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MAGAZINE

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ETORO

GRABBING THE BULL BY THE HORNS

PLUS...

CRYPTOCURRENCY: THE NEXT PHASE

THE BITCOIN BUBBLE WAS JUST THE BEGINNING...

SUPERSTAR FUND MANAGERS

CAN THEY REALLY OUTPERFORM CONSISTENTLY?

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UK STOCKS MAKING THE GRADE IN TERRY SMITH'S NEW TRUST

BUY BRITISH?

FIDELITY'S TOM STEVENSON ON 'CHEAP' UK EQUITIES

WELCOME

Dear Reader,

Welcome to another exciting issue of Master Investor Magazine!

As investors we're always looking for a better deal, so with that in mind, this month's cover feature goes to a company with a very interesting proposition. There are a lot of trading platforms out there, but few are as innovative as eToro. Having built a very sizeable following through pioneering 'social' trading and cryptocurrencies, the company is now looking to shake up the UK equity space and dramatically reduce costs for investors. You can read more about this in my interview on page 10.

Speaking of cryptocurrencies, Victor Hill reckons the bitcoin bubble is just the beginning of the story for this exciting new technology (see page 14). The technology which makes cryptocurrency possible – blockchain – is still generating huge interest in the world of tech. It is quite possible that second-generation cryptocurrencies will soon be everywhere we look, argues Victor.

Meanwhile, if you're invested in one of the funds run by a 'star' fund manager, then check out Nick Sudbury's article on page 56, where he investigates whether or not star managers can outperform over the long term. One such star manager is Terry Smith, who recently launched his Smithson Investment Trust, focused on investing in global mid-caps. Andrew Latto looks at the six UK stocks in the Smithson portfolio on page 76.

Last month I suggested that UK stocks could be worth a look given how out of favour they are versus the rest of the developed world markets. In the last of our cover stories, Fidelity's Tom Stevenson seems to concur. Turn to page 38 to see how you can take advantage of some of the cheapest valuations for UK stocks in living memory.

Last but not least, I'm looking forward to meeting lots of readers at the Master Investor Show on Saturday 6th April. If you've not yet registered to attend, please do so soon as time is running out fast. You can still secure a complimentary ticket using the discount code M419 – just use the code when checking out here.

I wish you all the best of luck in the month ahead.

Best regards,

James Faulkner
Editor

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BY JIM MELLON

MELLON ON THE MARKETS

I'm writing this sitting in an enormous mall in Dubai (again!) and thinking about what I am going to talk about at the upcoming Master Investor Show – one where the omens are good for a record turnout. This particular shopping mall has a ski slope, and it reminds me of the snow that characterized last year's show. (Praying for no repetition!)

On the surface, there hasn't been much movement in major markets in the past year (with the exception of China, which has been motoring), but there has been furious paddling under the unusually calm waters.

In the US, corporate buybacks have more or less single-handedly maintained some vague momentum for equities – though overall, American markets are barely up. A slowing of the rate of quantitative easing by a Fed rattled by emerging signs of economic softness has also contributed to modest buoyancy, as has the fact that valuations have become more moderate simply as a result of earnings growth.

In Europe, a panicking central bank in Frankfurt has read the ominous runes of recession in countries such as Italy, France and even Germany, and hit the switches on the printing presses once again. This has led to a good bounce in European equity markets in recent months, one which has probably run its course given anaemic earnings and the still considerable problems of the eurozone. It has also reemphasized the Japanification of the eurozone; endless amounts of "free" money have imperilled the banking system and rendered growth sporadic and fragile.

The announcement this past weekend that Deutsche Bank is likely to merge with Commerzbank is an indication of just that. These two banks,

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"AS THE WORLD MOVES FASTER, SO DOES THE CYCLE OF CREATIVE DESTRUCTION."

once behemoths, are also-ran and really kaput, and their combination results in nothing more than a higher risk concentration for the German government when it has to bail them out. This is a bit like hooking two broken locomotives together and hoping for miraculous traction.

"THIS IS A BIT LIKE HOOKING TWO BROKEN LOCOMOTIVES TOGETHER AND HOPING FOR MIRACULOUS TRACTION."

Europe's banks overall (excluding the UK) are still broken – indices of their combined share prices are down by more than 90 per cent in twenty years – and will likely need further recapitalisation.

Weathering the blitzkrieg

In the meantime, the UK economy has weathered a blitzkrieg of hostile verbiage – commentary which has attempted to talk it into self-prophesying doom – and has weathered it well.

Ticket Offer

Meet me and the rest of the team behind Master Investor Magazine on 6th April – just use the discount code MELLON to claim your complimentary ticket here.

It has also borne up against a Brexit negotiation of apparently enormous incompetence, and yet here we are, with modest growth, improved public finances and a City still sitting on its golden perch. And the pound – highly tipped by me in recent months – has risen to a two-year high against the euro in recent weeks and looks poised for further gains.

I do think that UK shares look attractive at the moment and I will highlight some of them in my talk at Master Investor. The country is "cheap" and that's why new money, in particular from Asia, is beginning to flood in. The UK is still by far the biggest recipient of Foreign Direct Investment (FDI) in Europe, and I bet it will remain so for the next decade at least.

Whatever happens with Brexit, an imaginative government (chance should be a fine thing!) should now be flattening taxes and instituting a bonfire of the regulations that cause the sludge that so many private businesses have to go through before they can generate the wealth the nation so urgently needs.

Time for rotation

Because the Fed, under newish Chairman Powell, has moved to a dovish stance, or at least a milder one, emerging markets have latterly been doing quite well. And deservedly so, as they were very cheap and in much better financial shape than they were in the last crisis.

But they have moved up sharply, and that is why I think that it's time for rotation. I have been a bull of China, and while it's done very well recently, now may be the time to take profits, and to rotate into India, where Mr. Modi looks set to retain power. The economic giant that lies somewhere

"THE SEA OF LIQUIDITY THAT HAS BEEN CONJURED UP TO AVOID ECONOMIC COLLAPSE HAS ALSO LED TO THE RUINOUS MISALLOCATION OF CAPITAL ALMOST EVERYWHERE."

in the heart of the country will surely emerge to astound us. I will have some Indian recommendations at the Master Investor show on April 6th for investors to consider.

In my talk, I will be dissecting some of the main themes that preoccupy our portfolio team, in terms of opportunity for both gain and loss. As the world moves faster, so does the cycle of creative destruction, and it will be my pleasure (in the case of Facebook) to describe how such tectonic plates will alter the investment landscape in coming years.

Although central banks are keeping things afloat through a persistent and aggressive use of monetary tools, the economic outlook for the world remains murky. This doesn't mean that a recession is imminent – it probably isn't, with the exception of the eurozone. It just means that the sea of liquidity that has been conjured up to avoid economic collapse has also led to the ruinous misallocation of capital almost everywhere.

An exciting – but dangerous – time to be alive

Zombie companies have been preserved in financial aspic; banks labour under the misery of negative interest rates and still high non-performing loans; and populists, of the left in particular, trumpet a rising inequality (not verifiable by the facts). This is why

Debby Wong / Shutterstock.com

dyed-in-the-wool Marxists in Britain's Labour party were thought just a little while back to be a possible government in waiting. That won't happen, in my opinion, but the fact it was even considered possibly says a lot about the easy money age we live in.

The fact of the matter is that real wages are rising, economies are generally OK (major exceptions being China, which is still a worry, the eurozone, and of course the wrecked outliers like Venezuela) and stocks are better value than they were, particularly against bonds.

In order of preference, I would buy gold and silver and all things associated with precious metals; then Japan (still got 25,000 as a target on the Nikkei, and the yen is way undervalued); then UK stocks on a selective basis; then India. I would short darling stocks which are clearly overvalued (more on that at the show) and most bonds.

There are meta themes that are important for investors to understand and I will try to elucidate on three or four in my talk. This is an exciting time to be alive, but it's also a dangerous one, and the reconciliation of the twin needs of thinking ahead and of generating enough of a return to live comfortably in the meantime, before the golden harvest of long-term thinking is reaped, will be the goal of my advice.

See you at the Master Investor Show!

Jim Mellon

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 JAMES FAULKNER

GRABBING THE BULL BY THE HORNS

AN INTERVIEW WITH IQBAL V. GANDHAM OF ETORO

There are a lot of trading platforms out there but few are as innovative as eToro. Having built a very sizeable following through pioneering 'social' trading and cryptoassets, the company is now looking to shake up the UK equity space. Our editor James Faulkner caught up with Iqbal v. Gandham, eToro's UK Managing Director, to find out more…

James Faulkner: We're all familiar with social networks such as Facebook and LinkedIn, but readers may not be familiar with eToro, which has taken the social network concept to the investment world. Please explain to our readers what eToro is all about.

Iqbal v. Gandham: *eToro was founded in 2007 with the vision of opening up the global markets for everyone to trade and invest in a simple and transparent way. We wanted eToro to become a community where people could share their ideas. We built the platform as a social network for traders and investors, where they can execute trades, but also see what others are doing and talk to each other.*

While we have come a long way since 2007, this social or community ethos still holds true. We now have a community of over 10 million registered users from over 140 countries. Today, eToro acts as a bridge between the old world of investing and the new, helping investors navigate and benefit from the transition of assets to the blockchain. eToro is the only place where investors can hold traditional assets such as stocks or commodities alongside 'new' assets such as bitcoin. We believe that in the future all assets will be tokenized and that crypto is just the first step on this journey.

JF: How does the performance of copy traders compare to those traders who perform their investing manually? Is there any research available on this?

IG: *We invented copy trading, or at least brought it to the masses, and 'copy' remains a key feature of our multi-asset platform today. Around half of our clients use it, both in terms of following others, or investing in our growing range of CopyPortfolios.*

For those who lack the time or experience, our CopyTrader technology enables clients to replicate another trader's portfolio and trading activity automatically so that they benefit from others' in-depth knowledge and investment expertise.

Investors can use our CopyPortfolios to access unique investment portfolios. Top Trader CopyPortfolios comprise the strategies of the best performing traders on eToro. Market CopyPortfolios bundle asset classes together under one chosen market strategy; and Partner CopyPortfolios offer portfolios from third party experts.

Our data suggests that social trading and investing works. Out of 124 million copied trades on eToro 73% closed in profit.

JF: For those of your clients who manage to become a "Popular Investor", what additional financial benefits can they enjoy? Can you provide some examples of individuals who have achieved this and how they did it?

"WE'RE ON A MISSION TO GET BRITAIN INVESTING."

IG: *eToro's business model is based on its clients' financial success, so when they succeed – we succeed. That's why we encourage our top traders to share their knowledge and reward them when more people copy them. The Popular Investor programme allows users to earn directly from eToro when their investments are copied, and allows others to gain from their wisdom, experience and success.*

The programme is built from 4 levels (Cadet – Elite) and each level has its own benefits and requirements. Elite Popular Investors can earn up to 2% of their annual assets under management (AUM) i.e. the total amount of money copying them, and so in a month where a PI has a $1m average AUM, they would earn $1,666. The payment level is determined by the average number of daily verified copiers throughout each month and the minimum account equity throughout the month.

Jay Smith, 30, is based in Basingstoke and goes by the name of 'jaynemesis' on eToro. Having dropped out of school at 13, he focused on the things he was passionate about: economics, politics, and eSports. He joined eToro in 2014 as he saw it as a trustworthy place he could trade bitcoin alongside traditional investments. The social features were also very appealing. Jay keeps in touch with his copiers via his livestream on Twitch and via chat. He highlights the financial benefits of becoming a PI which has allowed him to leave his job at eSports to trade full time.

Lena Birse is in her 40s and has the bulk of her eToro portfolio in tech firms as well as software company Microsoft and payment providers Mastercard, Visa and PayPal. Lena started investing full time about six years ago when she and her husband sold their renewable energy company and were left with a cash lump sum. She now has close to 1,000 followers on the eToro platform, collectively representing more than £1m of invested cash.

JF: You currently absorb the stamp duty on all UK shares, which already makes you one of the cheapest places to buy and sell stocks in the UK. However, you recently announced plans to go one step further. Can you tell us more?

About Iqbal v. Gandham, eToro UK Managing Director

Iqbal manages eToro's business activities in the UK and is Chair of CryptoUK, the first self-regulatory trade association for the UK cryptoasset industry. Prior to eToro, he held senior positions as a CMO and CTO, in addition to founding several companies. He co-founded India's largest web-hosting business, launched a telecoms start-up and then progressed to cloud computing. Following this, he joined a fledgling start-up called Nutmeg as CMO and helped shape it into the UK's largest robo-advisor.

IG: *We're on a mission to get Britain investing. First step, make it far more affordable. If I'm a first time investor wanting to buy a few stocks, how can you justify charging me 3% to do so? Either the new investor baulks at the outset, or is stung later down the line when they discover the cost. It's an instant barrier to investing. So we're making it simple – no transaction fees, no mark-up on spreads, no custody charge, and no stamp duty.*

As an industry we need to get people excited about investing. Price is a great starting point but alone is not enough. We need to show people how they can invest in their passions and the brands they care about. For most investors the FTSE100 means absolutely nothing.

Zero commission for UK investors buying and selling stocks on eToro will go live soon.

JF: One of the positives of crypto is that it has broadened the appeal of investing, especially among young millennials. Meanwhile, you have spoken out against the concentration of wealth in the hands of a tiny elite of financiers and asset managers. Is it your hope that eToro will 'democratise' investing and bring capitalism to the masses?

IG: *eToro data shows that the crypto boom has helped to create a new generation of investors. The majority (73 percent) of new investors joining eToro in 2017 and 2018 purchased crypto. Of these investors, more than one in ten (11 percent) have since gone on to invest in other assets including stocks, commodities and forex alongside their crypto investment. The move to invest in other financial instruments alongside crypto is particularly prominent in the younger generation, with nearly half (44 percent) of all those diversifying aged between 25 and 34.*

Globally, the most popular asset class for crypto investors to try next was stocks, with one-in-three (33%) of these investors doing so. 31 percent chose to

About eToro

eToro empowers people to invest on their own terms. The platform enables people to invest in the assets they want, from stocks and commodities through to cryptoassets. eToro is a global community of more than ten million registered users who share their investment strategies; and anyone can follow the approaches of those who have been the most successful. Due to the simplicity of the platform users can easily buy, hold and sell assets, monitor their portfolio in real time, and transact whenever they want.

"WE BELIEVE THAT WE WILL SEE THE GREATEST TRANSFER OF WEALTH EVER ONTO THE BLOCKCHAIN."

copy the activities of other eToro users as their second action and 23 percent invested in commodities.

Every day we read another story about how ordinary people, especially millennials, are not investing enough. Yet crypto shows us that if you can capture their interest then people will invest. Regardless of whether you believe in the long-term opportunity offered by crypto, it is worth us looking at what we can learn from these crypto investors, especially as we've seen that once they have dipped their toes into investing, some were then prepared to diversify.

As an industry we need to rise to the challenge and work harder to engage consumers. For too long investing has been seen as the preserve of the wealthy and/or something that is too complicated for the average man on the street. Crypto changed that. We now have an opportunity to show those people whose first experience of investing was crypto the other opportunities that exist. By making sure people can access all the assets they want to own in one place, we can encourage a new generation of investors to take more control of growing their wealth with a diversified portfolio of investments, including crypto.

eToro was founded 11 years ago with the vision of opening up traditional markets to all investors. Today we want to go one step further and also unlock the tokenized world.

The world has heard about the potential for blockchain to revolutionize global finance and we're beginning to see the industry accelerate adoption. We believe that we will see the greatest transfer of wealth ever onto the blockchain.

JF: **Your community has grown incredibly quickly over the past few years. You already have over 10 million registered users. For those who are still not convinced by the "social trading" model, is there anything you can say that might convince them to give eToro a try?**

IG: *We believe that investors are looking for three things: 1) access to the assets they want; 2) knowledge and insight; and 3) someone to make the process easy. Unlike traditional providers, eToro offers all three and at a price point which makes investing accessible to everyone. Joining eToro gives investors of all types access to the assets they want today from commodities and stocks, through to cryptoassets. They also benefit from being part of a global community of more than 10 million registered users who share their investment strategies and insights and anyone can follow the approaches of those who have been the most successful. It is simple and easy to set up an account, then buy, hold and sell assets. For those new to investing, the community aspect of eToro's platform and the educational resources introduce users to the risk profiles of the different asset classes and the types of returns to expect. Our community is alive 24/7 to answer questions and share insight.*

JF: **Given that eToro has been an early advocate of investing themes such as crypto and cannabis, what are the next big investing themes that our readers should be aware of?**

IG: *We are convinced that crypto and the blockchain technology that underpins it will have a huge impact on global finance and it is therefore a major focus for our firm. Blockchain has the potential to revolutionalise finance. We are already seeing the tokenization of assets – crypto is one example but we are also seeing tokenized gold and art. Just as eToro has opened up traditional markets to investors, we want to do the same in a tokenized world.*

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

CRYPTOCURRENCY: THE NEXT PHASE

In December 2017 I wrote a piece for this magazine entitled *The Future of Money*. I explained that money is just a conceptual construction of the human mind. It does not exist in nature; animals have no notion of it; even humans managed to live for countless millennia without it. If people agree to use cowrie shells as money, then cowrie shells *are* money.

So the world of monetary economics is like *Alice Through the Looking-Glass*. '*When I use a word*', Humpty Dumpty said, in rather a scornful tone, '*it means just what I choose it to mean — neither more nor less*[i]'. Money is whatever people regard as money – even if it only exists on computer hard drives.

That piece came out at the apogee of the bitcoin boom. I was partly trying to explain how the new asset class of digital money – cryptocurrency – had come about. When bitcoin plunged in value in early 2018, many of us thought that was that. Cryptocurrency – always a dubious asset class – had hyped itself out. But it turns out that the bitcoin bubble was just the beginning of the story...

Cryptocurrency did not go away, even though it became less attractive for speculators. And now social media networks – in particular Facebook (NASDAQ:FB), which also owns WhatsApp and Instagram – and payment platforms like PayPal (NASDAQ:PYPL) are working out how to use digital currency to effect secure transactions between their users and subscribers.

The technology which makes cryptocurrency possible – blockchain – is still generating huge interest in the world of tech. It is quite possible that second-generation cryptocurrencies will soon be everywhere we look.

“IBM, MICROSOFT AND JP MORGAN CHASE HAVE ALL ANNOUNCED THAT THEY ARE DEVELOPING BLOCKCHAIN TECHNOLOGY FOR THEIR OWN ENDS.”

Bitcoin: triumph and tragedy

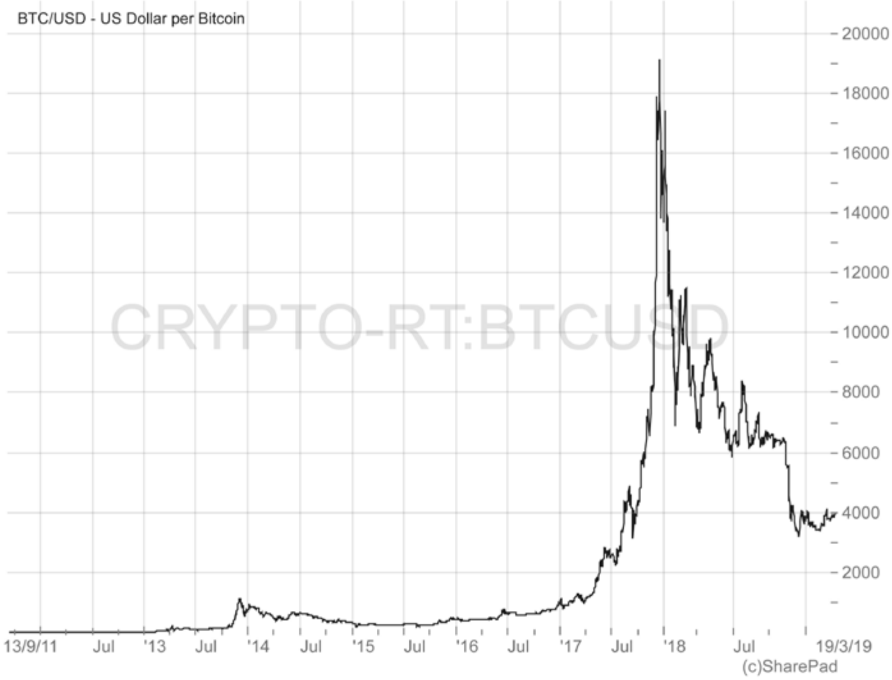
On 18 August 2008 somebody registered the domain name bitcoin.org. On 31 October 2008 a link to a paper authored by a certain Satoshi Nakamoto entitled *Bitcoin: A Peer-to-Peer Electronic Cash System* was posted to a cryptography website. Supposedly, Nakamoto then released the software behind bitcoin as open-source code (meaning that anybody could develop it) in January 2009. But was it the mysterious Nakamoto, whose identity remains one of the great mysteries of our time?

After bitcoin was launched it took seven years or so for it to attract attention outside the community of cyber-geeks who understood the sheer originality of the blockchain software technology on which the digital currency relied. Blockchain is a *decentralised digital public ledger* by means of which the entire history of each "coin" is recorded – not in one place but spread across hundreds of thousands of computers. Consequently, the supply of bitcoin (or other cryptocurrency) is limited; and every user can be confident that the provenance of any digital coin they buy has been verified.

In time, of course, the speculators piled in, viewing bitcoin as a type of digital gold. In January 2010 one bitcoin traded for $0.06 and it didn't go much above that for years. But around mid-2015 the world's leading digital currency began to gain value, gathering momentum throughout 2016. By 01 January 2018 each bitcoin was worth $19,498.63. Early enthusiasts – many of whom were by no means professional investors – had become, nominally at least, multi-millionaires.

I was one of those who urged caution. I argued in these pages in November 2017 that, while bitcoin (like other digital currencies) was *a medium of exchange* it was not *a store of value* and therefore had no intrinsic worth. In the event, a collapse followed the spike and many bitcoin fortunes (in dollar terms) were lost. In the first two months of 2019 the value of bitcoin has been hovering around the $4,000 mark. In terms of the total value of all bitcoin in circulation, that fell from an estimated $230.9 billion in January 2018 to $66.6 billion by the end of December last year.

Some said bitcoin was the future; others that it was a fraud. Either way, bit-



Regulation

Arguably, the real key to the future success of cryptocurrency is regulation. Most major financial centres have yet to approve cryptocurrency as they regard the technology for "mining" and storing it as still unproven.

In July 2017 the Securities and Exchange Commission (SEC) in the United States announced that laws governing the trading of securities may also apply to some cryptocurrency transactions – but it failed to provide concrete guidelines. At about the same time, China banned outright Initial Coin Offerings (ICOs) by means of which software start-ups were raising finance in promised digital currency to fund their expansion. Several Asian countries, including China and South Korea, also outlawed cryptocurrency exchanges (where investors can convert cryptocurrency into "real" fiat currency).

When digital entrepreneurs launch so-called Initial Coin Offerings (ICOs) they sell their own virtual currencies in order to raise money for software they plan to develop. In return for real money, investors receive digital tokens. Regulators worry that this novel fund-raising method allows start-ups to flout investor protection rules. Financial authorities around the world have been promising to crack down on ICOs, which came out of nowhere in 2017 to become a popular way for start-ups to raise tens of millions of dollars. Interestingly the Swiss authorities, thus far, have proved accommodating – Ethereum was launched there via an ICO in 2014.

One reason advanced for tighter regulation is the fear of money-laundering. But proponents of cryptocurrency argue that the role of crypto in the criminal underworld has been exaggerated. In 2014 the Common Reporting Standard (CRS) was adopted by most of the world's central banks (though not the Federal Reserve which had first instigated it). Under the CRS the Chinese authorities, for example, could demand that the Hong Kong authorities hand over information on any Chinese citizen residing in Hong Kong – except for property information. For this reason, property, rather than cryptocurrency is still the preferred way for people with guilty consciences to launder money.

The Swiss canton of Zug and the US state of Wyoming have both passed laws to accelerate the trade in cryptocurrency. In Zug you can pay parking fines in bitcoin. The Wyoming law gives cryptocurrency a distinct legal status alongside cash, bonds and property.

Those who advocate the wider adoption of cryptocurrency argue that it makes perfect sense for a digital, global economy to have a digital, global means of exchange. Once a major regulator defines a workable regulatory regime for trading cryptocurrency, others will probably follow for fear of losing out.

coin and its imitators were branded as volatile and ultimately unregulated. For all that, a number of prominent hedge funds have continued to show interest.

IBM (NYSE:IBM), Microsoft (NASDAQ:MSFT) and **JP Morgan Chase (NYSE:JPM)** have all announced that they are developing blockchain technology for their own ends. Jamie Dimon, CEO of JP Morgan, in October 2017, called bitcoin "a fraud". Yet in February this year – guess what – JP Morgan announced the first bank-backed digital token, the *JPM Coin*[ii]. The JPM Coin, the value of which is linked to the US dollar, will be used to settle transactions instantaneously between its largest clients within its settlements system.

How cryptocurrency could change the world

During the bitcoin bubble the global economic establishment – from George Soros to Mark Carney – told us, perhaps with some justification, that bitcoin was a serious threat to financial stability and that sensible investors should stay away. But, for all the frenzied speculation throughout the second half of 2017, we need to stand back and ask what the world would be like if – just as when cowrie shells gave way to metal coins – the nature of money were fundamentally to change.

"THE FACT IS THAT MOST MAJOR BANKS HAVE STARTED TO TRADE CRYPTOCURRENCIES TO SOME DEGREE AND BITCOIN IS ACCEPTED QUITE WIDELY BY RETAILERS AROUND THE WORLD."

The fact is that most major banks have started to trade cryptocurrencies to some degree and bitcoin is accepted quite widely by retailers around the world. It is difficult to get information about the number and value of total transactions conducted in digital currency, but, anecdotally, they are still growing.

