWS IN THE US IN THE PAST THREE YEARS HAVE BEEN INTO PASSIVE FUNDS, WITH THE TOTAL GLOBAL INDUSTRY RECENTLY BREAKING THROUGH THE $5 TRILLION BARRIER."

As well as being cheap and easy, index investing also allows investors to spread their money over a wide range of underlying investments, helping to reduce risk. Reflecting the attraction of these benefits, at the end of 2016 assets under management of ETFs were estimated to total around $2.54 trillion in the US – that's almost the same as the total annual GDP of the UK. According to consultancy firm ETFGI, 90% of net fund flows in the US in the past three years have been into passive funds, with the total global industry recently breaking through the $5 trillion barrier.

However, in *The End of Indexing*, author Niels Jensen argues that changes in the economic environment expected over the coming years and decades will be unsuited to index tracking strategies and that investors may need to change their approach in order to earn decent returns. Jensen is a Danish financial services industry veteran, having over 30 years of investment banking and investment management experience. He began his career in Copenhagen in 1984 before moving to London in 1986, holding posts with the likes of Goldman Sachs, Oppenheimer and Lehman Brothers. He founded investment firm Absolute Return Partners in 2002 and is currently its Chief Investment Officer.

What goes up must come down

Jensen opens his argument by pointing out that a number of economic indicators that were once consistently growing year on year are now slowing down or falling. For example, interest rates are currently at or near to record low levels around the world, inflation is no longer in the double digits of the 1980s, productivity gains are increasingly hard to come by and a number of countries are seeing their workforces steadily decline.

Given six structural "mega trends" which the author believes are set to shape the global economy over the coming years, he believes that these tendencies are set to continue and that, while some might be positive, it is hard to be too optimistic about global growth. As such, index funds which have previously benefited from long-term bull markets might not be the best place to put your money once the trends start to bite, as equity valuations will inevitably come down and returns become more modest.

With the first couple of chapters setting the scene, the next six cover Jensen's key mega trends which are expected to have a significant influence on the global economy. Firstly, it is expected that the debt super-cycle which has lasted pretty much since the end of World War II will finally end. This will have many implications for investors, including the best performing types of debt (corporate, government etc.) as well as opportunities in alternative lending companies such as crowd-funders.

Perhaps the most interesting trend covered is the demographic phenomenon of the retirement of the baby boomers. The eurozone alone, for example, is expected by the United Nations to see a 0.57% annual fall in the workforce between 2015 and 2050, largely as the population born after the Second World War end their working lives. Not only do older consumers spend their money differently, their departure from the workforce will create problems for economic growth, as well as issues for governments in terms of pensions and healthcare. This alone provides significant challenges for index investors but opportunities in those industries where the "grey pound" will be attracted.

Over in Asia the continuing rise of emerging markets will create opportunities and challenges as the populace becomes more prosperous and enjoys a strong rise in living standards. In contrast, ongoing declines in the spending power of the middle classes, those who are crucial for political stability, are expected to have significant economic ramifications in more developed economies.

The book concludes with the author discussing the various types of risks involved in investing and explaining how investors could structure their portfolios to find decent returns in the future. While Jensen states in bold text that *"it is time to step away from index investing!"* he does admit that he could be wrong. Only time will tell.

New beginnings

This is a thought provoking book for anyone who is concerned with increasing their wealth. It takes a long-term view and is packed with detailed stats, well discussed and interesting economic theory, along with a global perspective on how things might change. While many of the concepts discussed do not make for pleasant reading in investment terms, the fact is that many, especially the retirement of the baby boomers, are set in stone and are going to affect pretty much everyone on the planet either directly or indirectly. As such, this book is essential reading for anyone interested in getting a head start on the investment trends of tomorrow.

"THIS BOOK IS ESSENTIAL READING FOR ANYONE INTERESTED IN GETTING A HEAD START ON THE INVESTMENT TRENDS OF TOMORROW."

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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

MIND GAMES

Some of the latest research about how our minds really work has some profound implications for investors. It also drives a coach and horses through much of what passes for the science of conventional economics.

