ISSUE 50 – MAY 2019

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THE SHARING ECONOMY

OPPORTUNITY OR IDEOLOGY?

PLUS...

DIAMONDS

AN INVESTOR'S BEST FRIEND?

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GOOD VALUE AFTER THE SELL-OFF?

GETTING DEFENSIVE

HOW TO BUILD A LATE-CYCLE PORTFOLIO

NICK TRAIN'S OFFBEAT BETS

UNCOVERING THE STAR MANAGER'S MORE UNUSUAL PLAYS

WELCOME

Dear Reader,

On Saturday 6th April, thousands of private investors – many of them Master Investor magazine readers – descended on the Business Design Centre in Islington to watch the greatest show in the private investor calendar. The Master Investor Show 2019 was a terrific success with exhibitors, sponsors and delegates alike (don't miss Peter Higgins' review of the event on page 30) and it was lovely meeting so many happy readers. Don't forget you can already secure your ticket for next year's show by signing up HERE.

Speaking of the show, you can now watch the videos of all the Main Stage presentations on our YouTube channel. Jim Mellon was on fire, as usual, and one of the topics he covered was the proliferation of stock market listing for "sharing economy" firms such as Lyft, which launched on the market in an eyebrow-raising $24 billion flotation at the end of March. In this month's cover feature (page 10), Victor Hill – who very capably compered the Main Stage at the show – takes a deeper look at this undeniably hot area of the market to see what all the fuss is about. There is potential there, but as Jim suggested at the show, investors need to tread very carefully.

Elsewhere, keep an eye out for our podcast series which is launching very soon. You can sign up on Apple iTunes by searching for "Master Investors" and hitting the "subscribe" button to make sure you never miss a show. In this exciting series, I'll be picking the brains of fund managers, CEOs, big shot investors and various other luminaries from the investment world. Keep an eye out for my interview with Jim – and many more to follow.

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

Best regards,

James Faulkner
Editor

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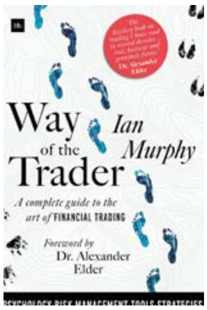

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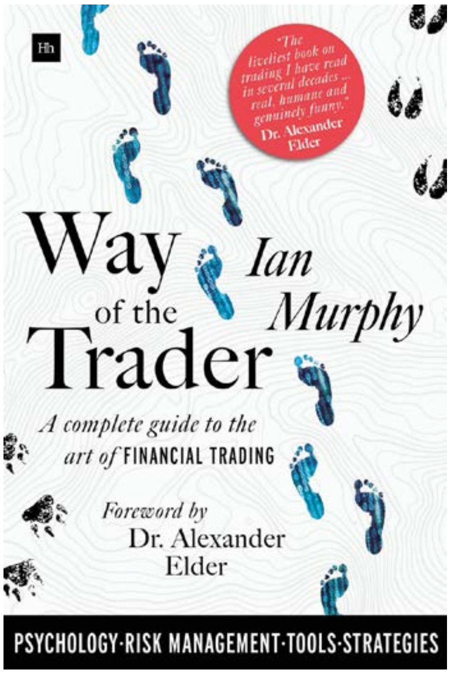

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BY JIM MELLON

MELLON ON THE MARKETS

Another year has flown past in the context of the Master Investor show. Those of us who attended, I hope, can agree that it was the best yet. Over 3,200 individuals thronged the Business Design Centre in Islington, London, with well over 100 exhibitors and a really fascinating roster of speakers. The organisers deserve to be congratulated on a brilliant delivery and execution. I was very happy to be there and to host a drinks party for exhibitors afterwards.

I went on a Brittany Ferries "mini cruise" (Plymouth to Santander and back over 48 hours) to prepare for my own talk, which focused on the importance of "metathematics" in portfolio construction. Being a lover of rough seas, I got my wish, and I am afraid that is where we are headed to in markets. I am pretty convinced that despite optimistic talk of "melt ups" and renewed optimism over (some) tech stocks, we are heading into a rocky period sometime this summer.

The flurry of offerings in the US, such as **Lyft (NASDAQ:LYFT)**, Slack, **Pinterest (NYSE:PINS)**, and coming up, Uber, indicates that venture capitalists and other early backers of loss-making behemoths are looking to cash out. This is not a positive sign for the broad market, and despite apparently bullish signals from liquidity measures and still strong economic growth in the US (but not, generally, elsewhere), there's a storm brewing.

My friends at Macrostrategy Partnership tell me that they think only a few weeks remain in the bull market, and they advocate shorting growth stocks, selling high yield bonds, and buying gold in spades. They think that there will be a tightening of US dollar supply, imperilling the emerging markets in particular, and that this will be no mere "flash crash" of which we have seen plenty in the past few years.

Now is the time to be cautious

I don't know if I buy the outright "sell" signal that they are highlighting, but I would be pretty cautious going into the summer. I know that gold has been very disappointing in recent years, but I guess that is the price of an insurance policy. Now may be the time for readers to up the ante and get a few gold coins, stocks or whatever to store against the hurricane.

> **"IN A SHORT-TERM DEFLATIONARY BUST, WHICH WE MAY BE ABOUT TO EXPERIENCE, GOLD ALWAYS SEEMS TO PERFORM WELL."**

"I AM PRETTY CONVINCED THAT DESPITE OPTIMISTIC TALK OF 'MELT UPS' AND RENEWED OPTIMISM OVER (SOME) TECH STOCKS, WE ARE HEADING INTO A ROCKY PERIOD SOMETIME THIS SUMMER."

"FACEBOOK IS A WONDERFUL SHORT."

In a short-term deflationary bust, which we may be about to experience, gold always seems to perform well. I personally like **Condor Gold (LON:CNR)** and **Highland Gold (LON:HGM)**, as well as any large ETF, physical or futures form of the yellow metal. There were also a couple of small Canadian companies which I met at Master Investor, **Quebec Precious Metals (CVE:CJC)** and **Auxico (CNSX:AUAG)**, both of which could do well.

Now, of course, not all stocks will fall and not all companies will fail; there are a few dividend yielding stocks which are worth tucking away – examples include some UK ones, such as **BP (LON:BP.), Shell (LON:RDSA), Direct Line (LON:DLG), Legal and General (LON:LGEN),** and especially beaten up, **Standard Aberdeen (LON:SLA)**.

And once the liquidity crunch becomes evident and scary (and it will), then the Fed and the other central bankers will loosen their purse strings and print as fast as the Venezuelans, with a rebound on the cards for mid-2020. Politicians and central bankers will bow to the mob and print rather than do what is necessary to restore financial rigour to the de-normalised financial system.

This will just further distort economies, and far from satisfying the populace on narrowing the widening wealth gap between the rich and the poor, will only serve to widen it. So, we can expect a continuation of the cycle of the past decade or so, except this time the rollercoaster ride will be really violent.

I have made the point before that the most vulnerable of stocks are those that are over-owned, and they tend to include those with seemingly endless bright prospects. At the risk of sounding like a broken record, I think **Facebook (NASDAQ:FB)** sits at the top of the heap. Last week it reported reasonable earnings but provided $5 billion for a fine in the US from the FTC in relation to Cambridge Analytica. The market reacted positively, thinking that that was that, and in the context of $45 billion of cash, the amount is relatively trivial.

But this is NOT the end of the matter; every single government where Facebook plies its trade will be looking to the golden goose to yield up its eggs, and many more billions will flow outwards in due course. Facebook is a wonderful short, and whatever "news" comes out (e.g. a Facebook payment system, WhatsApp monetisation etc.) the fact is that this business has peaked, and it is trussed up like a Christmas gift to cash hungry governments everywhere.

I also mentioned at the Master Investor show that I thought the mobility revolution (for the most part) was overhyped and that some of the cash-burning giants (Tesla, Uber, Lyft, Lime etc.) were outright sells (in the case of those already public). Tesla reported terrible earnings and is falling fast; Lyft has fallen sharply since its IPO; Uber has cut its IPO price drastically. Keep selling is my message here. But buy the picks and shovels of the electric revolution – and that means lithium.

Metathemes to the rescue

In terms of the metathematics that I like, two stand out. One is longevity. There isn't a lot to buy here yet, but **RestorBio (NASDAQ:TORC)** in the US looks good to me, and ultimately our own Juvenescence will go public, so watch out for that. The new edition of our book *Juvenescence* will come out some time later this year and will have more details on companies that are fast emerging as winners in this sector.

Anthony Chow (info@agronomics.im) is in charge of our efforts in clean meat (lab grown meat) and this is going to be a MASSIVE industry. Anthony is well versed on the industry landscape and no doubt clean meat will be a big feature of next year's Master Investor event, the day for which has been fixed as 28th March 2020. You can register now HERE, and I would, as I believe that we will be heavily oversubscribed.

My central message is to be very wary; investors in Patisserie Valerie will be sorely aware of how something can come from left field and hit you in a painful way. Today, there are too many complacent investors out there, and something is going to hit them. Don't let it be you.

One thing I recommended at the Show was Neil Woodford's **Patient Capital (LON:WPCT)**. Neil has been unfairly traduced, I feel, and will bounce back. With a long-term track record such as his, he is the classic case of "buy on the dip". High quality fund managers (and we had a few of them at the show) are hard to come by. When they have the odd blip, that is the time to back them for the long term.

Happy Hunting!

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 VICTOR HILL

COVER FEATURE

THE SHARING ECONOMY: OPPORTUNITY OR IDEOLOGY?

The sharing economy is not just an incipient technological reality but a new approach to how we organise our lives and resources. It offers a step-change in both efficiency and convenience. Potentially, it could also help in the battle against climate change and growing inequality of wealth and income.

Or so many people – particularly young people – believe. New ways of delivering services through the internet accord with a new attitude amongst the young – or as I call them the *millenarian millennials.*

Millenarians in western history were people who, in various centuries, thought that the end of the world was nigh – whether due to plague, war or sin. The young – as you may have noticed if you were caught up in the *Extinction Rebellion* protests in London last month – also believe that we don't have much time left to save the planet. In that belief they are encouraged by influential elder sages such as national treasure Sir David Attenborough.

