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PROPERTY

WHERE NEXT FOR BRITAIN'S FAVOURITE INVESTMENT?

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MELLON ON THE MARKETS

INSIDE THE MIND OF THE MASTER INVESTOR

DOLLAR REBOUND

WHY THE GREENBACK'S RECOVERY HAS LEGS

WELCOME

Dear Reader,

The property market conjures up some very deep-seated emotions in us Brits – *an Englishman's home is his castle,* and all that... But aside from the very obvious fact that everyone needs somewhere to live, our love of property has also spilled over into the realms of saving and investing, to the extent that it has been one of the most popular investments of the past twenty years or so.

In a survey conducted by the ONS, 49% of Britons said that investing in property instead of a pension was the best way to save for retirement. This isn't all that surprising in light of the fact that residential property investment in England and Wales delivered average annual total returns of 9.34% over the 20 years to 2016, easily outperforming shares.

But the mood music has struck a more sombre chord of late. There is a rising tide of opinion that the glory days of buy-to-let property investing may be behind us, as a wave of new tax changes and a cooling of the property market post-Brexit take their toll on sentiment. Put bluntly, property no longer appears to be a one-way bet.

According to a new survey of over 1,000 UK investors and 500 High Net Worth Individuals commissioned by Rathbone Investment Management, over half of UK investors no longer view property as a good investment. Furthermore, research by the National Landlords Association also reported in January that 20% of its members planned to sell a property in their portfolio in 2018.

This is being driven, in part, by the weight of measures introduced of late in order to curtail the growth of the private rented sector. In April 2016, the government introduced a Stamp Duty surcharge of 3% on additional properties. In addition, the tax relief that buy-to-let landlords could claim on mortgage interest costs has started to be reduced since 2017 and will continue to taper until April 2020, when landlords will no longer be able to claim.

However, despite the headwinds, property will continue to have its place in a portfolio. In this month's issue, we've assembled some of the leading minds in the property sector to get a better picture of what's really going on out there.

Whatever the case, I'm sure real-estate investing will retain its allure over the long term. As Mark Twain once said, "buy land – they're not making it anymore".

Best regards,

James Faulkner
Editor

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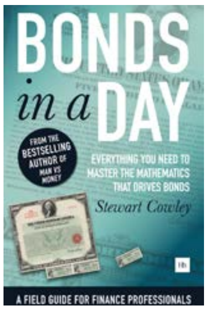

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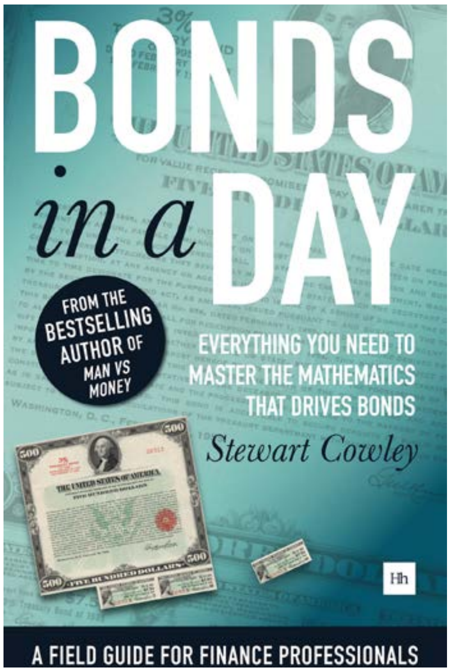

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BY JIM MELLON

MELLON ON THE MARKETS

At no point in my life has *tempus* seemed to *fugit* more than now. This year is nearly half over. I am at my house in the Isle of Man, a glass-fringed old café, and the place is boiling. Is this climate change or just an early summer? Who knows, but all this extraordinary weather will undoubtedly further propel the green energy revolution, especially as oil prices have recently been on the rampage.

A slick trade

My colleague Anthony Chow wrote an article last year on writing options to generate income on favoured (or unfavoured) shares and I think now might be a good time to sell (i.e. to go long, or neutral) calls on stocks such as **BP (LON:BP.)** and **Shell (LON:RDSB)**, which surely are significantly undervalued at these oil prices.

What is certain is that although US production of shale oil is rapidly rising to match rising prices, the overall productivity of fields in the US is declining, and political "stuff" like Venezuela and Iran doesn't help. Energy costs as a percentage of world GDP have been rising sharply, and although that in itself – plus the fact that we are at the latter stage of world economic recovery and that interest rates are rising – should mean a slowing world economy, oil demand should still be pretty good for a while.

So, I would load up on oil majors for a good 10% or so bounce, and I would also look at the providers of services (**Schlumberger (NYSE:SLB)**, etc.) as opportunities. There is so much scepticism about fossil fuels that these types of laggards are interesting in a tech-concentrated market. My chum Will Nutting is a believer in this and boy, he's a great commentator who I take very seriously indeed.

Although there is roaring interest in all things green as a result of the oil price surge and aberrant weather in various places (as well as the life choking pollution in China), there isn't a lot to choose from that makes sense stock market wise. So, I would just stick to the oil sector. Coal isn't a great idea, nor is nuclear, as there are too many risks.

The Italian question

I went to my friend Dan Hannan's dinner for the anniversary of Edmund


M DOGAN / Shutterstock.com

"I WOULD LOAD UP ON OIL MAJORS FOR A GOOD 10% OR SO BOUNCE."

"I THINK THE BRITISH POUND IS A SCREAMING BUY AT THESE LEVELS OF 1.33 OR SO AGAINST THE US DOLLAR."

Burke, the conservative philosopher, at Tate Britain recently. The whole of the Tory establishment seemed to be in attendance. The mood music around Brexit was fairly positive; something will turn up, a la Micawber, and there will be a muddle through. This is my view too, and always has been.

Of greater cause for concern is the patchwork of quasi-clowns being put forward as the next government of Italy. Regular readers will know that my view has always been that Italy is the fault line in Europe with the capacity to chuck the whole Euro Project into the sea. Even arch Europhile Martin Wolf of the Bremaniac FT is of like mind, though coming at it from a very different angle.

The result of any Italian debacle is clear to see; spreads on Italian bonds over German Bunds are at record levels, and although Italy's situation is slightly improving, it is still dire. Italy has seen no improvement in living standards for nearly thirty years and the younger generation has been sold down the river. No wonder the Italians vote as they do, although their candidates leave a lot to be desired. Anyway, watch this space.

My call recently has been for a dollar rally, but now I think it has gone too far. I think the British pound (as opposed to the Egyptian pound, the only other one) is a screaming buy at these levels of 1.33 or so against the US dollar. The economy in the UK will improve later this year, and I am optimistic.

I have been very bullish on Japan and still think that 25,000 on the Nikkei is in near sight, but actually the UK market looks cheap. Yes, the FTSE is at an all-time high but its move there has been tortuous and without conviction. Generally, the US is expensive, and the UK is cheap, so take note.

UK property – looking for a discount

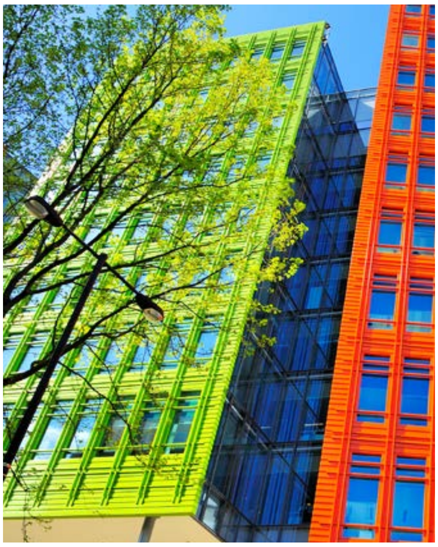
There has been a lot of talk of poor property markets in the UK recently, and this is definitely the case, especially in London. Although the providers of indices are always bullish, I really think many London properties are off 30-40 per cent from their peaks. It is an unheralded fact, but all those empty shiny new blocks are discreetly on sale at much less than advertised prices. A friend of mine, who sold at the top – and sold quite a lot – thinks a 50% correction is possible, and that it's not that far away.

I'm now looking at listed property companies to get a toehold in. Why bother buying direct when you can buy at a discount via the stock market and get a dividend? I know, you can get leverage on property, but that works both ways, as many property developers will now be discovering. I will report on UK companies in property soon.

I keep praying for gold and silver to break through – I remain convinced (memo to self: keep challenging this view!) that they will. I'm a real fan of Mark Child, who runs **Condor Gold (LON:CNR)**, and despite a few local difficulties in Nicaragua, I would be loading up on that stock.

Patience pays

Sometimes, patience pays. Last week, **Webis (LON:WEB)**, which I have been funding for years, and in which we have a majority interest, went up 7.5x – yes, that's 750%! – on the back of good news regarding sports gaming in the US, where Webis has a carefully assembled series of licenses. My 89-year-old



father, Sir Jimmy, who is on the board, brings luck to this enterprise, I'm sure.

On the subject of longevity, my excessive travel in recent months has been down mostly to this, and I am glad that we have raised our dough. It's going to great use, and the team is now amazing, with special thanks to Drs Greg Bailey and Dec Doogan.

We are all (or most of us) going to live – yes, I mean it! – to over 100, so read Master Investor and start taking the investment medicine – we will need the money to sustain us in what will be a much, much longer and healthier sojourn on this planet than the one that most people currently anticipate.

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 STEPHEN LEWIS

COVER FEATURE

IT'S GREAT UP NORTH!

WHY THE NORTH WEST IS THE PLACE TO BE FOR UK PROPERTY INVESTORS AND DEVELOPERS

Since the property market recovered from the apocalypse of the 2008-2011 recession, it has moved in some very interesting ways and taken participants, advisers and observers by surprise, particularly in how it is now funded.

Real estate of pretty much any form was a dirty word to most lenders immediately after the 2008 meltdown. In truth, it is only just off the naughty step for the mainstream bank lenders, whose participation in both the investment and development markets has shrunk significantly since the heady days when a few (mostly now defunct) banks were lending to newsagents to build residential and office blocks across the UK!

The recession took out most developers and investors who were reliant on large tranches of traditional debt funding and it meant that those that wanted to survive had to turn to alternative funding lines. This brought bridging finance into the mainstream arena in the same way that the collapse of Woolworths and the High Street malaise triggered the march of the discount retailers – more on that later.

Stretch lenders and big bazookas

In the current cycle, we are now at a point where this gap has been fully filled by short-term finance and has led to a more palatable description of their sector, no longer known as bridging finance with all its connotations, but dynamic '*stretch lenders*'. These lenders move quickly through the legal gears to agree loan documentation and require a great deal less capital from the borrower to make the loan work.

Stretch lenders do charge a far higher interest rate as well as a myriad of fees for taking out and repaying the loans as they become due. Although they are for notably shorter terms, they have become integral to the support of real estate investment and development in the North West, where the borrower cannot or does not want to access mainstream bank funding. For most borrowers, there is little attraction in tying up their capital by providing 40% of the LTV when they are happy paying more interest for borrowing more – a very different mind-set from the 'old school' propco whose mantra was 'out of debt, out of danger'.

The other type of finance that has come to fill the gap for the larger developments and investments are the '*big bazooka funds*', some of which can provide both debt and equity depending on the matter at hand. This name covers everything from hedge funds, pension funds, listed funds to family offices and off-shore structures. Many engage in stretch lending, but their USP is providing significant funds to partners and stakeholders for big ticket schemes and then to hold the long-term income in either a JV structure or on a forward funding platform once the investment or development is complete. Most are not interested unless the proposition is north of £75 million. This is most visible in the massive expansion of the Private Rented Sector (PRS).

Sound fundamentals

I am always conscious that the use of the term 'sound fundamentals' is akin to the board of a football club releasing a statement strongly endorsing their manager, but really PRS has great fundamentals. You just have to look at what it has been tailored to support. It supplements a modern transient workforce who are more likely to be in metropolitan locations and many without any ability (and in some cases little desire) to jump on the housing ladder. Such

"THE TAP IS STILL FULLY ON WHEN FUNDING INDIVIDUALS IN THEIR DESIRE TO GET ON THE HOUSING LADDER."

vertical conurbations, when developed out in bulk, create a fairly predictable income stream at inflation-linked pricing. The main area of concern is ensuring your capex is covered by your sinking fund, given most require a refurb every 7-8 years.

In Manchester alone, the PRS pipeline runs into the thousands and is underpinned by significant growth of the city as a business hub. Manchester's business reputation is complemented by an already world-class university and science base, with the two main football clubs adding that sprinkle of stardust which plays very well overseas and cannot be underestimated. Two Manchester-based companies delivering significant schemes in the North West are Glenbrook (www.glenbrookproperty.co.uk) and Select Property Group (www.selectproperty.com), both of whom are well established and continue to attract attention from the 'bazooka funds' who wish to allocate resources into these long-term income-generating assets.

In conjunction with the delivery and expansion of the PRS model, the residential sector (both apartments and more standard housing) has proved very resilient. The tap is still fully on when funding individuals in their desire to get on the housing ladder, and for the more central apartment schemes, there is still strong appetite from abroad to have a piece of the action in the main two cities of Liverpool and Manchester. One nice problem the developers have at the moment is holding back apartments for UK purchasers, such is the current demand as a result of the weak pound and the attractive yields of 6-8%, without any need for management input given this is already parcelled up in the sales package.

Most developers of residential apartments in these two main cities access both the stretch lenders and the big bazooka funds. Done well, it is an efficient way of building out apartment blocks, with deposits released and held as security for the funding or, alternatively, used in the build itself. This de-risks the scheme for both developer and funder, and helps with cashflow throughout the project. On the commercial side, Allied London (www.alliedlondon.com) has transformed a once unloved area north of Deansgate into a cluster of grade A office blocks supported by an upmarket leisure scene. The latest arrival on the scene is the Ivy, which services the growing disposable income generated by the Manchester workforce and aspirational visitors.

Haves and have nots

Retail, like the US version of capitalism, is clearly split these days into the 'haves' and the 'have nots'. Putting the internet to one side for a minute, the bricks-and-mortar operations are finding that a high street Zone A presence is close to becoming unsustainable, particularly for those whose products can easily be bought at the click of an Amazon 'proceed to checkout' button. What is saving some locations, and, in fact, driving footfall and underwriting strong rents, is a leisure component to sustain a person's interest in being there and ensure other members of the family can disappear whilst you enjoy a drink, a bite to eat, or even a bit of crazy golf.

The Grosvenor development in Liverpool, known as L1, does this extremely well, and has survived through developing and expanding its offering to attract, what is now, a thriving tourist industry for the city. This footfall continues to be driven by the lure of staycations in the UK, alongside international interest from visitors craving culture around the three graces and wanting their picture taken down

"PRICES ARE CURRENTLY ON AN UPWARD CURVE, AND IN THE MOST RECENT MARKET SURVEYS, THE NORTH WEST HAS BEEN SHOWN TO BE AN AREA THAT WILL OUTPERFORM ITS PEERS."

Mathew Street, by the Liver Building or at Anfield or Goodison.

The 'have nots' will soon disappear from the High Street mix and the Government needs to bring some relief to beleaguered landlords and tenants by reducing the burden of rates (which, like National Insurance, is really just another tax), or otherwise introducing an internet tax to level the playing field. As for the 'haves', they continue to make hay, most of them being either discount retailers who are able to negotiate fixed rents in previously unattainable positions on the High Street, or those retailers offering something different, unique, or an experience that cannot be replicated at the click of a button.

Northern powerhouse

Generally, the real-estate footprint in the North West is thriving, as it has re-positioned itself along value-based grounds. No longer do Liverpool and Manchester view each other with suspicion and disdain (save on the football terraces); in fact, they work in conjunction to promote each other, as was seen at MIPIM recently, and will be visible at the International Business Festival (www.internationalbusinessfestival.com) in Liverpool this June.

In the commercial sector, the repositioning of the retail offering is making for more vibrant high street experiences in many locations, with the retail parks like the Trafford Centre more than holding their own on Zone A rents, backed up by strong footfall. Where there are winners there are always losers, and secondary and tertiary locations will continue to suffer until there is a more holistic review of how best to reposition the old Victorian shopfronts and retail parades, so they can complement the online offering that will be the dominant force of the future.

In the residential sector, a buoyant economy and a population which is less inclined to head down south on graduation has led to a strong pipeline of schemes across the North West to service owner-occupiers, the PRS market and the overseas 'buy to let' market. Prices are currently on an upward curve, and in the most recent market surveys, the North West has been shown to be an area that will outperform its peers. Apologies for bringing George Osborne into this, but the North West has been, and continues to be, the 'powerhouse' behind the Northern Powerhouse and should cement that position in the coming years.

About Stephen

Stephen Lewis qualified as a solicitor in 2002, became a Partner in 2008, and works in the Manchester office of national practice Freeths, albeit he spends a day or so every couple of weeks in their Mayfair office. Stephen specialises in real estate development and investment throughout the UK but predominantly in the North of England. He acts for two significant European family offices managing their £300 million plus UK real estate assets and in the last few years for funds and developers in the dynamic PRS and residential market of central Manchester and Liverpool which continues to go from strength to strength.

BY JAMES FAULKNER

SHARPE MINDS

WHERE NEXT FOR COMMERCIAL PROPERTY?

AN INTERVIEW WITH JASON BAGGALEY OF ABERDEEN STANDARD INVESTMENTS

The commercial real estate sector has performed strongly in recent years despite Brexit, as the ongoing hunt for yield leads income-seekers to seek alternative sources of income. However, there is now a general sense that the low-hanging fruit of capital appreciation is behind us, and that the income component will play a greater role going forward. James Faulkner caught up with Jason Baggaley, manager of Standard Life Property Income Trust (LON:SLI), to get a better insight into the situation.

James Faulkner: Hi Jason and thank you for taking the time to speak with Master Investor. You're a Fund Manager at Aberdeen Standard Investments with mandates totalling £1.1 billion. Most notably, you're the manager of the £500 million Standard Life Property Income Trust (SLIPIT) (LON:SLI). That puts you in a great vantage point from which to survey the UK property market. What's your assessment of the current state of the market?

Jason Baggaley: *The UK commercial real estate market has performed well over the last year, and I am cautiously optimistic that 2018 will be a reasonable year as well. The industrial/logistics market will continue to drive returns, with retail remaining challenged. It feels as though we are at the end of the capital uplift cycle driven by yield compression, and that income will now be the key driver of returns.*

JF: The Brexit vote saw many UK commercial property trusts – including SLIPIT – move to trade at a discount, but share prices have since recovered. Has there been any tangible impact from Brexit in terms of levels of investment in UK commercial property? Is it possible to make any longer-term predictions for the market, or is it just a case of too little clarity from the negotiations at this point?

JB: *There was indeed a short-term reaction to pricing on several of the trusts just after Brexit, but it was only very short, and in many ways appears to have been a reflex action given the restricted liquidity in open-ended funds at that time. The Brexit vote had a number of impacts on investment in UK Commercial real estate. The fall in the pound meant overseas buyers remained active (and are the dominant buyer of Central London offices), and the extension of "lower for longer" expectations for interest rates also meant the higher income component of real estate returns remained attractive. Despite the positives, there has, however, been a more noticeable "risk off" approach from investors, and occupiers are increasingly looking for flexibility in their leases as uncertainty remains elevated.*

JF: In July 2016, trading in one of Standard Life's open-ended commercial property funds was suspended after a flood of withdrawals sparked by Brexit. Although trading has since resumed, doesn't this episode illustrate the attractions of the closed-ended structure when it comes to investing in commercial property?