Nick Chater is a Professor of Behavioural Science at Warwick Business School. In his recently published *The Mind is Flat*, he lays to rest a number of assumptions about how we think. It transpires that our minds have far less 'depth' than we might otherwise have thought.

Take emotional response, for example. One might have thought that when experiencing strong emotion, our body takes cues from our mental state and responds with a corresponding physical reaction. But it may actually be the other way around. In an experiment at the University of Minnesota, psychologists Stanley Schachter and Jerome Singer

"WE ARE FORCED TO CONCLUDE THAT TRADITIONAL FINANCIAL THEORY IS WRONG – AND THAT NOT ONLY ARE FINANCIAL MARKETS WILDER THAN WE EVER SUSPECTED, BUT OUR ABILITY TO MAKE SENSE OF THEM AND REACT OBJECTIVELY TO SOMETIMES HORRIFYING PRICE SWINGS IS FAR MORE FRAGILE THAN WE EVER FEARED."

injected volunteers with either adrenaline or a placebo. The volunteers were then made to sit in a waiting room and await further instructions.

It turns out that the waiting room *was* the experiment. The volunteers were accompanied by a 'stooge' – a participant in the study who would display either manic behaviour (by obsessively constructing and flying paper planes) or angry behaviour (by loudly and aggressively complaining about having to complete a questionnaire).

As one might expect, the adrenalized participants had stronger emotional responses to both stooges than those simply given a placebo. Intriguingly, however, their emotional reactions were stronger in opposite directions. Confronted with the 'manic' stooge, participants interpreted their raised heart rate, shortness of breath and flushed face as signs of their own euphoria. Confronted with the 'angry' stooge, on the other hand, participants interpreted the very same symptoms as indicative of their own heightened anger. The experiment would tend to suggest that emotions of joy or anger do not well up from our "inner depths"; rather, we seem to interpret our emotions in the moment, and our brains do a surprisingly fluid, and inconsistent, job of it.

Another example of our mental inconsistency can be seen in [this video](). Faced with a choice between a holiday in Bali or Bournemouth, most of those surveyed favoured the exoticism and excitement of Bali. But when asked instead which holiday destination they would choose to *reject*, most participants again plumped for Bali. It's almost exactly the same question, just framed in a subtly different manner – and it reveals just how unreliable and unpredictable our minds can be.

If we don't have hidden mental depths, how can we justify our behaviour? Nick Chater:

I want to argue that those apparent beliefs and desires that we cook up when we explain our behaviour are actually just being creative for that moment, they're not stable, we don't have stable beliefs and desires which generate our behaviour. In fact, we invent those beliefs and desires when we have to make a choice or justify our action ... we infer our own inner life from our words and actions, just as we infer those of a third person. And then we invent what we will say and do next. Mental 'depth' is an illusion.

"OUR ENTIRE LIVED EXPERIENCE OWES MORE TO STORY-TELLING THAN WE MIGHT CARE TO ADMIT."

Telling stories

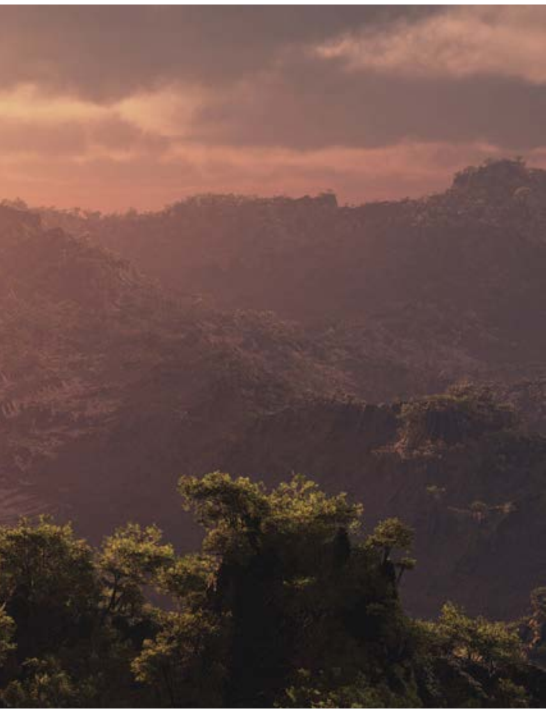
The argument has a lot in common with that advocated in Yuval Noah Harari's 2014 book *Sapiens*. Harari asks how it came to be that of all the early cousins of early Man – *Homo heidelbergensis, Homo habilis, Homo neanderthalensis* etc. – it was *Homo sapiens* (ourselves) who ended up the sole surviving species. Harari's suggestion is that it has a lot to do with our facility at, and enthusiasm for, telling stories.