If the use of cryptocurrency were to become truly widespread, then there would be massive implications for the economy. Firstly, central banks would no longer be able to control the money supply as they do for conventional "fiat" currencies by setting interest rates and carrying out interventions in

"IF THE USE OF CRYPTOCURRENCY WERE TO BECOME TRULY WIDESPREAD, THEN THERE WOULD BE MASSIVE IMPLICATIONS FOR THE ECONOMY."

the money markets (such as through quantitative easing (QE)). You can't just print more bitcoin when the whim takes you, because the supply is fixed. Second, bitcoin – or another crypto-currency – could become a truly global form of payment which would render central banks irrelevant as people dump traditional fiat money in favour of the most popular cryptocurrency.

The loss of power by central banks over monetary policy might be mirrored by a loss of control over fiscal policy by governments. Up until now, governments collect taxes in their own fiat currency and borrow in the bond markets (the gilts market in the UK) to make up any shortfall. If most people were paid in digital currency, then the state would have to levy taxes in that currency. But would governments be able to borrow in cryptocurrency to cover the fiscal deficit? The answer to that question is unclear.

Political repercussions

The rise of cryptocurrency will probably also impact our political institutions. Some crypto enthusiasts like Vijay Boyapati have proposed[iii] a new form of *delegative* democracy (instead of *representative* democracy) whereby a voter could choose different representatives for different issues (e.g. transport or education) and change them at any time. Proponents of delegative democracy believe that private, decentralised solutions will replace traditional public institutions.

Then there are the crypto-anarchists who live in hacker communes (a certain Amir Taaki has set one up in Barcelona); and the people who want to start their own micro-states, possibly floating at sea in *seasteads*, each of which will have its own cryptocurrency. One fervent champion of bitcoin, Brock Pierce (who is Director of the Bitcoin Foundation) tried to set up a crypto-financed state in hurricane-ravaged Puerto Rico (to be called *Puertopia*). Get ready for weird.

Governments would no longer be able to inflate their way out of debt – the classic pattern over the last century. Instead, they would have to rely on direct taxation alone – and that will put pressure on states to shrink their spending programmes.

Then there is the impact on the banking sector. If people start to store much of their purchasing power in their digital wallets, then that implies that they will reduce conventional deposits of fiat money within the banking system. Once traditional banks start to lose deposits on a large scale, many will become illiquid and some, ultimately, will fail. As the threat of systemic failure within the banking system increases – especially in highly vulnerable currency systems such as the eurozone – so individuals will convert more of their traditional cash assets into cryptocurrency. This would further exacerbate the banking crisis.

There might even come a point where, collectively, we decide that we don't need banks any more. Much as I have been rude about bankers in these pages, that would imply a massive change to the structure of our economy.

Facebook "likes" crypto

In May 2018 **Facebook (NASDAQ:FB)** announced that it was setting up a team to explore blockchain technology and to determine how to commercialise it. The team was to be headed by David Marcus, a former President of PayPal. There are now at least 45 engineers working on this top-secret project and Facebook is still recruiting new blockchain experts.

In a report by the New York Times on 28 February, the veil was lifted for the first time on what that team has achieved. The NYT claimed that five Facebook employees had briefed the newspaper on condition of strict anonymity. The company is working on a digital coin (*FaceCoin?*) that users of WhatsApp will be able to exchange with their contacts instantly. Since reporting this on the MI website on 08 March, I have learned that Facebook quietly secured a digital currency license from the Central Bank of Ireland two years ago, permitting the issuance of digital money and the provision of payment services throughout the EU[iv].

Sources suggest that the new cryptocurrency will first be made available in India where WhatsApp has 200 million regular users. Moreover, India receives more remittances from Indian citizens working overseas than any other country. In 2017 these amounted to $69 billion according to World Bank figures.

Facebook has about 2.5 billion users across its three messaging platforms – Facebook Messenger, WhatsApp and Instagram. Many of those accounts are corporate and there is much double counting as many individuals have multiple accounts. But that is still about one third of humanity. So it is probably fair to say that Facebook (whatever you may think of it on an ethical or societal level) is the most comprehensive net-

work in the history of mankind. If Facebook is really serious about cryptocurrency then investors should be too.

Messenger services in the crypto vanguard

Telegram (private) is a cloud-based instant messaging and voice-over service registered in London and founded by Russian mathematician Pavel Durov and his brother Nikolai Durov. Users can send messages and exchange photos, videos or any kind of file attachments. Telegram has an estimated 300 million users worldwide. According to the NYT, Telegram is also working on a digital coin which will work with Signal Messenger, an encrypted messaging service developed by super-geek Moxie Marlinspike. In March 2018 Telegram reportedly raised over a billion dollars via an ICO.

Two Asian messaging giants – South Korea's **Kakao** **(KRX:035720)** and Japan's Line – are also said to be working on their own digital coinage. The backers of early cryptocurrencies lacked reach but this new generation of messaging giants have the power to propel cryptocurrency into a new phase of its evolution.

Payment platforms

PayPal (owned by **PayPal Holdings (NADAQ:PYPL**) having been spun out of **eBay (NASDAQ:EBAY)** in 2015) is used by over 250 million account holders. One of its subsidiaries, Venmo (acquired in 2013), has taken off in the United States by making it easier to send payments by mobile phone. In China, over one billion people every month use the payment system that operates inside the hugely popular WeChat messaging system which is owned by **Tencent (SEHK:700)**. All of these companies are thought to be working on digital currencies of their own.

Remember that there is a welter of specialist payment platforms out there. For example, Ujo provides automated payment services dedicated to musicians who want to sell rights to their music. Even a traditional credit card company like Visa is reported to be recruiting blockchain talent. That suggests they are thinking of setting up cryptocurrency credit card platforms.

"THE BACKERS OF EARLY CRYPTOCURRENCIES LACKED REACH BUT THIS NEW GENERATION OF MESSAGING GIANTS HAVE THE POWER TO PROPEL CRYPTOCURRENCY INTO A NEW PHASE OF ITS EVOLUTION."

Four leading cryptocurrencies

Bitcoin (BTC) was the first cryptocurrency, originating in January 2009. Currently, there are almost 32 million bitcoin wallets according to data compiled by Statista. However, most bitcoin users have several bitcoin wallets and use multiple wallet addresses to increase their financial privacy when transacting in bitcoin, so the number of individual users is somewhat less than that. As I write bitcoin is trading at just under £3,000.

Ethereum (ETH) was first released in July 2015. Ether is a token whose blockchain is generated by the Ethereum platform. Ether can be transferred between accounts as a form of payment. In 2016, as a result of the exploitation of a flaw in software, and the subsequent theft of $50 million worth of Ether, Ethereum was split into two separate blockchains. The new separate version became Ethereum (ETH) while the original continued as Ethereum Classic (ETC). In mid-March 2019 one Ethereum was changing hands at about $138.

Litecoin (LTC) was an early bitcoin spin-off first appearing in October 2011. The Litecoin Network aims to process a block every 2.5 minutes, rather than Bitcoin's 10 minutes. While writing, one Litecoin was worth £46.50.

EOS. The EOS-IO platform was developed by block.one and released as open-source software on 01 June 2018. One billion tokens were distributed by block.one, whose CEO, Brendan Blumer, announced that the company would back the EOS-IO blockchain with over one billion US dollars in funding from the token sale. The platform raised over $4 billion to support the blockchain during the Initial Coin Offering (ICO). EOS is trading at $3.79 as at the time of writing.

There are 15 cryptocurrencies quoted on the Bitcoin Exchange Guide website.

Do cryptocurrencies have intrinsic value?

"Unlike bitcoin, fiat currencies have underlying value because men with guns say they do". This was Nobel Prize-winning economist Paul Krugman writing in the *New York Times* last year. In other words, fiat currencies work because they are backed by the state. (The German sociologist Max Weber (1864-1920) defined the state as *the monopoly of legitimate violence over a given territory*.)

But, hang on Professor Krugman, all bitcoin transactions are automatically verified by the blockchain – and millions of people are confident enough to use bitcoin to buy and sell products and services every day. Moreover, it is government that debauches fiat currency by triggering hyperinflation – as in Zimbabwe and Venezuela – *despite* the men with guns.

Professor Krugman also claimed that transaction costs are higher with bitcoin than with fiat money. Yet bitcoin offers international clearance within an hour – whereas payments through the international banking system usually take days to clear.

Bitcoin and the rest are definitely a medium of exchange – one that is immune from inflationary pressure precisely because states cannot print (or "mine") them. The question is whether they are a store of value. Initially, I thought not, because it had no intrinsic value – but now I'm not so sure.

Characteristics of next generation cryptocurrencies

While using the same basic technology (blockchain), the next generation of cryptocurrencies will seek to avoid the shortcomings of first-generation cryptocurrencies.

Firstly, the NYT thinks that any digital currency that Facebook were to develop would reside on a decentralized network of computers independently from its creators. The same goes for ones developed by messaging networks and payments platforms – in other words such currencies could be used universally. New cryptocurrencies would make it easier to move money between countries, particularly in the developing world where it is harder for ordinary people to open bank accounts and to obtain credit cards.

Second, new cryptocurrencies will do away with the energy-intensive "mining" process that bitcoin relies on. Facebook's digital currency will be a *stablecoin* – that is to say, a digital currency pegged to the US dollar[v] (though its value could vary marginally from the dollar).

According to the website Stable Report there are three types of *stablecoin*: asset-backed on-chain; asset-backed off-chain; and algorithmic. The first kind would be cryptocurrencies which are backed by other cryptocurrencies. The second type of stablecoin is collateralised by real-world *fiat* currency such as the US dollar or the euro or by a commodity such as gold. The third type, algorithmic, relies on a combination of algorithms and contracts to maintain price equilibrium. (But would the algorithms work?)

As far as we can tell, Facebook is working on the second type of stablecoin which would be collateralised by greenbacks or by other currencies. This implies that there would be a *trusted third party* which actually holds a dollar of "real" cash (residing somewhere in the banking system) for every dollar of digital currency in circulation. The question is: would Facebook act as the trusted third party?

And how much control would Facebook retain over the digital currency? If Facebook is to be responsible for approving every transaction and keeping track of every user, it is not clear why it would need a blockchain system at all, rather than a traditional centralised ledger like the one that PayPal uses. The whole point of blockchain was that it obviated the need for a trusted third party to sit between the two sides of a transaction.

A digital token with a stable value would not be of interest to speculators, the main champions of cryptocurrencies thus far. But consumers could hold it in order to pay for things online without worrying about its value fluctuating too much. The NYT reported that some Facebook insiders had suggested that its digital currency will be linked to the value of a *basket of foreign currencies* rather than just to the US dollar.

On the other hand, second-generation cryptocurrencies are likely to face many of the same regulatory and technological hurdles that constrained bitcoin. The absence of a *cryptocurrency central bank* has supposedly made them useful to criminals. (Though Arthur Hayes, co-founder of BitMEX, argues that buying bitcoin is a terrible way to launder dirty money because all transactions are recorded on the public ledger.) Further, computer networks that manage cryptocurrencies hitherto

How not to lose a cryptocurrency fortune

One problem with cryptocurrency investment has been that you are only a hard drive away from losing everything.

It was recently reported that cryptocurrency guru Gerald Cotten took a reported $200 million of bitcoin with him to the grave when he died in India last December. Mr Cotten was CEO of QuafrigaCX, Canada's biggest cryptocurrency exchange. (It is an outfit that is currently subject to litigation and contention and which I am absolutely NOT recommending. If you Google this company you will find that the website contains a message reporting that the company is under investigation for *financial issues*).

The problem is that Mr Cotten had erected layered security around his bitcoin stash with complex passwords for each layer. When he unexpectedly died his family realised that they could not get into his hard drive. As a result, a huge fortune remains locked on a piece of hardware – potentially forever.

That is not the first time that a cryptocurrency fortune has been literally wiped out by death. In 2013 Matthew Moody, an early bitcoin advocate, died in a light aircraft crash in California. His father has spent these last years trying to reclaim his digital fortune – so far without success.

And, supposedly, the mysterious progenitor of bitcoin, one Satoshi Nakamoto – who, if he ever existed, has now vanished – holds a stash of an estimated $3 billion worth of bitcoin. One can only wish him the best.

And what if a bitcoin holder were to be kidnapped – a gruesome thought? Well, it has already happened. In December 2017, an executive at UK-based bitcoin exchange Exmo was kidnapped in Kiev, Ukraine – and only released after a $1 million ransom was paid.

One possible safeguard is to set up a so-called *multi-signature key*. Let's say, so long as three out of four account holders log in, then the digital wallet can be unlocked. To be quite clear: If you do not have the private keys, then the bitcoin is lost.

made it hard to process huge volumes of transactions simultaneously.

A *stablecoin* known as Basis recently closed last December after just eight months. The New Jersey-based company announced that there was no apparent way around being classified as a security – as opposed to a currency – which would significantly reduce the number of potential buyers. Basis had attracted well-known backers like Andreessen Horowitz of Foundation Capital and Kevin Warsh, a former governor of the US Federal Reserve[vi].

The most high-profile stablecoin to date, Tether, (USDT) has been surrounded by controversy. While Tether's creators claim that each of its tokens is backed by one US dollar, the company's refusal to be audited has raised doubts as to whether that is true. On 14 March 2019 Tether changed the collateral to include loans to affiliate companies.

Meanwhile in Russia and China…

In January it was reported in *The Daily Telegraph* that Russia's Central Bank was preparing to replace the US dollar as a reserve currency with bitcoin[vii]. Supposedly, this will be a bid to circumvent the effect of western sanctions which were imposed on Russia further to its annexation of Crimea in February 2014 – and were then intensified further to the Salisbury poisonings of March 2018. It would also form part of Russia's plan to reform its state pension system.

Vladislav Ginko, purportedly an economist at the Russian Presidential Academy of National Economy and Public Administration (RANEPA), claimed that the Russian central bank could buy as much as $10 billion of bitcoin, financed by dumping US Treasuries. However, the Cryptoslate website has cast doubt on Mr Ginko's credibility. Apparently, Mr Ginko has tweeted on Russia's move into bitcoin several times before without showing great insight. In July 2018 he tweeted that Russia would soon move to a *cryptorouble*. In 2017 he predicted that bitcoin would rise

The largest cryptocurrency exchange

BitMEX (the bitcoin mercantile exchange) is the world's largest bitcoin exchange. It was founded by Sam Reid, Arthur Hayes and Ben Delo in 2014. BitMEX is not a spot market but a derivatives exchange. Users deposit bitcoin and then use those deposits to speculate on the future price of bitcoin using various futures and options contracts. It is the only bitcoin exchange which offers users the chance to leverage up their positions by up to 100 times. Apparently, Chinese users call BitMEX "100x". Unlike conventional futures markets there are no margining arrangements – but no one can lose more collateral than they have put up. By last November the daily value of trades on BitMEX was between $2.5 billion and $8 billion – equivalent to the daily turnover of the Australian stock exchange (ASX). BitMEX also provides in-depth reports on the crypto-currency ecosystem.

to $2 million. No one has been able to verify his bona fides at RANEPA.

There have been more reliable reports in the second half of last year to the effect that the People's Bank of China (PBOC) was preparing to launch its own digital currency. During a March political gathering in Beijing, former central bank CEO Zhou Xiaochuan said that any state digital currency must be compatible with financial stability while at the same time protecting consumers. The Digital Currency Research Institute of the PBOC has been hiring people with knowledge and experience of blockchain technology[viii].

According to Fintech News, Yao Qian, head of research at the PBOC said last year that a digital currency could drive down transaction costs, increase the efficiency of monetary policy and extend financial services to rural areas. It would also be easy to trace. (An autocratic government's dream.) He asserted that the development of the digital economy required an electronic currency issued by the central bank – that is to say it would be a state-sponsored digital currency: non-state digital currencies would presumably be outlawed.

"THE INTERNET TOOK 30 YEARS TO BECOME UNIVERSAL. BLOCKCHAIN TECHNOLOGY IS BARELY TEN YEARS OLD AND HAS ONLY RECEIVED THE SERIOUS ATTENTION OF INVESTORS OVER THE LAST THREE YEARS OR SO."

It is likely that such a state-sponsored digital currency would be pegged to the existing fiat currency in the first instance so as to make it less volatile – a *stablecoin*. There is conjecture that such a stablecoin could be adjusted in value periodically in accordance with the consumer price index. In that way, while fiat money might lose its value over time thanks to inflation, the stablecoin would have constant purchasing power.

Prepare for the next phase

In an interesting interview on 18 March the Winklevoss brothers (who were around at the birth of Facebook) declared themselves "extremely confident" about the crypto industry. The internet took 30 years to become universal. Blockchain technology is barely ten years old and has only received the serious attention of investors over the last three years or so. Even if bitcoin bombed in 2018, the number of people with digital wallets, which are capable of storing digital money, has continued to rise.

If a new generation of *stablecoins* does emerge in the near future, immune from the speculative volatility which characterised the first wave of digital currencies – manic buying and hoarding – that development could be a game-changer, especially for investors. For example, commodity-backed cryptocurrencies could become a way for investors to get exposure to gold, copper, Brent crude – whatever – at the click of a mouse.

Action

I am not qualified to judge the investment potential of buying into cryptocurrencies for speculative purposes. However, I would urge investors to consider who would gain most in a world where cryptocurrencies were to become the principal medium of exchange, and where, conversely, conventional fiat currencies took a back seat. This could happen sooner than we think.

If you think this is likely to happen soon, that would be an argument in favour of investing in social media platforms – especially Facebook and **Twitter (NYSE:TWTR)** – and of leading payment platforms such as PayPal and even credit card providers like **Visa (NYSE:V)**. Facebook and messaging networks like Telegram can put digital wallets full of cryptocurrency at the disposal of hundreds of millions – if not billions – of users. With more than $40 billion in annual revenue, and greater experience in navigating regulatory issues, Facebook has a good chance of creating a stablecoin that will be accepted by regulators. This will be bad news for banks if they do not keep up – JP Morgan has shown itself once again to be ahead of the curve. Also, opportunities may arise to invest in the various cryptocurrency exchanges.

This is a fast-developing space. Investors will need to stay awake.

Will Mr Trump go for gold?

In mid-March 2019 rumours started to circulate to the effect that President Trump has been considering the return of the US dollar to the gold standard. It is suggested that he fears that the IMF is going to issue a global currency in the form of Special Drawing Rights (SDRs) so as to usurp the greenback as the currency of choice for most international transactions. But the MAGA president will not take the demotion of the dollar lying down. Moreover, Mr Trump is known to be a lover of gold – Trump Towers everywhere are marked out with gold lettering...And he is thought to have made a killing in gold investments in the past.

While on the campaign trail in 2016, Mr Trump said: "Bringing back the gold standard would be very hard to do, but boy, would it be wonderful. We'd have a standard on which to base our money".

Mr Trump and many of his supporters regard the IMF-World Bank as the ultimate globalist conspiracy – a supra-national central bank. But he knows that reviving the pre-1971 gold standard would be problematic. As I wrote here in the December 2017 issue it is very unlikely that gold could ever be restored as the key reference commodity in the global monetary system.

Now – here is my point – some economists regard the adoption of a state-sponsored digital currency as the equivalent of a return to the Victorian gold standard. Therefore – this is purely conjecture on my part – I would not be surprised if Team Trump is looking seriously at digitising the dollar.

Ticket Offer

Meet me and the rest of the team behind Master Investor Magazine on 6th April – just use the discount code HILL to claim your complimentary ticket here.

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 Through the Looking-Glass, by Lewis Carroll (1871)
ii See: https://www.cnbc.com/2019/02/13/jp-morgan-is-rolling-out-the-first-us-bank-backed-cryptocurrency-to-transform-payments--.html
iii In "The Bullish Case for Bitcoin" (no longer in print).
iv See: https://techcrunch.com/2016/12/07/facebook-just-secured-an-e-money-license-in-ireland-paving-way-for-messenger-payments-in-europe
v See Bloomberg, 18 December 2018 at: https://www.bloomberg.com/news/articles/2018-12-21/facebook-is-said-to-develop-stablecoin-for-whatsapp-transfers
vi See: https://www.bloomberg.com/news/articles/2018-04-18/a-133-million-bet-on-a-cryptocurrency-designed-to-be-boring
vii Daily Telegraph, 14 January 2019, story by Hasan Chowdhury. Available at: https://www.telegraph.co.uk/technology/2019/01/14/russia-plans-tackle-us-sanctions-bitcoin-investment-says-kremlin
viii See: https://www.fintechnews.org/chinas-3
ix Video available at: https://thescene.com/watch/gq/donald-trump-weighs-in-on-marijuana-hillary-clinton-and-man-buns

BY MARK WATSON-MITCHELL

SILVER COULD SHINE IN 2019

This could well be the year to build up some positions in silver and to do so earlier rather than later in 2019.

I feel that investor sentiment has yet to get geared up, but when it does the white precious metal could show some spirit in its price moves. Always closely associated with moves in the price of gold, it currently lags behind the yellow metal. But that could change in a few months' time.

> **"SOME 55% OF THE YEARLY SILVER PRODUCTION, CURRENTLY EXPECTED TO BE SOME 26,000 TONS THIS YEAR, IS USED UP IN INDUSTRIAL APPLICATIONS."**

With so many economic factors weighing upon investors' minds, it is natural that they see gold as the sensible balancing investment when equities feel temperamental. Interest rates, China/US trade hassles, the ongoing Middle East conflicts etc. – all help to create equity caution and a search for portfolio protection.

Gold is moving higher and silver is due to follow its lead. Gold can be a steadier mover, but silver has proven itself to be volatile and extremely reactive to professional investor sentiment. Both metals have been used as significant stores of value, as coinage and as currencies, for thousands of years. From Turkey to Greece and then later to Spain, the mining of silver has been monitored way back to some 5,000 years ago. The Spanish were the major suppliers of silver to the Roman Empire and silver was a currency used along the Spice Routes into Asia.

As with gold, the discovery of the metal and its subsequent mining spread across the five continents. When Spain discovered the New World in the late 1400s, silver production grew at a very fast pace. The Americas are still significant players in the sector.

Over the subsequent centuries, mining technology improved substantially. Estimates suggest that some 5 billion ounces of gold have been mined since the dawn of civilisation, compared to 48 billion ounces of silver. It is reckoned that of the 48 billion ounces mined, there are today only around 1 billion ounces of silver bullion as opposed to some 2 billion ounces of gold.

Where gold has a high retention as a value store, silver has a higher use ratio. Both metals are extremely malleable – both are used in jewellery and considered very attractive and decorative.

> "AS A FORM OF PORTFOLIO PROTECTION IN UNCERTAIN FINANCIAL AND ECONOMIC TIMES, SILVER, LIKE GOLD AND OTHER PRECIOUS METALS, HAS VERY VALUABLE ATTRACTIONS."

Some 55% of the yearly silver production, currently expected to be some 26,000 tons this year, is used up in industrial applications such as solar cells, silver oxide batteries, photography, various electrical components, radiography, computer touch screens, metal solder, printed circuit boards, and tableware. Its high conductivity to electricity and heat, as well as its light sensitivity, makes it a favoured metal in so many industrial processes and products.

Silver is toxic to bacteria and its uses in modern micro-biotics are still being researched and expanded. And, of course, it is worth noting that spraying some silver iodide particles into the atmosphere helps to create rain and snow when used.

It is reckoned that a considerable amount of silver can be found in landfill sites across the world – but it is extremely uneconomic to get involved in any such metal recovery from all the buried electrical and electronic products.

Why should anyone want to buy silver?

As a form of portfolio protection in uncertain financial and economic times, silver, like gold and other precious metals, has very valuable attractions. As inflation continues and governments carry on printing money, the purchasing power of the dollar, the pound or other leading currencies, starts to reduce. Gold and silver both hold their respective values – with silver being the least expensive and easiest of the two to trade.

It is far better to hold physical metal, rather than equities that mine for physical metal, because corporate shocks like bad results, directors leaving the company or the like, can impact share prices instantly. Actual physical metal, because of its marketability on any time of any day of the year and anywhere geographically, means that it is highly liquid. And that liquidity is even more evident when financial markets collapse and other forms of 'currency' become 'suspect'.

Silver is cheaper per ounce than gold, which means that its lower cost gets the investor more ounces – a bit like buying penny shares. Unlike gold, which has two specific times for its price fix during the week, silver is traded on a minute by minute basis with prices reacting according to the current trading.

Even though gold is rarer than silver, when comparing the 'above ground' figures, it is evident that silver is actually scarcer than gold, with estimates suggesting that gold is some 6 times more abundant 'above ground' than silver.

Physically holding silver, or for that matter other precious metals, beats digital currencies that can get lost in computer mishaps like hacking, or funds held at your bank or even your broker which can get clogged up in 'failures'. Or when 9/11 events cause international mayhem, what would you prefer to hold: equities, currencies or physical metal?

"IT IS EVIDENT THAT SILVER IS ACTUALLY SCARCER THAN GOLD, WITH ESTIMATES SUGGESTING THAT GOLD IS SOME 6 TIMES MORE ABUNDANT 'ABOVE GROUND' THAN SILVER."

And with silver it is very useful to remember that governments do not hold reserves of the metal, like they do in gold. Which means that silver is actually less likely to be hit by sudden price drops when governments sell off their reserves to subsidise wars or even see funds diverted in times of crisis – like Venezuela currently.

So now let us look at the way the price of silver has traded in the last forty years or so.

Boom and Bust

Way back in the 1970s, Nelson Bunker Hunt and his brother William Herbert Hunt tried to corner the world market in silver. They had done their sums and worked out a cunning plan to make more billions – they already controlled their family oil business, Placid Oil, which was built up by their father Haroldson Lafayette Hunt Jnr.

Through taking physical delivery of the white metal, together with gearing up for even further optioned positions, they took the price up from just a few dollars an ounce to some $6 an ounce by the beginning of 1979. Then the price started to react to their hoarding. It was estimated that at one time the Hunts owned more than a third of the world supply in privately held silver, holding some 100 million troy ounces. The price escalated to $49.45 an ounce by the early part of January 1980.

The rest of the market had its nose put out of joint – remember that some half of production is used industrially, whereas only 10% of gold is used in creating such products, and 25% of silver production is used in jewellery. The market was suffering under such a massive price hike.