For investors, there is a new breed of unicorn which not only offers technological solutions but potentially lifestyle solutions as well. And they have the weight of youth culture behind them. The only problem is that many of them are currently loss-making.

Follow that trend...But can investors support the sharing economy, help save the Earth and still make money?

"THE NEW BREED OF FACILITATOR UNICORNS WHICH ARE NOW COMING TO MARKET SPEAK DIRECTLY TO THE RISING MILLENARIAN YOUTH CULTURE."

Cultural evolution and the sharing economy

Listening to some of the millennials (and their not so youthful agitators) speaking to the media during the *Extinction Rebellion* that paralysed central London in late April, I was struck by something. On the one hand, most of them did not seem to understand the scientific issues surrounding global warming stroke climate change (no one mentioned carbon capture) very well and were ignorant of how much the UK in particular has reduced its carbon emissions over the last decade. On the other hand – I admit this reluctantly, given my more mature vintage – they seem to have a very important point.

The baby-boomer generation has spewed carbon dioxide into the atmosphere with alarming consequences and filled the oceans with plastic – yet it is the young who will face the environmental music as they grow older... Mind you, I wasn't very impressed by Dame Emma Thompson, wearing dungarees, gesticulating from a pink boat that paralysed the traffic in Oxford Circus. (She had jetted in, business class, from LA for the gig thereby generating another five tonnes or so of CO2!) Nor was I impressed by their double-barrelled supposed leader whose Instagram account reveals a love of skiing holidays...The real star of the show was a tiny, pig-tailed Swedish schoolgirl called Greta.

Of course, we are all greens now. Environmentalism, or, to use the older term, conservationism, is universal, particularly in the corporate world. Who would invest in a company that admitted to being a polluter? And indeed, in the UK in recent years, listed corporates are required to disclose their total carbon emissions in their annual reports. As **Legal & General (LON:LGEN)** has recently attested, these metrics are rigorously analysed by institutional investors.

Now, as EM Forster said: *Only connect.* The new breed of facilitator unicorns which are now coming to market speak directly to the rising millenarian youth culture. These young people, whatever you might think of them, adhere to two principles. One is *fairness* (and I could write at length about what a floppy concept that is – but I shall discipline myself here); the other is *ecology* – using resources in a sustainable way. Actually, this does *not* amount to socialism. While the millennials are generally welfare-friendly (unlike more mature grouches like this writer) they don't seem to believe that *the means of production, distribution and exchange* should be brought under state control.

One possibility is that, as they mature, they will foster a newer, gentler form of capitalism which will try to address the major issues of our time: the widening gap between rich and poor in the developed world (including China, by the way); and the degradation of our environment.

Changing the world by disruption

Imagine a world where people, instead of *owning* lots of stuff, *hired* things as and when they needed to use them. If you think this is fanciful, just listen to what **Lyft (NASDAQ:LYFT)** had to say in its flotation prospectus:

DiDi drives China

The Chinese car-hailing giant DiDi Chuxing halted its expansion in August last year after a 20-year old woman passenger was raped and murdered in the eastern city of Wenzhou. DiDi is credited with chasing Uber out of China in a war of attrition which cost both firms billions. Finally, in 2016, Uber sold its Chinese operations to DiDi in exchange for an 18 percent stake. DiDi launched in Australia in early 2018 and then in Mexico.

In July last year DiDi secured a $500 million investment from the owners of the US travel website Booking.com, **Booking Holdings (NASDAQ:BKNG)**. This money is likely to be used to fund DiDi's expansion into western markets. DiDi's users can now book holidays through Booking.com and other websites such as Agoda and Kayak which are owned by Booking Holdings. China is rapidly becoming the world's largest market for travel services, sending more tourists abroad than any other country.

DiDi owns a stake in the Estonian taxi-hailing network Taxify (whose app is called Hopp) as well as in numerous other apps around the world. Last year DiDi also raised $4 billion in a funding round in Japan in which the Japanese tech conglomerate **Softbank (TYO:9984)** participated. DiDi has raised a total of about $20 billion since it was launched in 2012.

The company even secured a $1 billion investment from **Apple (NASDAQ:AAPL)** partly to fund its own research and development centre in Silicon Valley called DiDi Labs. There it has been testing self-driving cars (*taxis*?).

We believe that the world is beginning to shift away from car ownership to transportation-as-a-service (TAAS)... Lyft is at the forefront of this massive societal change...

Any newly-coined four-letter acronym should normally set the BS detector flashing and beeping – but there is a serious trend here. Car ownership amongst the young has been plummeting in the last decade in the US and the UK as compared with their parents' generation at the same age. Many millennials, apparently, don't even think it's worth passing their driving test: to be sure, a self-driving taxi will be arriving shortly to whisk them to the latest protest!

And, by the same logic, why would these free spirits wish to own a holiday home when they can click on the perfect get-away with Airbnb (another unicorn coming to market soon)? Then there are the technologies which facilitate the sharing not just of physical assets like cars or houses but of experiences too. **Pinterest (NYSE:PINS)** is one.

What gives us pause is that Lyft recorded the biggest loss last year of any new listing coming to market ever – nearly $1 billion. That record will probably soon be eclipsed by Uber which has burned through about $11 billion of investors' cash since its foundation in 2009. In contrast, **Facebook (NASDAQ:FB)** and **Google (NASDAQ:GOOG)** were well in the black by the time they launched on the market.

On the other hand, all these unicorns have tried-and-tested business models which are losing money in accounting terms because they are investing madly so as to globalise their offer. These are not the untried-and-untested nerds of the 2002 tech bubble. In any case, about 80 percent of initial public offerings (IPOs) in the US last year involved loss-making firms.

And there are still more players coming into this space. Last year Indian taxi-app giant Ola announced plans to launch in the UK. Ola was valued at about $5.7 billion at the end of last year. A number of venture capital firms including **Softbank (TYO:9984)** have stakes in the company.

Lyft launches first

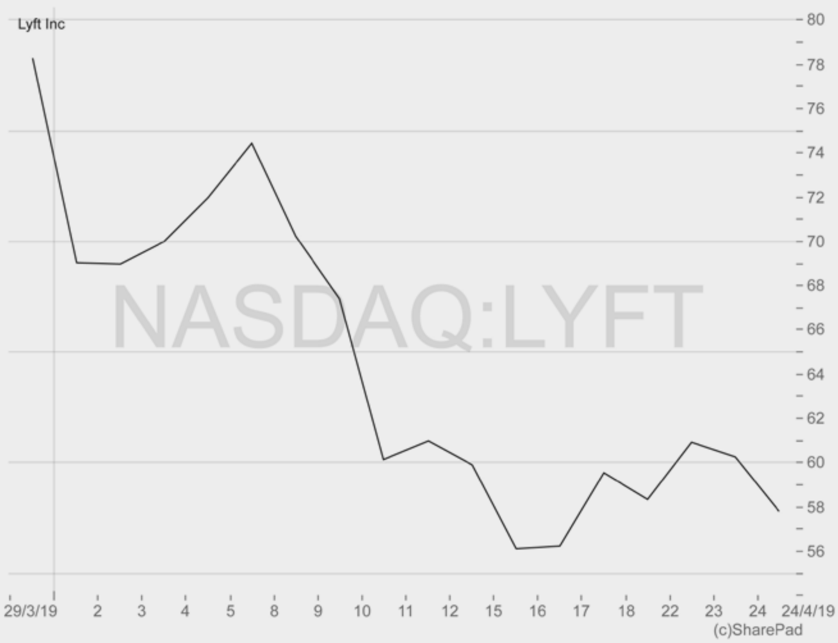
Lyft has beaten its more famous rival to the stock market. On 29 March the company's shares were launched on the NASDAQ (under the moniker LYFT) at a price of $72 a share, valuing the company at $24 billion – despite losses of $911 million last year. The shares reached $82 shortly thereafter. At the time of writing (the week after Easter), however, the share price was trading at about $60.

The company was founded in 2012 in San Francisco and was rolled out in hundreds of US cities. Lyft first came to prominence in the UK during TfL's ban on Uber in Britain's capital city. Although it operates a very similar business model to that of Uber it has cultivated a more socially conscious brand than its more controversial competitor.

Nevertheless, there is a feeling that, as the *Daily Telegraph's* James Titcomb put it, Lyft is Pepsi to Uber's Coke – a perennial runner-up. Most of the profits in any given sector tend to be gobbled up by the market leader. The US taxi hailing market is nearly 60 percent dominated by Uber and 39 percent by Lyft. Uber is thus much bigger and is diversifying more widely. There will be a permanent price war in this near-duopoly. Lyft is therefore an also-ran in a tech universe that favours monopolies. Already, the initial valuation of Lyft's shares looks optimistic.

Investors should also be aware that Lyft's founders, Logan Green and John Zimmer, are still major shareholders and hold disproportionate voting rights. The word is that, after the initial spike, the short-sellers moved in. Invest here cautiously.

Lyft not picking up investors



Uber above all

An early investor in Uber said about Travis Kalanick, its founder and first CEO, soon after the taxi app was first launched in 2009: "It's hard to be a disrupter and not be an a***hole". Mr Kalanick did not disappoint.

Uber has grown into a must-have tech brand which offers a hassle-free taxi service in decent cars (with generally pleasant drivers) right across the planet – and no dirty cash changes hands at the end of the ride. All people have to do to start using it is to download the app onto their smartphones and to register their credit card details.

But Uber has been plagued by corporate governance issues. Mr Kalanick was accused of sexual harassment at the company's San Francisco HQ in 2017. (Not a great image for an outfit that invites single women to get into strangers' cars at night.) Then Bloomberg posted a video of Mr Kalanick abusing one of his own drivers. Mr Kalanick was forced to step down as CEO in 2017 after Benchmark Capital (run by Bill Gurley) reportedly demanded his resignation. But he remains a board member and a major shareholder – he stands to reap about $10 billion in the coming flotation. Mr Kalanick was replaced as CEO by Dara Khosrowshahi.