A village of 100 people requires no external organisation; it can manage its affairs itself. But a city of several million people requires administration, as does a country of 60 million. More to the point, how does a country of 60 million persuade a cohort of its young male population to go off and fight in its defence, perhaps even to die in the process? It tells stories and creates national myths. And we tend to believe them.

The message from *The Mind is Flat*, and from *Sapiens*, is that our entire lived experience owes more to story-telling than we might care to admit. Far from being wonderfully rational, logical beings, we are in reality telling tales from the moment we rise in the morning until the moment we retire to bed at night – and of course the stories don't even end there.

But this is bad news for economists, who have tended to advocate the existence of a rational economic agent known as *Homo economicus*. *Homo economicus* lives and works inside wholly efficient markets that coolly and dispassionately trade goods and services in exchange for economic value. The problem is that *Homo economicus* does not exist. He never has, and he never will. It turns out that value itself is subjective – an insight that the classical economists grasped long before the Keynesians.

How else can we account for the shocking decline in the value of the US stock market on October 19, 1987, for example, when the Dow Jones Industrial Average fell by over 22% in a single day? Based on traditional financial theory



(notably the bell curve of standard deviation), the probability of the October 1987 Crash was less than one in 1050, odds so small that they have no meaning whatsoever in statistical reality.

And between 1916 and 2003, for example, the daily index price movements of the Dow do not fit even remotely neatly on the bell curve. The tails are too fat. Theory suggests that over that time period, there should have been 58 days when the Dow moved more than 3.4%. In fact, there were over 1,000 of those events. Theory predicts six days of index swings beyond 4.5%. In fact, there were 366 of them. Index price swings of more than 7% should, according to theory, come once every 300,000 years. In reality, the 20th century saw 48 separate occasions of them.

The crooked timber of humanity

We are forced to conclude that traditional financial theory is wrong – and that not only are financial markets wilder than we ever suspected, but our ability to make sense of them and react objectively to sometimes horrifying price swings is far more fragile than we ever feared.

Common sense, we are told, is not so common. But some people became aware of what Kant called "the crooked timber of humanity" a long time ago. Among them was the Roman emperor Marcus Aurelius – the last of the so-called 'Five Good Emperors', played by Richard Harris in the film *Gladiator*. A quote attributed to Marcus Aurelius runs as follows:

"THE ONE AND ONLY OBJECTIVE TRUTH ABOUT FINANCIAL MARKETS IS THE PRICE AT WHICH A GIVEN INSTRUMENT HAS TRADED. EVERYTHING ELSE IS PURE CONJECTURE."

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

Take the financial markets on those terms – the philosophical approach could be accurately described as 'Stoic' – and the business of investing becomes a lot less psychologically draining.

Another useful approach is to limit one's intake of subjective market commentary masquerading as news. In this excellent essay, the Swiss author and businessman Rolf Dobelli warns us that news is to the mind what sugar is to the body:

News is easy to digest. The media feeds us small bites of trivial matter, tidbits [sic] that don't really concern our lives and don't require thinking. That's why we experience almost no saturation. Unlike reading books and long, deep magazine articles (which requires thinking), we can swallow limitless quantities of news flashes, like bright-coloured candies for the mind.

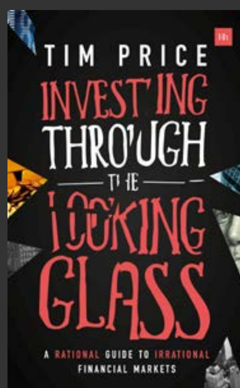
Today, we have reached the same point in relation to information overload that we faced 20 years ago in regard to food intake. We are beginning to recognize how toxic news can be and we are learning to take the first steps toward an information diet.