So much so that the New York Mercantile Exchange, together with the Federal Reserve and COMEX, weighed in with a wad of heavy restrictions concerning the purchase of metals on margin. The effect of these new rulings was to slam the price some 50% lower within days. That in turn caused massive position liquidation of the Hunt brothers' holdings. They were then unable to meet their required margins and prices fell back even further. They faced a $1.7 billion loss when they were unable to meet a $100 million margin call.

Such was the discomfort being felt all around that the leading US banks and commodity brokers were being hit for six – bringing about a hastily arranged $1.1 billion banking support operation to help the Hunts unwind sensibly their market positions and thereby saving a lot of companies from going bust in the process.

(I believe that Prudential Bache was very much involved in the 'rescue' – and that the Hunts actually owned a circa 6% stake in the 'rescuer'. An early example of 'quantitative easing', perhaps?)

It took another thirty years or so before the price of silver traded back up in the circa $49 an ounce range again. That was at the time of the US Federal Government debt being downrated by S&P – they issued a 'negative outlook' on the US 'AAA' status. The price of silver shot up to almost $50 by the end of April 2011. And the US equity market fell almost 2,000 points within a couple of months.

The US Treasury then moved to delay the financial apocalypse that had been forecast and gradually investors liquidated their silver positions and moved back into equities again.

Over the last eight years or so, silver has played a back seat to movements in the price of gold, but as I stated earlier, I am convinced that its time is coming again and by the end of 2019 the price of silver could well be a great deal higher than today's $15.40.

So, this is where we must start to look at the very important gold/silver ratio.

The Gold/Silver Ratio

It is known that silver is some 17 times more common than gold in the earth's crust. That is considered to be the 'natural ratio'. In the ancient times of the Greek and the Roman empires the ratio was actually 'fixed' at around 12 times.

The Gold/Silver Ratio is based upon how many ounces of silver it takes to buy one troy ounce of gold – so at the current $1,300 for gold and $15.40 for silver, that ratio would stand at 84.4 times.

During the 1920s, '30s and '40s that ratio crept higher, such that by World War II the 100 times level had been reached. The '50s and '60s saw it lower again such that by the 1970s it was down to just 20 times. The Hunt's shenanigans took it back up to 40 times before falling back to 20 on their crisis.

Briefly, in 1991, it peaked again at 100 times, since when it has traded a narrow 40 to 90 times range.

So today at 84 times, the price of silver is holding steady on the G/S Ratio. Gold is currently swinging around the $1,300 level and reacting more to political scenarios globally. Silver is almost dozing quietly in the background. But it was very interesting to note that silver bullion coins, like the US Eagle, actually jumped some 48% in the first two months of this year.

If you want to take out some positions in silver, it has many investment forms, ranging from Contracts for Difference (CFDs) to Spread Bets, or buying gold coins, rounds or bullion.

It may well be slumbering now, but industrial demand, I believe, will pick up towards the end of this year and we could well see the price of silver moving out of line with gold. Bloomberg's analysts reckon that the industrial applications sector will boost demand for the metal by the end of this year, whilst they anticipate a 50% upside for demand by 2023.

Personally, I anticipate a rise in the price of silver from $15.40 to between $18 and $20, giving a near 30% gain over the next year or so. That would mean that gold would also be a lot higher in price – but remember gold is much more expensive than silver, so the white metal certainly gets my vote in 2019.

About Mark

Director of SQC Research and Author of mw-m.com.

Mark, who has over fifty-five years' experience in the UK stock market, established SQC Research in 1993. He previously worked as a dealer for four stockbroking firms and an investment fund management business. Prior to SQC Research, which provides investment information and comment on smaller quoted companies, he published financial and investment magazines and newsletters.

BY RICHARD GILL, CFA

FROM ACORNS TO OAK TREES

THREE SMALL-CAP IPOS TO BOOST YOUR PORTFOLIO

As most investors know, the world of IPOs (initial public offerings) can be both highly lucrative and fraught with risk. For those who can get into a newly listed company early on, especially at the listing price, huge potential returns are on offer. However, as my book review last month noted, a study by Khurshed et al found that nearly 55% of AIM companies which IPO-ed from 1995 to 2004 had left the market within five years of listing.

While it's difficult for retail investors to get in on an IPO fundraise, there are still many opportunities to buy shares in exciting newly listed public companies – and sometimes at a discount to the IPO price should the markets provide that chance. My job this month is to identify three small-cap companies which have listed in London in the past year and look good value at the current price. In no particular order, they are...

THEWORKS.CO.UK

Anyone who wants a bargain book or a good value last minute Christmas present will be familiar with **TheWorks.co.uk (LON:WRKS)**, one of the UK's leading multi-channel specialist retailers of value gifts, arts, crafts, toys, books and stationery.

Founded in 1981 as Remainders Limited, by IPO in July last year, the company plied its trade via a core estate of 399 retail stores across the UK and Ireland. These were complemented by 48 smaller concessions and a fast growing e-commerce platform, www.theworks.co.uk. Products are categorised into four 'zones' – Kids, Arts, Crafts and Hobbies, Stationery and Family Gifts – with each supplemented by both regional and seasonal offerings. As the company's branding states, there are cer-

"THE WORKS HAS AN AMBITIOUS GROWTH STRATEGY IN PLACE."

tainly "Gifts for Everyone", with an average store holding c. 6,000 products, from fidget spinners to biographies of Norman Lamont.

The Works has an ambitious growth strategy in place which has picked-up pace over the past three years. A net 134 new retail stores and concessions were opened in that time, all funded from internal cash generation. However, there is plenty of room for further expansion, with the directors looking to open 50 new stores a year and believing there are up to 1,000 potential locations across the UK and Ireland. The firm's purpose built 183,000 square foot support and distribution centre, located in Birmingham, is expected to have the capacity to meet this ambition.

At IPO in July last year, the company raised money at 160p per share, with £35.4 million going to selling shareholders and £24.8 million to the company, which has been used to pay off borrowings. The business is chaired by Dean Hoyle, the entrepreneur who founded **Card Factory (LON:CARD)** and grew it from a market stall to a listed company which made over £70 million of profits in 2018. He contributes to a management team which has over 200 years of combined experience in the retail industry and owns 22% of the business.

Good work

The expansion efforts, combined with solid trading from the existing operations, have delivered strong growth for The Works over the past few years. For the three years to 29th April 2018, revenues grew at a CAGR of 14% to £189.3 million, with underlying EBITDA up by a CAGR of 14.1% to £12 million.

Interims for the 26 weeks to 28th October 2018 showed further top line

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growth, with revenues up by 15% to £91.5 million, boosted by 32 net new store openings and like-for-like sales growing by 3.8%. That's an impressive performance given that the like-for-like figures were up by 8.2% in H1 in the previous year. However, with the business being strongly weighted towards the second half and the key Christmas trading period, the adjusted loss before tax was flat at £4.4 million. The company also announced a maiden interim dividend of 1.2p per share.

On the balance sheet the key thing to note is that net debt fell from c.£24 million as at end-April 2018 to just £4.4 million after the previous loan facility was paid off by using the proceeds of the IPO. A further reduction in debt is expected by the year end given the strong second half trading bias. Encouragingly, like-for-like sales growth for the important 11 weeks to 13th January period was said to be 4.5%, against some tough comparable figures, to a record level.

Buy a Bargain

At the current 116.5p, shares in The Works are down by 27% on the IPO price. That isn't surprising given the market volatility seen in the latter half of 2018 but seemingly unfair given that trading has remained in-line with expectations since last summer.

For the current year to April 2019, analysts are looking for pre-tax profits to rise to around £7.7 million. An important point here is that in 2019, last year's £3.6 million of interest charges will be pretty much eliminated following the repayment of the debt, providing a material boost to the profit figures. I think that's a point many market followers may have missed.

As the store rollout continues, the markets are looking for c.£9.4 million at the pre-tax level for 2020, with earnings of 11.7p per share. That puts The Works on a forward rating of just under 10 times. Also attractive, the forecast 4.75p dividend for 2020 yields a decent 4.1%.

Of course, the high street has been particularly vulnerable of late to rising rental charges, business rates, wages, uncertain consumer spending and thin margins. But with its core value offering and profitable business, The Works does look to be resilient. Broker Peel Hunt has a 170p target price on the shares, which implies upside of 46% from current levels.

LITIGATION CAPITAL MANAGEMENT

Looking to imitate the huge success of listed peer **Burford Capital (LON:BUR)**, whose shares have risen 18 fold since IPO in October 2009, is litigation finance specialist **Litigation Capital Management (LON:LIT)**.

Litigation finance is an area of the market which sees companies such as LCM fund the legal claims of individuals and companies (paying solicitor and court fees etc.), in effect taking on the risk of the case instead of the client. Litigation financiers make money by recovering the amount invested in the case and taking a share of the settlement awarded to the claimant. Of course, if the case loses, they also lose out. This is a rapidly growing area of the market, with law firm Pincent Masons suggesting that assets under management at the 16 main UK third-party funders were at least c.£1.5 billion in mid-2018, up from £180 million in 2009.

Founded in 1998, LCM is an Australia based provider of litigation financing and ancillary services. Its own revenue model typically sees the company recover capital deployed to finance litigation, along with either a multiple of invested capital or a percentage (between 15%-40%) of the gross proceeds of any award or settlement, in return for meeting the litigation costs.

Clearly, the key here is to choose cases with a high chance of success. To identify these, LCM applies rigorous selection criteria to applicants, assessing areas including commerciality, legal principles, supportive evidence and strength of the legal team. Reflecting its strict approach, LCM has historically only entered into funding agreements with 4% of applicants. The company also aims to have a balanced portfolio of projects in terms of size, funding structure, area of law and geographical region.

LCM was previously listed on the ASX market in Australia. But just before Christmas last year it delisted and joined AIM, raising a total of £20 million at a price of 52p per share – pretty impressive given the status of the market at the time. The money raised has been earmarked for funding the existing portfolio of litigation projects and for the deployment of further capital

LCM
EXPERIENCE COUNTS

into new opportunities. Around the time of the IPO, the company also advanced an international expansion strategy, opening an office in London to serve the EMEA region, as well as an office in Singapore to cover the Singapore and Hong Kong markets.

State your case

LCM came to market with a strong track record, having reported a cumulative return on invested capital of 138% over the seven years to 30th June 2018 – that calculation consists of A$63.8 million recovered compared to A$26.8 million invested. Over the same period, c.95% of litigation projects achieved settlement, with 88% of those being profitable and taking an average 27 months to complete. As you can see by these numbers, it can take a long time for cases to come to fruition, and the timing of their completion can be unpredictable. For that reason, it's a better measure of performance to look at LCM's long-term numbers rather than annual figures.

Investors took well to the company's maiden set of results as a UK listed business, the numbers covering trading in the six months to December 2018. These showed revenues up by 181% at A$18.5 million, with adjusted pre-tax profits up by 268% at A$2.72 million. Notably, net cash stood at A$52.6 million at the period end, boosted by the IPO proceeds and giving the company significant financial resources to apply to new litigation cases. Also, an interim dividend of 0.506 cents was declared in line with a progressive but measured payment policy.

In terms of operational highlights, capital deployed into litigation investments increased by 96% in the period to A$12.83 million. As at 26th February 2019, LCM had a portfolio of 24 projects under management with 17 unconditionally funded and seven conditionally signed. There is plenty of further business with which to deploy the IPO proceeds, with the company said to be in advanced negotiations, and with term sheets issued, on eight projects. Additionally, LCM has pre-qualified 64 pipeline projects with estimated investment of A$409 million.

Order, order

Forecasting earnings is tricky for a company like LCM given the uncertainty over when cases will complete and when revenues will be received. Instead, net assets are the area to focus on here. At the current market cap of £80 million, the company trades at just over 2 times book value. That compares to Burford Capital, which is on just under 4 times, with the premium coming as investors anticipate strong growth in net asset value.

The key here is that, as well as being undervalued in comparison to its main peer, LCM has plenty of cash to invest in funding new cases. With the historic return on invested capital being 13.2% on an annual basis, then it is easy to see how NAV could grow substantially over the long-term.

It's also worth noting that Executive Vice Chairman and head of the UK team, Nick Rowles-Davies, was recently granted an interest over 4,347,517 ordinary shares as part of a joint share ownership plan. The award will only vest after three years subject to conditions, including the company's shares hitting 175p at any time up to the vest date. At a price more than double the current share price, this indicates that management interests are aligned with those of shareholders.

Analysts at Canaccord Genuity have an 88p target on the shares, 15% higher than the current 76.5p, but that price looks conservative to me given the opportunities available and the company's strong track record.

RA INTERNATIONAL

We end with an interesting business which, as well as supporting humanitarian causes, looks very cheap at current levels. Founded in 2004, **RA International (LON:RAI)** is a provider of various construction and support services to remote locations in Africa and the Middle East. The business was set up by current CEO and COO Soraya and Lars Narfeldt (who together own c.80% of the company) after they identified a gap in the market for providing a full service offering to large organisations operating in remote locations, typically in the areas of peacekeeping, humanitarian and commercial projects.

Based in Dubai (where it pays no corporation tax), the company today specialises in five areas: construction; integrated facilities management; operation and maintenance; accommodation; and supply chain services. Clients consist of top tier global organisations including UN agencies, western governments and multi-national corporations. To give an example, one contract in South Sudan saw the company look after maintenance at one of the World Bank's facilities, including generator, air conditioning and building maintenance as well as plumbing, pest control, grounds keeping and cleaning services.

The company's AIM IPO in June last year saw a chunky £18.8 million raised at 56p per share, a significant amount for a business then capitalised at £97.2 million. One of the reasons given for going public was to raise the company's profile, putting it on the radar of more potential clients which operate more significant projects. This is inline with a strategy to take on larger deals and enter into new geographic territories.

RA INTERNATIONAL

Nataly Reinch / Shutterstock.com

Superhuman-itarian efforts

Growth has been substantial over the past decade, with RAI having to date delivered over $400 million worth of projects in over 10 countries. The past three years in particular have seen strong numbers being posted, with revenues increasing by a CAGR of 59% to $53.3 million from 2015 to 2017 and profits rising from $1 million to $13.7 million over the same period – that's a CAGR of 253%!

Unfortunately, there is one major caveat to the investment case, as in December last year the shares plunged following a profits warning contained in an operational update. Fortunately, the market reaction could turn out to be significantly overdone. The majority of the text in the update was positive; however, investors focussed on one paragraph in particular which said that several projects expected to contribute to H2 2018 revenue have been delayed for reasons outside the company's control and will now take place in H1 2019. As a result, revenues and profits for 2018 are now expected to be "slightly" behind market expectations.

On the positive side, during the second half RAI secured a new deal with URS Group, Inc. to provide construction services in Somalia under a $9.1 million contract and won a five-year US$30 million+ contract for the electrical works and construction of power infrastructure for the United Nations Support Office in Somalia. These add to a (not-valued) contract in a Central African country with a large publicly listed US company. Seeing the benefits of its public listing, RAI has now been invited to bid for opportunities which were not available to it as a private company, although given their increase in size and the counterparties involved the bid to contract process is taking longer.

Good shares Dubai?

Shares in RA International currently trade at 36.5p, down by 35% on the IPO price and by 57% on the all-time high of 84.5p. The shares lost around a third of their value following the December profits warning. But remember that at the time the company stated profits would only be "slightly" behind expectations. On that basis, I think the shares look incredibly cheap at current levels.

Following the profits warning, house broker Cenkos chopped 10% off its forecast for 2018, now expecting earnings of 8.4 cents (6.35p) per share for the year. However, given the strong bid pipeline (see below), it kept its 2019 forecasts at 10 cents (7.56p) per share. This means that should the current year forecasts be met, RAI trades on an earnings multiple of just 4.8 times. For income focussed investors, a dividend is expected to be announced when the full-year results are released on 10th April.

Despite the downside of the company having suffered setbacks so soon after its AIM listing, I believe that investors should look at the bigger picture here. Indeed, the investment case is supported by a number of factors.

In addition to the low valuation, RAI had net cash of $28 million (£21.17 million) as at 30th June 2018 – amounting to a third of the current market cap. While the timing of revenues is uncertain, there is certainly revenue visibility here, with the contracted revenue backlog as at 31st August last year being $114 million – over two years' worth of historic revenues. What's more, the pipeline of projects for which a tender had been submitted or was in preparation stood at c.$200 million as at 30th April 2018 and is said to have increased significantly since then.

So unless there is something lurking in the background here, it looks like RAI shares could fly on any positive news, with the April results being the first major potential catalyst. Three non-executive directors bought a total of c.£116,000 worth of shares following the profits warning, and investors with a high risk appetite might be tempted to follow their lead.

"SHOULD THE CURRENT YEAR FORECASTS BE MET, RAI TRADES ON AN EARNINGS MULTIPLE OF JUST 4.8 TIMES."

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 2018.

BY TOM STEVENSON, INVESTMENT DIRECTOR FOR PERSONAL INVESTING, FIDELITY INTERNATIONAL

Fidelity INTERNATIONAL

IS NOW THE TIME TO BUY BRITISH?

A call to Buy British sounds quaint these days. It's a throw-back to a time when manufacturing was a bigger part of our economy and we were better at making stuff that the rest of the world wanted to buy. To be honest, it was already an outmoded concept when a well-intentioned 'I'm Backing Britain' campaign in 1968 prompted a flurry of patriotic but unsuccessful marketing pushes.

One of these, launched by Robert Maxwell in his pre-Mirror days, was quietly shelved after it emerged that Pergamon Press actually printed its textbooks and scientific journals in Eastern Europe while the T-shirts used to promote the cause were manufactured in Portugal. When the first episode of Dad's Army featured an ironic flash-forward scene with the main characters launching the Walmington-on-Sea Backing Britain group, it was all over.

One area where we have continued to fly the flag, however, is in our personal investments. According to the Investment Association's website, of the nearly £600 billion of retail equity funds under management in Britain, more than a third are held in the three UK categories – All Companies, Equity Income and Smaller Companies. When you consider that the UK accounts for less than a tenth of global market capitalisation, that is a significant overweight to the domestic market.

By comparison, North American funds represent less than 10% of this total, about the same as Europe ex UK, and Japan less than 5%. Around £3 is invested in UK funds for every £2 invested in their Global equivalents. We really do suffer from a serious dose of home bias here in the UK.

The fact that we already own too many UK shares from a strategic asset allocation perspective is not a reason to dismiss the UK as an investment destination if there is a compelling case to do so tactically. To do so, however, would be to go out on a limb in today's market if the monthly Bank of America Merrill Lynch fund manager survey is any guide. It routinely shows UK shares to be among the least-loved of all investments among the professional investors it questions.

Brexit blues

You would need to have been hiding in a cave to have missed the principal reason for this. Since June 2016, and more intensively in recent months, sentiment towards all British assets has soured as

"WE REALLY DO SUFFER FROM A SERIOUS DOSE OF HOME BIAS HERE IN THE UK."

"IF BRITISH INVESTORS HAVE TO WAIT A WHILE FOR THEIR SHARES TO PERFORM, THEY ARE AT LEAST BEING COMPENSATED IN THE MEANTIME BY A VERY HEALTHY INCOME."

the Brexit debate has descended into acrimony. For many overseas investors the complexity of Westminster politics and the navel-gazing battle for the soul of the Conservative Party has been too much to bother getting to grips with.

The relative insignificance in global terms of the UK's stock market has made it easy for a US or Asian investor to decide to come back when we've got over our collective nervous breakdown and agreed our place in the world. And frankly, who can blame them? If you are a global investor, being over- or under-weight the US, or even a specific area like the FAANG technology stocks, might make or break your comparative performance. Being in or out of the UK is far less likely to make much difference.

The consequence of that international indifference to the UK stock market, however, is that British shares have underperformed their global counterparts in recent years. They are not the worst performers (that honour goes to shares in the rest of Europe) but compared with markets in China, Japan and the US, the last five years have been a very disappointing time to be invested in London.

If you had invested £100 in the FTSE 100 in March 2014, it would have turned into just £107. That compares with £149 for the same amount invested on Wall Street, £130 in Tokyo and £178 if you had accepted the volatility of the markets in Shanghai and Shenzhen.

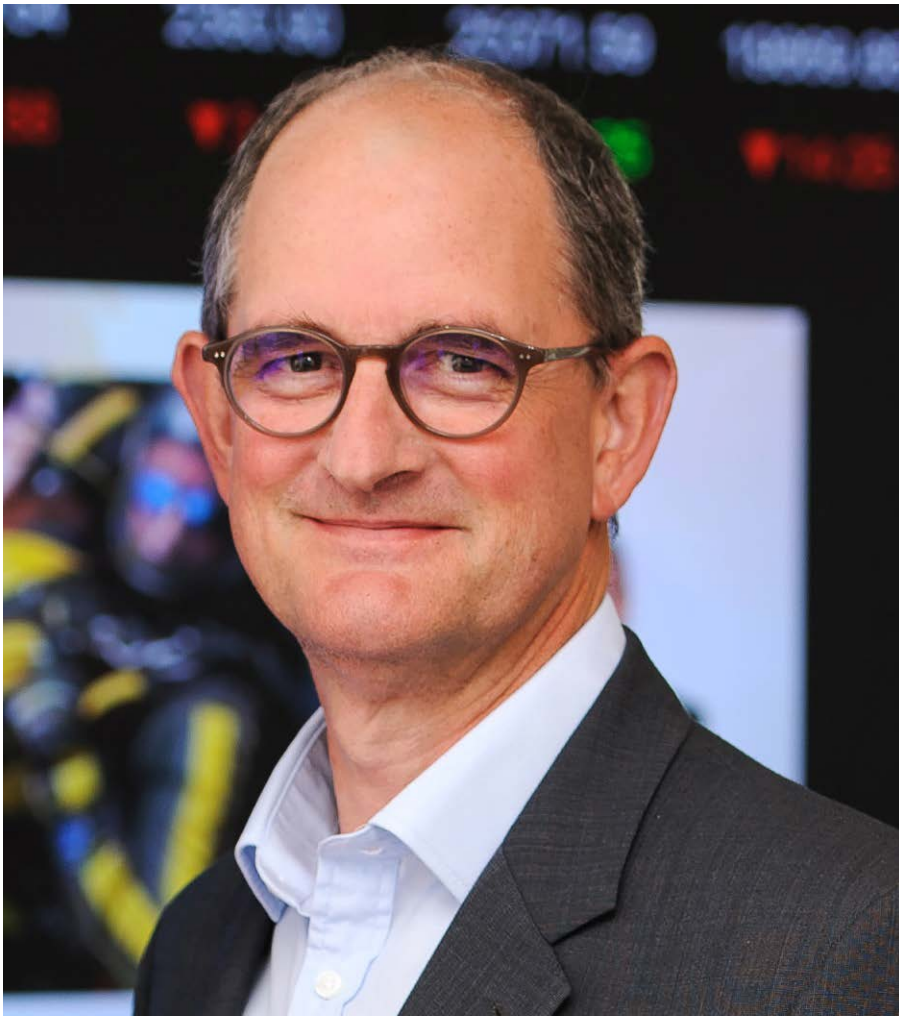
Attractive valuations

The underperformance of the UK market has meant British shares have become increasingly cheap. On the basis of the forward PE ratio (which measures share prices against expected earnings per share), the FTSE 100 is valued at a historically cheap 12.5 times earnings. That is similar to the market rating in 2003 after the implosion of the dot.com bubble, according to data from Goldman Sachs.

Shares were cheaper during the worst days of the financial crisis and they were a bit more expensive before David Cameron's ill-fated referendum, but they have now returned to where they were 15 years ago as a multiple of earnings. This, remember, was one of the most pessimistic moments in recent years for stock market investors.

The other key valuation that investors look at, the dividend yield, has also reached an apparently attractive level, with the FTSE 100 index offering an average income yield of 4.5%. That compares with the coupon on a 10-year Gilt here in the UK of less than 2% and base rate at the same 'emergency' level of 0.75% that it was slashed to in 2009. If British investors have to wait a while for their shares to perform, they are at least being compensated in the meantime by a very healthy income.

So, there is a compelling valuation case to be made for investing in the



"A UK-BASED INVESTOR COULD EASILY JUSTIFY HOLDING A QUARTER OF THEIR PORTFOLIO IN BRITISH FUNDS OR SHARES TODAY."

UK today. If you are prepared to look through the short-term uncertainty, then buying in at these kinds of valuations is likely to stack the odds in favour of an acceptable outcome in the long run.

Economic resilience

What about the economic outlook? Here it is a mixed bag, but the news is by no means all negative. Growth has been positive if unspectacular, with no sign of the recession that many expected in the aftermath of the 2016 referendum. In the past year, we have seen a recovery in real, inflation-adjusted wage growth with prices rising at around 2% and incomes at more than 3%. The number of people working in Britain rose in 2018 and unemployment has not been so low since the 1970s. Looking ahead, government spending is likely to increase as austerity is unwound slightly. Tax receipts have been higher than expected, allowing the Chancellor to build up a modest war-chest.

With most of the UK's leading companies having reported their results for the fourth quarter of 2018, expectations have been slightly exceeded, according to data from Goldman Sachs. At the time of writing, about 60% of companies had hit expectations, with 22% beating forecasts and just 16% undershooting predictions.

It's worth remembering, of course, that the health of the UK economy is an important but not decisive factor in the outlook for corporate profits growth. Among FTSE 100 companies, domestic sales account for just over a quarter of the total, only a little bit more than those made in North America (22%), Asia Pacific (21%) and Europe (17%). Britain's leading companies really are a proxy for the global economy. This is less true of the FTSE 250, but even among the mid-caps half of sales are made overseas.

Time to wrap the Union Jack round your portfolio?

So how much should investors allocate to UK shares at the moment? On the basis of their comparative valuation advantage and the built-in overseas exposure of the largest companies, a UK-based investor could easily justify holding a quarter of their portfolio in British funds or shares today.

Within this UK allocation, what should the main investment focus be? Given the uncertainty likely to surround the Brexit process for years to come – let's not forget that the negotiation of trade terms has not even begun yet – I would maintain a prudent balance between cyclical and defensive stocks, growth and value, domestic and international exposure. Without a crystal ball, it is simply impossible to know which of these tilts will pay off in the medium term.