JB: *The whole open-ended sector was impacted by the huge redemption requests at the time of the Brexit vote. They are all back open and trading again, and the honest answer is both forms of structure have their advantages and*

"IT FEELS AS THOUGH WE ARE AT THE END OF THE CAPITAL UPLIFT CYCLE DRIVEN BY YIELD COMPRESSION, AND THAT INCOME WILL NOW BE THE KEY DRIVER OF RETURNS."

"CENTRAL LONDON OFFICES IS ONE OF THE MOST CYCLICAL MARKETS AND LOOKS EXPENSIVE AT THE MOMENT."

disadvantages. I consider myself fortunate that I do not have to worry about investor flows in the same way, so I can focus on remaining fully invested (in fact, we have some structural gearing so are more than 100% invested in effect), and I do not have investor flows impacting on investment decisions. That said, short-term volatility in share prices can be off-putting for investors, and large investor trading volumes can impact the discount/premium.

JF: Where does a commercial property fund fit into a portfolio and what are the attractions of commercial property vis-à-vis residential property?

JB: *Commercial Real Estate can fulfil several roles in a portfolio but should be considered as a long-term investment in all of them. It can provide an attractive source of income (SLIPIT yields 5%), generated from rental income that is predictable and agreed under a contract rather than at the decision of the company as a dividend is. Most leases in the UK provide for upward-only rent reviews, which gives the opportunity to capture rental growth, but certainty of a base level for the duration of the lease. The "real" nature of the asset class means there is an ability to create value through asset management and refurbishment, and also that not all the value comes from the income stream from the tenants. Finally, the asset class can also provide diversification benefits, with a range of properties in different parts of the UK, let to different companies, in different sectors providing a balanced fund.*

For most investors, a balanced commercial real estate fund is easy to access, and they already have exposure to the residential market, with their house being their largest asset. It is not yet as easy to access a diversified residential fund, and to invest directly in one or two assets only has risk.

JF: SLIPIT tends to focus on smaller properties outside central London with shorter leases. You also have a high weighting towards industrial property. Doesn't this increase the risk profile of the trust, as opposed to peers with a greater focus on prime Central London property with longer leases?

JB: *Central London offices is one of the most cyclical markets and looks expensive at the moment – rental levels are falling a bit and supply is increasing; it is one of our least favoured markets. We actually sold our last City office in early 2017 to reduce risk in this sector, although we have an open mind to reinvesting where we can find sufficient value – overseas money has reduced the yield to unacceptable levels for our purposes. My philosophy has to be to focus on good quality property in good locations let to good tenants. If one has that, then I believe the entry price is sufficiently attractive to reward one for the risk of shorter leases. Moving property is very expensive, time consuming, and disruptive, so if one has a property that meets the needs of a tenant, there is every opportunity to retain them in it. On the other hand, if it is a good property in a good location, then if they do leave, there is a good chance to re-let it. It is very easy to confuse lease duration for security of income, and the long lease indexed income has become a crowded trade.*

JF: In SLIPIT's most recent Annual Report & Accounts, you suggested that "the steady secure income component generated by the asset class is likely to be the key driver of returns over the next few years". Does this mean that the outlook for capital growth looks weak?

JB: *In short, yes. It is difficult to forecast with certainty currently given the unknown outcome and impact of Brexit, but we anticipate a fall in capital values, led by central London offices and poorer quality retail. These falls should be muted, however, with total returns remaining positive. The fact that supply remains constrained in most markets with very little development over the last 10 years, and the relatively attractive yield from commercial real estate in the low interest rate environment we are in, means there should not be a major correction, and any falls in capital values will be short-lived.*

About Jason

Jason Baggaley manages the Guernsey registered and London-listed Standard Life Investments Property Income Trust. Jason, who joined Standard Life Investments in 1996, also manages a major segregated property mandate. He has 28 years' industry experience and is a Member of the Royal Institution of Chartered Surveyors.

JF: The current yield on the shares is an attractive 5%. Is there also scope to grow the dividend in future, given that dividend cover is 104%?

JB: *In the immediate future, I do not expect the dividend to grow – as you say, it is already at an attractive level. Last year, we sold out of a number of our higher yielding assets that had greater risk attached to them, and we are reinvesting but at slightly lower yields.*

JF: I was surprised to hear that the team at Aberdeen Standard Investments collect their own rent, which presumably gives you a better feel for the underlying dynamics of the market. What other ways is Aberdeen Standard Investments adding value for SLIPIT shareholders?

JB: *The recent merger means that the real estate team is very large: sat within a 30-metre radius of me is a huge amount of knowledge and experience in just about every market that I can benefit from. The scale of the company also enables us to have specialist knowledge in-house – for example, in development, tax and structuring, debt, and sustainability.*

JF: There has been a lot of criticism levelled at the fund management industry due to high costs and 'closet trackers'. However, it strikes me that the property sector is an area where portfolio managers can be truly active. How does your team go about researching investments and making investment decisions?

JB: *We start with having a clear objective – in the case of SLIPIT, it is to provide an attractive level of income to our investors. We then set an investment strategy based around our in-house research and utilise the depth of resource in-house to implement it. We do not reference the benchmark in this process – but do apply a stock-specific bottom-up approach to select assets that will meet our objective. We try to have a strong relationship with our tenants and see them personally to ensure we continue to meet their needs so that we can retain them in our properties, and we also regularly review each asset for opportunities to create value through refurbishment or lease restructuring. SLIPIT has a 54% exposure to the industrial/logistics sector (versus the IPD/MSI Quarterly Index benchmark of 23%) and an underweight exposure to retail of 15% (versus 36% benchmark).*

"SAT WITHIN A 30-METRE RADIUS OF ME IS A HUGE AMOUNT OF KNOWLEDGE AND EXPERIENCE IN JUST ABOUT EVERY MARKET THAT I CAN BENEFIT FROM."

JF: How has last year's merger of Aberdeen Asset Management and Standard Life affected the trust?

JB: *On a day-to-day basis the merger has had no impact on the trust, with the same people doing the same things now as before. As mentioned earlier, it does give me access to a wider knowledge base in the office, and I am sure further benefits will come out as the integration progresses.*

About James

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

BY NICK SUDBURY

FUNDS IN FOCUS

BUILDING ON THE SUCCESS OF COMMERCIAL PROPERTY

The last few years have been a good time to be invested in UK commercial property, with the sector offering an attractive level of income combined with steady capital growth. For most people the easiest way to benefit is via the Direct Property investment companies that provide a ready-made exposure to a diversified portfolio of commercially-let premises.

In 2017, the commercial property market generated a total return of 11.2% via a combination of capital growth and income. The healthy performance has continued into 2018, with aggregate capital values rising by a further 1% in the first quarter, although some areas have done much better than others.

An analysis of the underlying regional data reveals that most of the gain was driven by the 4% appreciation of industrial buildings in the South East, whereas shopping centres across the country fell by an average of 1.2%. This shows what a huge difference the nature of the properties – be they offices, retail or industrial – and their location can have on the returns.

Forecasts suggest that the sector will continue to generate an attractive level of income, but the short-term prospects for capital growth are a lot more uncertain due to the political and economic impact of Brexit. The Investment Property Forum, which consists of 23 property advisers and investment firms, is expecting modest total returns from the UK All Property index of 4.6% in 2018, falling to 3.9% in 2019, with both years being dominated by the income component of 4.9%.

> **"CLOSED-ENDED FUNDS ARE THE IDEAL WAY TO GAIN EXPOSURE TO THIS TYPE OF ILLIQUID ASSET CLASS."**

Investment companies

A Direct Property investment company will aim to generate outperformance by buying the most suitable premises in the best locations and then finding good quality tenants. They may also be able to add value by changing the nature or use of the buildings or acquiring sites with development potential.

These closed-ended funds are the ideal way to gain exposure to this type of illiquid asset class, as their shares can be bought and sold on the London Stock Exchange without having any cash flow implications for the underlying holdings.

The strong historic performance and attractive dividend yields that are in the order of 4% to 7% have helped to push about half of these vehicles onto a small premium to Net Asset Value (NAV). Investor sentiment has been further improved by the fact that portfolios are generally let to good quality tenants and voids are at low levels, with dividends typically well covered by the rental income.

"FORECASTS SUGGEST THAT THE SECTOR WILL CONTINUE TO GENERATE AN ATTRACTIVE LEVEL OF INCOME, BUT THE SHORT-TERM PROSPECTS FOR CAPITAL GROWTH ARE A LOT MORE UNCERTAIN."

There is also still a healthy level of investor interest in the sector, with the **PRS REIT (LON:PRSR)** able to close its recent secondary share placing early due to strong levels of support, although the Board of the **AEW UK Long Lease REIT (LON:AEWL)** decided to not to go ahead with their secondary issuance due to the extreme market volatility at the time of the proposed issue in February.

Nobody knows for sure what sort of impact Brexit will have on the UK economy, but in view of the uncertainty, it is important to think about what type of commercial property exposure you feel comfortable with. It is likely that funds with modest levels of gearing (debt), defensive property strategies and attractive yields well covered by income will have the best chance of withstanding any bouts of investor nervousness.

Attractive yields

The broker Numis recommends the £442 million **Custodian REIT (LON:CREI)**, which invests in smaller properties that are worth less than £10 million. These have typically experienced less competition amongst buyers and still offer an attractive, high level of income. The fund operates a low to moderate risk strategy and has successfully diversified its income stream to the extent that no single tenant makes up more than 2.5% of the overall rent roll.

Richard Shepherd-Cross, the fund manager, has been actively selling properties where the business plan has been achieved and then reinvesting the profits into assets with stronger growth potential. One such area that he has been targeting is retail warehousing and this now accounts for 16% of the portfolio's income.

Numis believes that the Custodian REIT is well positioned to thrive in a slower growth environment and it likes the fact that the REIT has a conservative balance sheet with long-term, low cost

“NUMIS BELIEVES THAT THE CUSTODIAN REIT IS WELL POSITIONED TO THRIVE IN A SLOWER GROWTH ENVIRONMENT.”

debt. The fund has a well-covered dividend yield of 5.5%, which has pushed the shares onto a substantial 14% premium to NAV, so it suggests using any dips in the share price as a buying opportunity.

Another attractive source of income is the £208 million **LXI REIT (LON:LXI)**, which was launched in February 2017 and invests in a portfolio of long-lease assets. These have an average net initial yield of over 6% and an average unexpired lease term to the first break in the contract of 24 years. The fund benefits from a diversified tenant base with almost all of the income being linked to inflation or having fixed periodic uplifts. It is currently yielding 5.2% with quarterly distributions.

Alternatively, there is the £500 million **PRS REIT (LON:PRSR)**, which was launched in May 2017 to invest in newly constructed private rental properties that are to be let on 12-month Assured Shorthold Tenancies to qualifying tenants in the largest English towns and cities outside of London. The fund is targeting a yield of at least 6% per annum and a total annual return of 10% or more once fully invested and geared, although the current yield is a more modest 4.6%.

Take advantage of movements in the discount

Share prices in the Direct Property investment companies are determined by the level of investor demand, and although this is influenced by the performance of the underlying holdings, there are times when they can trade at a substantial premium or discount to NAV. Savvy investors can take advantage of these movements to increase their return.

Earlier in the year, Numis identified the £478 million **Picton Property Income (LON:PCTN)** as a value opportunity, but since then its shares have rallied strongly and it is now trading close to NAV. The improvement in perfor-

"THOSE LOOKING FOR A CORE EXPOSURE TO UK COMMERCIAL PROPERTY WOULD BE HARD PRESSED TO FIND A BETTER OPTION THAN THE £1.39 BILLION F&C COMMERCIAL PROPERTY TRUST (LON:FCPT)."

FUND OF THE MONTH

Those looking for a core exposure to UK commercial property would be hard pressed to find a better option than the £1.39 billion **F&C Commercial Property Trust (LON:FCPT)**. This owns the highest quality portfolio in the sector with around 60% of the value concentrated in London and the South East. The fund has a strong long-term performance record and is yielding 4.2% with monthly dividends that it has maintained since it was launched in March 2005.

Richard Kirby, the manager, has been actively reducing his exposure to Retail, which has acted as a drag on performance in recent years. One of the latest examples of this policy was the sale of three retail centres in Shrewsbury town centre to the local council at a small premium to their book value. The disposal helped to reduce the Retail allocation to 30.9% at the end of 2017, with Offices being the largest weighting at 36.3% and the balance being fairly equally divided between Retail Warehouses and Industrials.

FCPT generated a NAV total return of 2.3% during the first quarter, including an increase of 1.1% in the capital values of the properties. The growth was led by its offices, which rose by 2%, followed by industrials with a gain of 0.8% and retail with an increase of 0.6%.

The fund pays a monthly dividend of 0.5 pence per share, which (based on the share price at time of writing) is equivalent to a yield of 4.2%. Unlike some of its peers, it has managed to maintain the dividend ever since it was launched in March 2005, although the level of cover is more stretched than it was in the past. F&C Commercial Property is currently trading on a 1% premium to NAV, which reflects its strong tenant profile, low level of gearing and successful track record. It should be well-placed to ride out any periods of economic uncertainty.

Fund Facts

Name:	F&C Commercial Property Trust (LON: FCPT)
Type:	Investment Company
Sector:	Direct Property
Total Assets:	£1.39bn
Launch Date:	March 2005
Current Yield:	4.2%
Gearing:	20%
Ongoing Charges:	1.22 %
Website:	www.fandc.co.uk

mance was due to the impressive first quarter results, during which the fund generated a NAV total return of 3.1%.

Picton is heavily invested in industrial properties, which make up 41.2% of the portfolio and grew by 2.6% in the first quarter. Its office buildings also did well with a gain of 2%, although retail, which makes up the remaining 22.9% of the fund, fell by 1.6%.

PCTN targets an annual dividend of 3.5 pence per share, which represents a yield of 3.9%, with dividend cover for the first quarter's distribution being a robust 128%. Recent lettings have been achieved at higher levels of rent, with occupancy rates improving to 96%.

One fund that offers better value is the £316 million **Schroder Real Estate Investment Trust (LON:SREI)**, which is currently trading on a 7% discount to NAV. Its shares have recently suffered a sharp de-rating for no apparent reason, and although the 4% yield is lower than many of its peer group, the dividends are well covered by recurring income.

SREI's main geographical weightings are in the South East ex Central London, the Midlands and Wales, and the North and Scotland, with each of these regions being home to 25% to 30% of the total value of the properties. Around 40% of its assets are offices, with a further 31% being retail premises and 26% industrials. The biggest tenant accounts for 5.5% of the rent roll, with the 10 largest making up around a third of the income.

“FORECASTS SUGGEST THAT THE SECTOR WILL CONTINUE TO GENERATE AN ATTRACTIVE LEVEL OF INCOME, BUT THE SHORT-TERM PROSPECTS FOR CAPITAL GROWTH ARE A LOT MORE UNCERTAIN.”

Moving in the right direction

The £230 million **Ediston Property Investment Company (LON:EPIC)** had a successful first quarter, with a NAV total return of 2.6%. It aims to generate an attractive level of income by investing in a diversified portfolio of high quality assets located throughout the various regions of the UK.

Ediston is heavily weighted in favour of retail warehouses, which make up almost three-quarters of the fund, with most of the rest being offices. Its five largest tenants – B&Q, Tesco, B&M Retail, Ernst & Young, and M&S – account for 31% of the exposure, with each of its other occupants contributing less than 4% each.

The fund managers are actively engaged in lease restructurings and other initiatives to protect and improve the income and capital values. They are also permitted to undertake speculative developments of up to 10% of the total assets, which adds to the risk and the potential returns.

A recent example was the purchase of a seven-acre development site in Haddington for £2.75 million plus costs. The site has planning permission for a supermarket and petrol station, but the manager is trying to change the consent to a retail warehouse development that once completed would provide a double-digit yield on cost.

Ediston pays an annualised dividend per share of 5.75p, which is equivalent to a yield of 5.2% with the payments made monthly. It has a vacancy rate of just 3.1% and a lengthy weighted average unexpired lease term of 6.7 years. The shares are trading close to NAV.

About Nick

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

BY JAMES FAULKNER

MOVERS AND SHAKERS

AN INTERVIEW WITH SAMUEL LEEDS

Samuel Leeds left school at 16, became a property investor and achieved financial freedom at just 21 years of age. He's since gone on to become a best-selling author and is now CEO of six successful companies. Master Investor Editor James Faulkner caught up with Samuel to quiz him on the current state of the buy-to-let market and his secrets to success...

James Faulkner: **At what age did you become interested in property? What sparked your interest and what were your motivations?**

Samuel Leeds: *I bought my first property just before my 18th birthday. I went on a property investors training programme shortly after leaving school at 16, because I didn't want to work for my dad forever.*

JF: **Hardly a day goes by that there isn't something in the news about how difficult it is for young people to get onto the housing ladder. What are the best pieces of advice you can offer to millennials who aspire to own a property?**

SL: *The best pieces of advice I can offer to young people to get on the housing ladder is to work out their priorities and think about the long haul. As a relatively young person myself from a very working-class background, I think I can say this. Many young people get into bad debt by getting degrees in subjects that, frankly, are not going to help them in the real world or even land them a job. I did not have any handouts as a teenager but chose to get into 'good' debt investing in the right thing, namely, careful property investment.*

JF: **Buy-to-let investors are being hit with the removal of mortgage interest relief, which is being replaced with a flat rate of relief at the 20% rate of income tax. Stamp duty rates are also a lot higher now for buy-to-let investors. Given that the government seems to be doing its best to steer people away from buy-to-let, isn't it fair to say that the glory days of buy-to-let investing are behind us?**

SL: *The rules to property investing are always changing. In 2008 when the recession came, many investors were jumping ship as lenders were closing down. However, the investors that made the most of the situation went on to make a lot of money. This is happening again in 2018. Section 24 is going to make thousands of UK landlords lose their income which will force them to increase their rents. This will push rents up all across the county. Whenever there is a negative change in the market, usually there is also a positive spin or a loophole because most of the people who make real money in property are the same people who make the rules. The tax changes do not apply when you buy through a company – and*

About Samuel

Samuel Leeds is an international motivational speaker, two-times best-selling author and property millionaire. His mission is to support and train deserving people to become financially free through property. As well as his business interests, Samuel runs his own charity called Good News All Round. He also founded the UK's largest Christian business network, Training Kings.

Samuel is the CEO of six successful companies as well as owning a substantial property portfolio throughout the UK. He has inspired and trained tens of thousands of people across the world on how to build a property portfolio from nothing, how anybody can achieve financial freedom within 12 months or less and, most importantly, how to invest smarter and to live better.

"MY FOCUS IS MAINLY TO BUY AND HOLD, THEREFORE I DO NOT GET CONCERNED ABOUT CAPITAL APPRECIATION, IT JUST HAPPENS OVER TIME."

they have suddenly made it very simple purchasing property through a company.

JF: The property market is overwhelmingly focused on London and the South-East. However, your hunting ground is the Midlands and the North. Was that a conscious decision or was it simply a case of invest in what you know?

SL: *I invest in the Midlands and the North because you typically get much higher returns. There is no direct correlation sometimes between the house price and rental value, so I search for properties that are low to buy, but still demand a high rent*

JF: I was surprised to see my very own Sheffield rise to the top of the housing market league tables recently. Given that London seems to have run out of steam of late, is it time for the North and the Midlands to shine, or will London drag the rest of the market down with it?