The term *the Uber economy* has become a by-word in the USA and beyond for the casual exploitation of freelance labour. Then there is the more piquant criticism that Uber is fundamentally an aggressive agitator which competes on price alone – with little concern for customer satisfaction. The *#DeleteUber* campaign on Twitter in 2017 lost Uber hundreds of thousands of users.

Add to that the brouhaha surrounding Uber's exploitation of a loophole in the UK VAT regime by means of which it shifted responsibility for VAT payments to its 40,000 British drivers. Uber did this by using an EU rule concerning business-to-business sales across borders within Europe, billing its UK drivers from its Dutch subsidiary. The UK accounts for about one third of Uber's total sales in Europe. In contrast, competitors Gett (which summons traditional licensed black cabs in the UK) and Mytaxi pay VAT on booking fees because they bill their drivers from within the UK.

In practice most Uber drivers do not pay VAT because their total earnings are below the current UK VAT sales threshold of £85,000. Uber drivers in the UK make on average £560 a week from fares – so about £28,000 a year and Uber takes a cut of 20-25 percent on those fares. Its UK revenues alone are thought to be well over £200 million a year.

In September 2017, after a series of incidents, Uber lost its license to operate in London. Transport for London (TfL) argued that Uber was not a "fit and proper" operator, saying that Uber failed to carry out sufficient background checks on its drivers. 600,000 people signed a petition demanding to reverse the ban. Uber was permitted to continue to operate pending an appeal.

Uber has also diversified. Uber Freight sought to do for the trucking industry what the company had done for the taxi sector. Over 70 percent of goods in the USA are transported by truck but productivity in the trucking sector has lagged behind other transportation sectors. Using Uber's smartphone app truck drivers can now sign up to deliver freight days or weeks in advance.

Uber even purchased Otto, a company that was developing driverless trucks. The company is now defunct as Uber closed it down to focus on the development of self-driving vehicles within its subsidiary Advanced Technologies Group. It is active in the field of food delivery with UberEats. It also owns spin-off businesses active in cycle and scooter hire.

Mr Kalanick followed his idol, Amazon's Jeff Bezos, by putting growth ahead of profitability. Uber has benefited from its size, pursuing a market dominance strategy. But it has not had everything its own way. The company was forced to retreat from China, Russia and Singapore by local incumbents. But in Dubai it has bought out local competitor Careem in order to consolidate its market leadership.

Uber is still burning through investors' cash with little prospect of going into the black in the near-term. The firm published its listing prospectus on 11 April. We now know that Uber lost nearly $3 billion last year on revenues of $11.3 billion (that's after the deduction of the drivers' share of the fares). Indeed, it has made cumulative losses of nearly $8 billion since it was founded in 2009.

Yet, according to CNBC markets[i] Uber could be worth up to $120 billion – making it more valuable than **Nvidia (NASDAQ:NVDA)** and **PayPal (NASDAQ:PYPL)**. More conservative analysts value the company at $90 to $100 billion, pointing out that the rate of growth in revenues is slowing.

"CAR OWNERSHIP AMONGST THE YOUNG HAS BEEN PLUMMETING IN THE LAST DECADE IN THE US AND THE UK AS COMPARED WITH THEIR PARENTS' GENERATION AT THE SAME AGE."

Turo advances

Turo makes it possible for people to hire cars in almost any location on a peer-to-peer basis – meaning that I can rent your car for a day (or longer) from you when you don't need to use it. Cars available are practical roadsters; but enthusiasts can take classic or luxury cars for a spin just for the hell of it.

This concept is much better established in the USA than in the UK but it is now available here too. Turo launched in the UK last September and now has 4,000 cars on the app and 92,000 registered users. 5,000 new users are signing up each month.

In the US, Turo and its smaller rival Getaround are engaged in what they regard as a David versus Goliath battle with the established car hire companies – dominated by the big three: **Avis (NASDAQ:CAR)**, **Hertz (NYSE:HTZ)** and Enterprise (private). These giants are lobbying to ensure that Turo and the nascent car-sharing sector should be tightly regulated in terms of tax, safety and insurance.

Turo has not made any financial information available so far. The word is though that Turo's cut of the hire fee is large. Unlike Uber's drivers, Turo's providers don't make a living out of making their cars available – just some useful extra cash. In contrast, in the traditional car rental market, margins are tight which explains why Zipcar, a fleet-based car-sharing app, was bought out by Avis in 2013. Significantly, **Daimler (ETR:DAI)** has invested in Turo, leading a $92 million funding round in 2013.

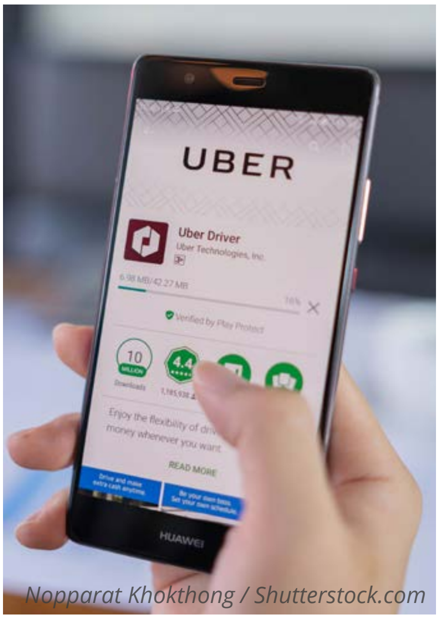
What about safety? That is an important issue; but good hosts (i.e. car providers) who provide well-maintained clean cars get good reviews – and vice versa. While mature business people might be squeamish about climbing into other people's cars, millennials are more comfortable with the idea of sharing other people's property – for a fee, of course.

One of the key conundrums is how quickly electric self-driving vehicles will become an everyday reality. If the likes of Uber could dispense with all their drivers then they will take their cut of the taxi fare from 20-25 percent to 100 percent (less the cost of electricity). Though that would leave a very large number of unhappy human drivers looking for work – 3.9 million worldwide in Uber's case. So maybe the new capitalism will not be gentler after all.

Ironically, Uber was launched in the dark days after the financial crisis of 2008-09 when there was a steady supply of drivers willing to work unsocial hours for low rates. When the cost of gasoline fell with the US shale boom, drivers (who pay for the running and maintenance of their own cars) increased their take-home pay. Maybe Uber's drivers should take comfort from the fact that the arrival of self-driving vehicles has been postponed: a pedestrian was killed by one of Uber's self-driving prototype vehicles in March last year.

Unicorns rampant

Lyft (NASDAQ:LYFT) launched on the market on 29 March in a $24 billion flotation and both Pinterest and **Zoom (NASDAQ:ZM)** made successful debuts on the market during the week of 15 April.



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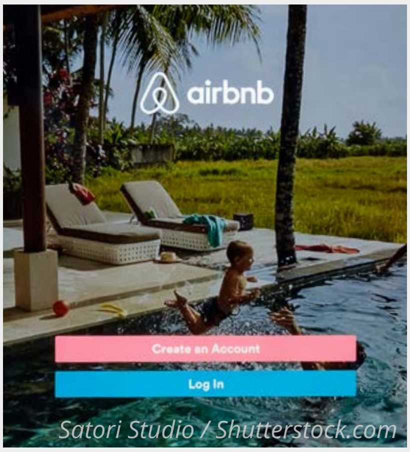
Shares in Pinterest, the photo-sharing social media phenomenon which describes itself as *a visual search engine*, shot up by 28 percent on its first day of trading, valuing the company at $16 billion. One successful investor was Michael Birch who founded Bebo before selling it to AOL in 2008 for $850 million. (Mr Birch later admitted that AOL overpaid.) He first invested in Pinterest eight years ago when it was worth just $52 million. His stake is said to have increased in value by 250 times. Pinterest grew its revenues in the first quarter of this year by nearly 50 percent to just under $200 million.

Zoom, which facilitates video-conferencing, was even more successful. Its shares soared by 72 percent on launch, valuing the outfit at $18 billion.

Investors these days might experience some doubt when they are invited to invest in unicorns. Terminology aside, we were accustomed to tech companies that provided services (information) like Google and Facebook and then entertainment like Netflix. But then this new genus of facilitator arrived – especially in the field of transport and delivery – which enables us to

Airbnb

In March this year Airbnb made a stock swap valuing the home-sharing and holiday rentals business at $35 billion. Interestingly, that's only a couple of billion more than the value attributed to the business two years ago. The company priced its shares at about $120 per share when it purchased the last-minute hotel room provider Hotel Tonight for more than $450 million[ii]. That deal paid out Hotel Tonight shareholders in both stock and cash. At that price, Airbnb would be privately valued at more than booking rivals like **Expedia (NASDAQ:EXPE)** at about $18.5 billion and hotel chains like **Hilton (NYSE:HLT)** at about $25 billion, but less than **Marriott (NASDAQ:MAR)** at $45.5 billion or **Booking Holdings (NASDAQ:BKNG)** at $85 billion. Airbnb's last funding round took place in 2017. It is still not certain that Airbnb will launch on the market in 2019.



Unicorns running rampant: Pinterest and Zoom

get to where we want to go or to receive the goods that we have ordered on Amazon and the rest...

There could be another six or so unicorns coming to market in New York over the summer – led, of course, by Uber which is likely to be valued north of $100 billion – maybe even more if the US market continues its bull run. Other unicorns due to launch later this year include Palantir, Airbnb, food delivery app Postmates and messaging service Slack. Uber's listing, expected in early May, will be the largest since Alibaba in 2014.

The UK herd

The UK has more than 60 unicorns with, prospectively, a market value each of over $1 billion, according to Tech Nation, the government's start-up incubator. Of those, 36 are located in London – more than in any other European city. In fact, Oxford and Cambridge between them have more than either Paris or Berlin. Silicon Fen (Cambridgeshire) is reckoned by some as Europe's biggest technology cluster. Much of these unicorns are being funded from the £24 billion that Softbank paid to buy ARM Holdings in 2016.

UK unicorns include the digital bank Monzo, the payments company TransferWise and the take-away food deliverer Deliveroo. But for all these household names there are a plethora of less well-known digital businesses.