I would look for contrarian opportunities where cyclical and secular headwinds have created significant undervaluation. One area that springs to mind is real estate, where discounts to asset values have widened dramatically and probably exceed actual reductions in valuations. There are likely to be some bargains in the bombed-out retail space too.

Countering the domestic value plays, I would maintain plenty of exposure to international growth opportunities, especially in areas that have suffered sector-specific headwinds like the oil and gas industry. Companies like BP and Shell have responded to a lower average oil price with self-help, creating a much more cost-conscious industry that can make decent profits and continue to pay attractive dividends with less assistance from the market.

Areas that I would steer clear of include the banks, which really need a significant uplift in bond yields to widen the margin between the rates at which they borrow and lend. Without that cushion, this is a sector with high costs and increasing regulatory and competitive threats.

Thanks to the appetite of British investors for home-grown investments there is no shortage of good UK funds, with a range of growth and income tilts and a focus on all the size bands from blue-chips to micro-caps.

Fidelity's Select 50 list of preferred funds includes nine of the best of these. Two that I would particularly highlight are:

- Nick Train's Lindsell Train UK Equity Fund. A quality-focused fund with a highly-concentrated portfolio of only around 25 shares. This is a more defensive play if you think that the economic headwinds will persist this year.

- Alex Wright's Fidelity Special Situations Fund. This is a more cyclical, value-focused fund that will do well if the economy picks up in a more stable post-Brexit environment.

Buy British never did catch on. But in investment, following the crowd was never a good strategy. Now might just be the time to wrap the Union Jack round your portfolio.

"I WOULD LOOK FOR CONTRARIAN OPPORTUNITIES WHERE CYCLICAL AND SECULAR HEADWINDS HAVE CREATED SIGNIFICANT UNDERVALUATION."

Sources:

- **Investment Association: https://www.theinvestmentassociation.org/fund-statistics/statistics-by-sector.html?what=table&show=21**
- **Wage growth and inflation: https://news.sky.com/story/real-wage-growth-climbs-to-two-year-high-11641799**
- **Goldman Sachs UK Weekly Kickstart report FY18**
- **FTSE 100 yield and gilt yield: Financial Times**

IMPORTANT INFORMATION

The value of investments and the income from them can go down as well as up so you may get back less than you invest. Investors should note that the views expressed may no longer be current and may have already been acted upon. Please remember, this is not a personal recommendation to buy funds. If you are unsure about the suitability of an investment you should speak to an authorised financial adviser. The Lindsell Train UK Equity Fund invests in overseas markets so the value of investments can be affected by changes in currency exchange rates. It also invests in a relatively small number of companies so may carry more risk than funds that are more diversified. Fidelity Special Situations Fund invests more heavily than others in smaller companies, which can carry a higher risk because their share prices may be more volatile than those of larger companies. It also uses financial derivative instruments for investment purposes, which may expose the fund to a higher degree of risk and can cause investments to experience larger than average price fluctuations.

BY FILIPE R. COSTA

THE MACRO INVESTOR

INVESTING IN THE "TECH-TONIC" SHIFT

FIVE BRAND NEW ETFs TO PLAY UPCOMING TRENDS

"The world is changing very fast. Big will not beat small anymore. It will be the fast beating the slow."

- Rupert Murdoch

As growth in the passive investment world continues, this month's edition of "The Macro Investor" is devoted to a fresh offering of thematic Exchange Traded Funds (ETFs). Resulting from a partnership between Goldman Sachs, the investment banking giant, and Motif, a small US company that provides data-driven investment themes and portfolios, the new ETFs aim to benefit from nascent trends that are expected to push the growth potential of some companies further than the rest of the market.

These new companies will be the new "tech" companies of the 2020s. But, unlike what happened in the 1990s, when technology stocks were at the forefront, today's "tech" revolution seems to be broader, spread across the entire economy and multiple asset classes. This means there isn't a simple index, like the Nasdaq, to capture all the new juice.

Nevertheless, through the use of data-driven algorithms, it is possible to build portfolios that capture the required characteristics and factors of the trend. That's what Motif does. The company has created five sub-

"THE NUMBER OF ETFs AVAILABLE IS GROWING BY THE DAY AS MORE AND MORE INVESTORS SEEK TO GAIN GREATER INDEPENDENCE FROM FUND MANAGERS."

"INVESTORS WITH LIMITED FINANCIAL KNOWLEDGE AND RESOURCES (I.E. TIME, MONEY AND PATIENCE) CAN USE ETFS TO GAIN EXPOSURE TO THE WHOLE MARKET OR TO JUST A SMALL SECTION OF THE MARKET."

themes for the upcoming trends and partnered with Goldman Sachs to market them in the form of five passively managed ETFs.

ETFs offer unlimited possibilities

The number of ETFs available is growing by the day as more and more investors seek to gain greater independence from fund managers. A few years ago it was about replicating major indices, like the S&P 500, and making them investible. However, the industry has changed and the number of offerings has expanded to include indices from around the world, groups of stocks, bonds of different risk profiles, riskier and riskless assets and very specific investment themes like obesity (the fight against), artificial intelligence (its growth), and longevity (its increase). With that in mind, if you want to invest in a specific theme, it is advisable, before anything else, to take a look at the database of ETFs, because it's likely that what you're looking for has already been covered.

From the perspective of retail investors, the rise of the ETF is one of the most important developments of the last two decades in terms of portfolio management, in my opinion. An institutional investor or someone with a considerable amount of money can invest into a hedge fund, but retail investors with £10,000, £50,000 or even £200,000 are often excluded from such investment because they do not satisfy the minimum investment amount requirement. At the same time, the fund charges are usually very high, thus eating into profits.

The only real alternative to hedge funds for retail investors is to buy assets directly and build one's own portfolio; however, selecting the right investments requires skill and time and ensuring that the portfolio is diversified can be costly and challenging. How can someone with €10,000 diversify across 30 to 50 stocks?

Fortunately, the passive investment industry brings a whole new world of possibilities for retail investors. It is now possible to gain exposure to the 500 stocks of the S&P 500 with just $280, by investing in the **SPDR S&P 500 ETF (NYSEARCA:SPY)**. For those willing to build a traditional 60/40 portfolio (i.e. 60% investment in equities and 40% investment in bonds), you're able to do so easily, by investing in both the **Vanguard Total Stock Market ETF (NYSEARCA:VTI)** and the **Vanguard Total Bond Market ETF (NASDAQ:BND)**. And it would cost only 0.044% per year in fees!

There are a plethora of other ETF options to invest in, such as funds that offer exposure to factors rather than asset classes, as I previously outlined in Factor Investing: How To Build A Portfolio For Upcoming Turbulence (Master Investor Magazine, issue 45, December 2018). Other options include ETFs that offer exposure to value, size, low volatility and small capitalisations.

Investors with limited financial knowledge and resources (i.e. time, money and patience) can use ETFs to gain exposure to the whole market or to just a small section of the market. Furthermore, they can easily top-up their portfolios every month.

A new "Motif" offering from Goldman Sachs

The key benefit of investing in the new "Motif" ETF offering is the exposure it provides to new technological trends and companies that are likely to grow on the back of such future trends, enabling investors to reap above market returns. Motif uses data science and automation to analyse and then identify these new trends and then captures them in portfolios in which investors can invest, cheaply and easily. The portfolios are usually composed of just 20 assets and provide creative, if not eccentric, investment themes. Example portfolios include *biotech breakthroughs, software as a service, world of sports, modern warfare, bullet-proof balance sheets,* and *taking flight.*

NEW GOLDMAN SACHS MOTIF ETFS – KEY CHARACTERISTICS

	GBUY	GMAN	GDNA	GFIN	GDAT
Expense Ratio	0.50%	0.50%	0.50%	0.50%	0.50%
Inception	1/Mar/2019	1/Mar/2019	1/Mar/2019	1/Mar/2019	1/Mar/2019
Tracking Index	Motif New Age Consumer Index	Motif Manufacturing Revolution Index	Motif Human Evolution Index	Motif Finance Reimagined Index	Motif Data-Driven World Index
No. of Holdings	119	121	120	120	119
% Assets in Top 10	22.9%	21.6%	29.0%	25.1%	24.7%
Top Sectors	Cons.Discr. (54.7%) Comm. Serv. (34.9%)	Industrials (34.4%) Inform. Tech. (31.5%)	Health Care (99.1%)	Inform. Tech (55.7%) Financials (31.4%)	Inform. Tech. (78.4%) Comm. Serv. (9.7%)
Net Assets	USD 5.05m	USD 4.82m	USD 5.03m	USD 5.06m	USD 5.02m

Data Source: Goldman Sachs

"GOLDMAN SACHS AND MOTIF BELIEVE THAT THE CURRENT TECHNOLOGICAL CHANGES PERMEATE SEVERAL DIFFERENT INDUSTRIES INSTEAD OF OCCURRING WITHIN A SINGLE ONE."

Goldman Sachs and Motif believe that the current technological changes permeate several different industries instead of occurring within a single one. This is what they call a "tech-tonic" shift that leads to a few nascent investment themes that are "potential drivers of secular change and capture future earnings growth". Beginning in March, Goldman and Motif partnered to launch five ETFs to allow investors to take part in these nascent trends.

GS Motif New Age Consumer ETF

The **Goldman Sachs Motif New Age Consumer ETF (NYSEARCA:GBUY)** invests in companies that are positioned to benefit from structural shifts in the way we consume goods and services, due to changes in demographics, technology and consumer preferences. With $5 million under management, the fund invests in 119 stocks from around the world, with a particular focus on the US market. It is designed to offer exposure to companies from developed markets that may benefit from the ongoing structural shifts in the consumer market. Top holdings are **Amazon.com (NASDAQ:AMZN)** (3.4%), **Alibaba Group (NYSE:BABA)** (3.2%), and **Facebook (NASDAQ:FB)** (3.2%).

GS Sachs Manufacturing Revolution ETF

The **Goldman Sachs Motif Manufacturing Revolution ETF (NYSEARCA: GMAN)** invests in companies that are positioned to benefit from the technology-driven transformation of the manufacturing industry, including the emergence of new processes, products and energy sources. Its top holdings are **Dassault Systemes SE (EPA:DSI)** (2.7%), **Rockwell Automation (NYSE:ROCK)** (2.5%), and **ABB (NYSE:ABB)** (2.5%).

GS Motif Human Evolution ETF

The **Goldman Sachs Motif Human Evolution ETF (NYSEARCA:GDNA)** targets companies that are well positioned to benefit from advances in medical treatment and technology, from robotic surgery and precision medicine to gene therapy and care for an older population. Investor interest in this theme has grown as life expectancy continues to increase. Unlike the other ETFs in the list, the fund is almost exclusively focused on just one sector – healthcare. Top holdings are **Intuitive Surgical (NASDAQ:ISRG)** (4.7%), **Medtronic (NYSE:MDT)** (4.3%), and **AstraZeneca (LON:AZN)** (3.1%).

GS Motif Finance Reimagined

The **Goldman Sachs Motif Finance Reimagined ETF (NYSEARCA:GFIN)** invests in companies that are expected to benefit from the evolving financial landscape, from the digitisation of traditional financial services to the development of block-chain technology. The fund is primarily exposed to infor-

> **"ONE THING THAT IS EVIDENT IS THE OUTPERFORMANCE OF THE MOTIF INDICES RELATIVE TO THE S&P 500 IN THE LAST THREE YEARS."**

mation technology and financials and is designed to benefit from structural changes in the support and delivery of financial services. Top holdings are **Mastercard (NYSE:MA)** (4.8%), **Visa (NYSE:V)** (4.2%), and **PayPal Holdings (NASDAQ:PYPL)** (2.9%).

GS Motif Data-Driven World

The **Goldman Sachs Motif Data-Drive World ETF (NYSEARCA:GDAT)** targets companies that will likely benefit from the proliferation of data, capitalising on data storage, security and analysis, as well as artificial intelligence and machine learning. The ETF is designed to deliver exposure to companies betting on the rapid increase in digital data, in particular the life-cycle of data delivery and processing. It is highly exposed to information technology (78.4%) and its top holdings are **Intel Corp (NASDAQ:INTC)** (3.2%), **Alphabet (NASDAQ:GOOG)** (3.1%), and **Microsoft (NASDAQ:MSFT)** (3.1%).

A Brief Analysis of The ETFs

In order to accurately analyse the performance of the above five ETFs, one requires data on historical returns; however, these funds were created only a month ago and historical data is not available yet. But not all is lost. These funds track indices, for which there are historical records. And if we assume that the tracking error of professional managed funds is small, we can analyse the indexes that these ETFs track to then determine the performance of the ETFs. Such analysis can provide guidance on the future performance of the ETFs, both relative to themselves and the broader market.

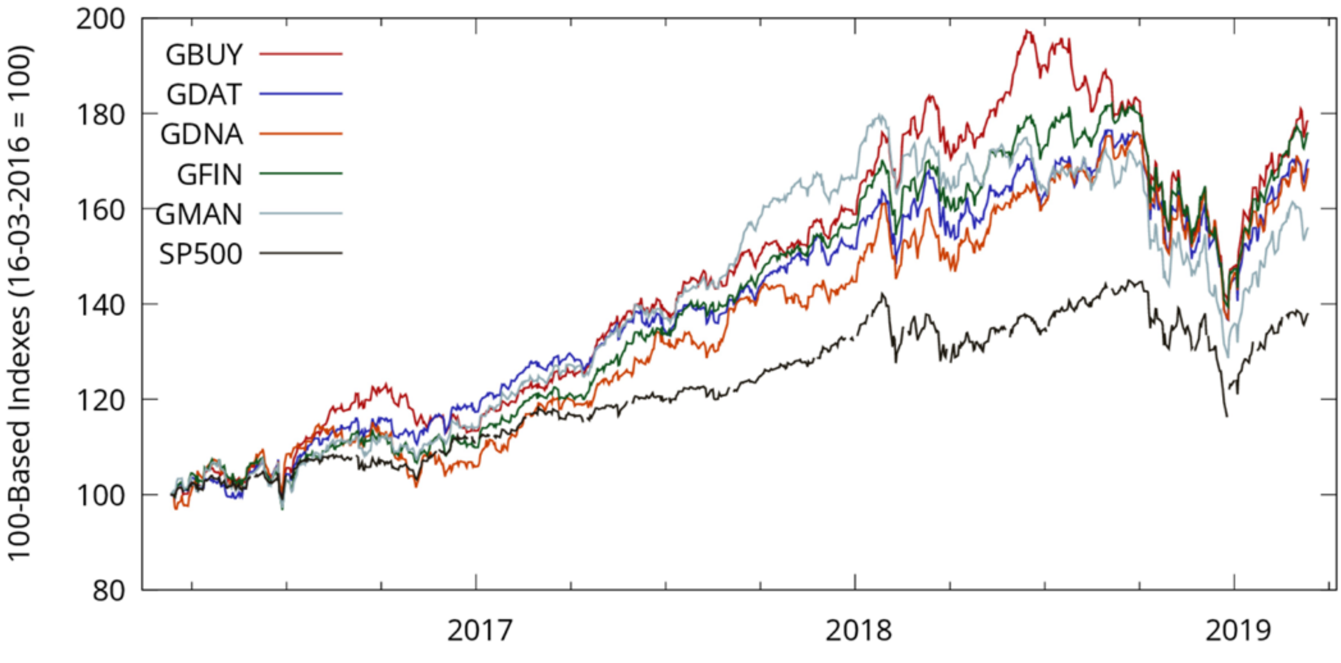
With this in mind, I collected daily returns over a 3-year period for each of the following indices:

- Motif New Age Consumer Index (tracked by the GBUY ETF)
- Motif Manufacturing Revolution Index (tracked by the GMAN ETF)
- Motif Human Evolution Index (tracked by the GDNA ETF)
- Motif Finance Reimagined Index (tracked by the GFIN ETF)
- Motif Data Driven World Index (tracked by the GDAT ETF)

First of all, let's plot these indices along with the S&P 500 to see how they performed over the last three years.

One thing that is evident is the outperformance of the Motif indices relative to the S&P 500 in the last three years. While the S&P 500 rose by 38.0% in the period, the Motif indices rose by between 56.1% (GMAN) and 78.5% (GBUY). In fact, not a single index performed below the broad market.

Motif Indexes Vs. S&P 500 (3-Years)



In order to get a complete picture, let's complete the analysis and consider risk, as measured by standard deviation of returns. The daily standard deviation of returns for the S&P 500 was 0.766% in the period, while for the Motif indexes it varied between 0.876% (GMAN) and 0.976% (GDNA). This means that the ETFs were riskier. However, it's better to consider risk relative to returns (i.e. risk-adjusted returns) and in order to do that, we can use the Sharpe ratio. For this calculation, I use the 10-year Treasury bond yield for the risk-free rate and annualised figures, for both standard deviations and returns.

From the pack, the S&P 500 index is the lowest ranked portfolio, with a Sharpe ratio of 0.722. The Sharpe ratios of the Motif indices ranged between 0.914 (GMAN) and 1.185 (GBUY), which confirms their superior risk-adjusted returns for the period under analysis.

The above data is still not enough to draw complete and accurate conclusions and I have assumed that the portfolio managers of Goldman Sachs are able to track Motif indices with minimal tracking error. Still, the analysis serves as evidence that the new ETFs are well conceived and it may be worth paying the 0.50% fee for them. But one last question remains:

Should you buy all these five ETFs at once and add them to your portfolio?

To answer this, I computed the correlations between all of the ETFs.

The table shows that the lowest correlation between the five ETFs is 0.7394 and that was between GDNA and GMAN; however, such a number is still quite high. The highest correlation is 0.9330, between GDAT and GFIN. Additionally, the correlation between each ETF and the S&P 500 is also high, varying between 0.7868 (GDNA) and 0.8912 (GDAT).

What does it all mean? The five ETFs under consideration and the S&P 500 vary, to a large extent, in the same direction and proportion, and, consequently, adding all ETFs to a portfolio would lead to minimal diversification. Investors, therefore, may be better off choosing just one of these ETFs.

MOTIF INDEXES – KEY STATISTICS

	GBUY	GMAN	GDNA	GFIN	GDAT	SP500
Total Return	78.45%	56.05%	68.46%	75.98%	70.32%	38.04%
Daily Return	0.078%	0.061%	0.072%	0.077%	0.073%	0.045%
Daily Standard Deviation	0.909%	0.876%	0.976%	0.910%	0.961%	0.766%
Annualised Standard Deviation	14.44%	13.90%	15.49%	14.45%	15.26%	12.16%
Sharpe Ratio	1.185	0.914	0.995	1.153	1.031	0.722

Data Source: Thompson Reuters, Own Calculations

CORRELATIONS BETWEEN MOTIF INDEXES AND THE S&P 500

GBUY	GMAN	GDNA	GFIN	GDAT	SP500	
1.0000	0.8415	0.7646	0.8956	0.8894	0.7927	**GBUY**
	1.0000	0.7394	0.8565	0.8670	0.8177	**GMAN**
		1.0000	0.7896	0.8007	0.7868	**GDNA**
			1.0000	0.9330	0.8789	**GFIN**
				1.0000	0.8912	**GDAT**
					1.0000	**SP500**

Notes:
Correlation coefficients using observations between 2016-03-14 and 2019-03-12
5% critical value (two-tailed) = 0.0728 for n = 726

Data Source: Thompson Reuters

Final comments

The passive investing offering is growing. Retail investors can now more easily diversify their portfolio and choose investment themes that are more aligned with their own goals. The use of data-driven algorithms helps to spot patterns in data and to then more easily disentangle returns into different layers to recreate the desired portfolio. In today's world, investors can pick themes rather than asset classes and control risk in a much better way. The five new ETFs from Goldman Sachs seem to add value to the current already extended offer in terms of risk adjusted returns. Still, investors must be careful and evaluate the diversification benefits of adding several of these ETFs to their portfolios given the high correlation between them. Often, the actual diversification from adding several ETFs to a single portfolio may be less than expected.

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 DAVID JONES

CHART NAVIGATOR

CHARTING PATTERNS

USEFUL – OR JUST STARING AT TEA LEAVES FOR INVESTORS?

It is understandable why some people dismiss charting and technical analysis as just gobbledegook and hocus pocus. It has been more than 20 years since I qualified as a technical analyst and I am still deeply sceptical of lots of the approaches. In particular, those that try to assign some sort of future importance to every little squiggle of price movement – some movements *are* just random and not everything is significant. But I do believe that looking at what a market is doing – studying the price action – can show changes or shifts in investor sentiment. One way of spotting these is using the various patterns that are a major part of technical analysis for some chartists, so it is a topic that is worthy of coverage.

I have to admit to still not being the greatest fan of patterns. One of the problems I have is the subjectivity involved in actually spotting some of them. They can sometimes appear to be like the Rorschach inkblot test – or those Magic Eye pictures from the '90s where if you squint long enough you should be able to see a tyrannosaurus rex or albatross. These patterns on price charts can often be easier to spot with the benefit of hindsight – which is not too helpful to those of us without a time machine as part of our investing toolkit. But they can still be useful for some – broadly speaking they can be divided into "reversal" or "continuation" patterns.

Reversal patterns suggest that a trend that has been in place for some time (either up or down) could be on the turn, which can give us the signal to either take profits on an existing position, or open up a new trade or investment in the direction of the anticipated new trend. Continuation patterns can be a signal that a sideways move in the current trend is just a pause before it resumes its previous direction – some would see this as an opportunity to jump on board that particular trend. As trend reversals tend to be more popular with investors and traders, let's take a look at some of the more popular patterns.

"REVERSAL PATTERNS SUGGEST THAT A TREND THAT HAS BEEN IN PLACE FOR SOME TIME (EITHER UP OR DOWN) COULD BE ON THE TURN."

Trend Reversal: Double Bottom

The psychology behind a double bottom is really straight forward enough, and one that I think makes a lot of sense in the real world. I

> **"WITH DOUBLE BOTTOMS IT IS THE 'HEIGHT' OF THE PATTERN PROJECTED FROM THE BREAKOUT POINT THAT GIVES US THE TARGET."**

also feel they are one of the easiest to spot – if this pattern is forming on a price chart it really should just jump out at you. Ahead of the pattern, the share is weak, then makes a low and recovers. As with previous rallies in the downtrend, this subsequent bounce back runs out of steam and the price turns lower once more. The expectation is for the downtrend to continue and for the previous low to be broken. But unlike before, that previous low is not broken and starts to show first signs of support – the share price starts to rise.

We have the start of a suspected double bottom pattern – is market sentiment turning and that previous low now seen as something of a bargain price? The pattern is said to be complete when the previous high just before that second low is broken. Some chartists will use patterns such as this to generate price targets. With double bottoms it is the "height" of the pattern projected from the breakout point that gives us the target.

The example below is FTSE350 financial business **St James Place (LON:STJ)**. The share price makes a low in December around 900p, then rallies to 1,000p before sliding back again. But the slide stops above the previous December low – the potential for a double bottom is there. When the price rallies and breaks through that previous 1,000p high this time around, the pattern is complete. The height of the pattern is 100p (1,000p – 900p), so the target following the breakout is the same, giving us 1,100p as an objective.

Trend Reversal: Double Top

Not surprisingly, for every positive reversal pattern on a chart there is a negative one that suggests an uptrend – or indeed bounce in a downtrend – is coming to an end. If we flip over a double bottom, then this gives us the double top pattern. The psychology is a mirror image of what happens when a double bottom is formed. With a double top, there is a previous rally in the share price that hits a high, before pulling back slightly. This does not yet change the previous uptrend. The assumption for now is that the drop back is just a normal pullback within that main uptrend. But as the price pushes higher once again it fails to break through that previous rally high and the trend does not hit higher highs. This is the first sign that a double top may be in the offing. As with a double bottom, the breakout through the previous level is the sign that the pattern is complete, and the height of the pattern can be used to try to forecast an objective.

Here's the example in **Wizz Air Holdings (LON:WIZZ)**. You can see that it is a double bottom just flipped over. The price trades up to 3,800p and then drops back to 3,400p. The subsequent rally doesn't break through that pre-

vious high of 3,800p – the price drops back again and ultimately breaks below 3,400p, completing the double top. With a height of 400p for the pattern, the target is 3,000p following the break through support.

Trend Reversal: Head & Shoulders

The cynical observer of patterns could be forgiven for thinking that chartists can come up with some sort of significance for every possible market movement – a view that is not without some weight! So, when something is not quite a double top or a double bottom it could actually be a head and shoulders. Again, as this is a reversal pattern, there needs to be a prior trend to reverse – either up or down. If we choose an uptrend as our example, the market is progressing steadily higher, making higher highs and lows, but importantly the latest high does not break the previous high. This lets us draw a form of sloping support known as the "neckline". When this is broken, that is the completion of the head and shoulders pattern, with most people using the height of the "head" (the middle extreme) as the target from the neckline break.

You can see the pattern in the chart of FTSE350 industrial business **Weir Group (LON:WEIR)**. The share price rallies in April, makes a higher high in May but a lower high in June. The head and shoulders is on – the break through the neckline around 2,100p in June completes the pattern, giving a target of around 1,900p.

I don't claim that these sorts of patterns work all the time – and personally, as mentioned, I have a lot of problems spotting them. But where they are valid is showing sentiment and momentum potentially changing or slowing, and this can be a useful "heads-up" for traders and investors alike.

Ticket Offer

Meet me and the rest of the team behind Master Investor Magazine on 6th April – just use the discount code JONES to claim your complimentary ticket here.

Chart of the Month

Given that this month's theme is patterns, I thought we should stick with that for the chart of the month and I have pored through some charts to try to find a double bottom. This has been a little difficult! Given the strong recovery in stock markets, plenty of shares are in strong uptrends and the double bottoms, if any, occurred last year. But I did find a FTSE100 share of interest – consumer goods company **Reckitt Benckiser (LON:RB.)**.

The share price hit a low in January but has found support in the 5,600p region. There was a decent rally into February that saw the Reckitt share price peak around 6,400p before dropping back. But importantly the slide did not take out that previous low and since then the share price has recovered – again, there is the potential for the double bottom.

To complete the pattern, Reckitt Benckiser needs to rally through that February high at 6,400p. As the "height" of the double bottom is 800p (6,400p – 5,600p), then a break through 6,400p would give a target of 7,200p.