SL: *Everywhere follows London. London has had extreme expansion from 2012 to 2015 but is now slowing down and correcting itself. Birmingham is now where London was a few years ago, and this expansion will ripple up through the country. After expansion will always follow recession, and after recession will always follow expansion.*

JF: Your particular area of expertise is HMO (Homes in Multiple Occupation) and high-yield residential property. Given that many commentators believe the housing market looks frothy right now, is a focus on income rather than capital gains the way forward for property investors?

SL: *My focus is mainly to buy and hold, therefore I do not get concerned about capital appreciation, it just happens over time. My focus is getting ROI and seeing good cashflow each month. Rents can only continue rising, so even as interest rates rise, I still expect to be increasing my cashflow year by year.*

JF: Presumably, HMOs are only really suitable for professional landlords or those with plenty of time to spare managing tenants? What advice would you give to prospective landlords who are apprehensive about managing tenants? Is it best to use a letting agency to begin with?

SL: *It is imperative when buying HMOs that you have a good letting agent to manage the tenants and the property lest it become a rope around your neck. This needs to be an agent that specialises in HMOs, as it is a different animal than single lets. This also means you don't have to worry about it being in your home town, thus potentially giving you much higher returns also.*

"BIRMINGHAM IS NOW WHERE LONDON WAS A FEW YEARS AGO, AND THIS EXPANSION WILL RIPPLE UP THROUGH THE COUNTRY."

Buy low, rent high, with a property manager nearby – that kind of sums up my investment approach.

JF: So, from your answer to one of the previous questions, I take it you're not concerned about rising interest rates?

SL: *Interest rates will rise over time, but the fact is you can fix interest rates for up to 10 years at the moment. I can't see them going above 8% for a very long time. However, it is important to make sure you have a cushion in your profits for this reason, which is why my high cashflow properties are sensible.*

JF: Do you invest in the stock market as well? If not, why not?

SL: *I do not invest in the stock market because I only invest in what I know. I have a little invested in crypto-currencies but am not an expert.*

JF: Your story is a pretty inspirational one for young people aspiring to success. If there is one piece of advice that you could give someone that has the potential to change their life, what would it be?

SL: *My one piece of advice would be to invest in yourself. You are the best investment you could ever make.*

About James

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

BY VICTOR HILL

OPPORTUNITIES IN FOCUS

THE FUTURE OF DATA

WHY THE TECH GIANTS WILL SURVIVE REGULATION

At the beginning of this century, it appeared that the internet revolution would empower private citizens at the expense of the state. The assumption was that social networks would create "people power" and it seemed that some political movements like the Arab Spring of 2011 were driven by social media. But the rising band of autocratic nationalist leaders who have emerged in the last decade or so – from Mr Putin to Mr Duterte to Prince Mohammed bin Salman – drew a different lesson. They perceived an opportunity for governments to become the leading mediators of information so as to tighten their political control.

In recent months, one of the key players in the control of cyberspace – Facebook (NASDAQ:FB) – has become embroiled in controversy for breaching its codes on data protection. Some observers have even predicted its demise. The other controlling giant of the internet, Google (Alphabet NASDAQ:GOOGL), has also come under fire. Both companies' share prices dipped but have now largely recovered.

But maybe, at a time when the internet is increasingly coming under the control of nationalist-populist governments, Facebook and Google should be considered for what they are: data machines that facilitate the free flow of information between citizens (albeit with biases). True, Facebook effectively makes data available to third parties while Google does not. A third behemoth, Amazon (NASDAQ:AMZN), collects data and uses it to sell products from its online global store – in unimaginable quantities. The fourth tech giant, Apple (NASDAQ:AAPL), also collects customer data but generally uses that data in benign ways to enhance its products. The last of the "Big 5", Microsoft (NASDAQ:NSFT), powers our computers and, therefore, makes the internet happen.

This month I want to ask how these five data giants will suffer in a regime of tighter regulation of data. It has become fashionable to argue that social media/data companies should be regulated "like utilities" – or so many people argue. But, at the end of the day, who would you trust most to own your most intimate secrets – Facebook CEO Mark Zuckerberg or Russian President Vladimir Putin?

"THE TECH GIANTS, WHO SPEND EYE-WATERING SUMS ON POLITICAL LOBBYING, SEEM TO HAVE RUN OUT OF FRIENDS IN WASHINGTON."

Tech giants accused

This has been a difficult year for the PR gurus working for the tech giants of Silicon Valley and its environs. Facebook is accused of abusing our data and possibly even assisting the Russians to subvert the electoral processes of Western democracies. Apple supposedly doesn't pay its taxes and is turning our children into illiterate smartphone addicts. Amazon is using its market power to destroy the high street/main street. And Google is using its monopoly control of the internet to push its own products. YouTube (owned by Google's parent Alphabet) has even been accused of encouraging terrorism. Facebook and Google combined are supposedly stealing news from ailing media companies in order to sell targeted ad campaigns. Both are invading our privacy. Only tough regulation, so the argument goes, will address these issues.

The tech giants, who spend eye-watering sums on political lobbying, seem to have run out of friends in Washington – not to mention Brussels and London. In Washington, even senior Republican politicians who are normally pro-billionaire and who favour light-touch regulation have taken umbrage, because all the tech giants seem to be inclined towards the Democrats and were openly anti-Trump in the 2016 presidential election. As for the Democrats, despite Mr Zuckerberg's liberal credentials, they now suspect that Facebook swung the election for Mr Trump – just as ardent Remainers in the UK often suggest that it was Facebook which lost them the Brexit referendum.

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Amazon: an *illegal monopoly?*

President Trump, whose instinct is normally to oppose greater regulation, would like to break-up Amazon – not so much because it misuses customer data but more likely because Jeff Bezos (Amazon's founder, Chairman, President, CEO and major shareholder) is a political opponent. Mr Bezos personally owns the *Washington Post*, which has pursued a virulently anti-Trump agenda since the President's inauguration last year. Mr Trump also believes that the US Postal Service undercharges Amazon for deliveries.

Some liberal commentators in the USA have likened Mr Bezos's Amazon to John D Rockefeller's Standard Oil. That notorious company came to an end in 1911 when the United States Supreme Court ruled that it was an illegal monopoly under the anti-trust Sherman Act of 1890.

Amazon's current valuation may seem astronomical – as I write it is trading on a P/E ratio of 254! But, as I wrote recently, it is now piling into consumer staples with own-label brands of household goods at a time when the power of established branded goods is on the wane. If it could come to dominate the consumer products market with its own label products, it could generate huge additional sales and profits. While there are lots of people out to get Amazon (and Mr Bezos), its customers are still voting for the company by the billion with their clicks. Amazon will get much bigger before its enemies confound it.

Diane Feinstein, the Democratic Californian senator, warned recently: "You created these platforms...and now they are being misused. You have to be the ones to do something about it – or we will". This view is widespread in the corridors of power in North America and Europe. But of course no such sentiment is expressed in China, a country already protected from cyber-barbarians by *The Great Firewall.*

Gillian Tett in the Financial Times – one of the few commentators to have foreseen the Financial Crisis of 2008 – recently wrote a piece entitled *Facebook or Google –which should worry us more?* I found this depressing because it seems to me that these two behemoths, obnoxiously powerful as they are, are in fact all that stand between us and the Iranian Mullahs, Chinese

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YouTube in retreat

YouTube, which was acquired by Google in 2006, has experienced a fall in advertising revenues as advertisers have taken fright at the prospect of being associated with unsavoury and inflammatory videos. In January, YouTube announced that it would no longer allow advertising channels that fail to generate less than 4,000 viewing hours in a year. That is a bar below which thousands of smaller users will fall. YouTube was based on the concept that independent (and amateur) film makers could supplement their production costs by generating advertising revenue. That is now more difficult.

Communist Party apparatchiks, Russian cyber-bots and the rest. Not to mention the government of the USA.

And we should not be surprised that they harvest our data. *If the product is free, then you are the product.* Most of us avail ourselves of the extraordinary potency of Facebook's and Google's product for nothing: in the case of Facebook – the ability to keep in touch with friends and colleagues and exchange news and information between interest groups that command our attention; and, in the case of Google, the ability to track down, quite literally, all the information in the world. As we reveal things about ourselves on Facebook, and as we search for things on Google and its other manifestations (YouTube and so on), so we leave a trail of clues as to our likes, dislikes, political affiliations, shopping habits, fears and concerns...and much, much more.

Ms Tett concluded that Google, though superficially more benign because it does not share data with third parties, has a much more potentially pernicious influence. This is because search engines have the power to manipulate people's searches from the very first character that they type by means of the *autocomplete* (prediction) feature. This can nudge people in a particular direction whether they intended to go there or not. This tends to lure users into digital echo chambers where their opinions are validated by other like-minded users.

In any case, Google probably has much more data about us than Facebook has. Most smartphones are now powered by Android – a Google operating system which is connected to the search engine and *Gmail* (email platform) plumbing. But not even Google knows as much about us as does Amazon, which sometimes gives one the impression that Mr Bezos can read our minds...

The "data" we give Facebook or Google or Amazon is freely given. What is more concerning is how governments, particularly autocratic ones, might

Benny Marty / Shutterstock.com

mine that data for their own sinister purposes – if only they could get their hands on it. And don't underestimate governments in "democratic" countries either. Five years ago Edward Snowden revealed to the world via WikiLeaks the extent to which the US National Security Agency (NSA) (and the UK's MI6) was using data analysis to keep tabs on its own citizens. This is the new normal.

The spat between Mr Zuckerberg and Mr Cook

In mid-March, it was revealed that Cambridge Analytica, a British data analytics company which was engaged by Mr Trump's US presidential campaign team, had accessed the data of a now estimated 80 million plus Facebook users' data. Facebook's corporate reputation took a pounding and Mr Zuckerberg endured weeks of acrimony. He was hauled before Congress where he was given a two-day grilling during the week of 9th April. One of his lieutenants, Mike Schroepfer, Facebook's Chief Technology Officer, also appeared before a public session of the UK parliament's Digital, Culture, Media and Sport Committee on 26th April. Then Mr Zuckerberg was then questioned (rather passively, I thought) by a committee of the European Parliament on 22nd May. Each appearance was accompanied by contrition and apologies.

Apple: more than iPhones

Janus Henderson believes that Apple is transitioning to a multi-platform technology company rather than one that focuses on a single product – the iPhone. While the replacement cycle for new iPhones appears to be lengthening (despite the built-in obsolescence issue – apparently older iPhones are designed to slow down), Apple is continuing to invest in the Apple Pay payment platform, media content, Apple Music and the app store in order to further monetise the 1.3 billion active accounts on the Apple iOS platform.

Apple Inc. has lavished cash on shareholders in the first three months of this year and it intends to continue to do so. Apple's shareholders are major beneficiaries from last year's cut in US corporate taxes from 35 to 21 percent. With a mountain of cash in overseas bank accounts suddenly repatriated, Apple bought back $23.5 billion of its own stock in Q1 2018, a record amount for any US company, according to S&P, and it added $100 billion to its target for future repurchases. It also paid out another $3.2 billion in dividends, which it plans to hike by 16 per cent going forward[iii].

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In early April, Tim Cook, CEO of Apple, was asked what he would do if he were in Mr Zuckerberg's shoes. Mr Cook drew a distinction between Facebook's and Apple's business models, saying "I wouldn't be in this situation". He said that Apple, the manufacturer of the iPhone, refused to use data harvested from customers in order to target ads at them. "We care about the user experience and we're not going to traffic in your personal life"[i].

Mr Zuckerberg hit back in an interview with the Vox website, describing Mr Cook's comments as "extremely glib" and "not at all aligned with the truth". He said that in order to build a platform that connects everyone in the world, regardless of their means, a revenue model based on advertising was the only way. He acknowledged that Facebook's ambition of connecting the world had changed further to the "global rise of isolationism and nationalism" – a dig at the Trump administration.

Mr Zuckerberg raised the prospect that disputes about content on the social media platform – what is acceptable and what is not – might in the future be subject to rulings by an independent third party. This comes at a time when regulators on both sides of the Atlantic are exploring tighter restrictions on social networks. Brussels even described the Cambridge Analytica revelations as *a threat to subvert our democratic systems.*

Facebook in the dock

There is absolutely no hard proof that either the Brexit referendum or the 2016 US presidential election were swung by foreign interference. Yet, it now seems likely that foreign-sponsored advertisements promoting political parties may be banned from social media by the UK government under proposals currently under consideration in Whitehall[ii]. The UK government under Mrs May also wants social media platforms to take a more pro-active role in policing political interference from abroad.

In April, the *Sunday Times* ran a story that the Russians had tried to influence the 2017 UK general election in favour of Mr Corbyn. The accusation is that parties coordinated by the

"DISPUTES ABOUT CONTENT ON THE SOCIAL MEDIA PLATFORM – WHAT IS ACCEPTABLE AND WHAT IS NOT – MIGHT IN THE FUTURE BE SUBJECT TO RULINGS BY AN INDEPENDENT THIRD PARTY."

Fake news is old news!

The way people talk about the prevalence of fake news – encouraged by Mr Trump's constant parroting of that phrase – one might think that this idea came out of social media. Actually, it has been with us throughout recorded human history. I recently described the Bayeux Tapestry – which President Macron is generously lending to the UK (even though it rightfully belongs to us) as *a piece of 11th century fake news.* Most of Shakespeare's history plays are attempts to legitimise the accession to power of the Tudor dynasty – fake news. In the 20th century, fake news was called propaganda. Nazi Germany and Soviet Russia even had ministries of *propaganda*. Now, anyone with a grievance can go online and set up their own ministry of propaganda.

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Russian state re-tweeted Mr Corbyn's pronouncements, using automated **Twitter (NASDAQ:TWTR)** accounts or "bots".

In early May, Facebook was exercised to ban foreign ads targeting Irish voters in the Republic's 25th May referendum on its abortion laws. It continued to run ads from Irish customers. American groups had been exposed as using *pro-life* ads to influence the vote. Google went further and banned all advertising in respect of the Irish referendum. Twitter imposed a ban on ads relating to the Irish referendum from the outset. Given that one Catholic user group wrongly suggested that abortion caused breast cancer, the Irish government has said it will propose new laws to regulate online political campaigning.

Then, in Washington, the House Intelligence Committee issued a list of 3,500 Facebook and Instagram ads that had been used to sow discord in US politics. They were supposedly linked to a Russian "troll factory" called the Internet Research Agency. The US midterm elections in November will be a litmus test, as these will be the first US elections since the allegations about improper Russian intervention in the 2016 elections. Expect accusations of nefarious interference.

Facebook's US$19 billion takeover of WhatsApp in 2014 would be a much more controversial acquisition today. And the adverse attention created by recent reputational damage has diverted attention away from some of the company's grand designs – such as its proposal to offer free internet to remote parts of the world using high altitude helium balloons.

Social media: changing demographics

Last year, it became apparent that teens and twentysomethings were abandoning Facebook in favour of two platforms which are more driven by exclusively image-based content: Instagram (owned by Facebook) and Snapchat (owned by **Snap Inc. (NYSE:SNAP)**).

Instagram was launched by Kevin Systrom and Mike Krieger in October 2010 and rapidly gained popularity with one million registered users in two months, 10 million in a year, and ultimately 800 million as of September 2017. In April 2012, Facebook acquired the service for approximately $1 billion in cash and stock. Over 40 billion photos have been uploaded to the platform. About

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"MORE TEENS AND TWENTYSOMETHINGS ARE REMAINING 'FACEBOOK-NEVERS' WHO BYPASS FACEBOOK ALTOGETHER."

one quarter of the UK population was using Instagram by the end of last year according to research firm eMarketer.

Those teens that have remained with Facebook tend to be logging on less frequently and spending less time on the platform. More teens and twentysomethings are remaining "Facebook-nevers" who bypass Facebook altogether. This has fostered the trope that Facebook is for oldies – oldies being of course people over 30 years old (like Mr Zuckerberg and myself). Facebook's market penetration is still unrivalled, however, with 2.2 billion user accounts worldwide (29 percent of the world's population) of which about 32.5 million regular users in the UK (about half of the country's population).

A confluence of change: social media and cryptocurrencies

It was only a matter of time before social media platforms developed their own payment systems. Last month it was reported that Facebook is considering the launch of its own crypto-currency using blockchain technology. This would allow its 2 billion or more users to make electronic payments by means of a digital currency[iv].

Reportedly, senior Facebook supremo David Marcus, until now head of the firm's Messenger app, has been put in charge of the project. Mr Marcus was the founder and CEO of Zong, which was acquired in August 2011 by online payments giant **PayPal (NASDAQ:PYPL)**, where he was appointed President. He is said to have been an early backer of Bitcoin. He is on the board of Coinbase, the crypto-currency exchange. Mr Marcus is credited with the introduction of Messenger's P2P payment platform which was released in the United States in June 2015.

There is an irony in so far as, in March, Facebook banned ads for cryptocurrency investment schemes because of the prevalence of scams in that arena. China's largest tech companies already dominate payment platforms. **Alibaba (NYSE:BABA)** operates *Alipay*, but this seems to have been overtaken of late by *WeChat Messenger*, facilitated by **Tencent (HKG:0700)**.

Digital currency enthusiasts are already calling the putative digital currency *FaceCoin*. We know that digital currencies have not fared well of late – but Facebook could change that. I have predicted that non-sovereign digital currencies will be outlawed soon...But what if the crypto-currency in question were backed by the US government...?

Snapchat: a poor investment

Snapchat is a multimedia messaging app which was created by Evan Spiegel, Bobby Murphy, and Reggie Brown, former students at Stanford University, and developed by their vehicle Snap Inc. Snap was listed on the stock market in March 2017. Currently, the company's shares are trading at less than half of their initial launch value of $27.

One of Snapchat's unique selling points is that pictures and messages are only available for a short time before they become inaccessible. The app has evolved from originally focusing on person-to-person photo sharing to presently featuring *stories* of 24-hour chronological content. The *Discover* function permits ad-supported short-form entertainment. Snapchat has become notable for representing a new direction for social media accessed overwhelmingly by smartphone. It emphasises its users' ability to interact with virtual *stickers* and augmented reality objects. As of February 2018, Snapchat had 187 million daily active users, of which about 14 million are in the UK.

The AI imperative

The revenue models of both Facebook and Google are based on targeted advertising (driven by data mining); but how they achieved their traffic impels them to create more and more sophisticated computer technology. Just consider how Facebook can recognise pictures of your friends: image recognition (like speech recognition) is a basic form of AI. Last year, South Wales Police became the first UK police force to make an arrest of a wanted man using facial recognition systems attached to a surveillance vehicle.

AI is often described as the development of *machines that think* – though thinking means many things. Software capable of exhibiting (or replicating)

"A SURPRISINGLY LARGE NUMBER OF US ARE ALREADY INTERACTING WITH (BASICALLY) INTELLIGENT MACHINES IN THE FORM OF AMAZON'S ALEXA, APPLE'S SIRI AND GOOGLE'S HOME."

several different kinds of human intelligence is called *general AI.*

In early May, Google unveiled a machine that was capable of making phone calls on people's behalf. The *Duplex* artificial voice software almost perfectly imitated a human at the end of the line and successfully booked a haircut and then a table at a Chinese restaurant – without arousing any suspicion that it was a robot. Duplex can even make human-like thinking noises like *um* and *hmmmn*…All this raises questions about how such technology might be abused by unscrupulous parties in the future if machines can imitate humans.