Action

Follow the trend – yes; but don't underestimate the risks. Many sharing econ-

Sharing skills

Toptask has signed up about 400 students from the top universities including University College London and the London School of Economics who want to do paid gigs – i.e. short-term jobs covering activities from research, design, child-minding, dog-walking, decorating to translations. The business was founded by Gregory Newman and his wife Lee Steinfeld after they had difficulty finding a suitable tutor for their children. Toptask interviews all students to ensure that they really have the skills that they claim to have. Once a prospective employer posts a job they are provided with a list of students in that area who are willing and able to undertake that task. The students receive a guaranteed minimum of £10 an hour for any work done.

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omy facilitators have fallen by the wayside. And beware inflated valuations.

Karhoo, the HQ of which was in London while the company was domiciled in the USA, collapsed in December 2017 at the cost of 200 jobs. Karhoo started out in May 2016 in London and reportedly raised $150 million to fund expansion in nine UK cities as well as New York, Paris and Singapore. Likewise, Autolib was lunched in Paris in December 2011 and built up a fleet of more than 4,000 cars. Its unique selling point was that all of those vehicles were electric. After acrimonious litigation around the use of its name and brand and a series of car fires the company went out of business on 31 July 2018. Autolib was the moving force behind Bluecity which facilitates electric car sharing in London.

The real question is: when will these app-master facilitator unicorns ever make money? I don't think even they know. But they are huge, popular and here to stay. And they are investing like crazy in order to become truly global players.

"UNICORN LISTINGS SUGGEST THAT THE REAL WINNERS ARE THE EARLY BACKERS – THE VENTURE CAPITAL FIRMS AND WEALTHY PRIVATE INVESTORS."

Unicorn listings suggest that the real winners are the early backers – the venture capital firms and wealthy private investors (such as Michael Birch who invested in Pinterest) – rather than the institutional and retail investors who queue up to buy the shares.

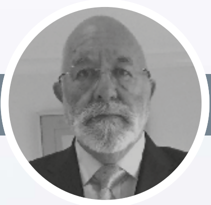
Personally, I would foreswear the IPOs and track the share prices thereafter. Investors will have to take a long-term view. But, ultimately, the dominant facilitators of the sharing economy are going to win out in the age of millennial smartphone capitalism.

It would be interesting to know what young Greta thinks.

About Victor

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

i See: https://www.cnbc.com/2019/03/15/ubers-eye-popping-valuation-worth-more-than-nvidia-and-paypal.html
ii See: https://www.recode.net/2019/3/19/18272274/airbnb-valuation-common-stock-hoteltonight



BY MARK WATSON-MITCHELL

PORTFOLIO INTELLIGENCE

DIAMONDS

CUT, CLARITY, COLOUR AND CARAT – OR ARE THEY REALLY JUST ABOUT LOVE?

Billions of years ago, diamonds were formed at depths of between 90 to 120 miles beneath the Earth's surface, by way of the explosive combination of tremendous pressure and temperatures of around 2,000 degrees Fahrenheit.

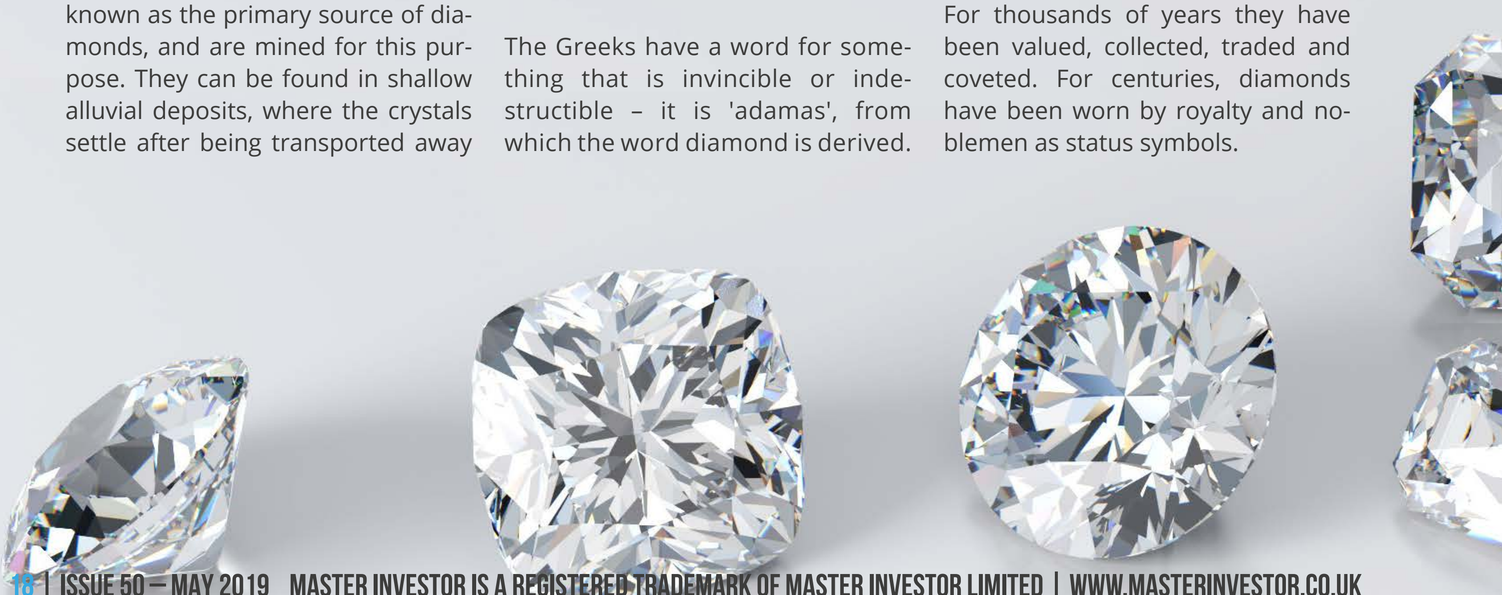
They were carried to the surface by violent, supersonic deep-origin eruptions. Known as 'volcanic pipes,' they are a deep, narrow carrot shaped cone of solidified magma. These pipes, which are relatively rare, are usually largely composed of one of two characteristic rock types – kimberlite or lamproite.

It is the kimberlite pipes that are well known as the primary source of diamonds, and are mined for this purpose. They can be found in shallow alluvial deposits, where the crystals settle after being transported away from the kimberlite pipes by geologic activity and rivers.

Diamonds are made of just a single element, almost 100% carbon. Under the immense heat and pressure far below the earth's surface, the carbon atoms bond in a unique way that results in a diamond's beautiful and crystalline structure.

The Greeks have a word for something that is invincible or indestructible – it is 'adamas', from which the word diamond is derived. They are the very hardest natural substance and the only thing that can scratch a diamond is another diamond. They also have the highest thermal conductivity of any natural material.

The earliest diamonds were found in India in the 4th century BC, and until the 18th century India was thought to be the only source of diamonds. For thousands of years they have been valued, collected, traded and coveted. For centuries, diamonds have been worn by royalty and noblemen as status symbols.



Tears, splinters or just magical

Diamonds are the oldest thing that most of us will ever hold. Ancient Hindus, believing that they could protect the wearer from danger, used diamonds in the eyes of devotional statues. The ancient Greeks and Romans thought that they were tears cried by the gods or splinters from falling stars. Even Cupid's arrows were said to have been tipped by the Romans with diamonds, as ways of showing romantic love.

Giving the wearer strength and courage encouraged many kings to wear them in their armour as they rode into battle. Whilst in the Middle Ages diamonds were considered to have healing properties, able to cure fatigue and mental illness.

Changing sources

Trading in diamonds started in Venice in the 1400s as they were brought through from India by way of the merchant caravans. Gradually such trading spread through Europe, initially in Amsterdam in the 1600s, and thereafter in other centres across the continent.

Gradually higher demand for India's diamonds helped to significantly reduce its supplies. In 1725 new discoveries in Brazil saw

> **"DIAMONDS ARE THE OLDEST THING THAT MOST OF US WILL EVER HOLD."**

that South American country become the principal supplier. It dominated the market for the next 150 years.

In 1866 a huge diamond reserve was discovered at Kimberley in South Africa. Some 22 years later businessman Cecil Rhodes established the De Beers Consolidated Mines company and by 1900 De Beers, through its many South African mines, ended up controlling circa 90% of the world's production of rough diamonds.

Through its cartel De Beers effectively held a monopoly over the global diamond mines – stockpiling diamonds, then limiting supply and thereby driving up demand and the market prices. Higher prices generated greater exploration, which added to better mining technology and thus the ability to identify more exploration areas.

Over the years, other countries, like Russia, Australia and Canada, identified significant new sources of supply. Subsequently, the increase of multiple geographic sources weakened the control that De Beers had in the 'custodian' role that it had assumed in the single-channel path in diamond supply.

The mining of diamonds

Diamonds come from two types of deposit and each type requires special mining techniques. Importantly, no chemicals are used to remove diamonds from the Earth.

Primary deposits, in which diamonds are contained in kimberlite pipes, require open pit or underground mining operations. Secondary deposits are defined as diamonds that have travelled from their original location due to erosion. These require alluvial mining, which uncovers diamonds in riverbed, coastal and marine/undersea locations.

Regardless of the way diamonds are mined, enormous investment and technical skills are necessary to construct, maintain and operate a mine. In open pit and underground mines, the ore is crushed to uncover the diamonds.

Coastal mining involves the excavation of sand to find diamonds. Undersea mining entails drilling into the seabed to recover diamond-bearing gravels. Meanwhile, riverbed mining is often on an informal, smaller scale – also known as artisanal digging – and involves the most basic of equipment, such as sieves and pans, to find diamonds.

Over the years, there have been many amazing diamond discoveries. But still holding the record today as the world's largest gem-quality diamond, the Cullinan was found in South Africa in 1905 and weighed 3,106 carats uncut.