As I always say, nothing works all the time and sensible risk management is important. Every investor or trader needs a strategy to get out for a manageable loss if the pattern is not playing out as expected. But every reversal of a major downtrend starts with a gradual shift in sentiment – and I think the patterns discussed this month all have their place in helping with this.

"TO COMPLETE THE PATTERN, RECKITT BENCKISER NEEDS TO RALLY THROUGH THAT FEBRUARY HIGH AT 6,400 PENCE."

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.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BY NICK SUDBURY

FUNDS & TRUSTS IN FOCUS

REACH FOR THE STARS

CAN SUPERSTAR FUND MANAGERS OUTPERFORM CONSISTENTLY?

With all of the thousands of different funds available in the market, it is inevitable that some will deliver outstanding performance relative to the rest. When this happens over an extended period of time, it becomes more noteworthy and is often attributed to the skill of the manager who receives star billing. The big challenge is whether they can repeat their success, especially if they attract a big money move elsewhere.

Recent research by Willis Owen suggests that funds run by star managers tend to experience a significant drop in their outperformance when the incumbent leaves their role. The study found that the average active annualised returns when measured against the sector average fell by almost 90% from 3.63% to 0.38%.

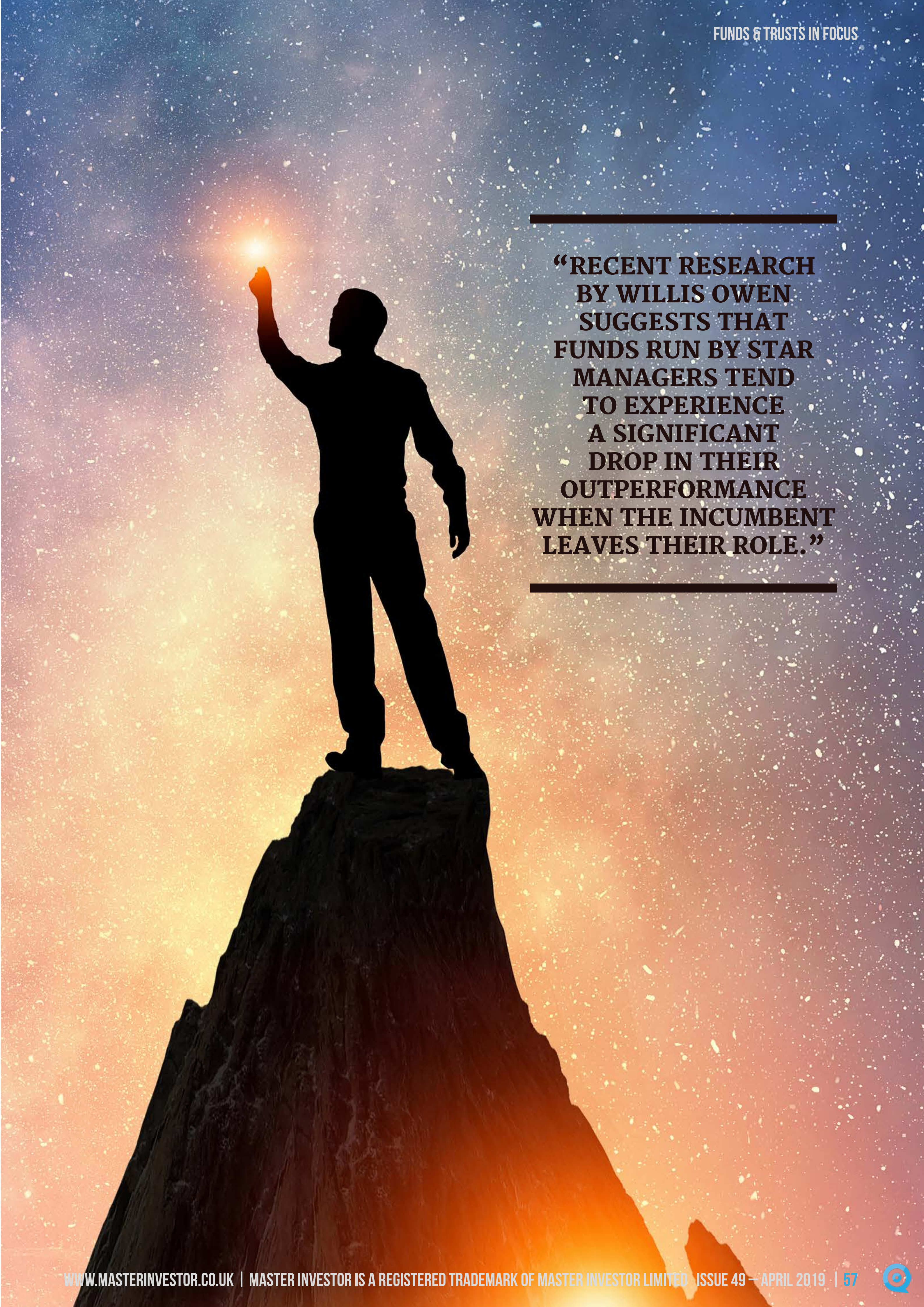
The analysis looked at the performance of 15 funds that lost star talent between 2013 and 2017, with the departees including Schroder's Richard Buxton, Invesco's Neil Woodford and Stewart Investors' Angus Tulloch.

Adrian Lowcock, head of personal investments at Willis Owen, says that investors shouldn't ignore star managers, but it is also presumptuous to think that the only thing that made them a star is their own ability. "I think the right environment, team and controls are required to support a star manager, so if they leave to go to somewhere else it is important that the new firm has those controls in place", Lowcock added.

Falling star

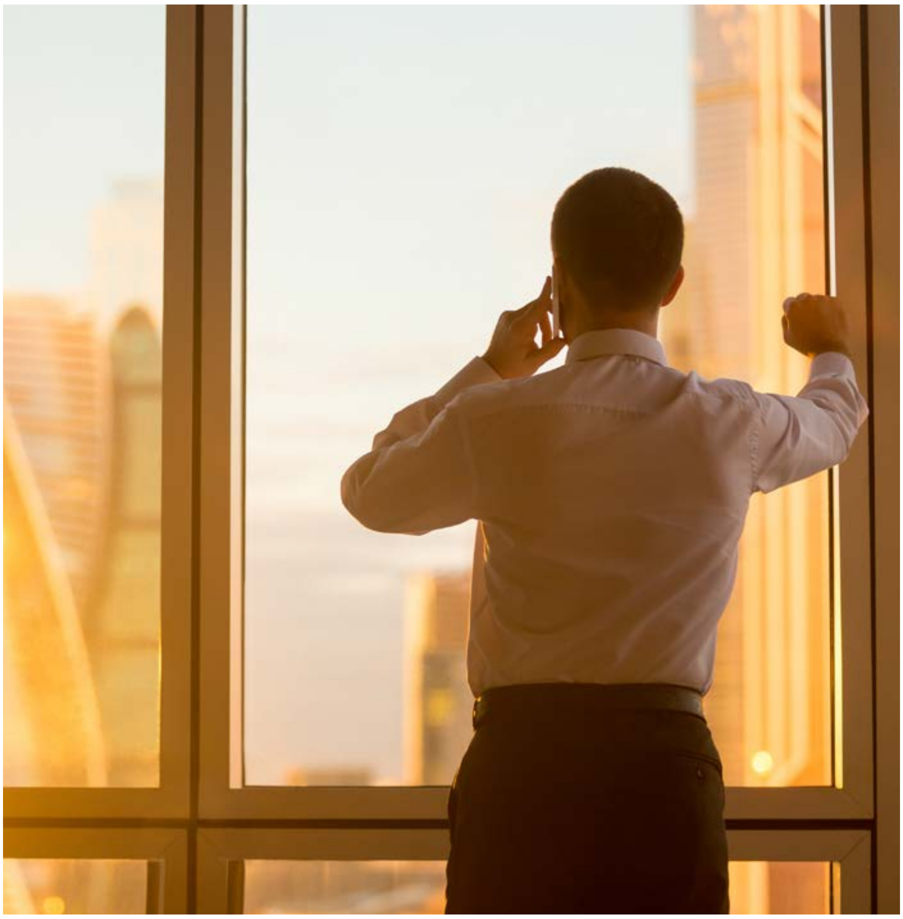
One of the highest profile managers who may have fallen victim to this is Neil Woodford, who made his reputation at Invesco Perpetual. Between 1988 and 2014, his High Income fund made an average annual return of 13.24%, which was comfortably ahead of the 9.3% recorded by the FTSE All-Share index.

When he left to set-up his own company, Woodford Investment Management, he attracted a huge amount of investor interest. Those who followed him were well rewarded as in the first two years his **Woodford Equity Income** fund returned a little over 20%, compared to the sector average of just 9.7%, but since then it has all gone horribly wrong.



"RECENT RESEARCH BY WILLIS OWEN SUGGESTS THAT FUNDS RUN BY STAR MANAGERS TEND TO EXPERIENCE A SIGNIFICANT DROP IN THEIR OUTPERFORMANCE WHEN THE INCUMBENT LEAVES THEIR ROLE."

"HIRING A STAR MANAGER IS NORMALLY A SUCCESSFUL WAY OF ATTRACTING NEW INVESTORS TO A FIRM, HENCE THE REASON THAT THEY TEND TO BE POACHED ONCE THEY HAVE ESTABLISHED THEIR REPUTATION."



"Woodford made his name on a large call on tobacco stocks, whilst successfully avoiding financials. To achieve the performance he did, he has had to be very contrarian, which means being out-of-favour with the rest of the market. He has tried this approach again with pharmaceuticals and more recently with residential property," explains Lowcock.

At one point his Woodford Equity Income fund had more than £10bn in assets under management, but the combination of poor performance and investor outflows has sent the figure plummeting to less than £5bn. This has led him to swap some of his illiquid, unquoted holdings for shares in his **Woodford Patient Capital Trust (LON:WPCT)**, although this vehicle has also been struggling.

"The processes that Woodford had been used to at Invesco were more robust than at his own firm, which means that the controls have not been as effective nor the challenge to his decisions as strong. This has led to some stock specific and portfolio construction issues. If he fails to deliver in a post-Brexit world then I think investors will lose patience with him," warns Lowcock.

Poached or scrambled?

Darius McDermott, MD of Chelsea Financial Services, says that star fund managers are worth following. "There are a handful of fund managers who have managed to outperform their index and their peer group most years, over a very long time period. This is not easy and their consistency in doing so is evidence of their skill."

Hiring a star manager is normally a successful way of attracting new investors to a firm, hence the reason that they tend to be poached once they have established their reputation. A good example of this is Richard Buxton, who achieved considerable success running the **Schroder UK Alpha Plus** fund until he left to join Old Mutual Global Investors – now Merian Global Investors – in 2013.

Buxton's £1.8bn **Merian UK Alpha fund** has a concentrated portfolio of 34 holdings, but his famed stock picking ability doesn't seem to have been up to scratch at his new firm. The fund has only returned 22.5% over five years compared to a sector average of 28.7% making it a fourth quartile performer.

McDermott acknowledges that Buxton has had a difficult few years and says that the underperformance has partly been due to a couple of stock-specific issues, but is mainly because he hasn't 'enjoyed' QE.

"The suppression of bond yields (through very low interest rates) has distorted valuations in the stock market with growth stocks getting more expensive and value stocks getting cheaper. This means he has had a 'style headwind'."

Buxton was also CEO of his new company for a number of years, during which he took it through a management buyout and brand change, which may have been a distraction from his asset management responsibilities.

"He is now focused purely on the funds he is running and is just as passionate as ever. He has a number of new stocks on his radar, which he may be adding to the portfolio shortly and which he thinks could have material upside potential. I fully believe that he can turn the performance around," notes McDermott.

"IF A STYLE BECOMES OUT-OF-FAVOUR THERE IS VERY LITTLE A MANAGER CAN DO, IT IS OFTEN JUST A CASE OF THEM BEING PATIENT AND CONTINUING TO DO THEIR JOB WHILST THEY WAIT FOR THE MARKET TO TURN."

Growth managers in vogue

Sometimes an investment style can outperform for years and this can help the managers that operate in that area, while hindering those that don't. This has been particularly evident since the 2008 financial crisis when growth has beaten value hands down, with two of the highest profile beneficiaries being Terry Smith and Nick Train.

"If a style becomes out-of-favour there is very little a manager can do, it is often just a case of them being patient and continuing to do their job whilst they wait for the market to turn. This is the only real approach they can take as changing style can be much more damaging to investors' wealth and the manager's reputation," explains Lowcock.

Terry Smith's £17.5bn **Fundsmith Equity** fund is ranked second out of the 307 funds in the Global Sector with a 5-year return of 150.1%. Smith uses extremely stringent investment criteria that very few companies meet, hence the reason for the concentrated 27-stock portfolio.

Smith's fantastic performance record enabled his **Smithson Investment Trust (LON:SSON)** to raise a record breaking £822.5m when it floated on the London Stock Exchange last October, despite the fact that he is only offering 'support and advice' to the managers.

Another star growth manager who applies tough investment criteria is Nick Train. His £6.2bn **Lindsell Train Global Equity** fund is ranked just behind Fundsmith Equity in third place in the Global sector with a 5-year return of 142.5%, while his **Lindsell Train UK Equity** fund and **Finsbury Growth & Income Trust (LON:FGT)** are also highly regarded.

"Both Terry Smith and Nick Train sit at the top of their peer group and their investment philosophy has certainly been in a sweet spot, but it is as a result of hard work and analysis," notes Lowcock.

Star income managers

Ben Willis, head of portfolio management at Chase de Vere, says that investing is an inexact science, but there are managers who clearly can deliver better relative and/or absolute returns than their peers over the long-term.

"These people are worth following but not in isolation. As we have seen over the years, star fund managers are not infallible and will suffer periods when they underperform."

One example is Henry Dixon, who has run the **Man GLG UK Income** fund since October 2013. Over the last five years it has returned 58.73% compared to a sector average of just 27.8%, which puts it in first place out of the 77 funds operating in its peer group.

Willis says that it is important to remember that although Dixon has enjoyed success over the medium to long-term, there have been periods when his style has been out-of-favour and he has materially underperformed.

"Clearly, he has designed a philosophy and process that can work over the long-term and this is one of the basic tenets of investing, which we tend to lose sight of – that investing in equities is a long-term game."

Operating in the same sector is the £5.5bn **Artemis Income** fund that has been managed by Adrian Frost since January 2002. Since the launch in June 2000, it has returned almost 400%, which is three times the return of the FTSE All-Share index, and is ranked first out of the 26 funds in the sector that have been in existence over the same time period.

Laith Khalaf, senior analyst at Hargreaves Lansdown, says that Adrian Frost is one of the most experienced UK Equity Income managers.

"He looks for companies that can sustain a growing dividend, and for them this means a strong focus on companies delivering high cash flows. Frost has used the same disciplined approach for decades with great success, and we think the fund could be a great core holding for investors looking for a growing and sustainable income well into the future."

European star

Another outperformer is Alex Darwall who runs the **Jupiter European** fund and the **Jupiter European Opportu-**

FUND OF THE MONTH

JOHCM UK Dynamic was launched just over 10 years ago and was designed and managed throughout by Alex Savvides, who has been tipped by both Chelsea Financial Services and Chase de Vere.

McDermott says that Savvides invests in UK companies that are undergoing substantial positive change that is unrecognised in the current share price.

"Each holding in the portfolio must pay a dividend, a discipline designed to underpin the valuation and limit the impact of mistakes. The result of this is that, unusually for a UK All Companies fund, it also provides a reasonable level of income, currently 3.4%."

His value style of management has largely been out of favour for most of the last decade, yet despite that the fund has beaten its peer group average in 8 of the 10 past calendar years, and this means the performance since launch has been first quartile, with a return of 195.85%, compared to just 96.7% for the UK All Companies sector average.

Fund Facts

Name:	JOHCM UK Dynamic
Type:	UCITS
Sector:	UK All Companies
Total Assets:	£1.2bn
Launch Date:	June 2008
Historic Yield:	4.17%
Ongoing Charges:	0.79%
Website:	www.johcm.com

The £1.2bn fund provides exposure to a concentrated 45-stock portfolio of UK shares, with the largest holdings including the likes of BP, Shell, GSK, Anglo American, Lloyds Bank and HSBC. It has generated an average annualised return since launch of 10.5%, compared to just 6.2% from its FTSE All-Share benchmark.

nities Trust (LON:JEO). The £5.3bn Jupiter European has a concentrated 40-stock portfolio and over the last ten years of Darwall's tenure has returned 335%, which is more than double the benchmark and sector average, making it the top ranked performer out of 74.

Khalaf says that managers can consistently outperform, though there are no guarantees, so investors should never keep all their eggs in one basket.

"We decompose the returns by style, sector, and geography to see whether their record can be explained by simply being in the right place at the right time, or the result of stockpicking skill, which is what we are looking for. If a manager demonstrates significant outperformance on this basis over a full economic cycle (at least seven years) then it's much more likely to be repeatable."

The analysts at Hargreaves Lansdown like managers that stick to their guns through the ups and downs, and as their particular style comes in and out of fashion, and that's something Alex Darwell has done with his portfolio.

"He has always looked for special companies that are in control of their own destiny, and believes that holding those companies for the long-term is what drives success," explains Khalaf.

Both of Darwall's funds have had a tough few months following allegations of financial wrongdoing at their biggest holding, a German payments company called Wirecard. This stock accounts for almost 9% of the open-ended fund and 14.7% of the investment trust.

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 JOHN KINGHAM

DIVIDEND HUNTER

THREE VALUE TRAPS TO AVOID

2018 was a bumpy ride for most investors and I was no exception. The market price of my portfolio declined by more than 10% during the year, but that's not really what I'm talking about. When I talk about a bumpy ride, I mean bumpy in terms of the performance of the companies I'm invested in rather than the performance of their shares. And in that regard, 2018 was too bumpy for my liking.

Don't get me wrong; I'm not saying 2018 was a complete disaster, but it was bad enough to make me take a step back and review my investments and my investment process from the ground up. What I found was that several of my holdings could be classed as value traps, and there were three classes of trap. For each class of value trap, I came up with a fix so that I wouldn't invest in that sort of situation in future, and this month I'd like to focus on these three types of value trap and my related fixes.

Value trap 1: Companies with large recurring 'exceptional' costs

Since 2011 I've been reviewing companies using adjusted earnings (as well as much else besides, such as dividends, revenues and so on). The idea was that adjusted earnings provide a clearer view of a company's 'core' business results, and to some extent that's true. Adjusted earnings focus on the core business by removing one-off 'exceptional' income or expense items. These tend to be things like one-off gains on the sale of a business unit or one-off expenses due to tax or regulatory changes.

If you want to know how a company performed in any single year, then I still think focusing on adjusted earnings and ignoring exceptional items is the way to go. But if you want to know how a company has performed over the long term (and that's exactly what long-term dividend investors should want to know), then reported rather than adjusted earn-

ings are the ones to focus on. That's because reported earnings include all those one-off exceptional income and expense items, and over the long-term those items can really start to add up.

For example, I recently sold **Centrica (LON:CAN)** because it no longer fits my evolving investment criteria. One of the things that didn't fit was the consistently large gap between reported and adjusted earnings (in practice, I use normalised earnings, which are a standardised version of adjusted earnings available from a variety of data providers, but here I'll refer to them as adjusted earnings as they're basically the same thing).

I bought Centrica in 2012 and at the time it had total ten-year adjusted net profits of £8.8 billion. Given that level of earnings, I thought the company was attractively priced. However, its total ten-year *reported* net profits came to just £6.5 billion, meaning the adjusted profits were some 35% higher than reported profits. If I'd looked at reported instead of adjusted earnings, I would have demanded a significantly lower entry price in order to offset those lower earnings. And if I'd invested at a lower price, my losses from Centrica would have been far smaller.

Another example is **N Brown (LON:BWNG)**, the size 20+ and age 50+ fashion retailer, which I've owned for several years. N Brown recently cut its dividend which, if you only look at adjusted earnings, was a bit of a surprise. Adjusted earnings have covered N Brown's dividend every year in recent years, with adjusted dividend cover over the last five years averaging 1.7. However, looking at reported earnings shows that over the last five years reported dividend cover has averaged just 1.2. More importantly, the dividend was barely covered by reported earnings in 2017 and was nowhere near covered in 2018. So, as with Centrica, reported earnings provided a much more realistic picture of N Brown's performance (or lack thereof), rather than the rose-tinted best-case scenario view given by adjusted earnings.

Fix: Look at reported rather than adjusted earnings to get a better picture of a company's actual long-term performance.

Another reason for looking at adjusted earnings is that they tend to be smoother and less volatile than reported earnings. Reported earnings include all those annoyingly large one-off exceptional items that can lead to profits which are up by 50% one year and down by 30% the next. That makes it much harder to measure a company's long-term progress. Adjusted earnings, in contrast, tend to be far smoother, and that makes it much easier to measure a company's growth over ten years, which is the timescale I usually focus on.

That's why, historically, I've used adjusted earnings in my ten-year growth rate calculation, along with revenues and dividends. And so, having just ditched adjusted earnings in favour of reported earnings, I needed to update my growth rate metric. But simply swapping adjusted earnings for reported earnings wouldn't work because the volatility of reported earnings would frequently mess up the growth rate calculation and give misleading results.

For example, if a company's reported earnings were 10p ten years ago and 5p last year, has the company grown or shrunk? The answer is that you have no idea; perhaps earnings will be 25p next year and this year's 5p result was due to a one-off exceptional expense. That's why reported earnings are too volatile to be a useful measure of growth, even over ten years.

For my growth rate metric, I needed to replace adjusted earnings with something that would, in most cases, follow the growth of the company's intrinsic value and earnings power (i.e. its ability to produce earnings rather than its actual earnings in any given year).

I went back to basics and thought about companies in terms of their fundamental inputs and outputs. Money comes into a company from customers as revenues and goes out to shareholders as dividends, which is why I was already measuring revenue and dividend growth on a per share basis. But money also comes into companies in the form of shareholder and debtholder capital. Capital from share-

holders comes from rights issues and retaining earnings, while capital from debtholders comes from bonds or loans of one kind or another.

In simple terms, capital is used to buy productive assets that are then then used to supply products or services which attract revenues from customers. So, one way to look at a company is as a black box which takes in money from shareholders and debtholders (as capital employed) and money from customers (as revenues) and pays out dividends to (or buys back shares from) shareholders.

Or if you don't like black boxes, think of capital employed as the engine of a company, revenues as the fuel going in and dividends as the horsepower coming out. As an investor what you want over time is a bigger engine, sucking in more fuel, producing more horsepower.

As well as being a fundamental feature of companies, capital employed is also a relatively stable number and that makes its true growth rate far easier to measure. Overall then, I thought it made much more sense to measure capital employed growth rather than reported (or even adjusted) earnings growth, in theory at least. In practice, across the 30 or so companies in my portfolio, there is a good correlation between capital employed growth and each company's overall progress in terms of revenue growth, dividend growth and so on.

"AS AN INVESTOR WHAT YOU WANT OVER TIME IS A BIGGER ENGINE, SUCKING IN MORE FUEL, PRODUCING MORE HORSEPOWER."

Of course, no financial metric or ratio has perfect foresight, but I'm confident that capital employed growth is worth paying attention to:

Fix: Instead of measuring earnings growth, measure capital employed growth along with revenue and dividend growth (all on a per share basis) to measure a company's long-term progress.

Having said all that, it's no good having capital employed growth which doesn't eventually result in earnings growth, so you still need to measure earnings. But I prefer to do that indirectly by looking at things like dividend cover and profitability; speaking of which:

Value trap 2) Companies with wafer thin profit margins

What I've finally come to realise is that some companies are like carbon fibre: they're strong but fragile at the same time. They can outperform peers and produce excellent returns for shareholders when the environment is benign, but when the going gets tough they fail catastrophically.

I experienced this years ago when I lost money on **Balfour Beatty (LON:BBY)** and **Serco (LON:SRP)**, both of which were performing well but then suffered dramatic declines. More recently, companies like **Mitie (LON:MTO)** (which I own), Carillion and now **Interserve (LON:IRV)** (which I don't own) have all suffered dramatic declines.

The thread that ties all these companies together, apart from excessive

"IF PEOPLE THOUGHT ABOUT SIGNING A CONTRACT AS TAKING ON A MASSIVE AMOUNT OF RISK AND RESPONSIBILITY INSTEAD OF 'WINNING', THEN PERHAPS THEY'D BE MORE CAREFUL ABOUT WHICH CONTRACTS THEY TRY TO 'WIN'."

amounts of debt, is their thin profit margins, relatively fixed costs and their need to win large contracts with large customers. This is a toxic mix if ever there was one.

Companies like Interserve need to win large contracts with large customers, and because the contract is large and expensive the customer is usually very cost and quality conscious. That makes perfect sense: When you buy a can of coke you probably buy it with barely a moment's thought, but if you're selecting a contractor to fulfil a multi-million-pound contract, you're going to take a lot of proposals and take a lot of time to do a lot of due diligence. From the supplier's point of view, large contracts can produce big profits and lots of excitement and prestige. The result is a super-competitive landscape of highly aware buyers and highly motivated suppliers.

In fact, the landscape for these large contracts is so competitive that some companies will bid for contracts at a price so low they know it won't make any money. They do this because it can be better to win a big contract and make no profit but at least be able to pay staff and retain them, than to not win a big contract and have to either keep paying staff and lose lots of money doing so or not pay staff and lose lots of staff (and then have to pay lots of money recruiting new staff when you do finally win another big contract).

This creates an environment where somebody somewhere is always willing to take on a contract with little or no profit margin, and that makes it incredibly difficult for even the best companies to generate reasonable returns.

The last straw for these companies is their relatively fixed and often unpredictable costs, or perhaps I should say their tendency to be overoptimistic on costs. For example, if you put in a bid to build an office block, you don't actually know exactly how much it will cost to build that office block. But the customer only wants to pay a fixed £10 million, and you think you should be able to build it for £9 million, leaving you with £1 million profit. But things don't go to plan (do they ever?) and it eventually costs you £11 million to build the office block. Congratulations, you just spent huge amounts of time and energy earning yourself a net loss of £1 million.