It seems that Google has re-focussed back from robotics to AI. In June 2017, Google's parent company Alphabet sold Boston Dynamics, a world leader in robotic humans and animals, to the Japanese tech giant **SoftBank (TYO:9984)**.

Just think of the economic implications. It is estimated that in the United Kingdom alone nearly one million people work in call centres. The figure must be very much greater in India. And on the day of Google's presentation, shares in **Booking Holdings (NASDAQ:BKNG)** (owner of restaurant reservations giant OpenTable) plunged by 6 percent, wiping over $5 billion off its market value.

A surprisingly large number of us are already interacting with (basically) intelligent machines in the form of Amazon's *Alexa*, Apple's *Siri* and Google's *Home*. I recently managed to confuse Alexa by asking her whether Aquinas' *ontological truth*[v] was correct. She thought about it and then answered that she was not able to assist in this regard. At least we know that computers are not truly intelligent yet. But they are going to get intelligent – really intelligent – very soon.

Amazon's *Echo* is already recording and analysing our speech within the home. What are they going to do with all this data? And, supposing an unfriendly government were to hack into all this data and use it for their own ends? We deserve reassurance – but little is forthcoming.

Last year, it was even reported that Facebook is developing technology that would enable users to communicate with one another using only the power of thought – telepathy, in short. The experimental technologies division which occupies Building 8 at Facebook's headquarters in Menlo Park, California, has been working on *optical neuro-imaging systems* that would allow people to type words just by thinking about them at speeds of up to 100 words per minute.

The team is headed by Regina Dugan who, like many others, joined Facebook from Google. She previously led the Defence Advanced Research Projects Agency (DARPA), an agency of the United States Department of Defence. Ms Dugan told Facebook's annual developer conference that such a technology might enable people to share thoughts directly, regardless of language. Thus, Douglas Adams' extraordinarily useful *Babel Fish*, which featured in the *Hitchhiker's Guide to the Galaxy*, might not be so outlandish after all!

I have written previously in Master Investor about Google's project to realise quantum computing (QC). Suffice to say here that if any quantum computer, the theoretical science of which is understood, could be created, it would provide an almost unimaginable increase in computer processing capacity and speed and could be used to provide solutions to mathematical problems which are currently beyond our grasp. When we combine quantum computing with AI, we enter the realm of science fiction where all kinds of extraordinary things become possible – though not without substantial risks to us poor feeble humans.

Of course, there are many questions about AI – most of them as yet unanswered. How could machines make intelligent, considered decisions without ethics? If they need to be ethically intelligent as well rationally intelligent, whose ethics should they adopt? What happens when intelligent robots get involved in warfare? Should thinking robots be accorded rights?

Significantly, Britain is emerging as a hub in AI research. On 22nd May, **Samsung (KRX: 005930)** announced its intention to locate its AI research centre in the UK. The company is following in the footsteps of Google and Microsoft, which have done the same.

Outlook for the tech giants

One way to think about the tech giants such as Facebook, Google, Apple, Amazon and Microsoft is that they are meta-corporations: post-modern states located in cyberspace. They are truly global, and they reach deep into their users' and clients' psyches regardless of national, linguistic, cultural or religious affiliations.

Unlike states, they exist in order to make money – not least for their shareholders. As such, it is unlikely in my view that they wish to harm or disadvantage their users. When Mr Zuckerberg talks about *communities*, I really believe he means well. Similarly, Google's house motto of *Do no evil* is equally well intended (which is not to say that it is incapable of evil).

Modern states, on the other hand, which have weaponised the internet, are out to use our data against us – if they can. One of the main issues that Facebook and Google must face up to is how hostile intelligence agencies have infiltrated them to influence opinion. So far, their response has been inadequate – but at least they are now aware of the problem.

At the end of the day, of whom should we be more scared: social media platforms or autocratic states? Mr Zuckerberg or Mr Putin? Or indeed Mr Trump – since the USA is most certainly more advanced than Russia in the realm of cyber-warfare? At least Facebook operates within the glare of public scrutiny while certain states are actively conducting hacking attacks and gathering data – actions for which they are not called to account. How actively involved the US intelligence agencies are in cyber-warfare is a subject I shall return to soon.

So, will more regulation bring an end to the alleged abuses of the five tech giants? Commentators like Irwin Stelzer foresee that there will be fines aplenty for perceived bad behaviour. There will be programmes to oblige them to raise awareness of the dangers of addiction to smartphones and social media. There will be new regulatory bodies set-up to curb fake news and to adjudicate on appropriate content – staffed no doubt mostly by representatives of minority groups.

Facebook, in particular, will probably face a ruling at some point that it is not just a platform but indeed a publisher: as a result of which it will be held ultimately responsible for all the content it facilitates. There is already a move to force Facebook to dispose of Instagram.

Google, which has already been found guilty under EU law of using its dominant search engine to promote its other products, may face a similar ruling in the USA. Both may become subject to explicit consent agreements before they can mine users' input data. Amazon is likely to find that proposed acquisitions of smaller competitors will be subjected to much closer scrutiny.

But none of this adds up to the demise of the tech behemoths. I believe that calls to regulate social media are poorly reasoned. Tax them effectively – yes: that is something that President Macron has moved up the agenda for Europe as a whole. But, the more governments set out to control social media and data management, the less free citizens will be to collect, analyse and exchange information – something which is absolutely at the core of a free, democratic society.

Gillian Tett has been persuaded by a psychologist that *Search engines can sway our minds in powerful and largely unnoticed ways.* In which case, we should be spending more energy teaching people how not to be framed – in the psychological sense of that term – using thinking skills. Personally, I call it *critical thinking*. Behavioural economists such as Daniel Kahnemann have written reams of books on this and it would be well within the competence of big data to configure programmes that inform people exactly how and why they are being manipulated (if they are not doing this already).

But, I am much more worried by autocratic governments (plus America and, potentially, the EU) that *can sway our minds in powerful and largely unnoticed ways* – and there is abundant evidence that this is already happening. Just consider how Google has been constrained in China. Or compare the powerful but endearingly gauche Mr Zuckerberg with the former Malaysian Prime Minister, Dr Razak, who made it a criminal offence to disseminate *fake news*. (Though, of course, he was the arbiter of what *was* fake news.)

One thing we learnt from the congressional grilling of Mr Zuckerberg was that the senators and representatives on Capitol Hill, the leaders of the most tech-savvy nation in the world, have very little understanding of the issues. One venerable senator even asked Mr Zuckerberg how Facebook generates revenue. Members of the European Parliament in Brussels were not much more sophisticated.

You may think that that is not a problem because the business of regulation is carried out by state agencies which are staffed by "experts". I am not so sure. Bureaucracies, even when they recruit high calibre people, are inherently stupid.

In *Homo Deus*, Yuval Noah Harari explains how, in the modern mindset, the concept of data has become the key to our understanding of the world. That the world is made of data is something that resonates with both scientists and political thinkers alike. The politicians have now become alarmed that they were behind the curve – as most of us already knew. Harari points out that nobody voted for the internet, yet decisions made by technology companies far from public view have created:

"A lawless zone that erodes state sovereignty, erodes borders, abolishes privacy, and poses perhaps the most formidable global security risk...But it is much harder to change an existing system than to intervene at its inception..."

If the internet had been invented by a committee of the great and the good, it

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might be less open to abuse. As it is, it reflects both human brilliance and human frailty. We had better forget about the notion of personal privacy that we had before the internet age – it is not possible to return to the pre-internet world. It is no good blaming Facebook or Google or Amazon – it is the venality of the human race that we should most regret.

Regulation will have all kinds of negative unforeseen consequences – including a likely curtailment of freedom of speech. But then, arguably, the 19th-century notion of representative democracy is in decline anyway. Before we rush to regulate these tech giants, we should reflect that they are a bulwark against intrusive, autocratic governments in the age of the new nationalism and cyber-warfare.

Action

While technology companies stand to lose out from the regulation of social media, they are much more than just internet portals. They are AI hubs. Now is not the moment to get out of technology – despite the prospect of more onerous regulation. Investors cannot afford not to be exposed to the big technology stocks and their suppliers. One fund which has consistently allocated to the tech giants discussed in this article is the **Janus Henderson Technology Fund (ISIN:GB0007698847)**, which returned 13.51 percent to its shareholders in the 12 months to the end of March 2018.

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 See Zuckerberg hits back at 'glib' Cook, by Matthew Garrahan, Financial Times, 03 April 2018.
ii See: Social media may be banned from taking overseas cash for political ads, Insight, The Sunday Times, 13 May 2018.
iii See: http://business.financialpost.com/investing/rpt-apple-plows-u-s-tax-cuts-into-record-share-buy-backs
iv See: Facebook plot to launch own currency, by Danny Fortson The Sunday Times, 13 may 2018, page 3.
v *God is perfect. Non-existence is an imperfection. Therefore God exists.*

BY FILIPE R. COSTA

THE MACRO INVESTOR

RISING RATES TO HIT EMERGING MARKETS

"You only find out who is swimming naked when the tide goes out."

- Warren Buffett, Berkshire Hathaway Annual Report 2001

One of the biggest problems of enlarging a central bank's balance sheet while cutting interest rates to the bone is that at some point in the future, normalisation is likely to occur. In other words, what goes up, must come down.

Many would say that the global economy will remain safe if normalisation comes occurs gradually. After all, it's easier to save £100 out of £10,000 than to save £100 out of £500. In the meantime, as central banks entertain markets with liquidity injections, global growth has picked-up, equity markets have reversed all losses, unemployment has fallen and inflation is heading towards target. But debt levels are still high around the world, as the declining dollar and low yields encourage corporations and governments in the emerging world to increase debt, in particular in hard currencies. For now, the prospects of a sudden hike in interest rates and bond yields in the developed world are unlikely; however, if that situation changes, many emerging market countries will be vulnerable to capital outflows as the growth rates in these countries are no longer able to absorb the levels of debt service costs.

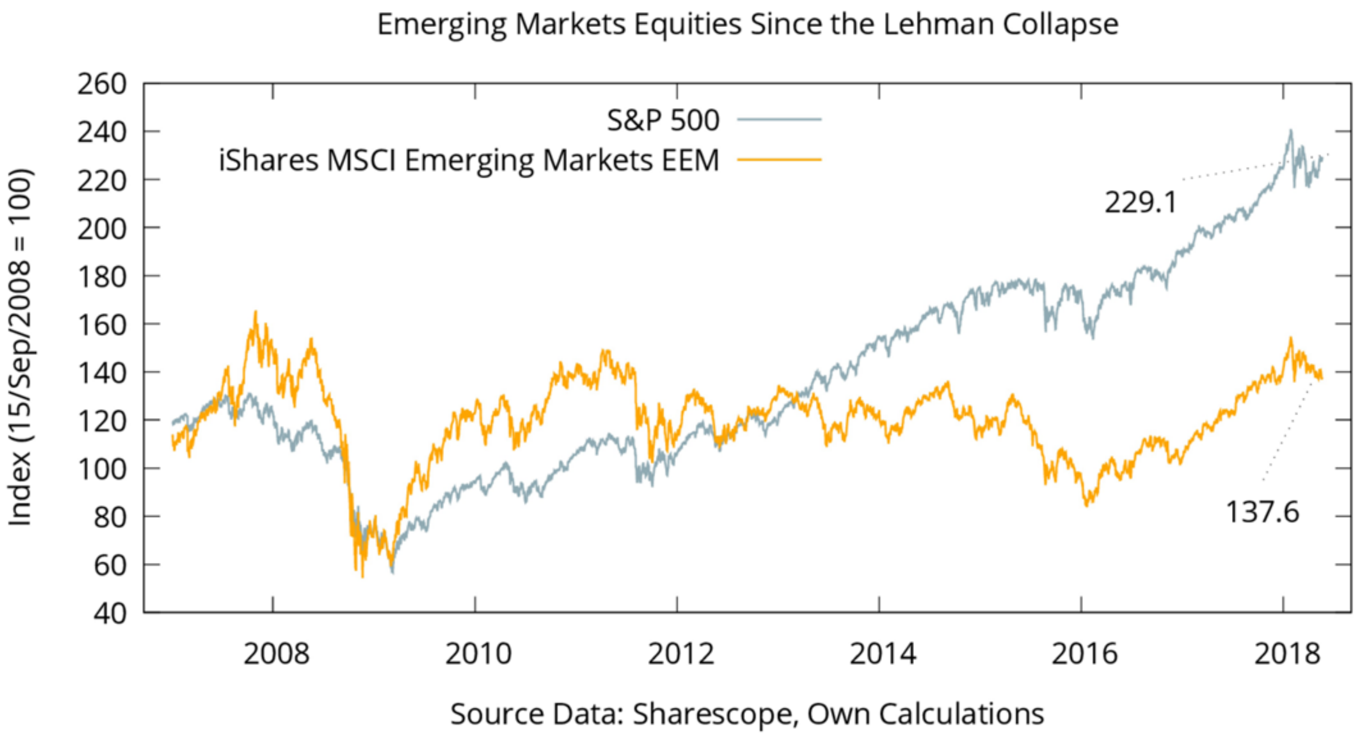
The last 10 years have witnessed eccentric monetary policy around the globe, with many developing economies filling their financing needs at tempting rates. Deprived of a decent return for their money, investors were more than happy to embrace the emerging markets asset class, as long as they could get a decent yield in return. Portfolio inflows in emerging markets averaged $240 billion per year between 2010 and 2017. But, at a time when interest rates are already rising, and the FED has announced plans to shrink its balance sheet, investors must rethink whether emerging markets still offer the same risk-to-reward ratio as before. As a group, emerging markets now appear stronger than 10 years ago, but they are still too vulnerable to monetary policy normalisation and macroeconomic shocks. While investors remain optimistic from a global perspective, there are a number of factors that are conspiring against emerging markets.

Emerging markets as an asset class

The monetary bazooka is a kind of "Midas" touch that turns everything into gold. Failing businesses can borrow with ease; risky countries are turned into friendly money destinations; hedge funds are all made outperformers; and there is no such thing as an unsound investment strategy. But, as Warren Buffet once said, "when the tide goes out... you will find out who is swimming naked". Monetary normalisation will uncover the many vulnerabilities that still affect the global economy. During the next few years, it will make a difference to hand pick investments carefully, rather than placing leveraged bets on the entire market or tilting a portfolio towards an entire asset class, like emerging markets.

After all, there is no such thing as an emerging markets asset class. There is a group of countries that belong

"PORTFOLIO INFLOWS IN EMERGING MARKETS AVERAGED $240 BILLION PER YEAR BETWEEN 2010 AND 2017."



to the developing category due to a series of economic and human factors that put them below another group labelled as developed. But the differences in terms of investment characteristics inside each group are so great that it is hard to find a commonality that applies to the whole group. At times of monetary policy eccentricity, everything looks very similar, but as normalisation occurs it is better to divide the group and treat the components separately.

"MONETARY NORMALISATION WILL UNCOVER THE MANY VULNERABILITIES THAT STILL AFFECT THE GLOBAL ECONOMY."

Since the collapse of Lehman Brothers on 15th September 2008, the S&P 500 has risen by 129%, which translates into an annualised rate of return of 8.95%. In the same period, emerging markets as a whole have risen by just 38%, as proxied here by the **iShares MSCI Emerging Markets ETF (NYSEARCA:EEM)**. For one reason or another, emerging markets have performed poorly as an asset class. High commodity prices, low commodity prices, political instability, collapsing currencies, and high current account deficits are just a few reasons why an investment in the whole group of developing countries hasn't performed as well as many might expect. The group may offer some degree of diversification to a portfolio, but it is still exposed to a number of problems that impact countries in the group asymmetrically.

The start of the collapse

If we look at recent news, we start to understand the vulnerabilities that come with monetary policy normalisation. Let's take the case of Argentina. Just one year ago the country issued a 100-year bond, which was yielding 7.9% while also being well subscribed by investors. In a world marked by tiny yields, an offer like this one looked very attractive, in particular after a change towards a more market-friendly government in the country. One year later, the central bank had to hike its key rate three times in a week, from 27.5% to 40.0%, and spend $5 billion in foreign reserves to avoid a decimation of the Argentine peso. Nevertheless, the central bank was unable to stop the outflow of money and the peso adjusted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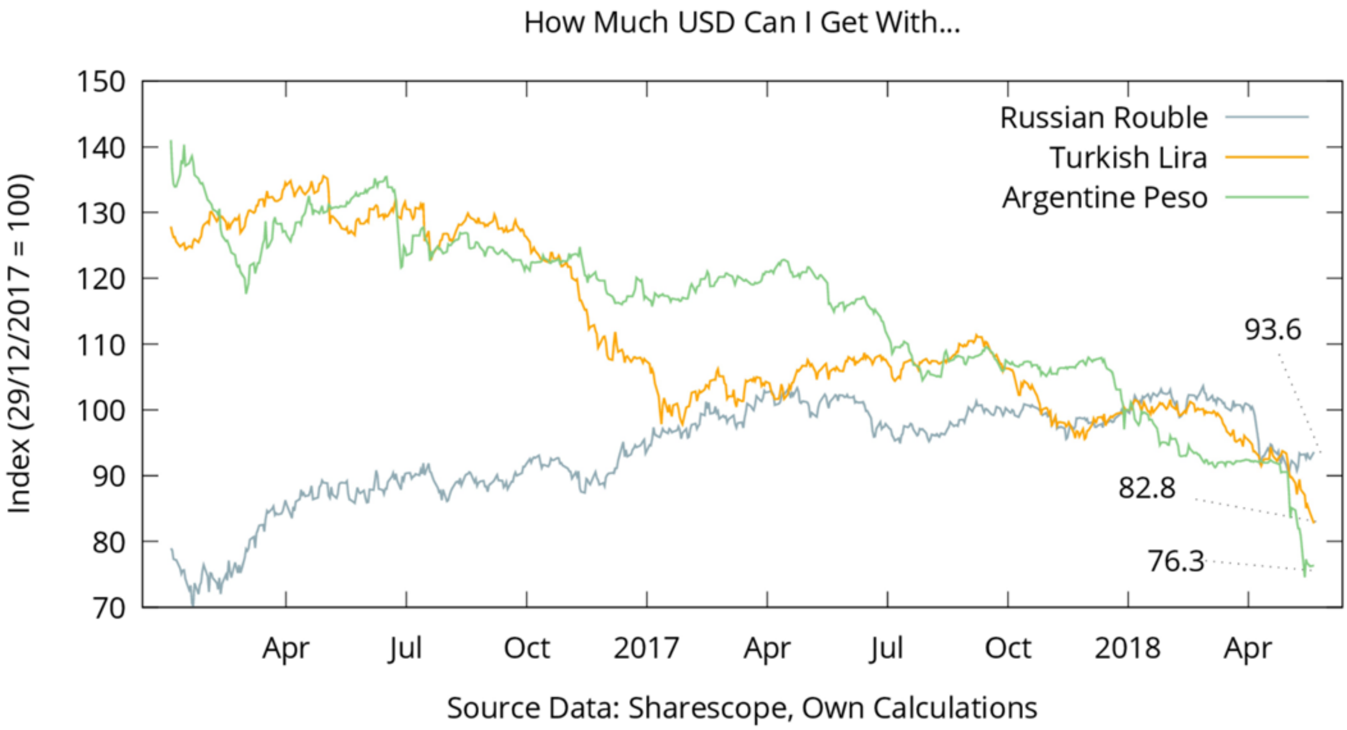


"JUST AS LOW YIELDS PUSHED MONEY OUT OF DEVELOPED COUNTRIES INTO DEVELOPING COUNTRIES A FEW YEARS AGO, IT IS ONLY REASONABLE TO EXPECT A REVERSION OF."

accordingly. At the time of writing, the peso had fallen against the dollar by around 25% since the start of the year and President Mauricio Macri had very little choice but to ask the IMF for help. The 100-year bond lost its shine, in a country that defaulted eight times on its government bonds during the last 200 years. How surprising can such a situation be considered to be? What's the likelihood of the 100-year bond being repaid in full? Only in a world distorted by central bank intervention could anyone take a 7.9% yield. Argentina is one of those naked swimmers that has been uncovered by the tide. But it isn't alone.