"EVEN THOUGH WORLD DIAMOND PRODUCTION HAS TRIPLED SINCE 1980, DIAMONDS REMAIN A SCARCE RESOURCE. MORE THAN 12,000 KIMBERLITE DEPOSITS HAVE BEEN FOUND WORLDWIDE IN THE LAST 25 YEARS, YET FEWER THAN 1% HAVE CONTAINED ENOUGH DIAMONDS TO MAKE THEM ECONOMICALLY VIABLE."

Annual diamond production

The annual production of rough diamond in the 1870s was well under 1m carats, and by the 1920s that figure was up to 3m carats. Come 1970 that yearly figure had increased to 50m carats, surpassed two decades later when it hit the 100m carats level. It is currently running at around 150m carats.

It is said that diamonds are rare and getting rarer every day. Apparently, the number of recovered diamonds peaked in 2005 and is forecast to decrease significantly over the next decade. Diamond-bearing kimberlites are very hard to find. In fact, most of the diamonds recovered today come from kimberlites discovered decades ago, which is why diamond production is gradually decreasing and diamonds are becoming rarer.

Even though world diamond production has tripled since 1980, diamonds remain a scarce resource. More than 12,000 kimberlite deposits have been found worldwide in the last 25 years, yet fewer than 1% have contained enough diamonds to make them economically viable. Geologists utilise many methods in diamond exploration, including satellite surveys, reconnaissance sampling and drilling in the ground.

The top diamond producing countries, in order of carat production, are Russia, Botswana, Canada, Congo, Australia, South Africa, Angola, Zimbabwe, Namibia, and Lesotho.

Rough diamonds

The main criteria used to determine the quality of polished diamonds may be well known to most. But what is less well known is how rough diamonds are valued when they reach the surface of the earth.

When diamond miners produce ore from deep within the ground, the di-

"THE NUMBER OF RECOVERED DIAMONDS PEAKED IN 2005 AND IS FORECAST TO DECREASE SIGNIFICANTLY OVER THE NEXT DECADE."

amonds extracted from it include a whole spectrum of stones of different qualities which are unsorted and uncategorised. Every single rough diamond with its own set of characteristics will yield a unique polished diamond which is measured by the criteria of the 4Cs combined with its irregularities. In the trade, this spectrum of rough diamonds is called 'run-of-mine', comprising millions of different combinations of diamond size, colour, shape, clarity and thousands of other characteristics.

To determine the accurate price of rough diamonds requires both an in-depth technical knowledge of rough and polished diamonds and a thorough mastery of the international diamond markets at any given moment. Before diamonds can be priced, they need to be sorted with precision. Like people, diamonds are unique and no two are the same.

Once mined, rough diamonds are delivered to sorting experts who categorise and assign a value to them. It is here that industrial quality diamonds – which are small, lower quality stones – are identified. Those industrial diamonds are then used in equipment such as drill bits and lathes.

Valuers determine the price of a rough diamond using reverse engineering. They estimate the yield of the polished outcome of the rough diamond and the resulting value of the diamond when polished and then work back to determine the price of the rough diamond. An accurate valuation relies on the experience and market knowledge of the valuer.

Those diamonds that are of gem quality are classified into thousands of categories based on size, shape, quality and colour. The majority of diamonds fall within a range of standard colours from colourless to faint yellow or brown tints. Almost all rough diamonds have some distinguishing marks, known as inclusions, which make each one unique.

Synthetic and imitation diamonds

Synthetic diamonds can be grown from high-purity carbon under high pressures and temperatures or from hydrocarbon gas by chemical vapour deposition. Imitation diamonds can also be made out of materials such as cubic zirconia and silicon carbide.

Natural, synthetic and imitation diamonds are most commonly distinguished using optical techniques or thermal conductivity measurements.

Conflict diamonds

Conflict diamonds, also called blood, hot or war diamonds, captured the world's attention during the extremely brutal conflict in Sierra Leone in the late 1990s. During that time, it is estimated that conflict diamonds represented approximately 4% of the world's diamond production.

While illicit rough diamonds have been used by rebels to fund conflicts across many African countries, the problem is not the diamond itself, but the rebels who exploit diamonds to achieve their illicit goals.

Today the trade in conflict diamonds has been virtually eliminated through the efforts of Kimberly Process participants and from adherence to warranties and monitoring processes as part of the Kimberly Process Certification Scheme.

IN 1939 DE BEERS RECOGNISED THE IMPORTANCE OF CREATING A UNIVERSAL LANGUAGE TO DEFINE THE UNIQUE TRAITS OF DIAMONDS

The 4Cs have since become the standard for describing a diamond's specific characteristics. The combination of Cut, Colour, Clarity and Carat denote a diamond's value and rarity.

CUT

A diamond's brilliance is largely determined by its cut. An expertly-cut diamond with perfectly symmetrical and aligned facets will reflect light beautifully, leading to unrivalled brilliance. True expertise is required to create facets with perfect proportions that maximise light and increase a diamond's signature sparkle.

CLARITY

Diamonds are created by tremendous heat and pressure deep within the earth. This thoroughly organic process means that virtually all diamonds contain internal inclusions and surface blemishes. Diamonds with fewer of these characteristics are deemed to have a higher clarity, ranging from FL, or Flawless, to I, signalling a number of inclusions.

COLOUR

White or colourless diamonds exist on a scale of many different shades, ranging from brilliant white to pale yellow. These subtle differences are graded on a colour scale from D (colourless) to Z (light yellow). Beautiful coloured diamonds, in hues of yellow, pink, blue, orange, green and red, for example, go beyond all other measures of rarity, and are graded based on their intensity and enticing depth of colour.

CARAT

In the ancient world, carob seeds were used as a reference for the weight of individual diamonds. Today, this historic practice has led to the word carat, which is now the contemporary measure of weight for all diamonds. Precise measurements are taken to the hundredth decimal place to ensure complete accuracy. A metric 'carat' is defined as 200 milligrams.

As a result, 99.8% of diamonds are Kimberley Process-compliant. Moreover, all major producers have safeguards in place to guarantee their diamonds are produced responsibly.

Coloured diamonds

It is said that just one in every 10,000 natural diamonds can be classed as a fancy colour diamond. Exceptional diamond colour can be traced to the lattice of carbon atoms that form a diamond's microscopic structure. Over billions of years, coloured diamonds were formed through exposure to heat, natural radiation or the saturation of natural elements.

Because the arrangement of atoms in diamond is extremely rigid, few types of impurity can contaminate it, with two exceptions being boron and nitrogen. Small numbers of defects or impurities can colour a diamond.

Blue diamonds are contaminated with boron, yellow with nitrogen, green diamonds are due to radiation exposure, whilst brown, purple, pink, orange or red are due from other defects.

Cut and polished

After sorting, the diamonds are cut and polished. In ancient times, diamonds were left uncut and mounted into their settings, which gave each piece a dark, deep, mysterious look. In the 1400s diamonds started to be cut and polished, which gave them their tell-tale sparkle and brilliance.

Currently cutting and polishing take place in southern Africa, Belgium, China, India, Israel, Russia and the US, among other countries. Cutting a rough diamond takes great skill. A

"DIAMONDS ARE INCREDIBLY PORTABLE, AND THEIR OWNERSHIP IS NOT REGISTERED ANYWHERE, MEANING THAT YOU COULD EASILY PUT HUNDREDS OF THOUSANDS OF POUNDS WORTH IN LESS THAN A THIMBLE."

well-cut diamond reflects light within itself, from one facet to another, as well as through the top of the diamond, bringing out its spectral brilliance. The most popular cut is the 57 facet round brilliant.

After a stone has been cut, it is then polished and classified again, this time by its cut, colour, clarity and carat weight, also known as the "Four Cs." After being cut, polished and categorised, diamonds are then sold via one of the 24 registered diamond exchanges (also known as 'bourses') located around the world, or direct to wholesalers or diamond jewellery manufacturers.

How to invest in diamonds

As De Beers claimed in a marketing slogan way back in 1947, 'Diamonds Are Forever'. Then Ian Fleming repeated it as a title for one of his world-famous James Bond stories.

Diamonds are incredibly portable, and their ownership is not registered anywhere, meaning that you could easily put hundreds of thousands of pounds worth in less than a thimble, ideal if you are wanting to transfer the proceeds of crime to anywhere in the world.

But if you are interested in investing in diamonds, then I can suggest that there are just five ways of doing so. You could buy shares in any number of quoted companies across the globe that have diamonds as their emphasis, with several listed in Vancouver, but do your own research please.

Three companies that are quoted in the UK, worthy of attention, are **Anglo American (LON.AAL)**, which is the owner of De Beers; **Gem Diamonds (LON.GEMD)**, with mines in Lesotho and Botswana; and **Petra Diamonds (LON.PDL)**, with operations and producing mines in South Africa, Tanzania and Botswana, it also owns the famous Cullinan mine.

The other four ways need an expert for advice, which will invariably cost you. There are diamond dealers, diamond brokers or you can use the internet. You could buy rough diamonds, through any of the brokers on the diamond bourses across the globe. Fancy or coloured diamonds can be purchased through companies like Asteria Diamonds, James Allen or Leibish & Co. Colourless stones will cost you a fortune but can be a truly excellent way of buying diamonds. Finally, buying polished diamonds can be handled through several companies, such as Armann International and Lumera.

But I do repeat, that if you wish to participate in this lustrous world, it is essential that you take the advice of experts in the diamond business.

Sources: Mining Global; Mining.com; De Beers; Lumera Diamonds; Geology.com; and, Ehud Laniado.

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

BARGAINS, BARGAINS, BARGAINS!

Being a proud Yorkshireman, there's nothing that Richard Gill likes more than a good old bargain. This month, he scours the small-cap markets for just that.

This month there is no wider theme to my small cap picks other than some good old-fashioned bargain hunting. I have scoured the small cap markets looking for unloved shares which I think look good value, be it on an earnings, income or net asset basis. Some of the stocks below exhibit clear value according to all three measures and in my opinion should be good bets for inclusion in a long-term focussed portfolio.