This optimism on cost is driven by a focus on volume over value; on winning contracts per se rather than winning contracts which are very likely to be highly profitable. It's a common flaw in peoples' thinking, which you can see just from the fact that it's called 'winning' a contract. If people thought about signing a contract as taking on a massive amount of risk and responsibility instead of 'winning', then perhaps they'd be more careful about which contracts they try to 'win'.

In most cases, companies with these structural problems have very thin profit margins, so an easy way to rule them out is with a rule on profit margins:

Fix: Only invest in companies where the ten-year average net profit margin is above 5%.

You might think 5% is still quite a thin margin, and you'd be right. But I like to keep new criteria quite loose, and then tighten them up over time if need be. In this case, I think 5% is thin enough to allow me to invest in a wide variety of companies, but thick enough to rule out basket case companies like Carillion and Interserve (and Centrica as well).

Value trap 3) Business transformations

The last type of value trap I found myself in last year was business transformations. What do I mean by 'transformation'? What I don't mean is a company which is just trying to improve its general performance or recover from a brief stumble. I call those turnarounds and recovery situations respectively, and in those cases the company is basically staying in the same business while trying to do a better job.

A transformation is different. It's more like a caterpillar turning into a butterfly. The scale of changes is on another level entirely. Either a) the core product or service changes completely, or b) the business model changes completely, or c) pretty much everything changes. You see this most often in companies where the core market is in long-term decline. N Brown, which I mentioned earlier, is a good example.

N Brown, the size 20+ and age 50+ fashion retailer, used to be a dominant force in the mail order catalogue business. People would sit at home and browse through a huge catalogue of niche fashion items and be able to order, receive and return goods without ever having to visit a shop.

For decades it was an excellent business model, but then came the internet, a computer in every home and rapid local delivery and return services. What was once a niche market (providing a way for people to shop, receive and return goods from home) became ubiquitous and N Brown must now compete against just about every clothing company with a website, which is all of them.

Transformations are incredibly hard. N Brown has recently cut its dividend, replaced its CEO and is now fully focused on a 100% mobile internet future. And while N Brown may yet survive and even thrive, it's going to be a very long, difficult and risky journey. Absent a miracle, the return on my N Brown shares is unlikely to ever be satisfactory (which in my book means an annualised return of 10% or more).

For an even more dramatic example, look at **Connect Group (LON:CNCT)** (which I don't own), the dominant leader in the UK newspaper distribution market. As with N Brown, Connect's core market is in long-term decline. To create a brighter future for itself, Connect has been acquiring companies in vaguely related growing markets such as parcel delivery (N Brown's strategy has been to organically migrate key brands from catalogue to web). In my experience, the combination of a declining core market and the acquisition of companies in areas where the acquirer has little experience is, to put it bluntly, another highly toxic mix.

Regardless of the details, I am no longer willing to buy into business transformations. That's because, more often than not, they're a good way for investors to permanently lose money.

Fix: Don't invest in business transformations where the core product, service or business model is in rapid permanent decline.

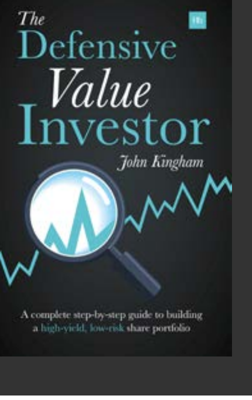
A slightly less clear-cut situation exists when a company's core business is in very slow decline. This applies, for example, to businesses operating in fossil fuel sectors and tobacco. Both these markets are likely (in my opinion) to decline rather than grow over the next decade or two, but that still leaves quite a bit of time before these businesses are forced to radically transform or die. In the meantime, it's possible that good returns can be had, so for me companies undergoing this sort of slow transformation may still be investible, but caution is definitely required.

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

FORENSIC FOREX

IS IT TIME TO SELL THE US DOLLAR?

Although we are only a few months into the year, as usual it has been anything but quiet in the world of foreign exchange. Admittedly, much of the excitement has been Brexit-driven – the pound has been the best-performing major world currency this year. The lack of progress on the UK's terms for leaving the EU has, perversely, been the main driver, with the hopes of financial markets being raised on some sort of better deal, or delay.

But I think it's fair to say we are all a little Brexit-weary, so for this issue I thought we would shift our focus to the US dollar to see if the greenback has gone far enough for now.

2018 – A much better year than many expected

After a dire performance in 2017, suffering its biggest fall in more than a decade, the dollar was the best-performing major currency last year, up by 4.3%. This is based on the Dollar Index – a measure of the dollar against a basket of other world currencies. The Japanese yen was the only other main currency to enjoy an upswing during 2018.

There were a couple of significant factors behind the US dollar's rise. The American central bank, the US Federal Reserve, had a more aggressive approach to raising the nation's base rate than had been expected. Plus, the end of the year saw sizeable falls for stock markets. Many investors saw the US dollar as a safe haven in the face of all this volatility, which also helped lift it at the cost of other less desirable currencies.

Referring back to the Dollar Index, the largest currency in the basket is the euro, making up 58% of the weighting, and the chart below shows just how the euro suffered as the dollar staged a comeback from April 2018.

By mid-November last year, the euro had declined in value by almost 10% versus the US dollar and was trading at its worst level since June 2017.

“IT ALREADY LOOKS AS IF THE US CENTRAL BANK WILL NOT BE RAISING RATES AT THE PACE EXPECTED AT THE END OF 2018 EUR/USD AUGUST 2018 TO PRESENT.”

EUR/USD 2018

2019 – Why it may not be more of the same

I also write about charting in this magazine and one of my favourite mantras in that section is "the trend is your friend". So really, I should be expecting the US dollar to continue the trend since last April – surely? It does feel a little hypocritical to start talking about a turn in the dollar's fortunes this year, but let's walk through some of the possible catalysts.

It already looks as if the US central bank will not be raising rates at the pace expected at the end of 2018. The Fed normally gives some reasonable hints about its future direction, and market expectations have already been scaled back to expect just two rate rises this year, compared to the four that were delivered in the previous 12 months.

The worry is the potential for a slowing US economy – the Federal Reserve does not want to raise interest rates and add pressure to any potential slowdown. There are already murmurings of the possibility of a US recession this year. Whilst these concerns are arguably premature, the various trade war discussions going on at a political level has made for a more uncertain future for the economy in 2019 – and all of this serves to heap pressure on the US dollar.

Another political factor is the Democrat party gaining power in the US Congress. This is expected to make it far more difficult for President Trump to push through any changes designed to give a short-term boost to the economy. The greenback is certainly facing some headwinds in 2019 that were not present previously.

Is the euro signalling a major turnaround?

Although the sub heading here reads a little like clickbait – e.g. "the stock

EUR/USD August 2018 to Present

market secrets the rich don't want you to know" – what has been happening with the euro/US dollar (EUR/USD) rate in recent months is worthy of closer study – and could be a handy early signal of what the rest of this year may have in store.

This chart shows a couple of major breaks downwards by the euro. During the summer of last year, 1.1300 was proving to be quite the floor, stopping any further dollar strength and euro weakness. But this major support broke in November. Quite often, a break of a big level like this can be the sign of a new trend starting. But that did not happen, and the euro snapped back and recovered.

The same thing happened in March 2019, when the European Central Bank downgraded its outlook for the EU economy and pushed back expectations on when it would start finally raising rates, to 2020. The euro again breaks major support – but then recovers once more. There appears to be an unwillingness to continue selling the euro, and conversely buying the dollar, on these major breaks.

If we examine the reasons the pound has done well this year, I wonder if there is a parallel with how the euro may make a comeback against the US dollar. Coming into this year, the markets knew the worst medium-term outcome for the pound – a no deal Brexit. Anything else potentially was an improvement – all the bad news was out there. For the eurozone, Italy is already in recession, Germany narrowly avoided it last quarter and the ECB has downgraded the growth outlook. This is all pretty bad news – but the euro is not seeing sustained selling when it breaks to new lows.

Perhaps the euro will end up being the surprise turnaround story for the rest of this year – and the dollar might start to give up some of those gains made in 2018. All the bad news – for now at least – would appear to be known for the eurozone, and there are enough potential hurdles out there for the US economy to suggest that 2019 is going to be a tricky one at best for the dollar.

Ticket Offer

Meet me and the rest of the team behind Master Investor Magazine on 6th April – just use the discount code JONES to claim your complimentary ticket here.

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 CHARLOTTE RANSOM, CHIEF EXECUTIVE OFFICER, NETWEALTH.COM

HOW TO GENERATE A SUSTAINABLE LONG-TERM INCOME – NO MATTER WHAT HAPPENS

For many investors, their main priority is to generate and sustain a consistent income. This is usually in retirement, but it can be valuable at any stage in life. Of course, having a regular income is one thing, but how do you ensure that you can make it last?

It's not enough to have the capital to provide an income – how effectively you preserve that capital has a direct result on how long you can generate a sustainable income.

The persistent effect of inflation

Spending beyond your means will obviously reduce your income pot quickly, but that is something you can control. What you can't control is the effect of inflation, which can cause serious harm to your total funds over time. So those seeking income must first ensure that their capital is aiming to outpace the rate of inflation.

For example, let's take the period from the end of 2007 to the end of 2018 which accounts for a time of both strong overall stock market growth and includes a considerable decline. If you had left your nominal £100,000 'safely' in a bank account, its actual purchasing power – after retail price inflation – would have slumped to £82,299. By investing in a balanced portfolio on the other hand, such as Netwealth's medium risk portfolio (Risk Level 4), the invested capital would have risen to £117,822 over the same period.

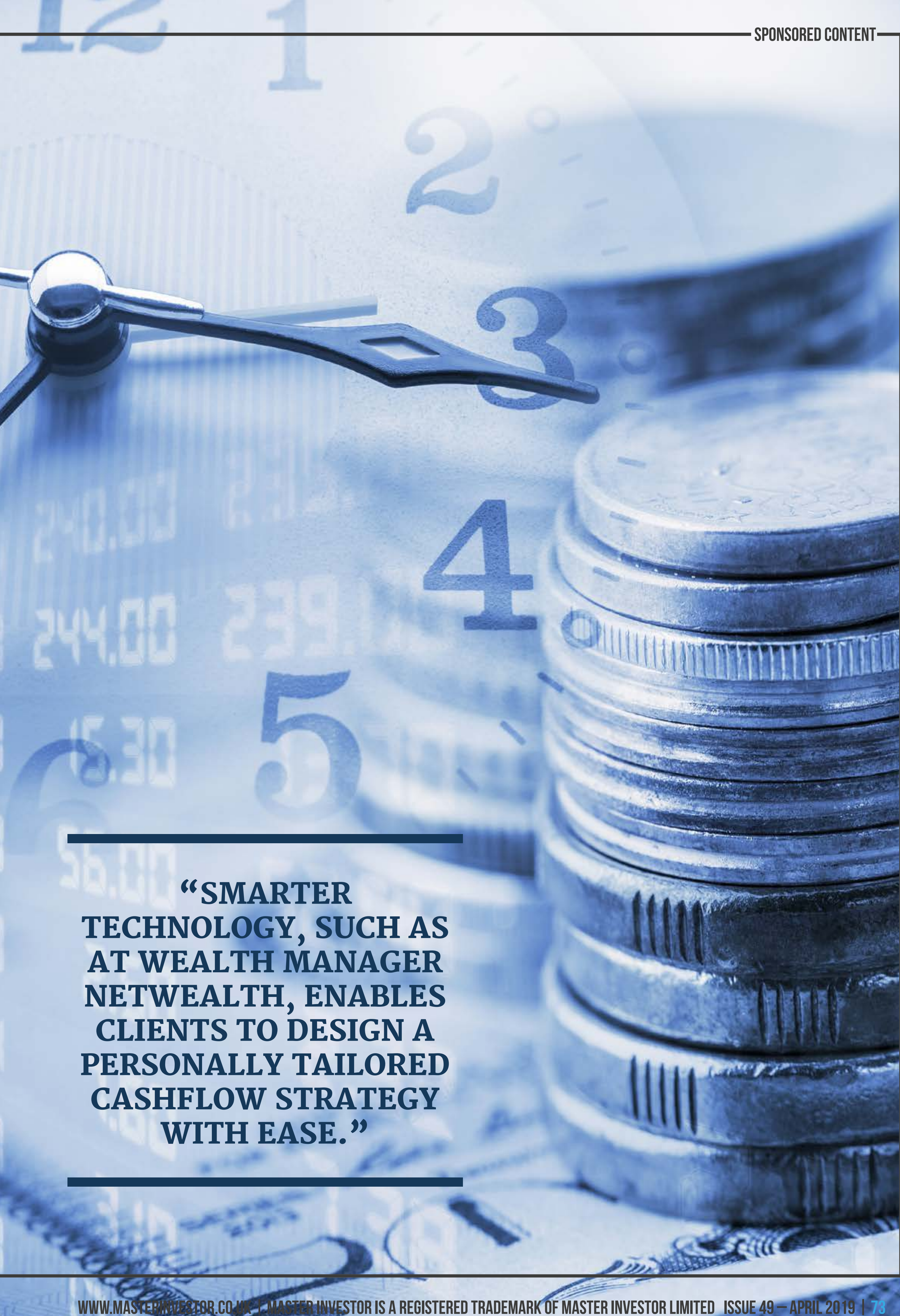
Providing an income in all environments

Stock markets go up and down, as does the level of growth in economies. Income seekers value consistency since they are targeting regular cashflows, but what happens if there is a bear market and the stock market falls for an extended period? If you rely on dividends from single stocks or an equity fund to provide your income, your income level may be maintained for a while, but your capital is likely to be dented, reducing the length of time an income can be drawn from it. This is why a diversified portfolio, that blends returns from both global stock markets and fixed income bonds, is often valuable as a way to smooth returns over time while cashflows are being drawn from the investment pot.

How a total return approach, rather than a pure income approach, can provide a sustainable income

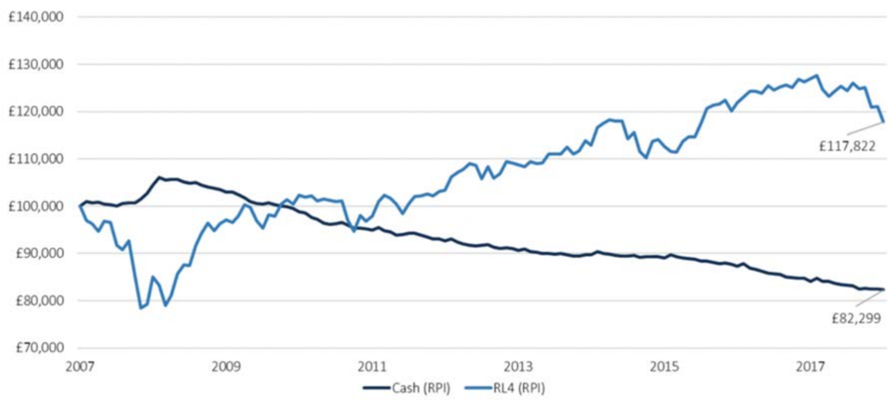
We often read about income-based funds; however, portfolios designed purely for income necessarily focus on a narrower set of opportunities

"AN EMPHASIS ON THE TOTAL RETURN FROM A PORTFOLIO MEANS IT ISN'T RESTRICTED TO CHASING POTENTIALLY EXPENSIVE INCOME ASSETS."



“SMARTER TECHNOLOGY, SUCH AS AT WEALTH MANAGER NETWEALTH, ENABLES CLIENTS TO DESIGN A PERSONALLY TAILORED CASHFLOW STRATEGY WITH EASE.”

How inflation can deplete your income pot over time



Source: Bloomberg, Netwealth Investments' Calculations. Past performance is no guarantee of future performance.

– there are only so many stocks and bonds whose dividends and coupons are attractive and predictable enough for an income manager. The risk is that income funds become too concentrated in similar assets and may miss out on important returns elsewhere.

A better alternative is for wealth managers to take a more rounded approach to building portfolios. An emphasis on the total return from a portfolio means it isn't restricted to chasing potentially expensive income assets; the manager can be agnostic as to whether returns come from dividends, interest or capital appreciation, allowing for more drivers of portfolio performance.

Importantly, smarter technology, such as at wealth manager Netwealth, enables clients to design a personally tailored cashflow strategy with ease, funded from different portfolio components. This provides the opportunity to match payment requirements precisely, driven from a portfolio's total return rather than relying on a narrow set of income-based assets. We believe that combining a more balanced portfolio targeting total returns, with tailored cashflows, is a better approach for those who are seeking income.

Watch out for high fees

We've stated that inflation will deplete returns, but excessive fees can do just as much damage to a pot of money over time. When you invest, even paying 1% more than necessary in fees each year makes a big difference to how much you may earn from your capital. For example, the cost of an extra 1% per year in fees can amount to as much as 15% of capital being eroded over a 10-year period, or £15,000 per £100,000 invested.

If you know how much you are paying in fees each year – or even if you don't – you should find out how much better off you could be when you pay less. You can make a meaningful difference to your income plans.

Speak to one of our advisers on 020 3795 4747 to learn more, or visit netwealth.com

Please remember that when investing your capital is at risk.

BY ANDREW LATTO

QUALITY INVESTOR

SMITHSON'S SIX UK STOCKS

In October 2018, Smithson Investment Trust (LON:SSON) raised £822.5 million, making it the UK's largest ever investment trust launch. The fund invests in mid and small-cap companies in developed markets, and its portfolio has twenty-nine holdings, six of which are listed in the UK.

Smithson is the third fund from Fundsmith LLP, which follows a quality-driven approach and aims to hold onto positions "forever." With smaller companies having more growth potential than larger ones and close-ended funds typically outperforming open-ended ones over the long-term, Smithson has the potential to outperform the open-ended Fundsmith Equity Fund, the company's flagship fund, which has returned 18.2% a year from November 2010 to February 2019.

The UK was the second-largest country exposure in the Smithson portfolio, at 18.3% of assets at the end of February 2019, and the US was the largest exposure with 13 US-listed positions, accounting for 51% of portfolio assets.

Smithson's six UK picks

Smithson's six UK picks are **Rightmove (LON:RMV)**, **Halma (LON:HLMA)**, **Spirax-Sarco Engineering (LON:SPX)**, **Domino's Pizza Group (LON:DOM)**, **Abcam (LON:ABC)** and **Diploma (LON:DPLM)**. At the end of 2018, Rightmove was the second-largest Smithson holding at 5.1% of the portfolio.

Halma was the ninth largest holding at 4.3% of the portfolio and Spirax-Sarco Engineering was the 17th largest at 3.1%. The remaining three UK positions were Domino's Pizza Group at 3%, Abcam at 2% and Diploma at 1.9%.

Are they quality businesses?

Typically, the quality threshold of an investment is a return on capital employed (ROCE) of 15% or more, and all six UK Smithson companies generated a three-year average underlying ROCE (excluding goodwill) above the threshold. In fact, the lowest underlying ROCE was 19.7%, by Domino's Pizza Group, and the highest was 813%, by Rightmove. The three-

Smithson's UK stocks at the end of 2018

	Market cap	Position in the fund	% Fund
Rightmove	£4.4bn	2	5.1%
Halma	£6.1bn	9	4.3%
Spirax-Sarco Engineering	£5.2bn	17	3.1%
Domino's Pizza Group	£1bn	19	3%
Abcam	£2.4bn	26	2%
Diploma	£1.6bn	27	1.9%

Source: Smithson IT


3513.567
288.456
499.221
1349.234
343.567
342.246
31.532
662.232
44445.785
354.234
636.111
78.673
8339.111
67.632
98.232
2333.452
12.543
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3341.332
6441.323
62227.112
33.562
271.286
77.218
31.532
66.232
89.111
67.632
98.232
41.332
61.323
67.112
77.218
53.682
87.322
69.321
59.113
79.322
12.321
99.223
87.124
89.332
97.234
11.435
43.129
99.345
76.223
97.234

year average ROCE including goodwill, which takes into account the premium paid for acquisitions (i.e. it is the realised return), was 14% for Halma and 17.4% for Abcam – both of which have been acquisitive.

Quality businesses typically earn an earnings before interest and tax (EBIT) margin of at least 10%, and the lowest 3-year average EBIT margin in the portfolio was recorded by Diploma, at 15%.

Return on capital employed for the Smithson six

	3-year average ROCE		3-year average EBIT margin
	Ex. Goodwill	Inc. Goodwill	
Rightmove	813%	741%	74%
Halma	25.4%	14%	17.2%
Spirax-Sarco Engineering	25.3%	20.7%	21.4%
Domino's Pizza Group	19.7%	19.6%	17.5%
Abcam	26%	17.4%	27.2%
Diploma	37%	22.5%	15%

Source: SharePad

Rightmove – Online property listing platform

Rightmove – the UK-based company that runs rightmove.co.uk, the UK's largest online real estate portal and property website – is the most profitable UK-listed company in the portfolio by some margin. Furthermore, the group's EBIT margin continued to improve during the period of 2015 and 2018, increasing from 71.4% to 74%, and it is forecast to increase further, hitting 75.5% by 2021.

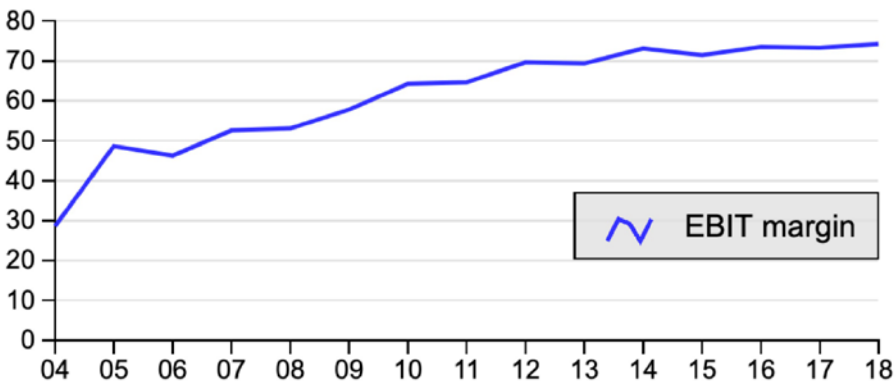
The group benefits from the network effect – whereby increased numbers of buyers and sellers improve the value of an offering – making it challenging for its competitors, such as OnTheMarket and Zoopla, to take market share.

The number of estate agency branches listed on Rightmove declined by 2% to 17,328 in 2018. Website traffic, though, rose by 4% to 132 million visits per month and "time on the site" increased by 5% to in excess of 1 billion minutes per month.

Revenue from estate agencies rose by 9% to £201m in 2018, with average revenue per advertiser up by £85 to £1,005 per month. Rightmove's total revenue rose by 10% in 2018 and underlying EPS increased by 12% to 18.3p. Revenue is forecast to increase by 7.4% a year over the next three years.

Rightmove bought back 31% of its shares over the last 11 years and is continuing to buy back shares.

Rightmove's EBIT margin: onwards and upwards



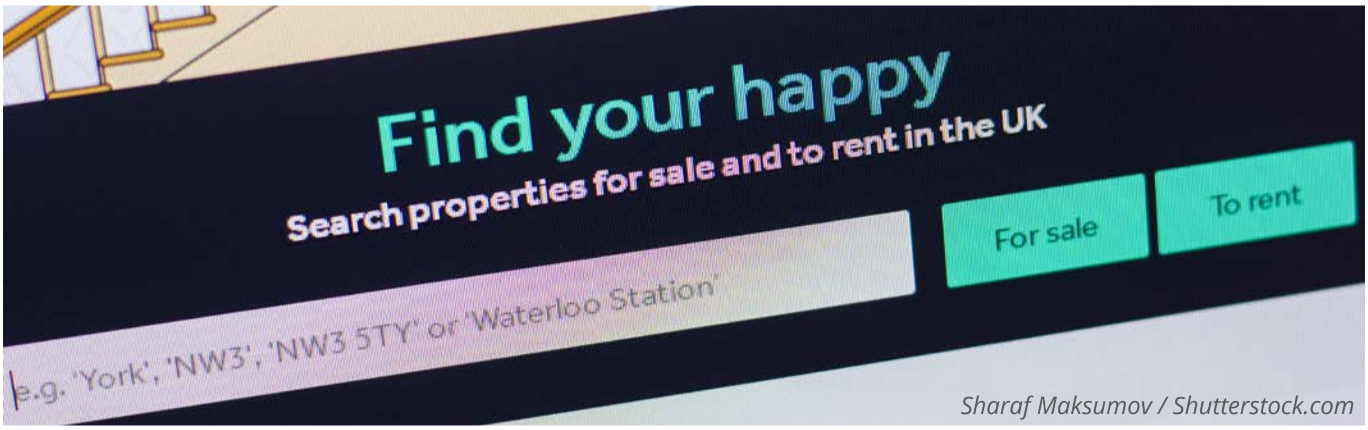
Source: SharePad

Halma – Safety-related products

Halma sells safety-related products into four markets: infrastructure safety, medical, process safety and environmental & analysis. Revenue has increased in every year since 2006 and the EBIT margin has been over 16% since 1989.

Safety product makers clearly make for safe investments. In fiscal 2018, the group generated 33% of its revenue from infrastructure safety, 26% from medical, 24% from environmental & analysis and 17% from process safety.

The US market accounted for 35% of revenue, Europe (excluding the UK) for 22% and the UK for 12%. Asia Pacific accounted for only 16% of group rev-



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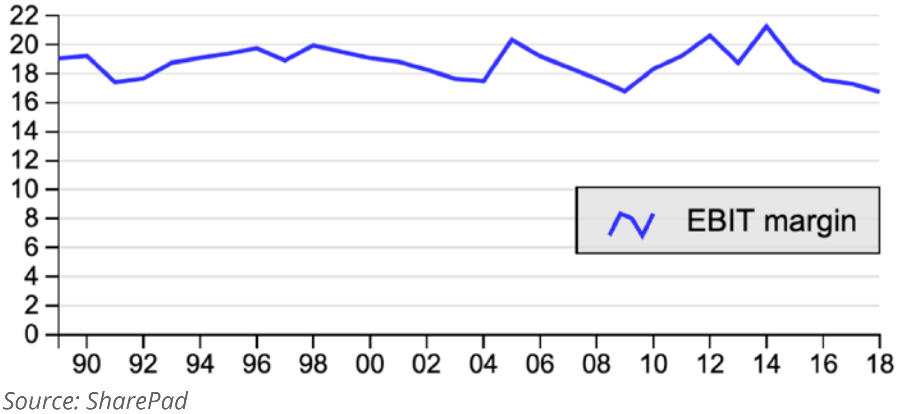
"HALMA'S STRATEGY IS TO DOUBLE IN SIZE EVERY FIVE YEARS THROUGH ACQUISITIONS AND ORGANIC GROWTH."