This is my attempt to clarify the toxic dangers of news – and to recommend some ways to deal with it. I have now gone without news for a year, so I can see, feel and report the effects of this freedom first hand: less disruption, more time, less anxiety, deeper thinking, more insights. It's not easy, but it's worth it.

One of the most important insights about the workings of the financial markets came to me via friends who practised technical analysis (the study of price charts). They told me, "News follows price, rather than the other way around." The financial markets may or may not be clever – it partly depends on who's participating in them – but they are always endeavouring to anticipate the future. By the time a given event is reported (probably melodramatically) by the news media, it has already been priced in. The one and only objective truth about financial markets is the price at which a given instrument has traded. Everything else is pure conjecture. And at a time when much of the newsflow seems to be distinctly miserable, especially in relation to geopolitics, there are clear psychological advantages to just *turning it off*.

About Tim

Tim Price is manager of the VT Price Value Portfolio (www.pricevaluepartners.com) and author of 'Investing Through the Looking Glass: a rational guide to irrational financial markets'.



MAY 2018

INVESTOR EVENTS DIARY

WEDNESDAY, 9 MAY

Event:	SR Live webinar
Organiser:	SyndicateRoom
Time:	12.30pm
Place:	Webinar
Link for tickets:	https://www.syndicateroom.com/events/sr-live

MONDAY, 14 MAY

Event:	A conversation with Gervais Williams and Merryn Somerset Webb
Organiser:	Small Cap Network
Time:	12.30pm
Place:	NEX Exchange, 2 Broadgate Circle, London, EC2M 7UR
Link for tickets:	https://www.eventbrite.co.uk/e/a-conversation-with-gervais-williams-and-merryn-somerset-webb-tickets-44669827657

TUESDAY, 15 MAY

Event:	The Big Call: The Dividends Debate: ideas for diversification in equity income
Organiser:	The Big Call
Time:	9.00-1pm
Place:	Schroder Real Estate investment Management, 31 Gresham Street, London EC2V 7QA
Link for tickets:	https://www.eventbrite.co.uk/e/the-big-call-dividends-debate-tickets-44832373837

WEDNESDAY, 16 MAY

Event:	SR Live webinar
Organiser:	SyndicateRoom
Time:	12.30pm
Place:	Webinar
Link for tickets:	https://www.syndicateroom.com/events/sr-live

TUESDAY, 22 MAY

Event:	Women in angel investing forum 2018
Organiser:	UK Business Angels Association
Time:	2-5:30pm
Place:	Home House, 20 Portman Square, Marylebone, London W1H 6LW, UK
Link for tickets:	https://www.eventbrite.co.uk/e/women-in-angel-investing-forum-2018-tickets-45583371090

WEDNESDAY, 23 MAY

Event:	AngelClubRCA
Organiser:	AngelClubRCA
Time:	6.30-9.00pm
Place:	Senior Common Room, Royal College of Art, London SW7 2EU
Link for tickets:	Emailing Alyssa Becht, AngelClubRCA Operations Manager on alyssa.becht@rca.ac.uk

THURSDAY, 24 MAY

Event:	Ignition Financial Investor Evening
Organiser:	Ignition Financial
Time:	6.30-9pm
Place:	Techspace Shoreditch, 25 Luke St, London EC2A 4DS
Link for tickets:	https://www.eventbrite.com/e/ignition-financial-investor-evening-tickets-45345556781

WEDNESDAY, 23 MAY

Event:	SR Live webinar
Organiser:	SyndicateRoom
Time:	12.30pm
Place:	Webinar
Link for tickets:	https://www.syndicateroom.com/events/sr-live

THURSDAY, 24 MAY

Event:	The Great British Private Investor Summit
Organiser:	AngelNews
Time:	8.30-5pm
Place:	Grange Tower Bridge Hotel, 45 Prescot Street, London E1 8GP
Link for tickets:	https://www.eventbrite.co.uk/e/the-great-british-private-investor-summit-2018-tickets-41273934449?discount=MasterInvestor
Website:	https://www.privateinvestorsummit.com