In Turkey, the autocratic government of president Erdogan believes that inflation is a consequence of higher interest rates. With that in mind, Erdogan has labelled the interest rate as "the mother of all evil" and sees an opportunity to influence central bank intervention. At a time when the inflation rate is in double-digits, the central bank is quiet. As a consequence, the Turkish lira is in a downward spiral, having lost 17.2% of its value against the dollar year-to-date. Meanwhile, in South Africa, despite the ascension of the market-friendly Cyril Ramaphosa, foreign investors are net sellers of South African debt, as purchases amount to 485 billion rand while sales amount to 493 billion rand so far in the year.

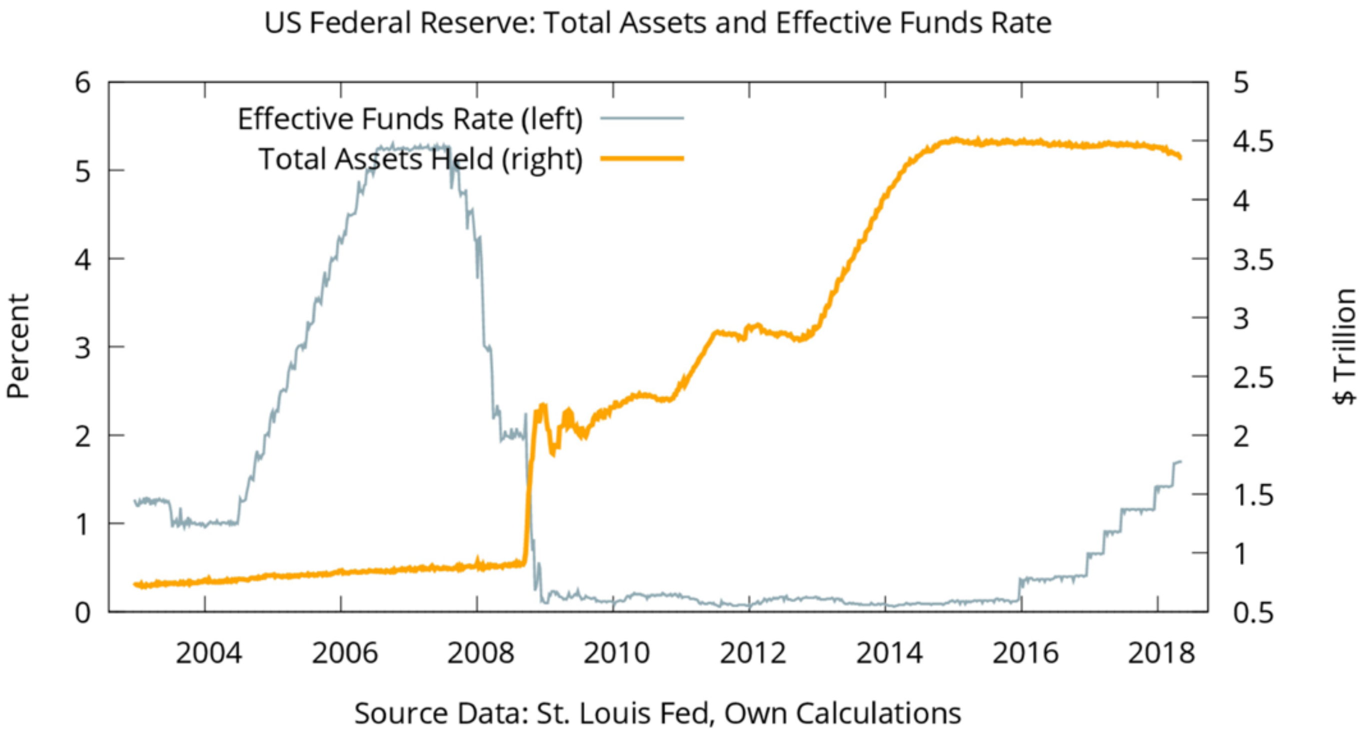
The above are just some examples of how vulnerable emerging markets may be to currency moves and in the case of Turkey and Argentina, how ill-equipped their central banks are at coping with money outflows.

Diverging risks

While the key risks impacting emerging markets are manifold, there are five key areas that should always been weighed carefully: current account deficit, amount of dollar-denominated debt, political uncertainty, dependency on oil, and quantity of foreign exchange reserves to cover short-term external debt.

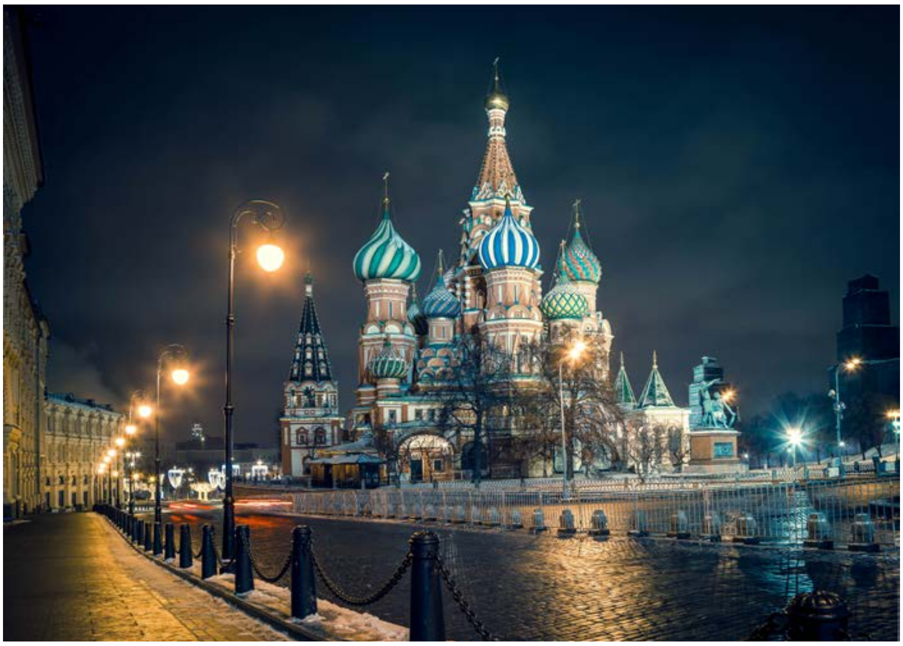
At a time when interest rates are already rising in the US, the appetite for riskier assets is deteriorating and precipitating outflows of money from developing economies. Just as low yields pushed money out of developed countries into developing countries a few years ago, it is only reasonable to expect a reversion of the flow as yields rise. The IMF translates the current pace of interest rate hikes followed by the FED along with its planned asset reduction into an average portfolio outflow of $70 billion per year during 2018 and 2019 in emerging markets. Such estimates are based on the optimistic scenario under which inflation is under control and the FED hikes rates gently.

Despite the fact that the FED policy rate is already at 1.75%, the central bank balance sheet still stands at $4.33 trillion, which is still near the peak of $4.51 trillion recorded in January 2015. But, as this balance sheet starts shrinking, money outflows will gather pace in emerging markets. Countries with enough foreign exchange reserves can provide the demanded dollars without much impact on currency values. Countries where there is an adequate coverage of short-term debt by foreign exchange reserves are safer. By that token, both Argentina and Turkey are highly exposed to capital flows. In general, South American countries are



more exposed than South Asian countries.

Current account deficit is another weakness exposing a country to potential problems. Again, many of the South Asian developing countries like South Korea, Taiwan, Malaysia and Thailand don't carry that risk. Argentina and Turkey are again exposed on this front, as both countries carry significant current account deficits. But they are not alone: Pakistan, Brazil, Chile, Peru, and South Africa all show deficits.



Another important point to consider, in particular at a time when oil prices are rising and already high at $80, is oil dependence. Some emerging markets like India, the Philippines and Indonesia are negatively exposed to oil prices as they have a significant level of dependence on the commodity. In fact, these three countries are not only oil dependent, they also carry current account deficits. That mix of factors exposes them to the current macroeconomic environment. Still, the Indian economy is one of the fastest growing in the world and a serious future threat to China's place at the top. Long-term prospects for India look good, despite any shorter-term vulnerabilities. Other countries, like Mexico and Colombia, carry current account deficits, but have significant oil surpluses and, therefore, benefit from rising oil prices.

Political stability, or the lack of it, is another key factor for developing economies. While some developed countries seem exposed to political instability with the rise of populist parties, such a problem is quite common in emerging markets. Turkey, Brazil and Russia have been hit recently due to corruption scandals and weak democratic processes. In the particular case of Turkey, the political instability compounds an already large pack of problems, one of which is crucial for foreign investors: a lack of central bank independence from the government. Russia's Putin is certainly not the model that investors typically look for, but given the country's dimension, international influence, and rigorous central bank, the country is much more attractive than Turkey. In fact, Russia is at the top of my investment list, as the country has enough foreign reserves, carries a positive current account, seems less exposed to the dollar trade and stands to benefit from rising oil prices. The rouble is down by 6.4% against the dollar year-to-date, but it is holding very firmly at a time when many currencies are losing ground.

Suggested trading direction

As mentioned above, there is no such thing as an emerging markets asset class. We have a universe of different countries, all of which need separate consideration. Russia benefits from rising oil prices while India stands to lose from the same. Argentina holds a large current account deficit, but that is not the case for most South Asian countries. Mexico and Colombia, like the Philippines and Indonesia, carry current account deficits, but the first two in the pack hold oil surpluses while the last two show the inverse position.

At a time when there is a clear inversion in the path followed by central banks in the developed world, the hot money flows of the past will reverse direction and put the emerging markets with the worst fundamentals at risk of collapse. My first trade is in the direction of selling the Turkish lira against the dollar and/or the euro. With the central bank standing quietly at a time when inflation is above 10%, capital outflows will intensify in a matter of weeks. Erdogan, who has strategically called a snap general election, to be held on 24th June, will certainly do everything to prevent the central bank from hiking interest rates. If a hike does occur, it will likely be insufficient nevertheless.

A second trade is on Russian equities. As I suggested above, Russia looks much better placed than other emerging markets. While there are several ways of getting exposure to Russia, I particularly like the **VanEck Vectors Russia ETF (NYSEARCA:RSX)** and the **iShares MSCI Russia ETF (NYSEARCA:ERUS)**.

As a third trade, for those who believe in a more broad-based collapse of emerging markets currencies, there is the **WisdomTree Dreyfus Emerging Currency Fund (NYSEARCA:CEW)**. In that case, the trade would be in the direction of shorting the fund.

My last trade is reserved for something outside the emerging world. In the US, technology stocks continue to rise, despite a less optimistic view on the broader market. With almost all Q1 earnings reported, the S&P 500 shows an increase of 8% in revenues and 25% in profits. Still, there isn't much investor enthusiasm, with the S&P 500 is mostly flat year-to-date. This may be a sign that the peak is near. If sentiment reverts and volatility returns, the FAANGs will be the first to see their stretched valuations shrink. It is time to get away from **Facebook (NASDAQ:FB)**, **Amazon (NASDAQ: AMZN)**, **Apple (NASDAQ:AAPL)**, **Netflix (NASDAQ:NFLX)**, and **Google/ Alphabet (NASDAQ:GOOG)**.

"RUSSIA IS AT THE TOP OF MY INVESTMENT LIST."

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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 JOHN KINGHAM

DIVIDEND HUNTER

IS BT'S NEAR-8% DIVIDEND YIELD A GOOD REASON TO BUY?

If you wanted to invest in a safe and stable company with the aim of receiving a reliable dividend today, plus good prospects for dividend growth tomorrow, an obvious choice would be BT (LON:BT.A). From a dividend investor's point of view, what's not to like? The company has paid a dividend every year since 1985 and operates in an extremely defensive sector (people don't typically stop making phone calls just because there's a recession). Having started life as a state-run monopoly with 100% market share, BT is still the UK's market leader in fixed line voice and fixed line broadband services. And now, following its recent £12.5 billion acquisition of EE, BT is also the UK's market leader in mobile.

Perhaps best of all, BT shares are now available with a near-8% dividend yield. Potentially, that's an almost 8% cash return on your investment from day one. This combination of a defensive company and a very high yield are compelling, so let's have a closer look at whether BT is likely to be a dream investment, or a nightmare. I'll use four simple questions:

Q1: Is BT growing faster than inflation?

The first thing I look for in a company is growth, because the last thing most dividend investors want is capital losses and a declining dividend. For me, growth is something to be measured over the long-term, so I always look at a company's ten-year record of growth, measured across revenues, earnings and dividends.

Thanks to the wonders of inflation, companies must grow by about 2% per year for their dividends to at least retain their real-world purchasing power. Anything less than that and the company is effectively shrinking. So how does BT measure up to that standard? Not very well, unfortunately.

Over my usual ten-year measurement period things look pretty good, with BT's average growth across revenues, earnings and dividends coming in at 7.4% per year. However, most of that growth has simply been a recovery from the damage done by the global financial crisis. If you look beyond the last ten years, BT's growth story falls apart.

For example, according to ShareScope, BT's 1998, 2008 and 2018 revenues were £15.6 billion, £20.7 billion and £23.7 billion, respectively. So, BT's revenues have been increasing, but more slowly than the 2% needed to keep up with inflation. In terms of earnings per share, BT's adjusted figures for 1998, 2008 and 2018 are 23.8p, 23.3p and 25p, which means that BT's earnings have basically been flat for 20 years. Finally, and perhaps most importantly, BT's

"BT'S EARNINGS HAVE BASICALLY BEEN FLAT FOR 20 YEARS."

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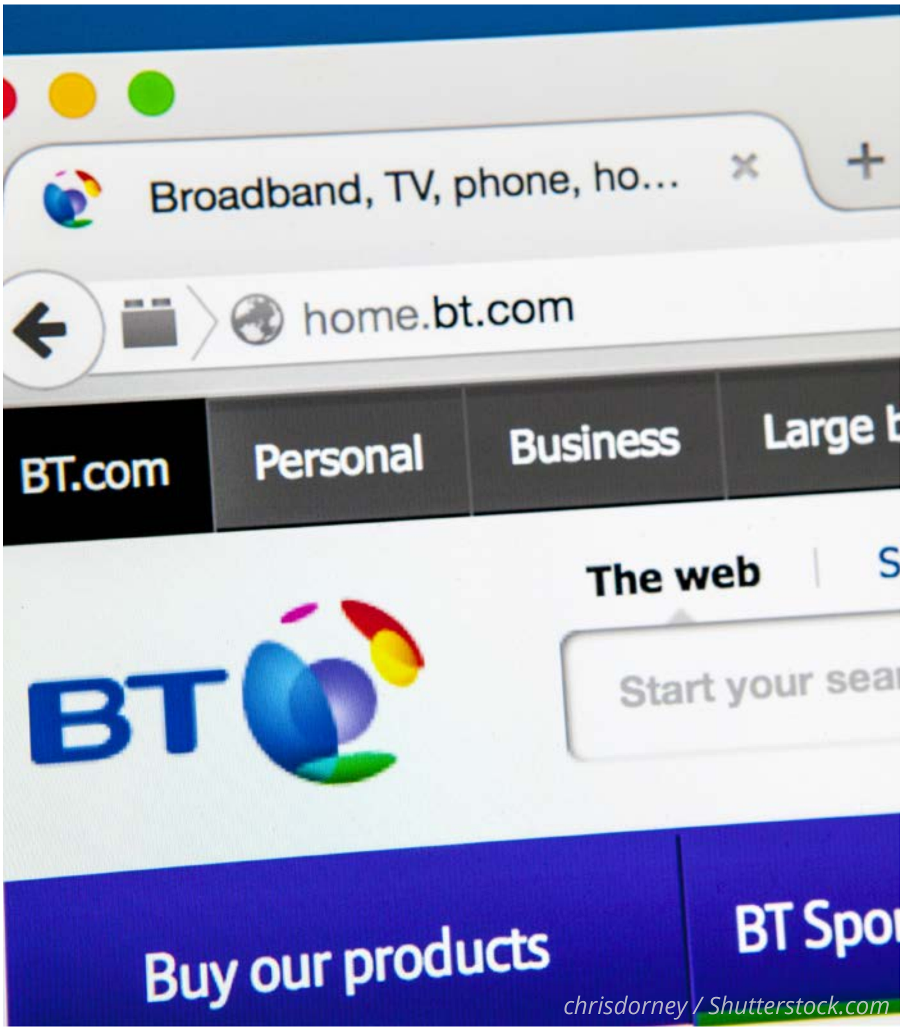
"OVER THE LAST DECADE, BT SPENT ALMOST £22 BILLION ON LONG-TERM FIXED CAPITAL ASSETS, WHICH IS MORE THAN IT MADE IN PROFITS."



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dividends in 1998, 2008 and 2018 were 14.7p, 15.8p and 15.4p, so BT has also failed to grow its dividend for the past 20 years.

This is not exactly a confidence-inspiring start. However, BT has managed to "grow" by more than 7% per year over the last decade (even if that growth was more of a recovery from a fall than a rise to new heights), so I might be willing to overlook its weak growth record if its other key factors are suitably impressive.

Q2: Is BT sufficiently profitable?

After growth, the next thing I look at is profitability. My preferred measure is returns on capital employed (ROCE), which basically measures the amount of profit generated from a company's long-term fixed capital (e.g. factories, machinery) and short-term working capital (e.g. inventory or cash in the bank). A simplistic example (and ignoring working capital) would be a £1 million widget factory generating profits of £200k per year. That would be a return on capital employed of 20%. A £1 million dongle factory generating profits of £50k per year would be producing a return on capital employed of 5%. All else being equal, a 20% return from a factory is better than a 5% return.

Profitability is important for a couple of reasons. First, it makes expansion and growth easier because the money for the next factory, for example, can be saved up more quickly when ROCE is higher. Second, return on capital employed is a reasonable indicator of competitive strength. If a company has no competitive advantages then it will be forced to sell its products cheaply, or it won't sell them at all. If a company has a high ROCE then it is probably selling its products at a premium price, and there must be some reason why customers are willing to pay top-dollar for that company's products. If ROCE is consistently high then the company may have a durable advantage over competitors, and that could help the company to sustain a decent growth rate for many years into the future.

On average, dividend-paying companies earn a return on capital employed of about 10%, and I won't invest in any company where ROCE is consistently below 7%. So where does BT fit into this profitability spectrum?

The answer is that BT's profitability is decidedly average, which isn't necessarily a disaster. Compared to an average ROCE of 10% from UK dividend-payers, BT's ten-year average ROCE is 9.2%, which is below average, but only just.

This isn't a complete surprise because BT is a relatively capital-intensive business. In other words, it must build a lot of physical telecommunications infrastructure before it can earn a penny of revenue or profit. For example, over the last decade, BT spent almost £22 billion on long-term fixed capital assets, which is more than it made in profits.