CAFFYNS

One sector currently unloved by investors is car retailing. The UK industry has experienced some tough times of late, seeing challenges associated with meeting new emissions regulations, a fall in diesel sales due to uncertainty over government policy and the Brexit malarkey seeing consumers and businesses delay big ticket purchases. Out of all the London listed vehicle sellers the cheapest in my opinion is the South-East England based car dealership **Caffyns (LON:CFYN)**.

The business has a history going back to 1865, when William Caffyn opened a gas & hot water fitting shop in Eastbourne. Caffyns moved into motors in the industry's early days in 1903 and has been selling new and used cars ever since. As of today the company operates 13 car dealerships across Sussex and Kent representing seven major manufacturers including Audi, Volkswagen and Volvo.

Easy Rider

Caffyns is one of those businesses that likes to keep a low profile. Over the past few years the most material news investors have seen has been limited to the interim and full-year results. These have generally showed stable trading over the long term, with the cyclical effects of the UK car market being smoothed out over the years.

The most recent numbers were for the six months to 30th September 2018 and showed a period of relatively flat trading, delivered amidst tough market conditions. At the top line, revenues were down by around £1.5 million at £105 million, with a 10.4% like-for-like fall in new car unit sales offset by like-for-like used car sales up by 6.7% and after sales growing by 9%. Pre-tax profits for the half grew marginally, by 3% to £0.7 million.

The real attraction of the investment case appears on the balance sheet, with Caffyns having a strong property portfolio and owning the vast majority of the freeholds for its operating premises. Not only does this provide substantial asset backing, it minimises exposure to periodic rent reviews.

As at 30th September 2018 the total portfolio plus investment property stood at £48.5 million. Providing further "hidden" value, the last annual revaluation (as at 31st March 2018), completed on an existing use basis, showed an excess value of £10.3 mil-

lion, which as per the firm's accounting policies has not been incorporated into the accounts.

Elsewhere on the balance sheet, net borrowings were £12.2 million at the September period end, with total interest payable covered over 4 times by underlying operating profits. There was also a modest pension deficit of £6.9 million which under a recovery plan is being reduced by annual cash payments of £0.48 million, increasing by a minimum of 2.25% per annum.

An opportunity you can't a-Ford to miss

Like many of its peers, Caffyns saw its shares fall off a cliff in 2007/08 as the financial crisis took hold. Yet, a recovery in trading over the past decade hasn't been mirrored in the share price. It's worth noting that in 2007 the shares peaked at a price of £11.50, with the company making just over 40p of adjusted earnings for that financial year and paying a dividend of 25p per share. The most recent annual earnings and dividend figures are only marginally behind 2007 (38.2p and 22.5p respectively) yet the shares trade at only a third of their pre-recession high.

While we have minimal guidance on what the figures will be for the full year to March 2019, Caffyns commented in the interims that the outcome will be dependent on the success of the bi-annual registration plate change in March. Looking at the latest figures from industry body The Society of Motor Manufacturers & Traders there were 458,054 new car registrations in March, down just 3.4% compared to March 2018. This was better than some commentators were expecting and well up on the September figures which were the worst since 2011. That gives reasonable confidence that second-half trading would have been steady, so assuming that the first-half performance is repeated, we are looking at earnings of around 35p for the full year. That puts the shares on a reasonable looking price/earnings multiple of 11.3 times.

Where the real value is apparent is in the wide discount to net assets. With a current market cap of £11.4 million the discount to NAV as at 30th September 2018 is a huge 61%. What's more, this figure doesn't include the unrecognised £10.3 million surplus mentioned above. If it did the discount would be a more pronounced 71%.

For income seekers, the yield will be an attractive 5.7% if the dividend is maintained at 22.5p per share for 2019. This looks likely in my opinion given that the interim payment was held flat, considering the sound financial position and that the board have been committed to making consistent distributions to shareholders.

ROTALA

There has been a lot of disappointing news in the transport sector over the past few months for both commuters and investors. Fares continue their onward march upwards, rising by 3.1% in January, and large new projects such as Crossrail seem to be announcing delays on a quarterly basis – it was supposed to be ready for the Olympics wasn't it? On the operator's side, Virgin Trains and partner **Stagecoach (LON:SGC)** were recently excluded from bidding

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"THE DISCOUNT TO NAV AS AT 30TH SEPTEMBER 2018 IS A HUGE 61%."

on a range of franchises due to pension concerns. However, one transport operator which continues to deliver for its passengers and shareholders is AIM listed **Rotala (LON:ROL)**.

The Rotala business was formed in 2005 and joined AIM in March that year as a cash shell looking to acquire businesses within the parking and transportation management sectors. Over the years the company has expanded its operations through the acquisition and amalgamation of a number of local coach and bus operations, now having operations at Heathrow Airport, in the West Midlands, the North West and South West of England. The current strategy remains largely unchanged, with the focus being on acquisitive and organic growth around depots situated where there is a suitable density of population and prospects of economic growth.

The business is currently divided into three segments, with the largest in the last financial year being Commercial Services. Here, Rotala provides a purely commercial bus service where, in contrast to the Contracted Services division discussed below, it takes all the risk of operation.

Second largest division, Contracted Services, provides local bus services under contract to local authorities and individual customers. Here, the service is delivered under contract, to specified standards, with the price for the service determined by the contract alone. This is a less risky operation for the company and provides good visibility of income.

Finally, the relatively small Charter Services division provides a transport management service to a variety of customers. Typically this covers business or service disruption (such as rail replacement buses) and bespoke large event management.

Across all the operations, Rotala currently operates more than 600 vehicles, employs more than 1,500 members of staff, with its registered bus services carrying more than 29 million passen-

gers every year. Key brands include Diamond, which provides bus services in the West Midlands and Worcestershire areas; Diamond North West, offering a mix of Commercial and Contracted bus services in around the Manchester area; transfers and private hire business Hallmark Connections which is based near Heathrow; and Preston based Preston Bus.

Driving revenues

The last financial year was a good one for Rotala, with revenues surging ahead by 19% to £62.4 million in the 12 months to November. This was on a continuing basis, with minor operations in the South West discontinued during the period. However, the business continued to expand via the £1.95 million acquisition of Central Buses, an operator of commercial and contracted bus services in the northern part of the West Midlands.

At the bottom line, the adjusted pre-tax profit figure grew by 18% to £4.23 million, with earnings up by a more modest 9% to 7.22p per share after a rise in the number of shares in issue. The cashflow from operations was impressive at £4.125 million, ahead of the statutory pre-tax profit of £3 million and after adding back £3.4 million of depreciation.

One major event of 2018 was the entering into of new banking facilities with HSBC for a total of £24.5 million. At the end of the period that gave c.£10 million of headroom to finance further potential acquisitions. Also providing certainty for the current financial year,

"ROTALA CURRENTLY OPERATES MORE THAN 600 VEHICLES."

all of the company's fuel requirement for 2019 was covered by hedging contracts at an average price of 100p per litre, thus eliminating exposure to volatile oil prices.

All aboard

Shares in Rotala haven't performed as badly as some small cap companies in recent months, having fully recovered from the sell-off which investors saw last October. At the current price of 54p the company is capitalised at just under £26 million. That prices it on a multiple of just 7.5 times last year's adjusted earnings figure and on a historic yield of bang on 5%. Rotala should be attractive to income investors given that, as well as the high yield, the company has a progressive payment policy and has set a target dividend cover of 2.5 times earnings.

There is also good asset backing on the balance sheet, with the major items being £39.4 million of property, plant and equipment (mainly vehicles and freehold property), along with £15.9 million of trade receivables. Net assets of £34.9 million at the period end mean

that the company is currently trading at a 26% discount to book value. Even if we strip out goodwill and intangibles of £14.9 million, this nonetheless means that 77% of the market cap is backed by hard assets.

Overall, Rotala is a solid, strongly cash generative business, trading on a low multiple of earnings and offering investors decent income. What's more, the headroom in the banking facilities provides further firepower for more acquisitions, which the board are said to be, *"actively engaged in hunting out"*.

600 GROUP

Finally, a long-term favourite of fellow Master Investor contributor Simon Cawkwell is industrial engineering company **600 Group (LON:SIXH)**. This business is a distributor, designer and manufacturer of industrial products which takes its name from its early head office address at 600 Commercial Road in East London. The company formed its first machine tool company in 1932, became the UK's leading lathe manufacturer in 1954 and now has three main areas of operation. While the majority of income comes from the US (65% last year), 600 sells into more than 100 countries around the world.

The Machine Tools business focusses on metal turning machines (used for shaping pieces of metal) with products ranging from small conventional machines for education markets, Computerised Numerical Control (CNC) workshop machines and CNC production machines (see image below). Outsourcing partners support the manufacturing of these machines and they are marketed through a wholly owned international sales organisation and global distribution network. This division operates in a global industry which was estimated by Oxford Economics in Spring 2018 to be worth nearly $79 billion in annual sales.

Second, Precision Engineered Components distributes machine spares to global customers to help maintain the installed base of group machines which number in excess of 100,000. Additionally, work holding products and taper roller bearings are sold via specialist distributors to OEMs, including other machine builders.

Finally, the high margin Industrial Laser Systems business has proprietary software and technology which offers a superior alternative to ink jet marking. Subsidiary TYKMA Electrox is headquartered in, Ohio, US, and specialises in the design, production and distribution of industrial laser systems for a broad range of industrial manufacturing applications from telecommunications to pharmaceuticals.

Early retirement

One of the features of 600 Group is that trading is cyclical, with it being exposed to the investment decisions of manufacturers and typically lagging the main cycle of the economy. However, by all accounts the 2018 financial year (to March) was a good one, with revenues rising by 12% to $66.01 million and net profits up by 19% at $3.05 million. But an arguably more important event came after the year end.

"600 SELLS INTO MORE THAN 100 COUNTRIES AROUND THE WORLD."

For a long time, the pension was a prominent feature of 600 Group's balance sheet, showing a healthy surplus (unlike many of its peers) over recent years but having a high level of liabilities given the company's size. In July last year, just before the full year numbers were published, it was agreed for the pension scheme liabilities of c. £201 million to be bought out by insurer Pension Insurance Corporation Plc. This removed a high level of risk in terms of potential future financial obligations, with surplus funds having also been received.