Halma's EBIT margin – over 16% since 1989



Source: SharePad

enue, but it generated revenue growth of 15%.

Halma's strategy is to double in size every five years through acquisitions and organic growth. Revenue in the five years to fiscal 2018 increased by 74%.

Recent acquisitions have been modest with £136.5m spent on deals since the start of 2017. At September 2018, the group's net debt to EBITDA ratio was 0.7, leaving plenty of scope for further takeovers.

Interest cover was also robust at 18.6x in fiscal 2018 and is expected to hit 29x in fiscal 2021. Average free cash flow conversion was 85.5% over the last five years.

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Organic revenue (constant currency and excluding acquisitions) rose by 10% in fiscal 2018, 4% in 2017 and 6% in 2016. Revenue is forecast to grow by 8.3% a year (annualised) over the next three years.

Spirax-Sarco Engineering – Steam, valves & pumps

Spirax-Sarco Engineering is another industrial goods business that has delivered for investors. The group's EBIT margin has been in excess of 14% since 1989, while annual revenue has declined only in four years during the same period.

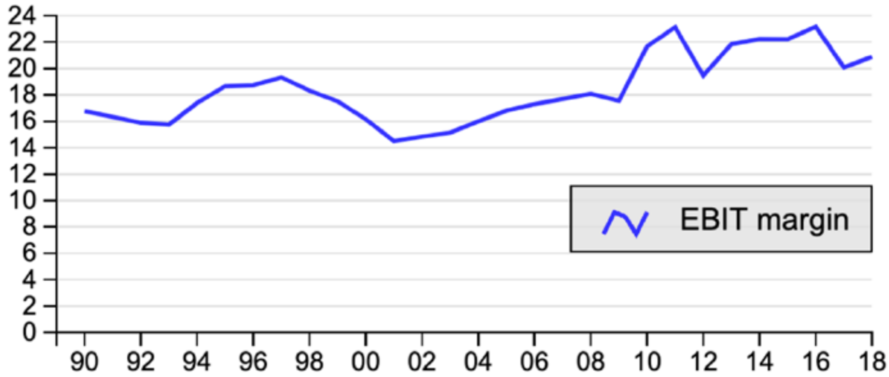
The group generates 85% of revenue from the operating budgets of its customers and 15% from their capital spending budgets, which explains the relative stability of both its revenue and margins.

Spirax-Sarco's steam specialities division – which includes the brands of Spirax-Sarco and Gestra, bought in April 2017 for £160 million – generated 64% of revenue in 2018. 23% of revenue was produced by the Watson-Marlow division, which makes niche peristaltic pumps. The Chromalex process heating and temperature management division, which was acquired in July 2017 for £317 million, generated 13% of revenue.

Despite these acquisitions, the company's net debt to EBITDA ratio was only 0.8X at the end of 2018. Spirax-Sarco Engineering's average free cash flow conversion over the last five years was 86%.

Organic revenue growth (constant currency and excluding acquisitions) was 7% in 2018, 6% in 2017 and 2% in 2016. Revenue is forecast to increase by 4.8% a year (annualised) over the next three years.

Spirax-Sarco EBIT margin – over 14% since 1989



Source: SharePad

Domino's Pizza Group – Takeaway pizza franchisor

Domino's Pizza Group was a surprising addition to Smithson's portfolio given the maturity of the UK takeaway market. The company splits analyst opinion with four sell ratings, four hold ratings, one outperform rating and three buy ratings.

Domino's Pizza Group had 1,103 stores in the UK at the end of 2018 and is targeting store number growth of 45% to 1,600 stores. Tensions with UK franchisees, however, threaten both the pace of new store openings and profit margins.

The takeaway market is becoming more competitive given the rise of delivery apps like Deliveroo, Just Eat and Uber Eats. Domino's Pizza Group EBIT margin reached a high of 24.5% in 2016 and is expected to come in at 17.5% in 2019.

UK like-for-like sales excluding store splits rose by 4.6% in 2018 versus 4.8% in 2017. Total system sales in the UK and Republic of Ireland improved by 7% in 2018 versus 9.2% growth in 2017.

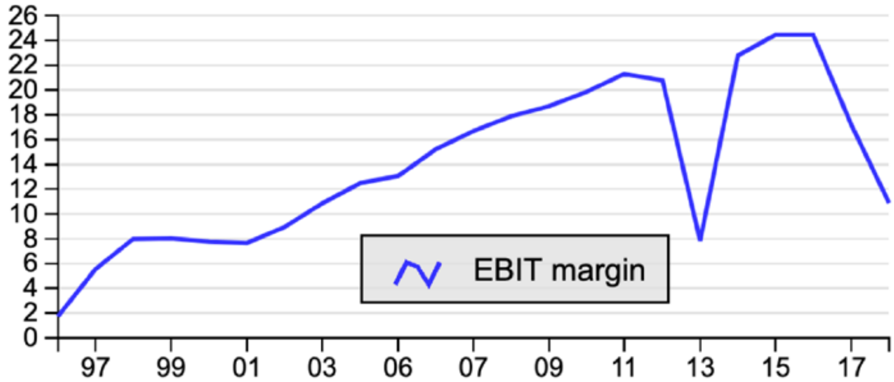
Domino's Pizza Group wrote down the value of its international business (outside of the UK and Ireland) by £14.1m in 2018. The international business operates in a number of European countries and is expected to breakeven this year.

Underlying profit before tax fell by 1.1% in 2018 and reported profit fell by 22% due to one-off costs and impairments. The shares are currently trading on a forward-looking P/E of 13.2X (FY2019), the lowest multiple it's traded on since 2003.

Abcam – Antibodies

Abcam develops antibodies for the life science and clinical research communities. Group revenue increased from £9.2 million in 2004 to £278 million in 2018 with antibody products accounting for 75% of revenue. The company's guidance is for low double-digit revenue growth of 10.5% over the next three years.

Domino's Pizza EBIT margin – under pressure



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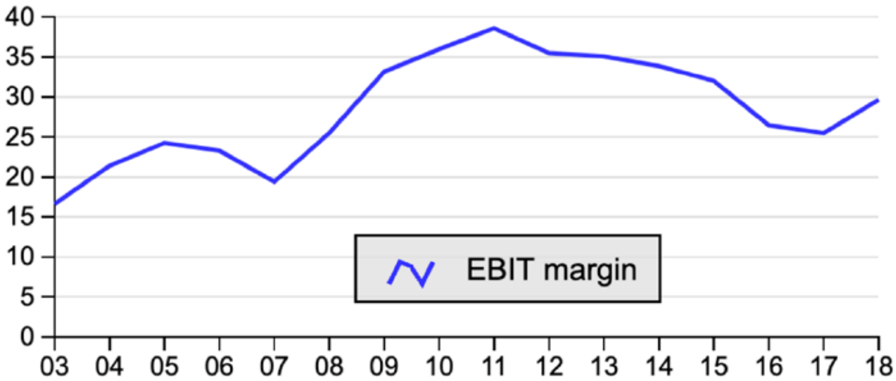
“ABCAM IS A RARE EXAMPLE OF A FAST-GROWING BUSINESS THAT HAS BECOME MORE PROFITABLE OVER TIME.”

Abcam's EBIT margin – an improving trend



Source: SharePad

Abcam describes itself as the "global market leader of research antibodies" with "unique capabilities [that] support continued [market] share gains." The US generated 41.8% of revenue last year while China produced 14.2% of revenue.

Abcam is a rare example of a fast-growing business that has become more profitable over time. EBIT profit margins have doubled since 2003, reaching 30% in 2018, and are expected to increase further to 32% by 2021.

Abcam's addressable market is estimated at $8 billion. This is made up of the research-use proteomic tools market, estimated at $3 billion, and the antibody development for the pharmaceutical and diagnostic sector market, estimated at $5 billion. These areas are expected to grow by 4% a year and 5-8% a year, respectively.

Diploma – industrial product supply

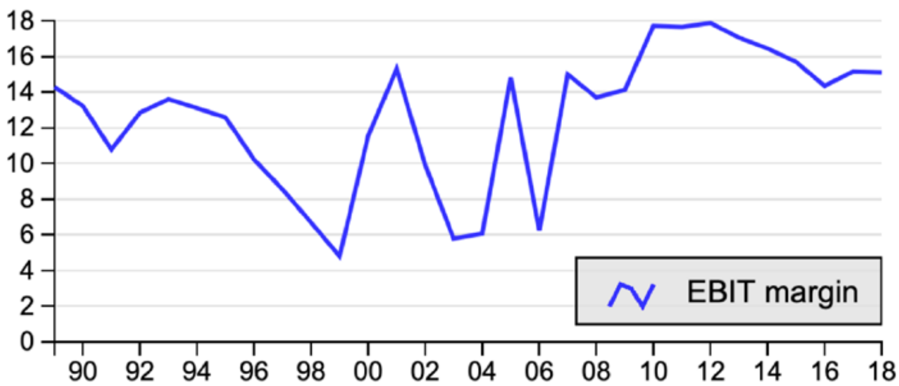
Diploma, which supplies specialist technical products and services to three key markets (life sciences, Seals and Controls), reported an EBIT margin of 15.1% in 2018 and is expected to announce a higher margin of 17.6% in 2021.

The group's competitive edge is its relationship with suppliers and customers and its ability to deliver a broad range of quality products.

The Seals division, which accounts for 43% of total revenue, supplies items that include gaskets, filters, cylinder component seals and custom moulded parts. The aftermarket seals business supplies own-branded products to repair heavy construction equipment. The controls division (29% of revenue) supplies high-performance wiring, harness components, fasteners and control devices, and its Life sciences division (28% of revenue) serves the healthcare and environmental sectors and sources products on a long-term exclusive basis.

Europe is its largest market, at 48% of revenue in fiscal 2018, while North America generated 40% of revenue. Diploma is targeting organic revenue growth of 5-6% per annum over the economic cycle, which is expected to be supplemented by "value enhancing" acquisitions.

Diploma's EBIT margin – stable since 2010



Source: SharePad

"The Smithson UK Six"

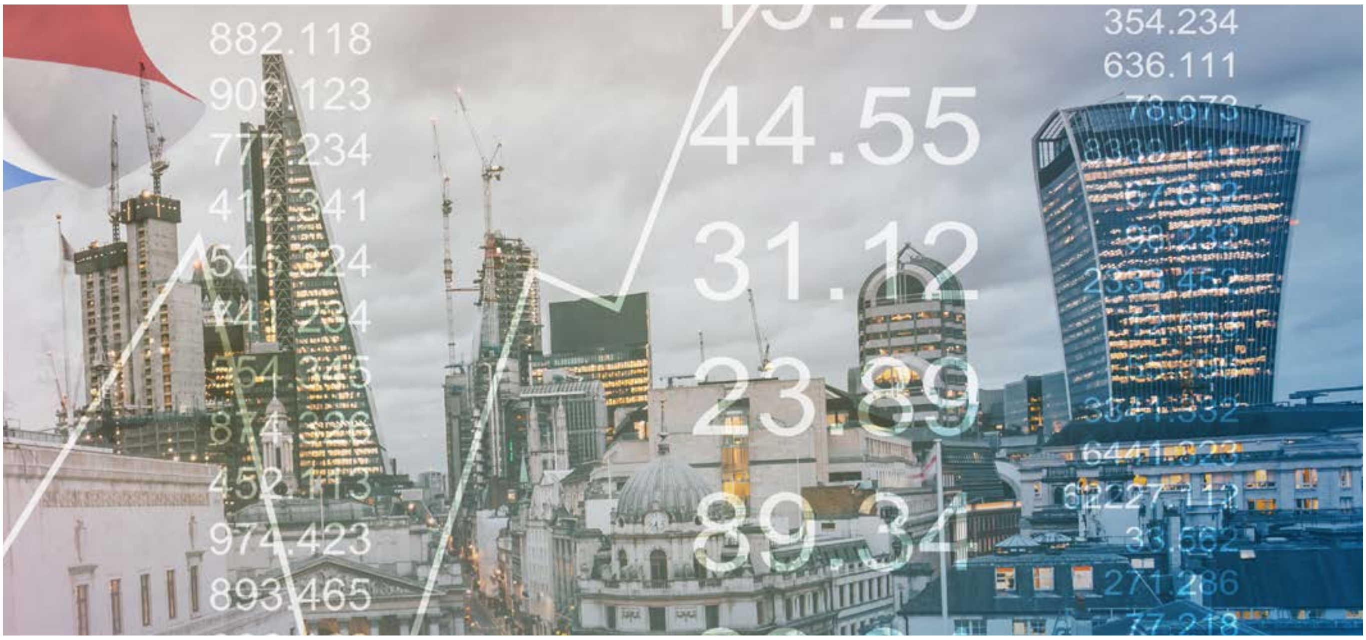
Growth

Smithson's six UK stocks have increased revenue by an average of 55% over the last three years (or 15.7% annualised), boosted by the investments of Spirax-Sarco, Halma, Diploma and Abcam.

The average forecast pace of revenue growth over the next three years is 24% or 7.4% a year. Abcam is expected to grow revenue by 35% over the three year period while Spirax-Sarco Engineering is expected to see revenue growth of only 15%.

Valuations

Of the six companies, Domino's Pizza Group has the highest forecast free cash flow yield – which is the excess cash available to shareholders as a percentage of market capitalisation – at 8% in 2019. Rightmove has the



"THE JURY IS CURRENTLY OUT ON WHETHER DOMINO'S PIZZA GROUP CAN CONTINUE TO DELIVER."

3-year revenue growth

	Historic	Forecast
Rightmove	39%	24%
Halma	48%	27%
Spirax-Sarco Engineering	73%	15%
Domino's Pizza Group	78%	27%
Abcam	62%	35%
Diploma	46%	18%
Average	58%	24%
Annualized	16.4%	7.5%

Source: SharePad

Free cash flow yields

	Share Price*	Free cash flow yield		
		Last fiscal year	Forecast Yr 1	Forecast Yr 2
Rightmove	£5.01	3.7%	4%	4.4%
Halma	£16.36	2.2%	2.6%	3%
Spirax-Sarco Engineering	£71.25	3.1%	3%	3.3%
Domino's Pizza Group	£2.24	5.2%	8%	8%
Abcam	£11.87	1.1%	2.1%	3.1%
Diploma	£14.53	3.6%	3.5%	4.1%

*Source: SharePad *At the close on 14 March.*

second highest with a 4% free cash flow yield in 2019 and 4.4% in 2020. This is somewhat surprising given that it is the highest quality of the six by some margin. Reflecting the long-term growth potential of the biotechnology business, Abcam is the most expensive of the six, with a forecast free cash flow yield of 2.3% in 2019 and 3.2% in 2020.

Summary

Smithson's six UK stocks include three industrial businesses that tend to fly below the investment radar. Halma, Spirax-Sarco Engineering and Diploma have all delivered strong long-term returns for investors. Rightmove is a high-quality business at a reasonable price and Abcam is a fast-growing business that investors have to pay up for. The jury is currently out on whether Domino's Pizza Group can continue to deliver.

About Andrew

Andrew Latto, CFA is an independent analyst who writes for Cube.investments. He recently founded www.Fund-Hunter.co, which is set to launch soon. Fundhunter uses asset allocation (where is best to invest) and fund selection (active and passive). Andrew previously worked for an investment manager and a research company.

BY ROBERT STEPHENS, CFA

STOCKS IN FOCUS

WHY TAYLOR WIMPEY COULD BE A STOCK FOR ALL SEASONS

It's rare to find a stock that offers income, growth and value appeal at the same time. Often, a company's shares may have one or perhaps two of those attributes. Taylor Wimpey, though, seems to be a good value share with a high yield and earnings growth potential.

The performance of the business has been sound in recent quarters. Demand for new homes has been buoyed by demand-side government policies, such as Help to Buy and SDLT relief, which are due to remain in place over the medium term. Population growth is expected to remain ahead of housing starts, which signifies that the UK's imbalanced property market could get even worse.

Since emerging from the financial crisis, Taylor Wimpey has sought to strengthen its balance sheet. In 2018 it reported a record level of net cash, while a large land bank could provide a solid foundation for long-term growth.

Risks, of course, remain to the wider housing market. A fluid Brexit process which, at the time of writing, is no clearer than it was a number of months ago and a weak consumer environment could hold back the sector, as well as investor sentiment. But with a low valuation, the stock could be a strong performer in the long run.

> **"DEMAND FOR NEW HOMES HAS BEEN BUOYED BY DEMAND-SIDE GOVERNMENT POLICIES, SUCH AS HELP TO BUY AND SDLT RELIEF, WHICH ARE DUE TO REMAIN IN PLACE OVER THE MEDIUM TERM."**

Demand and supply imbalance

While house price growth in the UK has been subdued over the last year, the recent Halifax House Price Index showed a 2.8% increase in house prices. According to Taylor Wimpey's recent updates, demand for its new homes has been resilient, with the company reporting increased completions and a rising order book.

Part of the reason for this is a continued imbalance between demand and supply. It is forecast that between 2014 and 2039, the UK will have an additional 210,000 households per year. In 2017, 178,000 homes were built in the UK. Therefore, the difference between the number of homes required and those being built – the housing gap – could increase over the long run. This could put upward pressure on

"ALTHOUGH THERE COULD BE A SIGNIFICANT INCREASE IN THE NUMBER OF HOMES BEING BUILT EACH YEAR, THIS SEEMS UNLIKELY BASED ON THE INDUSTRY'S TRACK RECORD."

Colin Burdett / Shutterstock.com

house prices, and mean that demand for new homes remains robust.

Although there could be a significant increase in the number of homes being built each year, this seems unlikely based on the industry's track record. The last time more than 210,000 homes were completed in a year was in the late 1970s. This has been a key driver behind house price growth over the last few decades, and could continue to have a major influence over the direction of house prices in the long run.

New homes demand buoyed by government policy

Under the Conservative government, and the Coalition government before it, demand for new homes has been boosted by the Help to Buy scheme. This provides a 20% loan to first-time buyers, which means that only a 5% deposit is required in order to get onto the property ladder. The loan does not incur interest in the first five years, while it is repayable when the home is sold.

The policy has enabled a larger pool of first-time buyers to gain access to the property market. Crucially, though, it has pushed first-time buyers towards newbuild properties. This has benefitted Taylor Wimpey and its peers over a prolonged time period. The government is expected to keep the Help to Buy scheme in place until 2023, which could provide the company with a continued tailwind over the medium term.

Alongside Help to Buy, the government has also introduced SDLT relief. This has made it even easier for first-time buyers to purchase their first home, since no stamp duty is payable for the first £300,000 of a property's value when purchased by first-time buyers. This continued focus on demand-side policies, rather than supply-side policies, may be beneficial to housebuilders, since it means less competition and increasing demand for their homes.

Difficult market conditions drives stronger balance sheets

Having experienced a difficult period during the financial crisis, a number of leading housebuilders have sought to put in place stronger balance sheets in case of difficult market conditions in future. Taylor Wimpey is no exception.

> **"INVESTORS ARE STILL WARY REGARDING THE PROSPECTS FOR NOT ONLY THE HOUSEBUILDING SECTOR, BUT ALSO THE WIDER ECONOMY."**

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For 2018 it reported a record net cash position of £644 million. This provides it with significant financial flexibility, and means it can afford a more generous dividend payment policy.

It also means that should there be a challenging operating environment in future, it will be in a much stronger position to overcome it than was the case in the financial crisis. This could help to support investor sentiment to some degree should the outlook for the UK economy come under pressure.

The company has also invested heavily in its land bank in recent years. It has been steadily acquiring land so that it now has one of the largest strategic land banks in the industry. It stands at 127,000 plots, which provides it with greater flexibility and control over the planning permissions it receives.

Political uncertainty

Taylor Wimpey, of course, faces a number of risks to its outlook. While government policies such as Help to Buy and SDLT relief are expected to continue over the medium term, political uncertainty at the time of writing means that there could be significant change over future months.

For example, a general election could be called, or there may be a new Prime Minister in place over the near term. This could change government policy, and may mean that there is less focus on demand-side policies that ultimately inflate house prices, and a greater impetus on supply-side policies that could narrow the housing gap over the long run.

Affordability may also limit the potential for continued house price growth. House prices as a multiple of earnings reached their highest ever level last year. This suggests that they may be unable to match the same level of growth as in recent years.

Should interest rates move higher following Brexit, obtaining the necessary level of finance required to afford a home at current prices may also become more challenging. Clearly, the future path of interest rates will be closely linked to the performance of the economy post-Brexit. Given the fluid nature of the Brexit process, this

may prove to be difficult to accurately forecast. As such, investors may demand a margin of safety in case a weak pound causes a spike in inflation over the medium term.

Attractive valuation

The Taylor Wimpey share price has risen sharply since the start of the year. Despite this, the stock continues to have a relatively low valuation. For example, it has a P/E ratio of 8.5. This indicates that investors are still wary regarding the prospects for not only the housebuilding sector, but also the wider economy. It also suggests that they may be pricing in some of the risks that are currently faced by the company.

The financial outlook for Taylor Wimpey continues to be positive. It is forecast to record a rise in EPS of 4% in the 2019 financial year. With a growing order book and resilient demand for its properties, it may be able to grow its bottom line at a modest pace despite the general caution surrounding the UK's economic outlook.

In terms of its income potential, the company stated in its 2018 financial results that it intends to pay a dividend of £600 million in 2019. Part of this is set to be made up of a £250 million ordinary dividend that equates to 7.6p per share. This is expected to be paid in all market scenarios, and has been stress tested in a variety of challenging conditions including a 20% fall in house prices and a 30% fall in volumes.

The balance of the dividend payment is expected to be from a special dividend that has been paid in each of the last five years. This puts the company

"WHEN SPECIAL DIVIDENDS ARE INCLUDED, ITS FORWARD DIVIDEND YIELD FOR 2019 IS 10%."

on an ordinary dividend yield of 4.2%. When special dividends are included, its forward dividend yield for 2019 is 10%. It is due to be covered 1.2x by earnings. Due to the highly cash-generative nature of the business, it would be unsurprising for there to be further special dividends paid in future years.

High total returns relative to the wider index

The near-term prospects for the Taylor Wimpey share price could be highly volatile. The political situation in the UK is highly uncertain, and it could have an impact on investor sentiment. It may also influence the future of government policy, which could directly impact housebuilders, while the outcome of the Brexit process may change the prospects for interest rates and demand for new homes.

The company, though, has a strong balance sheet which could afford it a degree of protection from challenging operating conditions. Its large land bank provides it with a strategic advantage, while the housing gap could act as a major catalyst on its financial prospects. Should there fail to be a change in government, a continued focus on demand-side policies may lead to continued high demand for newbuild properties.

With a low valuation, modest growth potential and a solid income outlook, the company appears to offer investment appeal to a range of investors. Sentiment may ebb and flow over future months as the prospects for the UK economy remain difficult to predict. But over a long-term timeframe the stock could produce high total returns relative to the wider index.

About Robert

Robert Stephens, CFA, is an Equity Analyst who runs his own research company. He has been investing for over 15 years and owns a wide range of shares. Notable influences on his investment style include Warren Buffett, Ben Graham and Jim Slater. Robert has written for a variety of publications including The Daily Telegraph, What Investment and Citywire.

BY RICHARD GILL, CFA

BOOK REVIEW

THE SCEPTICAL INVESTOR

HOW CONTRARIANS BET AGAINST THE MARKET AND WIN – AND YOU CAN TOO

BY JOHN STEPEK

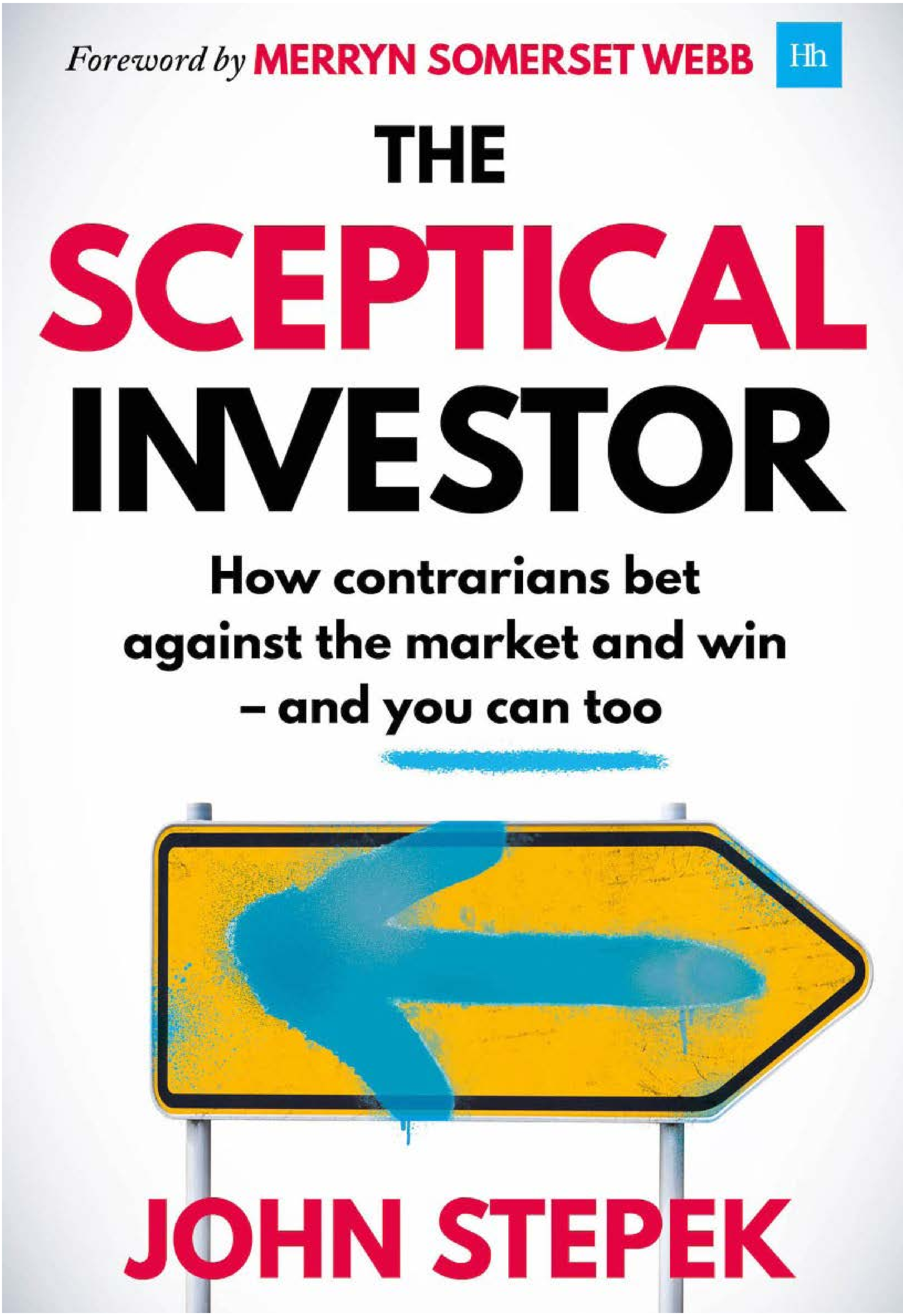
The term "sceptic" has ancient roots in philosophy, referring to the school of thought that questions the possibility of certainty in knowledge. That's a topic well beyond the scope of this book review (and my own knowledge, I'm sure).