But, as I said, slightly low profitability isn't a disaster; it just isn't particularly impressive either, especially for a company with a dominant market position and a universally well-known brand.

Even with relatively low long-term growth and low levels of profitability, I might still invest in BT if it can answer my next two questions in a suitably impressive manner.

Q3: Is BT's balance sheet strong enough to withstand an unexpected disaster?

Even a fast growing, highly profitable company can find itself bankrupt if its debts are too high. That's because interest payments and the obligation to repay the debt are relatively fixed, while the profits used to pay back those debts are most definitely not fixed. And that's true even for a defensive company like BT. A year or two of weak profits for an overleveraged company can leave it in administration or liquidation, so one thing I always try to avoid is companies with an excessive amount of debt.

As a general rule, I'll only invest in a defensive sector company like BT if its borrowings are less than five-times its five-year average profit. Over the years I've found that to be a reasonable maximum, beyond which the odds of debt-related problems increase dramatically.

Today, BT's debt ratio is slightly above that limit. With borrowings of £14.3 billion and average profits of £2.5 billion, BT's debt-to-profit ratio is 5.7. Even for a company as defensive as BT, I think that's an imprudent amount of debt. However, thanks to BT's enormous pension fund, the picture is much worse than that.

> **"AS FAR AS I'M CONCERNED, BT IS DANGEROUSLY OVERLEVERAGED."**

In recent years, investors have grown used to hearing about pension funds and how a seemingly healthy company was brought down by a massive pension fund deficit (Carillion being a recent poster-child for this trend). The problem is that a pension deficit is much like any other form of debt in that the company has a legal obligation to repay it. That's why I treat any pension deficit as a form of debt and add it to the company's borrowings to calculate a debt plus deficit ratio to profits.

In BT's case, it has a pension deficit of £11.3 billion. If you classify that as debt, then BT has total debts of some £25.6 billion. That sounds like a lot, and it is. It is in fact more than ten-times the company's recent average profits, or more than double my five-times profits debt rule.

In other words, as far as I'm concerned, BT is dangerously overleveraged, regardless of how defensive it may or may not be (and looking at its low-growth history and dividend cuts in 2001 and 2009, I don't think it's as defensive as many people think).

Q4: Is BT's share price attractive, given its growth, profitability and balance sheet strength?

Looking at growth, profitability and leverage is a quick way to separate good companies from bad and ugly companies. However, the price you pay to buy a share of a company is just as important as the quality of that company. If you pay too much then your investment could produce weak or negative returns, even if the underlying company produces consistent and highly profitable dividend growth.

This is exactly what happened to investors who bought shares in Coca-Cola in 1998 when the dividend yield was less than 1%. Over the past 20 years, Coca-Cola has increased its dividend almost five-fold, which is a very solid performance. However, the share price has remained stuck at or below its 1998 level for most of the past 20 years, so those investors have seen zero capital gains, despite the underlying company's continued growth. The moral of the story is that you can turn a great company into a bad investment by paying too much in the first place.

There are various ways to think about what is and isn't an attractive valuation, with most investors using the PE ratio and dividend yield. I like dividend yield, but I use PE10 (price to ten-year average earnings) instead of the standard PE ratio because the standard PE ratio can be thrown off when a company's latest earnings are abnormally high or low.

So how does BT compare to the average for UK dividend-paying stocks by those measures? Somewhat obviously, BT's dividend yield is far above average. With a yield of almost 8%, it's well into most dividend investors' "red-flag" territory, where the yield is so high it seems unlikely it will ever actually be paid (in other words, a dividend cut is probably imminent).

Personally, I fall into this red-flag camp. BT's debt and pension obligations must be keeping the CEO awake at night. And if they're not, they should be. To me, it seems like madness for a company to be paying cash out to investors while at the same time it has debts and a pension deficit which are huge multiples of its earnings. The newly agreed pension deficit reduction plan has BT obliged to pay almost £1 billion into the pension scheme each year until 2030. And this from a company whose annual post-tax profits have never consistently been above £2 billion.

John Williams RUS / Shutterstock.com

"BT'S DEBT AND PENSION OBLIGATIONS MUST BE KEEPING THE CEO AWAKE AT NIGHT. AND IF THEY'RE NOT, THEY SHOULD BE."

For me then, BT is not a serious investment candidate. I'm not a turnaround investor and I don't like to invest in high risk situations if I can help it. And to me, BT looks like a high-risk turnaround, with its recent strategy update announcing management's commitment to *"transforming BT's operating model"* via a *"three-year reduction of c.13,000 mainly back office and middle management roles"*, plus *"[c]ost reductions to help offset near term cost and revenue pressures"* while *"[h]iring c.6,000 new employees to support network deployment and customer service"*.

The strategy update also says that *"BT is uniquely positioned to be a leader"*, but this has been true for decades and it hasn't led to any sort of decent performance, so I have zero faith in BT suddenly turning into a high growth tech giant (or even just maintaining its dividend).

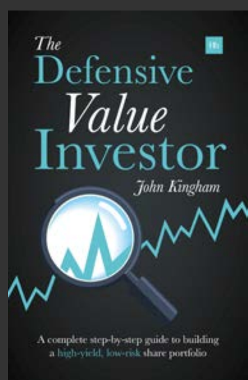
If a potentially distracting transformation project on top of BT's massive debt and pension obligations isn't enough to put you off, then you might also want to know that BT's PE10 ratio is 8.2. That's well-below the UK dividend-payers' average of 24, which is partly why BT is the 21st highest-ranked stock on my stock screen. So if you can handle the potential risks, then I would say that BT is attractively valued, but I certainly won't be investing in this particular high yielder.

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 DAVID JONES

CHART NAVIGATOR

HOW TO TRADE INDICES AND FOREX USING CHARTS

This month I will start off by saying that I realise it may be somewhat heretical of me to write about short-term trading in a publication named "Master Investor". But in my experience, there are many investors who have the occasional dabble in the black art of the short-term trade – or at least get the urge and, so far, have resisted taking the plunge. Given this, I thought this time around it would be a good idea to look at how charts can help give some structure to short-term trades and hopefully make them less of a stab in the dark.

Trading – the reality

In short-term trading, most people lose. There is no way of dressing this up. I have worked in the industry for the past 15 years and although various markets come in and out of fashion, the cold, hard reality is that, as human beings, most of us are just not very good at trying to extract profits over a short time frame. There are various reasons for this, but the majority are psychological. The biggest stumbling block – and this will not come as a surprise to a lot of people – is that most of us are not very good at cutting our losses. Research has shown that your average private trader is very good at taking profits – snatching at them quickly before the evil market takes them away. But, show that same trader a losing position and they will often be only too happy to stick their head in the sand and hope that the trade turns around. Of course, this does happen sometimes – but also, they can just end up sitting there and watching the loss increase in size.

It is the age-old problem of discipline. It is very simple to say it – cut losses quickly, let profits run. But just as the theory of losing weight

> **"MOST OF US ARE NOT VERY GOOD AT CUTTING OUR LOSSES."**

is easy – eat less, move around a bit more – the actual reality of doing it is something more of a challenge.

This is where using a simple chart-based approach can help. Rather than a finger-in-the-air or gut-feel approach to trading, at least if we are using some sort of historical reference point for our ideas, enforcing our discipline if things do not go to plan could be a little bit easier, and improve our performance accordingly.

The importance of the previous day's high & low

So, you want to be a day-trader – in and out of your trades the same day and holding no positions overnight. It is probably the most difficult type of trading and not one I would recommend – I would always take a longer-term view over at least a few days to filter out some of the market noise.

> **"THIS IS WHERE THE CHART ENFORCES THE DISCIPLINE THAT SO MANY SHORT-TERM TRADERS LACK."**

But stubbornly you want to battle the market over a few hours – where do you start? I would suggest the very first point is the previous day's high and low. Let's think about this. If XYZ market traded as high as 500 yesterday and then fell back and traded as low as 450, then we have two very important reference points. Yesterday, opinion was that 500 was too expensive and 450 was too cheap – otherwise these levels would not have ended up being the high and low.

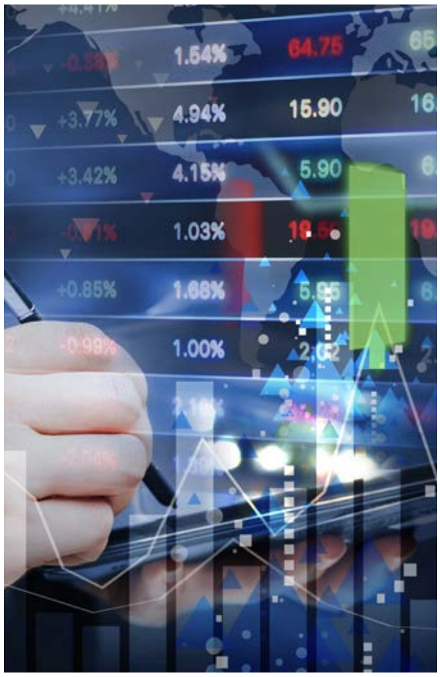
One approach to short-term trading is to see how the market reacts today if these levels are threatened. At the time of writing, here is an example from just three days ago in the popular foreign exchange pair the pound/US dollar (GBP/USD).

A short-term trade in GBP/USD

Let me just explain what we are looking at here. This is a 10-minute chart of GBP/USD – each candle represents 10 minutes' worth of trading. On 15 May, the market traded as low as 1.3450 – the low with the large arrow pointing at it. As the day went on, GBP/USD recovered and traded above 1.3520. This is a 70-point recovery, which is a decent sized move in one day in the foreign exchange market. Now, look to the right on the chart – this is the next day. The market has drifted back towards the low from 15 May. This could be a day-trading opportunity.

Markets can spend a lot of time during the day just chopping around. A level that in the past brought the buyers back in and was the base for a recovery is known as support. The low from the previous day is an obvious level of support. Our day trader may want to be a buyer here and, if the level gets broken, may want to exit the trade for a small, manageable loss. This is where the chart enforces the discipline that so many short-term traders lack. Rather than just blindly buying and crossing our fingers, we are choosing an area where the market has seen value in the past – as recently as the day before – and taking the approach that the short-term history is going

"THE CHART CAN GIVE US A ROADMAP OF SORTS AS TO WHERE WE MAY WANT TO THINK ABOUT PLACING OUR TRADE."



to repeat. Let's jump forward to what happens next.

It did end up being a pretty much text-book example. GBP/USD drifted down to the previous day's low of 1.3450, sentiment changed (as it had the day before) and the forex pair rallied back up to the previous day's high – a move of around 100 points in this example.

Of course, this does not work every time, but it can help set-up trades that offer up a potential profit that is a multiple of the risk taken – another mistake that many losers make. Let's take a look at a trade in the opposite direction.

A selling opportunity in the Dow Jones?

This is a slightly longer-term example as we are going back – brace yourself – TWO whole days. It's the 9 May and the Dow is struggling with the 24,480 level. It rallied up to it at the open and a few hours later, it is back here again. This also ended up being a barrier two days previously, on 7 May. So, we have an area where the sellers keep coming into the market.

We may consider this an opportunity to sell-short – with the all-important stop loss above that level at, say, 24,500. We are expecting the market to fall back from this level as it did earlier today and also two days ago. Let's

Chart of the Month – TP ICAP (TCAP)

I thought I would continue with this theme of previous highs and lows when it comes to the chart of the month. Obviously, it does not make sense to focus on a very short-term trade, as by the time you read this, the opportunity will have been and gone! But this simple approach of looking to see if history repeats can be applied to longer-term daily charts, and FTSE250 financial services business TP ICAP seems an interesting candidate.

It has been something of a choppy 18 months for the share price. In its favour, the move above 560p was, albeit briefly, a fresh all-time high – which is always a good thing from a trend point of view. Since then, the share price has slid back, and this is where it gets interesting. In April, the 430p level brought the buyers back in and the price rallied to 480p. It has dropped back again, and the test is whether the 430p level will hold. If an investor believes that will be the case, then this is a "buy the dip" opportunity. One place for a stop-loss would be below that April low of 430p. But perhaps a more generous stop-loss for the patient is the longer-term support shown on the chart in the 410p area.

bring things up to date.

Thank heavens for the stop-loss. The market burst through that level and moved another 100 points higher before dropping back. The less disciplined trader may well have blindly stuck with it in the hope that the loss would turn around – but that loss would have just increased.

I think these real-world examples illustrate two important points about using charts for short-term trading. First of all, no-one has a crystal ball when it comes to market direction – we just do not know with certainty if it will go up or down. But the chart can give us a roadmap of sorts as to where we may want to think about placing our trade. And, more importantly, when that road map does not go to plan, it gives us a definite "throw in the towel" level for the trade – where we can get out with a manageable loss. This is what finishes so many people in short term trading – the inability to take the small loss. I am not saying this approach is the key to successful short-term trading – but it definitely puts you at an advantage compared to so many who chance their hand.

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

FROM ACORNS TO OAK TREES

NEW PRODUCTS, NEW MARKETS, NEW OPPORTUNITIES

THE SMALL CAPS ENTERING NEW HORIZONS

Small cap investors love spectacular returns. And some of the most spectacular returns seen from small cap shares over the past few years have come from companies which have taken advantage of growing demand for completely new products.

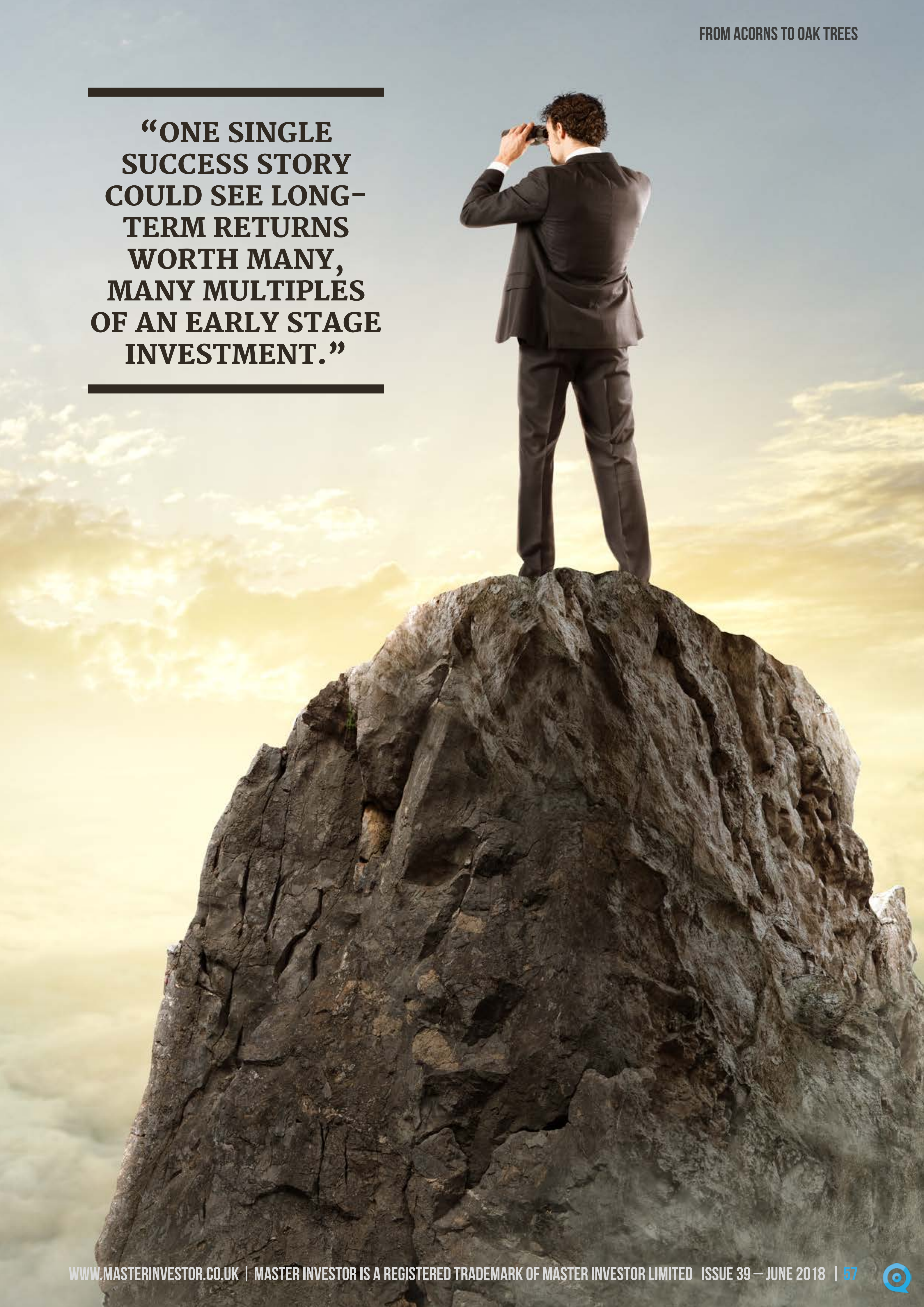
Take **Accesso Technologies (LON:ACSO)**, for example. Named Lo-Q in its early days as a listed company, and with a market cap of only a few million pounds, the company went on to flourish by providing theme parks with a nifty gadget that helped customers to electronically claim their place in a queue for a rollercoaster. This helped to improve guest satisfaction and freed up time for them to do other more productive things like spend money on hot dogs. Accesso built on its early success to now be a wider provider of technology solutions to over 1,000 clients in 27 countries around the globe. Shares in the company recently hit an all-time high of £25, up from just 28p at the same time a decade ago.

In a similar vein, other companies have seen huge returns from selling already existing products in completely new markets. **ASOS (LON:ASC)**, for example, came out of nowhere in 2001 to take advantage of the explosion in demand for buying fashion online. Driven by a shrewd management team, along with some quirky and cutting edge marketing, shares in the company are currently up by 202,977% since hitting a low of 3.25p in August 2003. While is it difficult to know with certainty what the next big thing will be, there will always be a number of dynamic small cap firms listed in London which are looking to ride the wave of opportunity. As young companies operating in developing markets most of these will be highly speculative investments. But as we have seen in the past, even one single success story could see long-term returns worth many, many multiples of an early stage investment. For the brave investor, here are three small caps which I believe offer that kind of potential.

SATIVA INVESTMENTS

Like David Cameron, I too had a "normal university experience". But little did I imagine 15 years ago that what was then a taboo industry would soon become a growing and potentially lucrative, and legal, investment opportunity. I'm not talking about pigs' heads here but cannabis – also known in its recreational form as African broccoli, grandpa's medicine, jazz cabbage and by thousands of other creative slang terms.

Recreational use of cannabis remains largely illegal, or at least illegal but decriminalised or unenforced, in most countries around the world. In this context it stays well off the



"ONE SINGLE SUCCESS STORY COULD SEE LONG-TERM RETURNS WORTH MANY, MANY MULTIPLES OF AN EARLY STAGE INVESTMENT."

> **"CANNABIS HAS A NUMBER OF BENEFITS IN A MEDICAL CONTEXT."**

investment agenda. However, recent years have seen a liberalisation of laws in many jurisdictions for use of the plant and its derivatives in medical and scientific applications. Some countries where weed is now legal in one or both of these contexts include Argentina, Australia, Canada, Denmark, Israel and the Netherlands, with medical marijuana now broadly legal in 29 US states.