As a result of the good operational performance in 2018, the reasonable commercial outlook and following the resolution of the pension scheme, the Board decided to resume payment of a dividend, recommending a pay-out of 0.5p per share. Trading has continued steadily since then, with revenues up by a modest 2% to $32.8 million in the six months to 29th September 2018 but with underlying pre-tax profits surging by 36% to $1.46 million. A 5% rise in the order book provides good visibility, with an interim dividend of 0.25p being made.

Cool tools

After bottoming out at 7.35p in March 2016, investors in 600 Group saw the shares rise to a peak of 19.45p before last year's small cap sell off drove a slippage to the current 14.15p. But despite the almost doubling in value over the past three years the shares still look incredibly cheap.

On last year's underlying earnings figures, and at current exchange rates, the company is now being valued on a multiple of just 5 times. Analysts at research house Hardman are looking for earnings of 3.6 cents in 2020, which means the multiple falls to 4.4 times if targets are met. Following the reinstatement of the dividend last year, the historic yield is a decent 3.5%.

Again, this is a company with good asset backing, with net assets of $28.31 million (£25.13 million) as at 29th September 2018 representing 157% of the current market cap. If we strip out goodwill and intangibles however, which amounted to $11.19 million (£10 million), the coverage falls to a still decent 95%.

As Mr. Cawkwell pointed out with regards to 600 Group early in 2018, *"Month after month goes by and no evidence emerges that this stock is anything other than very cheap."* Over a year on and this still seems to be the case. Granted, 600 Group is a cyclical stock. However, that looks more than priced in given the current valuation.

Typhoon L Series CNC Turning Centres

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 PETER HIGGINS

CONKERED BY THE MASTER INVESTOR SHOW

Peter Higgins, a private investor with over 25 years' experience and the host of the Conkers' Corner interview series, explains why he attends Master Investor Show as a private investor.

Providing the opportunity to learn

As a private investor, I am passionate about learning and set up the Conkers' Corner interviews and Conkers 3 interviewing services, in order to enable others to access learning about investing, finance and business leadership.

I have been attending the Master Investor Show for the last five years and had the pleasure of first interviewing Jim Mellon at the 2017 Master Investor Show. This year, I was pleased to be able to interview Jim Mellon once more, along with three other thought leaders and investing industry experts at the 2019 Master Investor Show.

Value for private investors

Given my pursuit of continual learning, one of the best things about the Show has to be the volume, variety and quality of the company presentations. With around 5,000 delegates, 100 companies/exhibitors and 50+ high quality keynote speakers, I value the opportunity to learn from experts, and the Master Investor Show provides this in abundance. I love being able to look into the whites of a CEO or CFO's eyes and ask them the important questions about their business. Being able to do this in person enables you to also see how they respond or react and that tells you even more about how they lead and run their business.

> **"I VALUE THE OPPORTUNITY TO LEARN FROM EXPERTS, AND THE MASTER INVESTOR SHOW PROVIDES THIS IN ABUNDANCE."**

Innovation and future thinking

There were some innovative and progressive areas e.g. "The Lab", which is a 21st-century interactive lab. For the second year running, Insilico Medicine, a biotechnology company specialising in the application of artificial intelligence (AI) for drug discovery and aging research, partnered with the Master Investor Show. They put together a state of the art, interactive and immersive room, presenting Young AI, an AI-powered platform for the investors and visitors to engage with and see at first-hand how exactly they could manage their health and optimise their lifestyle. A futuristic feast for attendees/investors with interests in health, well-being science, technology, biotech, pharma, medtech, artificial intelligence and more.

The allure of the Master Investor Show was also strong enough for the ever-enthusiastic Evil Knievil, who

master investor
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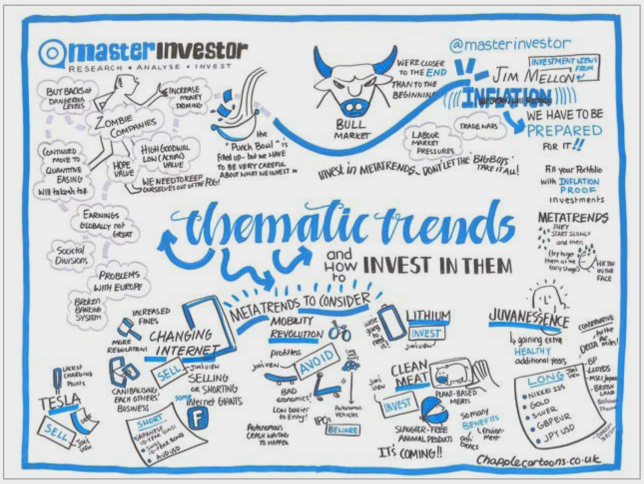
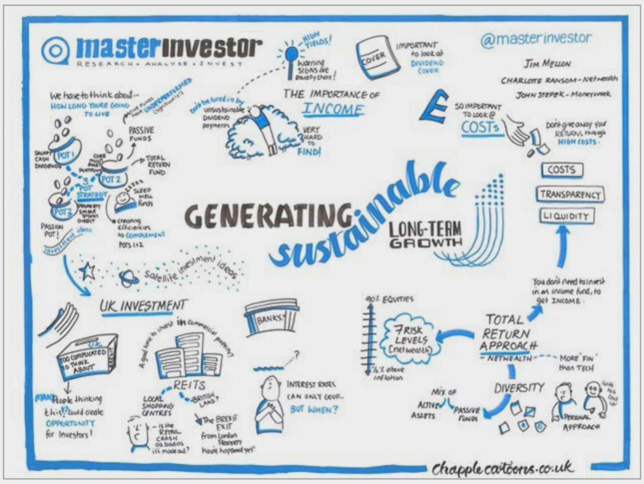
MADDOX GALLERY
MADDOX GALLERY

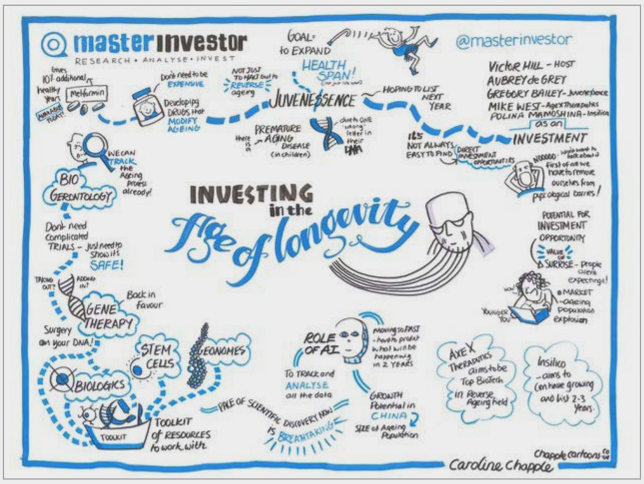
Main Stage Talks

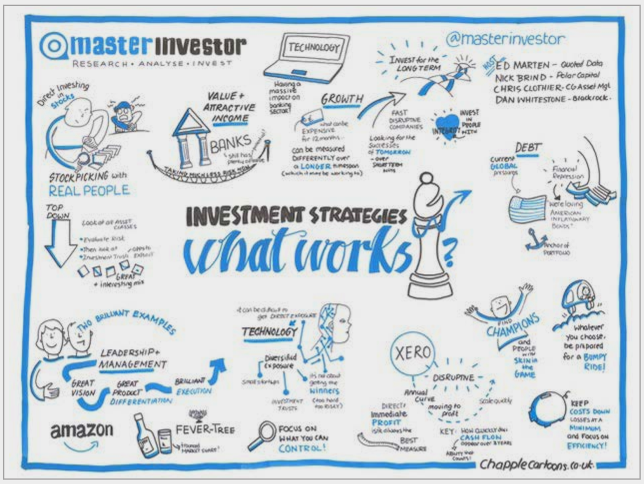
Caroline Chapple of Chapple Cartoons put together some brilliant sketches that neatly summarised the themes covered in the Main Stage presentations.

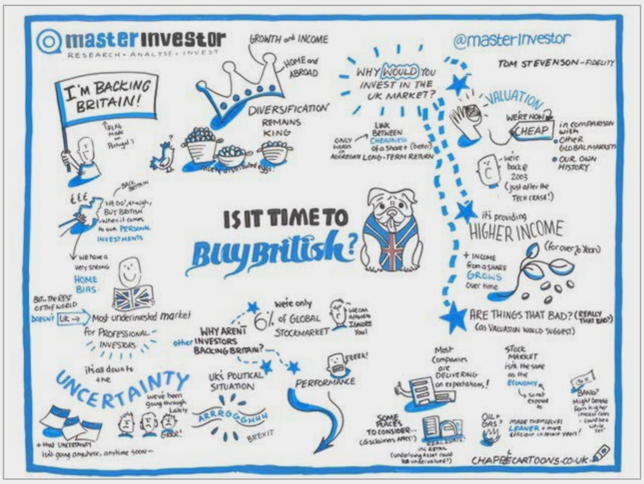
But don't forget you can now watch all these on the Master Investor YouTube page:
https://www.youtube.com/channel/UCb8cynEsmaTbk0XWUzUFGBg











despite being ill, streamed his suitably titled "The Horizontal View" from his hospital bed. Now that is dedication to the cause of learning and paying it forward to all of the delegates at the Master Investor Show. Evil, I hope to see you there next year!

Presentations

This year's Master Investor show proved to be an informative and inspiring day for investors of all backgrounds and experience. The event provided a broad range of activities and enlightening presentations across the board. From Dan Whitestone's eye-opening outlook on the retail industry or Tom Stevenson's perspective on the British market, through to Jim Mellon's powerful keynote speech on thematic trends – the event covered tremendous ground.

In addition to these talks, the networking zone and ground floor boasted a diverse range of companies of all sizes providing further insight into their wide range of operations. Whether it's an innovative trading platform you're interested in, or an exciting small firm specialising in a cutting-edge field, there was no shortage of options.

Feedback

I gained feedback from some attendees, some of which has been shown below:

"The life of a private investor can be a solitary task, so it is a great opportunity to come to an event like the Master Investor Show to connect with fellow investors and gain new insights."