In more modern times, "sceptics" are mainly referred to in the context of science, religion and sometimes politics, to refer to individuals who question or doubt commonly held beliefs or opinions. Science in particular has seen a number of great sceptics grace humanity with their work over the years including the likes of astronomer Carl Sagan, evolutionary biologist Richard Dawkins, author Isaac Asimov, magician Teller of Penn & Teller fame, and many more.

The world of investment has its own sceptics, also known as contrarians – people who go against the general consensus in the markets and sometimes go on to make huge profits. Some contrarians are considered to be the "rock stars" of the investment world. Who could forget George Soros, for example, whose short sale of sterling in 1992 made him a profit of $1 billion during the Black Wednesday crisis. Warren Buffett is another famous contrarian, as encapsulated in the famous line, *"Be fearful when others are greedy and greedy when others are fearful".*

The Sceptical Investor, written by the executive editor of MoneyWeek, John Stepek, is a comprehensive manifesto for contrarian investing. It contains a discussion of the latest findings in the field of behavioural finance, along with examples of how well known contrarians make money in the markets, to help readers spot potentially profitable investment opportunities. The book comes at an apposite time given the current popularity of low-cost passive investment strategies, which surely creates even more opportunities for clever investors to beat the market.

John Stepek is well versed in the subject matter, having over 20 years' experience writing about business, economics and investment. Moving on from working for his family's chain of electrical retail shops in Glasgow, he began writing articles about challenges facing family firms, but now writes about all aspects of financial markets, from bonds to gold to derivatives. A speaker at this year's Master Investor Show, he has a particular interest in psychology (having studied it at university) and also in behavioural finance and the way human instinct works against investors' best interests.


Foreword by MERRYN SOMERSET WEBB
Hh
THE
SCEPTICAL
INVESTOR
How contrarians bet
against the market and win
– and you can too
JOHN STEPEK

Believe it or not

Investopedia defines contrarian investing as a strategy whereby investors go against prevailing market trends by selling when others are buying, and buying when most investors are selling. There is some crossover with value investing, where investors look for under-priced stocks, with a contrarian believing that crowd behaviour can lead to mis-pricings in the markets.

On this theme, Chapter One asks *What is Contrarian Investing?* Here, Stepek expands on the definition above and argues that the most important factor in contrarianism (a term which he prefers to refer to as sceptical investing) is *not* blindly second guessing the market. After all, the market sometimes gets it right and can stay wrong for longer than you can stay solvent.

> **"CROWD BEHAVIOUR CAN LEAD TO MIS-PRICINGS IN THE MARKETS."**

Instead, important for the author is the size of the gap between the underlying "reality" and the market's perception of that reality. In the words of George Soros, ...*"the more an investment thesis is at odds with the generally prevailing view the greater the financial rewards one can reap if it turns out to be correct".* The key point is that sceptical investors are always questioning the market's (and their own) assumptions to try to have a clear evidence-based understanding of reality and to profit from it. Investors should not be rigidly attached to one idea (that a stock they hold will go to the moon, for example) but be open-minded about what could happen in the future.

Pounds for your thoughts

In the following 14 chapters Stepek covers three main themes: why sceptical investing is a better approach and how it works; the psychology of markets and investing; and finally, some successful methods used by sceptical investors to make money.

Chapter 2 sets the scene for *Why Sceptical Investing Works,* beginning with an explanation of the efficient market hypothesis (EMH), the claim that markets instantly price in all available information about an asset. This is reflected in asset prices which are claimed to be "efficient", so there are no inefficiencies for investors to exploit, so the EMH posits. While the theory has its uses, it is simply not true that assets can't be mispriced, otherwise asset bubbles like the dotcom boom would not happen. In the next chapters, Stepek further discusses why investors should take a sceptical approach and how, perhaps surprisingly, it can provide them with a big advantage over professional fund managers.

Out of the various psychology themed chapters, my favourite is Chapter 9, *The Importance of Intellectual Humility.* Here, the book gives the example of hedge fund manager Hugh Hendry who made a fortune in 2008 after positioning his portfolio to rise on the back of the unfolding credit crisis. However, he remained bearish, and while others were taking advantage of the huge bull-run that began in early 2009, Hendry's performance was not so great and the fund was closed in 2017. The lesson here, Stepek argues, is that if you are willing to go against the market consistently then you are primed to believe you know better than the rest so fail to adapt to changing circumstances. Fortunately, to avoid this intellectual arrogance, the author provides five key signs that might suggest hubris is happening.

The final few chapters look at how to use your sceptical mind-set to seek out investment opportunities, covering topics such as how to find cheap markets across the globe; how to buy companies for less than they're worth; and how to identify turnaround situations. Chapter 10 is particularly interesting, looking at *How to Spot Bubbles and What to do About Them.* No matter how long you've been in the markets, you're probably familiar with asset bubbles. While relatively rare, the likelihood is that eventually there will be another around the corner. While no one can accurately predict the rise and inevitable burst of a bubble, Stepek explains how a sceptical mind-set can place you in a good position to profit if you get caught up in one.

Think again

Overall, *The Sceptical Investor* is the ideal companion for anyone seeking to make money from investing. It is packed with practical advice and useful tools on how to overcome behavioural bias, spot investment anomalies and beat the markets. In a world where passive investing has become the *plat du jour*, it is refreshing to see a book which fights back and champions the active investment cause. This is all the more important for investors under the backdrop of ultra-low interest rates, disappearing workplace pensions and an increasing need to take care of their own finances.

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 2018.

BY TIM PRICE

THE FINAL WORD

WHAT REALLY MATTERS

THE PERVASIVE INFLUENCE OF PSYCHOLOGY

"The purpose of studying economics is not to acquire a set of ready-made answers to economic questions, but to learn how to avoid being deceived by economists."

- Joan Robinson.

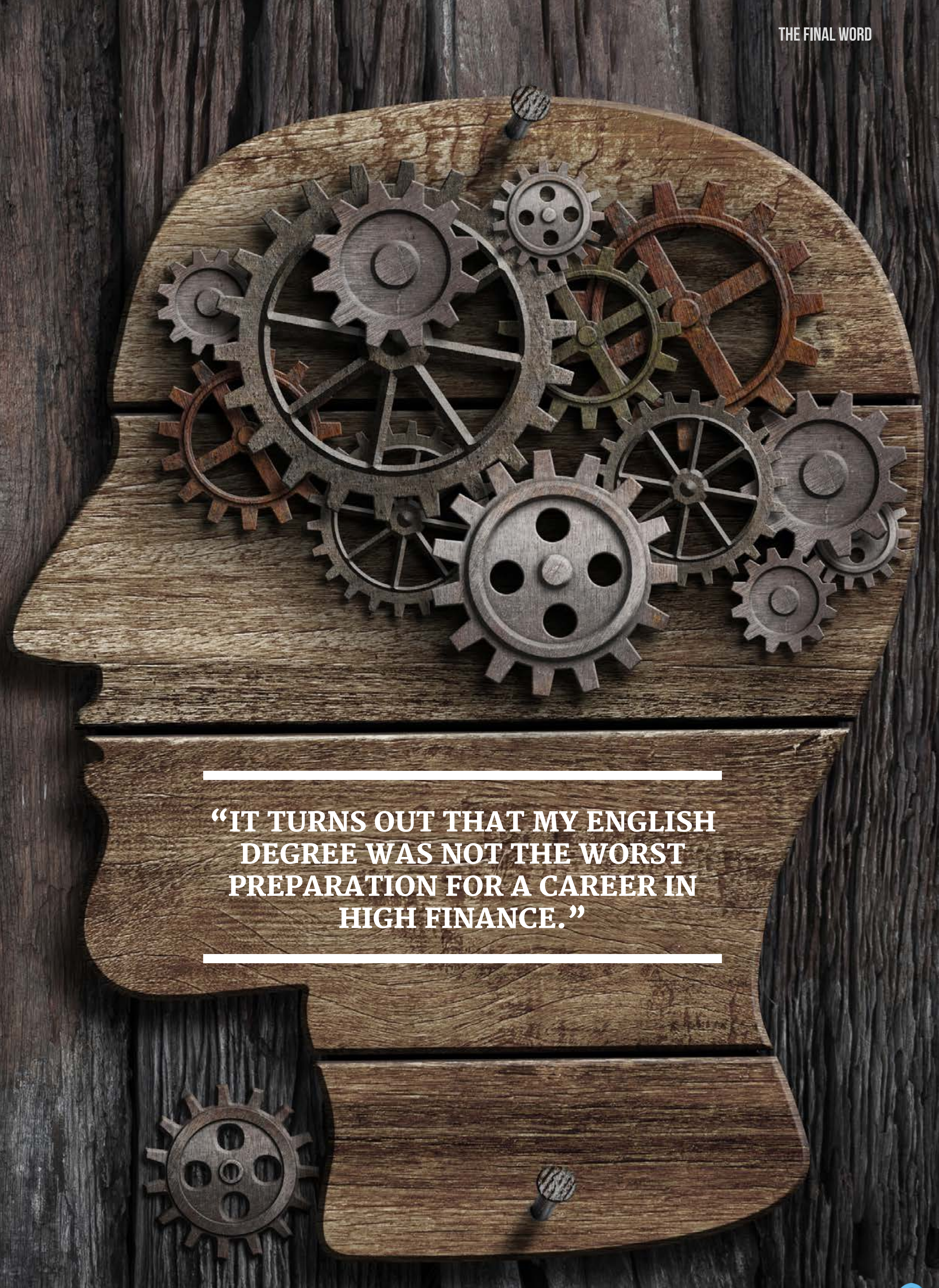
At the start of my career in the capital markets, I used to be somewhat defensive about not having studied economics. Then, in seemingly short order, came the Asian Financial Crisis, the collapse of Long Term Capital Management, the dotcom bust, the US property bust, and the Global Financial Crisis. After which point it became obvious that PJ O'Rourke was precisely right: economics really is "an entire scientific discipline of not knowing what you're talking about". Or, as someone mildly corrected him: "I take issue with your use of the word 'scientific'."

But it is all too easy to accuse economists of being quasi-scientific charlatans (which most of them are – and it makes them all the more dangerous for not being aware of the fact). Rather than turn this commentary into a counsel of despair, what practical advice is there for investors looking for guidance and a way forward through a thicket of confusion?

It turns out that my English degree was not the worst preparation for a career in high finance. The classics of English literature are classics for a reason. They deal with timeless issues of human emotion, ambition and interaction. And isn't that a perfect description of the financial markets?

But if I were asked for subjects in which I suspect our schools and universities are not yet giving students a sufficient grounding, two would stand head-and-shoulders above the rest: negotiation and psychology.

The shambles of our Brexit negotiations are an object lesson in how unfit our politicians and civil servants are for the task to which they have applied themselves. Yanis Varoufakis, the former Greek finance min-



"IT TURNS OUT THAT MY ENGLISH DEGREE WAS NOT THE WORST PREPARATION FOR A CAREER IN HIGH FINANCE."

ister and author of *Adults in the Room*, has some experience of negotiating (albeit not necessarily successfully) with Brussels. Earlier this year he made the following criticisms of the UK government's negotiating strategy, such as it has had one:

> *First, the British Government erred in imagining that the EU's considerable economic losses from a no deal translated into a strategic incentive to negotiate in good faith. Secondly, Mrs May committed an elementary mistake in accepting Mr Barnier's two-phase negotiation process which committed Britain to giving the EU everything it demanded before discussing Britain's demands.*
>
> *Thirdly, an extension of Article 50 for the purposes of extracting a better deal from the EU is delusional – since a reset day N will not give Brussels reason to change its stance before the new day N arrives. Fourthly, Mrs May's withdrawal deal deserves to be ditched courtesy of another fixed deadline that is embedded in it which, effectively, extends the current phoney negotiation, and standstill, until the final day of the fixed transition period.*
>
> *What should the UK Government be doing instead? When faced with a fixed deadline and a disadvantageous default outcome, there is only one thing to do: select your dominant strategy; the strategy that you consider your best response to everything the other side may throw at you; a strategy whose appeal does not rely on the success of bluffs, threats or enticement.*

Is there anything to be done? The UK government has made its Brexit bed and must lie in it. As for the rest of us, we could do worse than secure a copy of Chris Voss' book *Never split the difference*, which is a guide to negotiation written by a former FBI hostage negotiator. Now *that* is an example of skin in the game.

Negotiation plays a role in almost every aspect of our lives. The only environment in which negotiation is not present that I can think of is one in which someone lives entirely in isolation, which brings a different order of challenges (see our piece *Be a contrarian – enter the cave!* in Master Investor Issue 47 for more on this theme). We negotiate daily with members of our family, with friends, with colleagues, with business rivals, and counterparties – how on earth did such a fundamental aspect of human life manage to evade our educational system?

"HOW ON EARTH DID SUCH A FUNDAMENTAL ASPECT OF HUMAN LIFE MANAGE TO EVADE OUR EDUCATIONAL SYSTEM."

As Chris Voss puts it,

> *Negotiation is a psychological investigation. You can gain a measure of confidence going into such an investigation with a simple preparatory exercise we advise all our clients to do. Basically, it's a list of the primary tools you anticipate using, such as labels and calibrated questions, customised to the particular negotiation.*
>
> *When the pressure is on, you don't rise to the occasion – you fall to your highest level of preparation.*

Which brings us to the next big deficiency at the heart of our educational system – its inability to teach the most fundamental aspects of human psychology.

While I haven't studied psychology in any formal sense, I have had the benefit of working in the financial markets for nearly 30 years, which is pretty good preparation. All of human life is there, warts and all. But if I were only allowed one book to recommend on the topic, it would be Robert Cialdini's *Influence: the psychology of persuasion*. I have yet to visit any marketing company or ad agency and *not* see copies of this book adorning the shelves.

As someone who initially wanted to work in advertising (happily, fate intervened and sent my career down a different path), I have long been drawn to stories about the creative folk who inhabit the world of Adland. Rosser Reeves was one of the most celebrated American advertising executives from the 1950s onwards – he helped define the era of *Mad Men*. There's a story about him, now many times retold, that goes as follows. Reeves and a colleague were having lunch one day in Central Park. On their way back to Madison Avenue, they came across a beggar. The man was holding a cup for donations and a handwritten cardboard sign, that read:

I AM BLIND.

Sadly, the man's cup was almost empty. His plight, for some reason, was not moving people to donate. Reeves immediately told his colleague that he could see what the problem was; he bet his colleague that he could dramatically increase the money in the beggar's cup, simply by adding four words to his sign. His colleague, intrigued, took him up on the bet. Reeves then introduced himself to the man, explained that he was in advertising, and offered to change his sign slightly to increase people's willingness to give. The man agreed. Reeves took out a pen, added his four words, and with his colleague stepped back to watch. Almost immediately, passers-by started to drop coins into the blind man's cup. Others came by, began talking to the man, and took dollar bills from out of their wallets. Pretty soon, the man's cup was overflowing with cash. What four words did Rosser Reeves add to the sign?

IT IS SPRINGTIME AND

The new sign, that captured the sympathy and triggered the generosity of passers-by, read:

IT IS SPRINGTIME AND I AM BLIND.

By nudging people to put themselves in the position of the beggar, Reeves was exploiting something psychologists call "the contrast principle". He was arguably "guilting" people into giving. But most observers would conclude that, assuming this story isn't apocryphal, the end justified the means.

The mistake that many private and professional investors make is to concentrate on "the numbers". But financial data, no matter how reliable it is, can only be the start of the investment journey. My friend Guy Fraser-Sampson puts it as follows,

> *Finance is at best a social science studying human behaviour, like psychology or sociology, and can never be a physical science such as physics. It is for this reason that neither observation nor mathematical techniques can ever offer any valid universal guide to future outcomes.*

So, when John Maynard Keynes wrote, during the depths of the Great Depression, that "we have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the working of which we do not understand", his analogy was poignant, but not quite accurate. Keynes was looking for a lever to move the economy, but the lever does not exist. The economy as machine does not exist. The metaphor Keynes used has no grounding in objective reality.

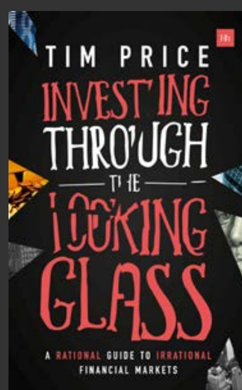
The final word should perhaps go to the one group of economists who saw what Keynes did not. The so-called Austrian, or classical, economists, recognised something that the scientific economists *could* not. The economy is not just some abstract assembly of cogs and wheels and inputs and outputs that can be neatly sliced and diced and subject to mathematical theory. *The economy is us.* Investors ignore the human dimension to financial markets at their peril.

Ticket Offer

Meet me and the rest of the team behind Master Investor Magazine on 6th April – just use the discount code PRICE to claim your complimentary ticket here.

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'.



APRIL 2019

INVESTOR EVENTS DIARY

EVERY WEDNESDAY	
Event:	SR Live webinar
Organiser:	SyndicateRoom
Time:	12:30
Place:	Webinar
Tickets:	www.syndicateroom.com/events/sr-live

SATURDAY, 6 APRIL	
Event:	Master Investor Show
Organiser:	Master Investor
Time:	09:30-17:00
Place:	Business Design Centre, 52 Upper St, London N1 0QH
Tickets:	www.masterinvestor.co.uk/show

SATURDAY, 6 APRIL	
Event:	London Cryptocurrency Show 2019
Organiser:	Investor Conferences (UK)
Time:	09:30-17:00
Place:	Novotel London West, 1 Shortlands, London W6 8DR
Tickets:	https://www.eventbrite.co.uk/e/the-london-cryptocurrency-show-tickets-45189200114 Use code: MASTERINVESTOR19 for a free ticket

WEDNESDAY, 24 APRIL	
Event:	Netwealth Investor evening
Organiser:	Netwealth
Time:	18:30 onwards
Place:	60 Charlotte Street, London W1T 2NU
Tickets:	www.netwealth.com/events

WEDNESDAY, 5 JUNE

Event:	Netwealth Investor evening
Organiser:	Netwealth
Time:	18:30 onwards
Place:	60 Charlotte Street, London W1T 2NU
Tickets:	www.netwealth.com/events

WEDNESDAY, 26 JUNE

Event:	Small Cap Awards 2019
Organiser:	Small Cap Network
Time:	18:00-23:00
Place:	The Montcalm Hotel, Marble Arch W1H 7TN
Tickets or sponsor-ship:	Email amanda@masterinvestor.co.uk to register interest

WEDNESDAY, 26 JUNE

Event:	Women in Finance Awards 2019
Organiser:	Bonhill plc
Time:	19:00-00:00
Place:	The Grosvenor, London
Tickets or sponsor-ship:	www.womeninfinance.co.uk/london/the-awards

FRIDAY, 25 OCTOBER

Event:	London Investor Show
Organiser:	Investor Conferences (UK)
Time:	09:30-17:00
Place:	Novotel London West, 1 Shortlands, London W6 8DR
Tickets:	https://www.eventbrite.co.uk/e/london-investor-show-2019-tickets-53471905910 Use code: MASTERINVESTOR19 for a free ticket

FRIDAY, 15 NOVEMBER

Event:	Manchester Investor Show
Organiser:	Investor Conferences (UK)
Time:	09:30-17:00
Place:	Manchester, TBC
Tickets:	www.eventbrite.co.uk/e/manchester-investor-show-2019-tickets-53471910925 Use code: MASTERINVESTOR19 for a free ticket

SATURDAY, 28 MARCH 2020

Event:	Master Investor Show
Organiser:	Master Investor
Time:	09:30-17:00
Place:	Business Design Centre, 52 Upper St, London N1 0QH
Tickets:	https://masterinvestorshow.eventbrite.co.uk

MARKETS IN FOCUS

MARCH 2019

GLOBAL EQUITIES

Index	Last Month %	YTD%	52-Week Strength
CSI 300	5.5	28.6	
NASDAQ 100	4.0	16.6	
FTSE 100	2.9	8.2	
Euronext 100	2.3	13.7	
CAC 40	2.1	13.1	
S&P 500	1.8	13.1	
Hang Seng	1.5	12.4	
FTSE All-World	1.0	11.5	
Swiss Market	0.9	12.4	
Russian TSI	0.9	12.1	
S&P/ASX 200	0.2	9.5	
DAX Xetra	0.1	9.2	
Dow Jones	0.0	11.2	
Nikkei 225	-0.8	6.0	
Bovespa	-1.3	7.4	

COMMODITIES

Commodity	Last Month %	YTD%	52-Week Strength
Bitcoin	7.7	11.6	
Crude oil (Light Sweet)	5.0	31.0	
Cotton	4.2	5.1	
Crude oil (Brent)	1.7	24.0	
Cocoa	0.4	-6.6	
Iron Ore	0.1	17.1	
Palm Oil (Crude)	-0.2	1.4	
Gold	-1.2	1.2	
Sugar (No. 11)	-2.0	4.2	
Platinum	-2.2	6.7	
Copper	-2.8	9.2	
Silver	-3.4	-2.8	
Natural Gas	-4.0	-9.2	
Coffee	-4.5	-7.7	
Palladium	-9.8	13.0	

FOREX

Pair/Cross	Last Month %	YTD%	52-Week Strength
USD/CAD	1.3	-2.0	
EUR/GBP	0.3	-4.4	
AUD/USD	-0.1	0.6	
USD/CHF	-0.2	1.1	
USD/JPY	-0.5	1.1	
EUR/USD	-1.4	-2.2	
EUR/CHF	-1.6	-0.8	
GBP/AUD	-1.6	1.6	
GBP/USD	-1.7	2.3	
EUR/JPY	-1.8	-1.1	

CENTRAL BANKS – RATES & MEETINGS

Central Bank	Key Rate	Next	After
Bank of England (BoE)	0.75%	May 02	Jun 20
European Central Bank (ECB)	0.00%	Apr 10	Jun 06
Federal Reserve System (FED)	2.50%	May 01	Jun 19
Bank of Japan (BoJ)	-0.10%	Apr 25	Jun 20
Bank of Canada (BoC)	1.75%	Apr 24	May 29
Reserve Bank of Australia (RBA)	1.50%	Apr 02	May 07
Swiss National Bank (SNB)	-0.75%	Jun 13	Sep 19
Banco Central do Brasil (BCB)	6.50%	May 08	Jun 19
Central Bank of Russia (CBR)	7.75%	Apr 26	Jun 14
Reserve Bank of India (RBI)	6.25%	Apr 04	

FTSE 350 TOP RISERS

Company	Last Month %	YTD%	52-Week Strength
Inmarsat PLC	38.8	46.3	
Ocado Group PLC	32.5	73.5	
Ultra Electronics Holdings PLC	28.7	22.8	
Premier Oil PLC	26.6	41.2	
Keller Group PLC	16.4	25.0	

FTSE 350 FALLERS

Company	Last Month %	YTD%	52-Week Strength
Just Group PLC	-40.6	-33.3	
Kier Group PLC	-30.4	-11.0	
Amigo Holdings PLC	-22.8	-35.9	
Cairn Energy PLC	-20.2	7.9	
Thomas Cook Group PLC	-17.9	-18.9	

FTSE 350 SECTORS RISERS

Sector	Last Month %	YTD%	52-Week Strength
Tobacco	12.7	22.8	
Personal Goods	8.5	7.7	
Beverages	7.3	12.0	
Industrial Metals	6.8	28.8	
Food Producers	6.4	15.4	

FTSE 350 SECTORS FALLERS

Sector	Last Month %	YTD%	52-Week Strength
Industrial Transportation	-5.5	3.9	
Automobiles & Parts	-5.2	-8.1	
Tech Hardware & Equip	-4.0	21.5	
Life Insurance	-2.8	11.3	
Real Estate Inv & Serv	-2.6	9.1	

IA SECTORS RISERS

Sector	Last Month %	YTD%	52-Week Strength
UK Index Linked Gilts	7.7	7.5	
UK Gilts	3.7	4.1	
China/Greater China	2.3	12.7	
Asia Pacific Excluding Japan	2.3	7.9	
Technology and Telecom	2.2	13.1	

IA SECTORS FALLERS

Sector	Last Month %	YTD%	52-Week Strength
North American Smaller Comp	-1.1	12.6	
Money Market	0.1	0.2	
European Smaller Comp	0.1	6.9	
Short Term Money Market	0.2	0.3	
UK Direct Property	0.4	0.8	