In 1961, cannabis was recognised under the United Nations' Single Convention on Narcotic Drugs as a plant that no longer served any medical purpose. However, research carried out in recent years has found that cannabis has a number of benefits in a medical context, including pain management, treatment of muscle spasms and treatment of nausea associated with chemotherapy. While research on the subject remains limited, mainly due to the drug's historic illegality, the discovery of these benefits has led to a growing acceptance of cannabis for medical use.

Joint venture

Looking to take advantage of growth in the industry, in March this year **Sativa Investments (LON:SATI)** completed the UK's first medicinal cannabis investment IPO, listing its shares on the junior NEX Exchange and raising £1.1 million. This gave it a net £1.548 million for investment opportunities. The company is looking to put its cash into businesses which focus on the production, testing & compliance, research & development, commercialisation and sales & marketing of medicinal cannabis in jurisdictions where it has regulatory acceptance, with an initial focus on Canada.

Crucially, Sativa has committed to an independent legal review prior to each investment to verify compliance with the prevailing regulatory environment. Canada, where medical use of marijuana has been legal since 2001, seems a good place to start, with forecasts from Brightfield Group looking for the medicinal cannabis market in Ontario to grow from C$379 million in 2018 to C$2.22 billion by 2021.

Since going public Sativa has announced three notable investment agreements. In April, the company signed an MoU to buy 51% of George Botanicals, a UK-based manufacturer, wholesaler and distributor of wellness CBD products, for c. £0.2 million. CBD, or cannabidiol, is a chemical produced by the cannabis plant and as a food supplement is legal in the UK. George Botanicals has been providing its customers with CBD products since September 2017, including vape pens, balms, E-Liquids, drops and edible gels.

Then in May the company announced a C$0.2 million investment in Canada based pharmaceutical company Veritas Pharma Inc. Veritas focuses on the discovery, product development and commercialisation of effective patented medicinal cannabis therapies which target disease conditions in the areas of chronic pain, senior long-term and palliative care. This deal was followed by a C$0.2 million investment in Toronto-based Rapid Dose Therapeutics Inc, a business which has a patent-pending technology, QuickStrip™, a fast-dissolving strip that is placed

on or under the tongue, or inside the cheek, for the delivery of medicines.

Shares to get high?

Shares in Sativa currently trade at a mid-price of 2.5p on the NEX Exchange, capitalising the business at just over £10 million. That valuation may be well ahead of the net cash position as at the IPO date but reflects the huge growth opportunities in the medicinal cannabis market – analysts at market research firm Technavio forecast the global medical marijuana market to grow at a CAGR of 21.11% during the period 2018-2022.

Overall, I believe the shares provide a unique way to play this exciting growth market, with the firm's investment approach giving it fund-like characteristics in terms of diversification. It is also worth noting that CEO Geremy Thomas owns c. 55% of the company and has a successful track record of building up and selling businesses.

Leonel Calara / Shutterstock.com

"THE INTERNATIONAL OLYMPIC COMMITTEE HAS RECOGNISED THAT COMPETITIVE ESPORTS COULD BE CONSIDERED AS A SPORTING ACTIVITY."

GFINITY

Another part of university life back in the early 2000s was playing computer games until 3 in the morning. Little did I know then that this could have been a future career.

Founded in 2012 and listing on AIM in December 2014 raising £3.5 million, **Gfinity (LON:GFIN)** is one of the world's leading eSports companies. For those not familiar with the subject, eSports are a form of competition which sees players compete against each other on popular video games. While video game competitions have been around pretty much as long as the games themselves, it has only been in the past decade or so that professional competitions have taken off, with players competing for prize money. There has also been a sharp increase in the number of people watching the competitions, mainly via live streams on the internet.

According to analysts at statistics company SuperData, the eSports industry brought in revenues of $1.5 billion in 2017, with it on track to hit $2.3 billion in 2022 if current trends continue. Sponsorship is the biggest source of income, along with media sales, advertising, merchandise and ticketing. Sponsors are targeting growing audience numbers, with an estimated 143 million people being frequent viewers of eSports in 2016, up from 58 million in 2012 and the numbers set to grow to 250 million by 2021 according to market intelligence firm Newzoo. Additionally, the estimated number of occasional viewers are more than double these figures. The sector has become so popular that even the International Olympic Committee has recognised that competitive eSports could be considered as a sporting activity, pointing out that players prepare and train with an intensity which may be comparable to athletes in traditional sports.

Game on

London based Gfinity organises and hosts eSports tournaments, both online and off-line, which are attended by leading international players and teams, in addition to producing industry leading eSports broadcasts. The company's Gfinity Esports Arena at Fulham Broadway showcases regular tournaments, including the flagship Elite series which was launched in 2017, across the full range of competitive games. Beyond its own tournaments Gfinity provides a full service for brands wanting to create their own eSports tournaments and has staged premium events around the globe for leading publishers and brands including Formula 1, Microsoft, Activision, EA, Xbox, Gillette and HP.

Gfinity makes money via a combination of sponsorship, advertising, and broadcast income relating to its own events. It also receives license fees and revenue share from licensing the Gfinity Elite Series format as part of an international roll-out, along with fees from creating and delivering bespoke eSports events for commercial sponsors and game publishers seeking to engage with the eSports community.

The company has had an eventful time so far in 2018, with the year's major event being a £6.7 million fundraise in March, completed at a price of 12p per share. The funds will be used to deliver Seasons 3 and 4 of the Gfinity Elite Series in the UK, to support the launch of Season 1 of Gfinity Elite Series Australia, along with investment in the eSports digital platform, growing the digital community and providing the potential to drive license revenues through the provision of technology to partners.

Earlier in the year Gfinity announced a major agreement with Facebook for the exclusive global online streaming rights for the Gfinity Elite Series, excluding Australia, until the end of 2018, providing a major new customer and significant revenue stream. Prior to this the company completed the acquisition of RealSM, owner of the fan-oriented digital sports media platform, RealSport, for £2.4 million in new Gfinity shares. RealSport has built an online user base of more than half a million active monthly users, with eSports currently accounting for over 40% of all traffic on its website, putting the deal in line with Gfinity's strategy to build a large and engaged digital eSports community.

A sporting chance?

While having built up a good business over the past few years, Gfinity has yet to turn a profit as it remains in investment mode. For the year to June 2017, while revenues rose by 64% to £2.37 million, the pre-tax loss was £5.3 million. This was in line with management expectations, reflecting investment in expanding the executive team, refurbishing the eSports arena, investing in technology and launching the Gfinity Elite Series. More recent results for the six months to December 2017 showed a loss before tax of £7.7 million on revenues up 103% at £1.8 million.

Investors seem to be getting a bit impatient with Gfinity, the shares falling from a peak of 36p in December last year to the current 13.875p. That capitalises the business at £39.7 million. There is no doubt that the valuation looks racy at the present time, especially with profits looking several years away at the earliest. But considering the growth opportunities in the market I believe Gfinity looks worthy of a risky punt. I also note that investor Nigel Wray, who has a certain following, owns 11.19% of the business.

SILENCE THERAPEUTICS

AIM listed **Silence Therapeutics (LON:SLN)** is a biotechnology company operating in an area which has been described as one of the most exciting in drug discovery today – RNA interference (or RNAi). This is a fast growing industry, with analysts at Mordor Intelligence expecting the global market for RNAi technology to grow from $12.56 billion in 2016 to $31.52 billion by 2021, that's a CAGR of 20.19%.

First discovered in the late 1990s, RNA interference is concerned with gene suppression, or "gene silencing", a process which enables the regulation of gene expression - the process whereby information from a gene is used to produce proteins and ribonucleic acid (RNA). RNAi is a naturally occurring process and can be used to selectively suppress the genes which cause certain diseases, thus providing the potential for treatments to be developed.

"RNAI TECHNOLOGY HAS MADE SIGNIFICANT ADVANCES OVER THE PAST DECADE."

RNAi technology has made significant advances over the past decade or so following the 2006 Nobel Prize in Physiology or Medicine being awarded to Andrew Fire and Craig Mello for, "their discovery of RNA interference – gene silencing by double-stranded RNA". The industry looks to be on the verge of having its first drug go to market, with pharma giants Alnylam Pharmaceuticals and Sanofi having reported positive Phase III results for their RNAi drug patisiran last year and looking set to launch later this year pending marketing approval.

Gene geniuses

Broadly, there are two parts to the company's technology – molecules and the delivery system. Silences' focus is on so called short interfering RNA (or siRNA), molecules which carry an "anti-code" into the body and result in the expression of a disease causing gene being inhibited. These are then combined with delivery systems which enhance the molecule's efficiency by directing them to the right part of the body. Silence current focusses on the GalNAc delivery system, a highly efficient, simple and specific delivery approach whereby a sugar molecule (N-Acetylgalactosamine, GalNAc) is conjugated to the siRNA molecule. In recent years GalNAc conjugates have become the main accepted and clinically validated technology for optimised stability, delivery, targeting, specificity and efficacy of RNAi.

The company's current focus is on conditions of the liver where it is looking to develop treatments for conditions with a high unmet need and those where its therapies can make a dramatic difference to patients. Lead candidate SLN124, which is being developed for the treatment of iron overload disorders, will enter clinical development by the end of 2018 and will be Silence's first GalNAc-siRNA candidate to gen-

"AT CURRENT LEVELS I WOULD NOT BE SURPRISED IF THE FIRM WAS ON THE WATCHLIST OF POTENTIAL ACQUIRERS."

erate data in humans. Second programme, SLN226, designed to help patients with alcohol use disorder at high risk of fatal consequences, is on track for a Clinical Trial Authorisation filing by mid-2019, potentially with a partner company.

Important patents

Silence Therapeutics' technology is protected by an extensive patent portfolio, which strengthens its competitive position within the industry and provides opportunities for licensing to third-parties. One such deal is with industry giant Quark Pharmaceuticals under which Silence receives licence payments, milestones and potential royalties for use of its technology. In July 2017 Quark announced positive results of a Phase 2 trial (which used Silence's proprietary chemical modification technology) evaluating the efficacy and safety of an siRNA treatment for the prevention of Acute Kidney Injury in patients at high risk following cardiac surgery.

Perhaps more significantly, in July last year Silence issued a claim in the UK High Courts of Justice (Patents Court) against Alnylam Pharmaceuticals, largely considered to be the market leader in GalNAc technology, for patent infringement. This included the accusation that Alnylam was using Silence's IP on the soon to be approved patisiran drug and three other late stage candidates. This litigation is proceeding towards a trial in the High Court in London which is expected to begin in early December this year. To highlight the potential value to Silence, CEO Ali Mortazavi told The Sunday Times last year that a potential pay out, if the company is successful, could be in the "hundreds of millions of pounds" if the drugs being developed by Alnylam are approved for sale.

Healthy gains to come?

Shares in Silence Therapeutics have slipped from a two year high of 245.5p since October last year to the current 152.25p. That capitalises the company at a shade under £107 million. But with net cash standing at £43 million at the beginning of 2018, the markets are effectively valuing the business at just £64 million. I believe that looks excellent value for a business with a strong IP portfolio, operating in a rapidly growing market. At current levels I would not be surprised if the firm was on the watchlist of potential acquirers – it would not be difficult for a number of big pharma companies to snap up Silence given their vast cash resources. What's more, the possibility of a successful court case later this year provides an additional "bonus ball" for investors.

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 DAVID JONES

FORENSIC FOREX

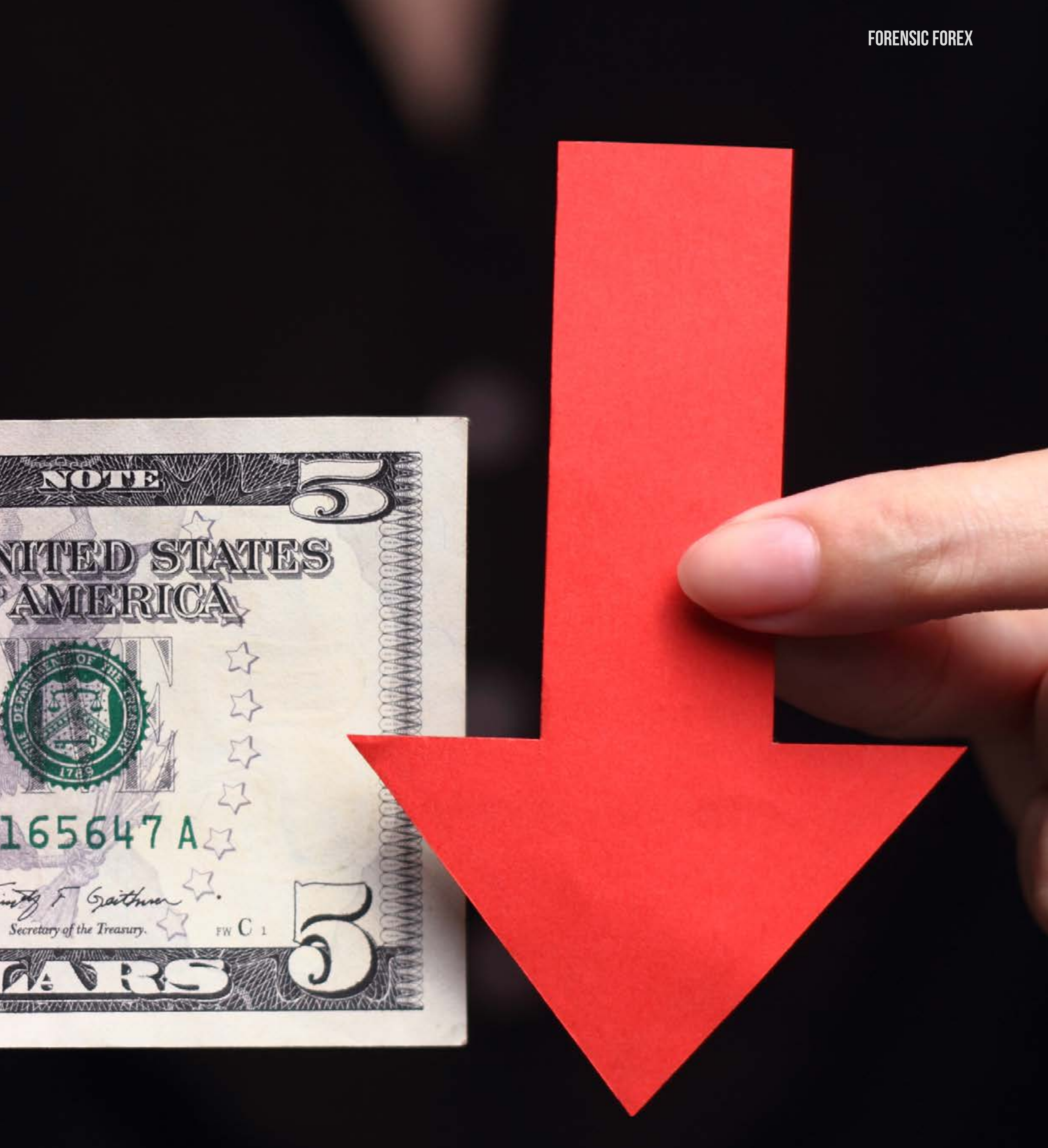
IS EVERYONE TOO PESSIMISTIC ABOUT THE US DOLLAR?

It was around six weeks ago when I decided this was going to be the topic for this month's column. I thought it would be an interesting one as the US dollar was languishing around multi-year lows against a basket of other currencies. Of course, time, tide and markets wait for no man – since then, the US dollar has rallied by more than 5%, which is no mean feat by a currency in such a short amount of time!

Despite this blip higher, I still think the US dollar is an interesting market to watch and possibly profit from for the rest of this year. Usually when talking about forex, most people tend to focus on the short-term manic trading of day traders, clicking away trying to catch the next ten-minute move. But with various Exchange Traded Funds that track the performance of the US dollar, there is no reason why investors can't position themselves for a more longer-term move and that's why I think this is such an interesting market. Here's one I watch: the catchily titled, US-listed Power Shares DB US Dollar Index Bullish Fund (UUP).

2017 – A one-way bet for the dollar

To set the scene, let's wind the clock back to 2017. Last year saw the dollar decline for the first time in five years – and a near-10% drop meant that it was the worst annual performance since 2003. As is often the case in financial commentary, many analysts extrapolated this weakness into their forecasts for 2018, with the likes of Gold-



"LAST YEAR SAW THE DOLLAR DECLINE FOR THE FIRST TIME IN FIVE YEARS – AND A NEAR-10% DROP MEANT THAT IT WAS THE WORST ANNUAL PERFORMANCE SINCE 2003."

man Sachs and UBS expecting further gains by other currencies, such as the euro, to the detriment of the greenback.

This "consensus of opinion" is often the first warning sign. When everyone thinks it is a dead cert that a market will move in one direction, the contrarian investor's ears should start pricking up. It can often mean that everyone has made their "bet" – in this case sold – so there's no one left to sell. The line of least resistance could be in the opposite direction. And if this starts to build a head of steam, those who are positioned the wrong way around can switch sides, accelerating a turnaround.

The effect of interest rates

What is at least partly helping to lift the US dollar is the Federal Reserve's attitude to interest rates. The US central bank has increased rates more often than the other major central banks, and markets are expecting four in total for 2018. Compare and contrast with the UK's policy from the Bank of England. The UK's central bank was widely expected to raise rates in May, but a wobble in inflation data and the economy saw the bank back off and it did not go ahead. This was a disappointment for those bullish on the outlook for the pound – GBP/USD has slid heavily in recent weeks. Of course, currencies do not move in isolation and a sliding pound means a rising dollar, hitting a six-month high during May.

It is a similar story in continental Europe. In April, the European Central Bank (ECB) said that interest rates would stay the same "for an extended period of time". The eurozone economy is still growing – but at a slower rate than before. Central bankers are

understandably continuously paranoid about raising rates and derailing the wider economy. "When in doubt, do nowt" is probably not a phrase on the tip of the tongue of many central bankers – but it does seem to aptly sum up the approach since the financial crisis.

So, interest rates are playing the part – but also currency markets are like any other market, they don't move in one direction forever. Perhaps the US dollar weakness had just got overextended. Here's a long-term chart of euro versus US dollar to help make the case for dollar bulls.

EUR/USD – the last ten years

You don't need to be a dyed-in-the-wool chartist to see a trend here. Back in 2008, the EUR/USD rate was around 1.58 – a euro was worth more than one and a half dollars. By the end of 2016, it was only buying just over one dollar. That strong rally in 2017 is clear to see – but you can also see how it has brought the currency pair back to the longer-term trend. 2017 did see the euro rally stronger – but the theme over the last 10 years has been for a sliding euro – and of course the flip-side of this is a stronger US dollar. Viewed over this sort of time frame, the dollar weakness in 2017 was just a short-term move against the trend – perhaps we are overdue a dollar comeback.

"WHAT IS AT LEAST PARTLY HELPING TO LIFT THE US DOLLAR IS THE FEDERAL RESERVE'S ATTITUDE TO INTEREST RATES."

How to profit as an investor

One obvious way to profit if you believe we are going to see further dollar gains is via some sort of tracking fund, such as the one mentioned above. This could be treated the same way as any other index tracker – for example, allocating a fixed sum on a regular basis to buy into the fund, smoothing out the week-to-week ups-and-downs but trying to profit from an ongoing recovery.