WEDNESDAY, 30 MAY

Event:	SR Live webinar
Organiser:	SyndicateRoom
Time:	12.30pm
Place:	Webinar
Link for tickets:	https://www.syndicateroom.com/events/sr-live

MARKETS IN FOCUS

APRIL 2018

GLOBAL EQUITIES

Index	Last Month %	YTD%	Proximity to 52w High*
CAC 40	6.8	3.9	
FTSE 100	6.4	-2.2	
Euronext 100	5.1	3.0	
Nikkei 225	4.7	-1.1	
DAX Xetra	4.3	-2.4	
IBEX 35	4.0	-0.6	
S&P/ASX 200	3.9	-0.8	
Bovespa	2.7	12.7	
Hang Seng	2.4	3.0	
NASDAQ 100	0.4	3.1	
S&P 500	0.3	-1.8	
Dow Jones	0.3	-3.6	
Russian TSI	-7.4	0.8	

COMMODITIES

Commodity	Last Month %	YTD%	Proximity to 52w High*
Cocoa	7.9	52.5	
Crude oil (Brent)	7.6	11.6	
Crude oil (Light Sweet)	5.6	13.4	
Coffee	3.9	2.0	
Cotton	2.9	11.3	
Natural Gas	1.4	-6.2	
Iron Ore	1.2	-3.5	
Palladium	1.1	-9.6	
Copper	1.1	-7.1	
Silver	0.1	-4.6	
Gold	-1.0	0.5	
Sugar (No. 11)	-2.3	-11.7	
Platinum	-3.2	-2.7	

FOREX

Pair/Cross	Last Month %	YTD%	Proximity to 52w High*
USD/CHF	3.9	2.2	
USD/JPY	2.9	-2.7	
EUR/CHF	1.8	2.2	
EUR/JPY	0.9	-2.6	
GBP/AUD	0.2	5.2	
EUR/GBP	-0.2	-0.8	
USD/CAD	-0.5	2.3	
GBP/USD	-1.7	0.8	
AUD/USD	-1.9	-4.1	
EUR/USD	-2.0	0.1	

CENTRAL BANKS - RATES & MEETINGS

Central Bank	Key Rate	Next	After
BOE	0.50%	May 10	Jun 21
ECB	0.00%	Jun 14	Jul 26
FED	1.75%	Jun 13	Aug 01
BOJ	-0.10%	Jun 15	Jul 31
SNB	-0.75%	Jun 21	Sep 20
BOC	1.25%	May 30	Jul 11
RBA	1.50%	Jun 05	Jul 03
RBNZ	1.75%	May 10	Jun 28
BOS	-0.50%	Jul 02	Sep 05
BON	0.50%	May 03	Jun 21

FTSE 350 TOP

Sector	Last Month %	YTD%	Proximity to 52w High*
AA PLC	69.0	-19.1	
FirstGroup PLC	38.0	1.1	
Capita PLC	33.0	-52.3	
Sainsbury (J) PLC	29.0	30.3	
Micro Focus Int PLC	27.0	-49.9	

FTSE 350 BOTTOM

Sector	Last Month %	YTD%	Proximity to 52w High*
Clarkson PLC	-20.0	-15.4	
Rank Group (The) PLC	-15.0	-28.0	
Sanne Group PLC	-12.0	-24.5	
William Hill PLC	-11.0	-8.4	
Telecom plus PLC	-11.0	-10.6	

FTSE 350 SECTORS TOP

Sector	Last Month %	YTD%	Proximity to 52w High*
Travel & Leisure	5.5	-1.4	
Tobacco	-1.1	-21.3	
Support Services	5.1	-3.2	
Soft & Computer Serv	9.4	-24.3	
Real Estate Inv Trusts	4.7	0.2	

FTSE 350 SECTORS BOTTOM

Sector	Last Month %	YTD%	Proximity to 52w High*
Tobacco	-1.1	-21.3	
House Goods & Home	0.3	-12.3	
Automobiles & Parts	0.9	39.0	
Aerospace & Defense	1.9	2.9	
Chemicals	2.3	5.0