The other way is via a derivative based on the Dollar Index (DXY). This is the index that tracks the dollar against a basket of other currencies. There is a futures contract that can be bought and sold and many spread-betting or contract-for-difference companies also quote it. If you are trading a futures contract, you should not have to pay a daily financing charge, but you must be ready to either exit the contract at expiry – or "roll over" into another month. This is my preferred approach and the rollovers are normally handled automatically.

I think it does all make for an interesting second half of 2018 for the US dollar. My positive view would change if we were to see it break below the lows set earlier this year – or the euro to surge past its previous highs. For now, at least, it does seem as if the pessimistic view for the greenback's fortunes at the beginning of 2018 was somewhat overdone.

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

BONDS IN A DAY

EVERYTHING YOU NEED TO MASTER THE MATHEMATICS THAT DRIVES BONDS

BY STEWART COWLEY

Despite equities being the sexier of the conventional investment asset classes, they play second fiddle to bonds when it comes to total value and amounts traded by investors on a daily basis. The bond markets are in fact much, much larger than stock markets.

According to recent figures, the global bond market has more than tripled in value over the past 15 years. Driven by an explosion in new issues after the plunge in interest rates seen following the financial crisis, it is estimated to now be worth more than $100 trillion. What's more, according to data from industry group SIFMA, around $700 billion in bonds are traded on a daily basis compared to around $200 billion a day for stocks.

While bonds don't get as much attention from investors and the media as equities do, perhaps due to their being perceived as a more boring and lower risk investment, they are an incredibly important part of the global financial system and play a crucial part in most people's portfolios. The fact is that pretty much everyone has exposure to a bond in some form or another, perhaps in the form of their pension or investment fund. But, for the uninitiated, what exactly is a bond?

"THE BOND MARKETS ARE IN FACT MUCH, MUCH LARGER THAN STOCK MARKETS."

Put simply, a bond (also known as a loan, or debt) is an obligation by a borrower to make periodic interest payments to a lender, at a specific rate, for a set amount of time, with the amount borrowed typically repaid at the end of the period. A huge range of bonds exist, from relatively risk-free government bonds, higher yielding corporate bonds, through to a number of more exotic instruments such as peer-to-peer loans, property bonds and convertible loans.

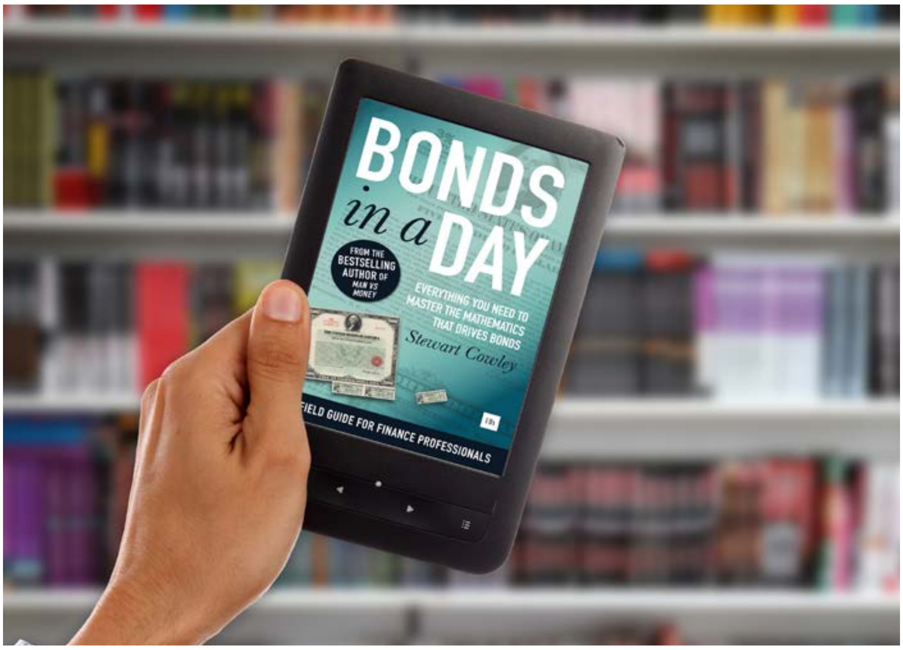
Used correctly, bonds can be a great driver of economic growth, with money flowing from lenders to borrowers who go on to use the funds to grow their businesses and increase prosperity for everyone – a well-functioning lending and borrowing system is indeed a key component of the capitalist method. But borrow or lend too much and, as we saw during the 2008/09 financial crisis, things can go wrong very quickly.

Dealing in debt

Author Stewart Cowley argues that throughout history humans have repeatedly borrowed too much money from one another, leading to periodic financial crises and economic misery. In part, he puts this ongoing behaviour down to our inability to understand the maths which underpins bond transactions. His third book, *Bonds in a Day*, is an attempt to educate investors about the numbers behind the bonds, how to make money from them and, hopefully, how to avoid the crises of the past.

Cowley himself has been working in the financial markets since 1987 and has held the role of Head of Fixed Income at a number of institutions including Invesco and Old Mutual Global. He was one of only a few people to have

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



ever held a triple-A rating by Standard & Poor's and he was also awarded the prestigious "Gold Medal" for long-term investment performance by FE Trustnet. Cowley has written for a number of financial publications, with his two previous books, Man vs Money and Man vs Big Data, being bestsellers.

Following a brief introduction, the second chapter of Bonds in a Day introduces some of the basic concepts of finance which are crucial to how bonds work, including interest rates, the time value of money, compounding and required rates of return. Equity investors with minimal bond knowledge should already know about these concepts, given their importance in any investment. Again, just like equities, financial theory says that the value of an asset is equal to the discounted value of its cashflows, so Cowley also provides some worked examples of bond valuation using discount rates.

Chapter three is where things start getting interesting, with more advanced bond terms starting to be discussed including the all-important yield to maturity – the discount rate at which the sum of all future cash flows from the bond is equal to the current price. Another key bond concept, developed by the son of a cattle breeder, Frederick Macaulay, is duration. This shows how sensitive bond prices are to changes in the yield and can be used by investors to measure how risky their investment could be.

Most of the rest of the book is dedicated to an analysis of the total returns investors can make from bonds. While a simple bond might pay 5% interest per annum, this does not necessarily equal the actual return that investors will make from it. Other factors can affect the total return made including how frequently interest payments are made, whether they are reinvested, at what rate they are invested and if the bond is sold before it matures.

My word is my bond

As the title suggests, *Bonds in Day* is an introductory text to the world of bond mathematics. The author assumes no knowledge on the part of the reader and explains each new concept as it comes up in a simple and informative manner, often mixed in with a few humorous stories. With quite a lot of maths involved, worked examples of the concepts covered are provided along with images of the spreadsheet figures for those who want to play around with the figures. For those not au fait with the finer workings of Excel, don't worry, even the most difficult formulas in the book would be understood by an average 16-year-old.

Bonds can be baffling at times. Yield curves, convexity, modified duration, multi-variable total return analysis and so on are terms and concepts which are hardly in everyday usage, nor are they taught outside of specialist business courses. That's why any investor interested in improving their knowledge should purchase this book, a well written, step by step guide to this important market.

About Richard

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

BY TIM PRICE

THE FINAL WORD

THE TIPPING POINT

The US corporate earnings season for Q1 was impressive. The stock market reaction… not so much. Whereas first quarter earnings for S&P 500 companies typically grew by almost 24% year-on-year, Bespoke Investment points out that the average company reporting earnings saw its share price *fall* by 0.30% on the day of the release. This suggests that investors may now be anticipating an imminent turn in the business cycle. With that may come a downturn for US stocks.

This has already been one of the longest economic expansions in US history. It has also been one of the longest stock market rallies in US history. Notwithstanding the fact that all good things must come to an end, are there other reasons for being at least sceptical about the likely longevity and robustness of further market gains? Well, there's one giant one, and it's called the bond market.

The iron law of investing

One iron law in investing is that if interest rates go up, bond prices go down. This is intuitive, to the extent that most bond instruments carry a fixed interest rate – called a coupon – and therefore if deposit and short-term interest rates rise, those fixed coupon payments become relatively less valuable, so bond prices fall to compensate their investors. (The bond market is nothing if not relentlessly logical.)

But the global bond market, of which that of the US is the largest, also dwarfs the value of all listed stock markets, so what happens to bonds (and especially US Treasury bonds) inevitably matters to other asset markets as well. And there is growing evidence that the US bond market has decisively turned.

Monetary policy by the US Federal Reserve – the US central bank – certainly has. The Fed has been raising its monetary policy target rates since 2015. This reverses a secular trend in (declining) interest rates that goes back to the early 1980s, and which has arguably been one of the main drivers of the global bond and equity rallies of the last several decades. Again, all good things must come to an end. But from a behavioural perspective, note that there is now effectively **nobody** at work in a dealing room who has ever seen western market interest rates rise. Not until now.

The millennial generation may well be in for a shock. The editor of *MoneyWeek* magazine, Merryn Somerset Webb, recently tweeted a photocopy of a mortgage statement from 1990. The principal sum: £35,000. (Which looks, admittedly, trivial today.) Monthly payment: £447.10. (Which doesn't.) Initial rate of interest: 14.75% per annum. (Which certainly doesn't.)

That is not to say that UK mortgage rates are suddenly going to shoot

"THE PRIMARY FACTOR THAT HAS DRIVEN STOCK MARKETS HIGHER AS A SECULAR TREND FOR OVER 30 YEARS HAS NOW GONE INTO REVERSE."

back up into double digits. Rather, investors should be alive to a more insidious prospect – that *the primary factor that has driven stock markets higher as a secular trend for over 30 years has now gone into reverse*.

The US bond market has noticed. Two-year US Treasury notes, which are acutely sensitive to the direction of policy rates, have seen their yields shoot up from just 0.50% or so, two years ago, to 2.50% or over today. (As bond prices fall, their yields rise.) Much more of this, and the stock market will be forced to respond. It is unlikely to do so in any particularly constructive way. Its main asset competitor – the bond market – has suddenly got dramatically cheaper.

The US earnings season, as already stated, was surprisingly strong. As John Authers for the *Financial Times* asks:

Just how close are we to the end of the cycle, and how can we know? This question has overshadowed all others in the past few weeks. It explains why stock markets have failed to put in a rally despite historically good earnings in the US. Much hinges on the answer.

With 417 S&P 500 companies now having reported, the picture for the US is unlikely to change much. Even after accounting for tax, the results are very good, and surprisingly so….

To be clear, these were not just good results, but surprisingly good. Wall Street had known about the tax cut for months at the time that it published the final forecasts for the first quarter, and yet the results still came in far better than expected….

Authers speculates that the top of the market cycle could have arrived late in 2017 as President Trump's tax bill was passed, and US earnings multiples peaked. There is a case that exuberance in the stock market, as demonstrated by high price/earnings (p/e) multiples, put in a high at pretty much exactly the same time as the price of bitcoin did, just before Christmas.

Either way, time, as always, will tell.

"THERE IS NOW EFFECTIVELY *NOBODY* AT WORK IN A DEALING ROOM WHO HAS EVER SEEN WESTERN MARKET INTEREST RATES RISE."

House of cards

Other reasons for mild (or not so mild) concern are largely anecdotal. One of them has been the acute focus of market interest in the so-called FAANG family of tech and internet stocks that have driven all else before them. Tesla, admittedly, is not a member of the original FAANGs, but as a high concept glamour stock it is something of a fellow traveller. And in early May we had an object lesson in its owner's casual disregard for shareholder representation.

Tesla's Q4 2017 conference call for investors, held on May 3rd, was nothing if not lively. Toni Sacconaghi of the brokerage firm Bernstein had just asked an entirely legitimate question about the company's capital spending when CEO Elon Musk cut in:

Excuse me. Next. Next. Next. Boring bone-


Willy Barton / Shutterstock.com

head questions are not cool. Next.

No sooner had another analyst raised a question than Mr Musk interjected again:

We're going to go to YouTube. Sorry, these questions are so dry. They're killing me.

The conference call then moved, bizarrely, to some questions from a blogger called Galileo Russell hosted via his YouTube channel.

Unfortunately for Mr Musk, there is a somewhat awkward precedent for his conference call *faux pas* (which you can listen to, here).

In April 2001, on a conference call for then glamour stock Enron, Richard Grubman of Highfields Capital asked (quite legitimately) why the company was the only financial services business that was unable to provide shareholders with either a balance sheet or a cash flow statement with its earnings. Enron CEO Jeff Skilling replied as follows:

You, you, you… Well, uh… thank you very much. We appreciate it.

Before terminating the call, Skilling made one final vocal outpouring. He called Grubman an a**hole. (You can hear that particular shining gem of public relations here.) Within a matter of months, Enron was bankrupt, and its stock was worthless. Baiting Wall Street analysts may be fun, but it may also highlight that your cash-burning concept business is a house of cards just waiting for its share price to collapse down to its intrinsic value of zero.

But compared to the giant that is the bond market, all tech stocks combined are puny pixies.

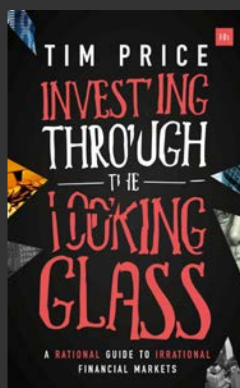
The reckoning

One of the reasons our current situation is so precarious is because of that long, effortless bull market in interest rates and inflation. It has conditioned an entire generation of investors, and perhaps more than one, to believe that bonds are safe havens, the perfect complement to a portfolio of otherwise 'risky' stocks. But after years of monetary interference from governments and their agents, the central banks, most bond prices have become entirely decoupled from any underlying market reality.

Bonds are, by and large, so outrageously overpriced – and dependent on sustained deflation to justify their current valuations – that they now represent the closest thing we will ever see to return-free risk. This is doubly awkward given the extent to which they form a significant share of the assets held by pension schemes and individual investors. As and when we see a true bond market correction, the outcome for many investors who have outstayed their welcome at the interest rate party will make for a grim reckoning.

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'.



JUNE 2018

INVESTOR EVENTS DIARY

WEDNESDAY, 6 JUNE

Event:	SR Live
Organiser:	SyndicateRoom
Time:	12:30
Place:	Webinar
Link for tickets:	https://www.syndicateroom.com/events/sr-live

MONDAY, 11 JUNE

Event:	Mayor of London's TechInvest
Organiser:	UKBAA and Mayor of London
Time:	16:00-21:00
Place:	41 Luke Street, London EC2A 4DP
Link for tickets:	https://form.jotform.com/80444551843962

TUESDAY, 12 JUNE

Event:	Fintech North Liverpool 2018
Organiser:	Fintech North
Time:	08:30-16:30
Place:	ECL Liverpool, Kings Dock, Liverpool L3 4FP
Link for tickets:	https://www.eventbrite.co.uk/e/fintech-north-liverpool-2018-tickets-42988740480

WEDNESDAY, 13 JUNE

Event:	SR Live
Organiser:	SyndicateRoom
Time:	12:30
Place:	Webinar
Link for tickets:	https://www.syndicateroom.com/events/sr-live

THURSDAY, 14 JUNE

Event:	Small Cap Awards 2018
Organiser:	Small Cap Network and NEX Exchange
Time:	18:30
Place:	The Montcalm Hotel, 2 Wallenberg Place, London W1H 7TN

WEDNESDAY, 20 JUNE

Event:	SR Live
Organiser:	SyndicateRoom
Time:	12:30
Place:	Webinar
Link for tickets:	https://www.syndicateroom.com/events/sr-live

TUESDAY, 19 JUNE

Event:	UK Angel Investment Summit and Awards
Organiser:	UKBAA
Time:	10:00-23:00
Place:	Liverpool Cathedral
Link for tickets:	https://www.eventbrite.co.uk/e/ukbaa-global-investment-summit-awards-2018-tickets-43568925830

WEDNESDAY, 27 JUNE

Event:	SR Live
Organiser:	SyndicateRoom
Time:	12:30
Place:	Webinar
Link for tickets:	https://www.syndicateroom.com/events/sr-live

MARKETS IN FOCUS

MAY 2018

GLOBAL EQUITIES

Index	Last Month %	YTD%	Proximity to 52w High*
NASDAQ 100	5.5	10.6	
FTSE 100	2.2	0.2	
S&P 500	2.2	2.3	
Dow Jones	1.0	-0.3	
S&P/ASX 200	0.5	-1.2	
DAX Xetra	-0.1	-1.5	
Russian TSI	-0.1	1.2	
Hang Seng	-1.1	1.9	
Nikkei 225	-1.2	-2.6	
Euronext 100	-1.4	2.6	
CAC 40	-2.2	2.9	
IBEX 35	-5.2	-5.8	
Bovespa	-11.0	0.5	

COMMODITIES

Commodity	Last Month %	YTD%	Proximity to 52w High*
Cotton	11.0	23.7	
Natural Gas	6.5	-0.1	
Sugar (No. 11)	6.1	-6.4	
Crude oil (Brent)	4.1	16.2	
Palladium	2.4	-7.5	
Coffee	0.7	2.7	
Silver	0.6	-4.1	
Platinum	0.4	-2.3	
Copper	0.2	-6.9	
Gold	-0.9	-0.4	
Iron Ore	-1.2	-4.7	
Crude oil (Light Sweet)	-2.1	11.0	
Cocoa	-11.0	35.7	

FOREX

Pair/Cross	Last Month %	YTD%	Proximity to 52w High*
USD/CAD	0.9	3.0	
AUD/USD	0.4	-3.2	
EUR/GBP	0.3	-1.6	
USD/JPY	-0.5	-2.8	
USD/CHF	-0.6	1.4	
EUR/USD	-3.2	-2.7	
GBP/USD	-3.5	-1.1	
EUR/JPY	-3.7	-5.4	
EUR/CHF	-3.8	-1.4	
GBP/AUD	-3.9	2.2	

CENTRAL BANKS - RATES & MEETINGS

Central Bank	Key Rate	Next	After
BOE	0.50%	Jun 21	Aug 02
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%	Jul 11	Sep 05
RBA	1.50%	Jun 05	Jul 03
RBNZ	1.75%	Jun 28	Aug 09
BOS	-0.50%	Jul 02	Sep 05
BON	0.50%	Jun 21	Aug 16

FTSE 350 TOP

Sector	Last Month %	YTD%	Proximity to 52w High*
Ocado Group PLC	67.0	120.0	
ZPG PLC	36.0	47.7	
Paddy Power Betfair PLC	27.0	2.4	
IWG PLC	26.0	20.6	
Virgin Money H. UK PLC	23.0	20.7	

FTSE 350 BOTTOM

Sector	Last Month %	YTD%	Proximity to 52w High*
Nostrum Oil & Gas PLC	-29.0	-33.3	
Hansteen Holdings PLC	-20.0	-25.9	
FirstGroup PLC	-20.0	-13.3	
Superdry PLC	-18.0	-36.3	
Centamin PLC	-18.0	-20.4	

FTSE 350 SECTORS TOP

Sector	Last Month %	YTD%	Proximity to 52w High*
Leisure Goods	19.0	31.9	
Oil Equip, Serv & Dist	11.0	11.9	
Support Services	8.3	5.4	
Food & Drug Retailers	8.2	22.9	
Elect & Electrical Equip	7.9	8.8	

FTSE 350 SECTORS BOTTOM

Sector	Last Month %	YTD%	Proximity to 52w High*
Fixed Line Telecom	-17.0	-23.8	
Mobile Telecom	-9.1	-17.1	
Industrial Transportation	-5.2	0.5	
Automobiles & Parts	-3.0	41.2	
Life Insurance	-2.5	-1.2