"I particularly enjoy the educational aspect, to gain a greater understanding about companies and industries and form a view on an investment similar to solving a puzzle."

"I always enjoy Jim Mellon 's presentations. Apart from being an engaging speaker, he looks at future themes and trends that may impact the performance of companies. This is particularly relevant in this age of disruption and it was interesting to hear his thoughts on ageing, longevity, robotics, artificial intelligence, technology and health care."

"Thinking about big picture themes is important when assessing an investment. I like to consider not just the performance of the company but also its ability to adapt to a changing market place. Private investors would do well to pay heed to Jim's motto on investing, which I have paraphrased: be curious, be flexible, adaptable and the most important thing is application, hard work is required to be a successful investor!"

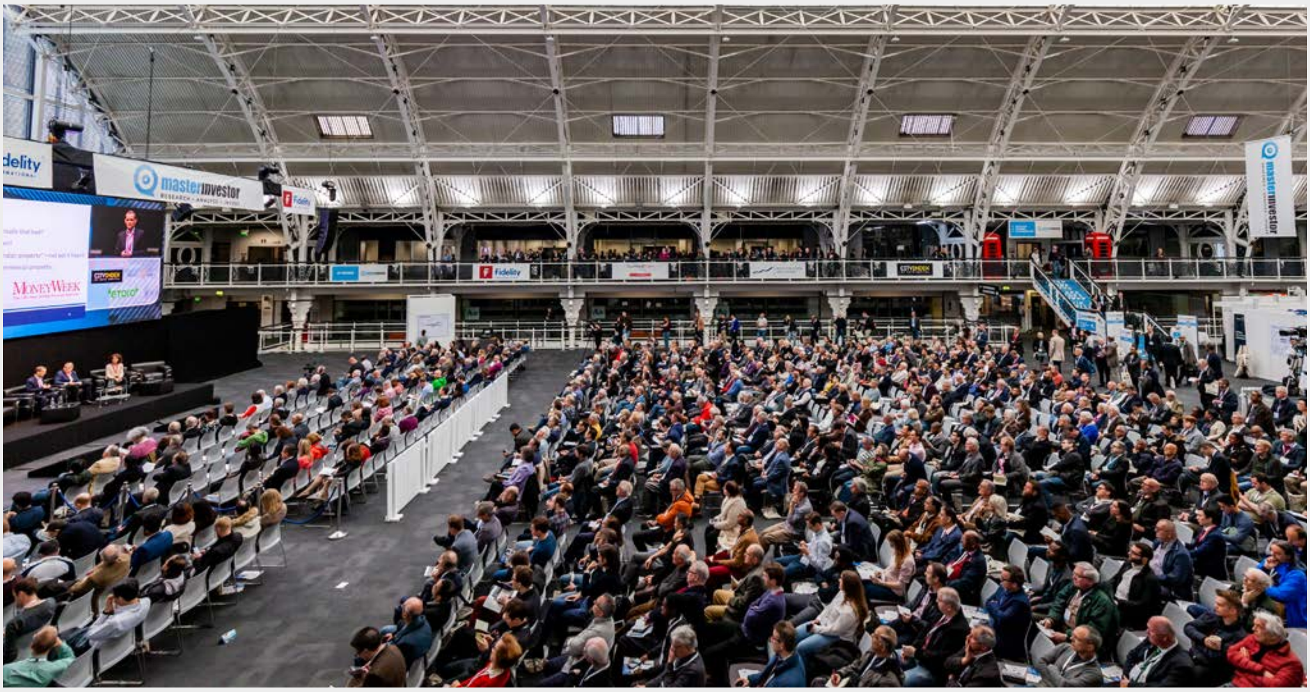
"As one-day investor shows go, none can match the sheer scale and draw of the Master Investor Show, each year it just gets better."

"For those who did not attend the Master Investor Show this year, I would say they missed an event that offered something for the novice investor as well as the experienced and well informed. There was a strong steady schedule of platform presentations as well as opportunities to meet some of the high calibre hosts".

Session in Focus:
Netwealth Panel Discussion - How to generate a sustainable income

Charlotte Ransom, Netwealth CEO, took to the stage with MoneyWeek's John Stepek and Master Investor's Jim Mellon as moderator to discuss the problems facing investors when it comes to generating a sustainable income. As Jim makes clear at the beginning of the discussion, there is nobody who is serious about investing who isn't interested in income. However, the question for investors is how to generate that income, especially given that a higher dividend pay-out can often be at the expense of growth over the long term.

As Charlotte points out, we're all living longer, and we therefore need to think long and hard about what our income requirements will be in retirement and how we expect to meet them. In the fascinating discussion that ensues, Charlotte explains the logic behind Netwealth's "Three Pot Theory", where a Core Multi-Asset Portfolio (Pot One) is complemented by two satellite pots – one that includes more longer term, riskier investments (Pot Three); and another that aims to meet short-term liquidity needs (Pot Two). Later in the discussion, John provides specific ideas for populating Pot Three. Don't forget you'll soon be able to watch all the Main Stage videos (including this one) on the Master Investor YouTube channel.



Getting up close and personal

Being able to speak with the companies themselves after they have presented gives us the chance to see how open and candid the company's representative is with retail/private investors such as myself. I want to learn from their responses and see how transparent and honest they are about the health and resilience of their company and its strategy.

I have learnt over the years that a closed or defensive response from representatives of listed companies often does not bode well for the long-term strength of the company's share performance. The benefits of attending the Master Investor Show every year are, for me, to continue to grow; to be informed, educated and sometimes inspired about current and potential future investments.

Meeting like-minded people

Without attending the Master Investor Show, I would miss out on the synapse-firing feel good factor of being in a buzzing environment with thousands of like-minded investors, and drinking from the pool of investing knowledge, from the likes of Jim Mellon, Tom Stevenson, Charlotte Ransom, John Stepek, Aubrey de Grey, Simon Cawkwell (aka Evil Knieval), Ed Marten or Bill McQuaker.

As the revered Italian poet, sculptor architect and poet Michelangelo once said, "I am still learning".

Master Show 2020

Overall, the Master Investor Show 2019 brought with it a wealth of knowledge, opportunity and an all-round inspiring experience helping investors shape the future landscape of their investments.

Be sure to put the next date in your diary for Master Investor 2020 – it will be taking place on March 28th 2020 at the Islington Design Centre. No doubt it will be even bigger, even better and even more people will be in attendance, so find out more or book your tickets now https://www.eventbrite.co.uk/e/master-investor-show-2020-tickets-55626420120

> **"BE SURE TO PUT THE NEXT DATE IN YOUR DIARY FOR MASTER INVESTOR 2020."**

I would like to thank the following people for contributing their feedback to me in preparing this article: Borna Banafshe, a recent graduate from Cass Business School; Martyn Ingram, City of London Business/Finance veteran; and Diana and Alan Patterson.

About Peter Higgins

Peter Higgins (also known as Conkers on Twitter @conkers3) is the founder and Managing Director of Conkers3 Ltd. Peter is a successful long-term private investor, presenter and interviewer who places a high degree of importance on deep research, followed by 'mindful investing'. He has over 25 years of experience investing in stocks and shares.

Peter established his business, Conkers3 Ltd to work with the investing and corporate world to promote their insights and journeys through bespoke interviews to a target audience e.g. potential investors or potential customers. Peter is the brainchild of and producer of the popular podcasts and video interviews called Conkers' Corner. These were created to enable shrewd investors, high net worth individuals, millionaires, billionaires, fund managers, business leaders and authors to share their investing journey https://www.conkers3.com/conkers-corner-investment-hub

He has also recently created, launched and now co-presents a new investing podcast called "Twin Petes Investing https://soundcloud.com/user-479955511

BY ALEX CROOKE

A YEAR OF TWO HALVES?

Alex Crooke, Fund Manager of the Bankers Investment Trust, explains how the team is preparing for a different investment landscape in the second half of 2019.

It's in our nature as fund managers to continually contemplate the future, but the level and scope of uncertainty facing investors today is almost unprecedented. What's disappointing is that many of the questions that dominated 2018 have still not been answered as we move into the second quarter of 2019.

The most prominent of those questions include the 'trade war' between the world's two largest economies; the UK's expected exit from the EU; a tightening of monetary policy by central banks in key economies; and the corporate profit growth outlook. You'd have thought by now we would have more certainty around some of these issues, but clarity is coming.

At The Bankers Investment Trust – a Janus Henderson-managed trust – we believe the second half of the year will look and feel very different to the current state of play; and we are positioning the portfolio to benefit from that clarity, which we think will restore market confidence as 2019 rolls into 2020.

It's important to remember that markets are discounting mechanisms by nature, matching buyers and sellers. Markets are also forward looking, so the sharp sell-off we saw last October was a message from the sellers that global growth had probably peaked and a global recession is coming.

As I outlined in a recent piece, *Banking on Diversification*, I don't see enough signs of stress in markets to warrant such a negative outlook. Global growth is slowing and it appears we are in the latter phases of the business cycle, but without a significant trigger I can't see a sharp global recession or economic crisis coming this year.

Goldilocks and the three bears

My central view is that we continue to live in the 'goldilocks' environment where the economy is not too hot and not too cold, with modest returns in a long cycle. Around that view the Bankers investment team has identified three alternative scenarios we think could feasibly play out this year. The first comes back to the US-China tariff war. An escalation of tensions between the two nations could have hugely damaging consequences for global economic growth. It's not in anyone's interest to go down that route, so I only give it a fairly slim chance of unfolding into an all-out trade war and altering our view of the world.

"I DON'T SEE A RECESSION COMING IN THE US BUT I'M ALSO STRUGGLING TO SEE HOW IT GETS ANY BETTER."

The second and third scenarios relate to the US economy, which grew at an impressive rate last year relative to the rest of the world. There is a danger that the US' central bank, the Federal Reserve, has 'left the taps open' a bit too long. By that I mean the economy is in some danger of overheating and may need action from the Fed in the form of steeper interest rate hikes, but I think that's unlikely.

In equal measure, the US economy could slump if the Fed has overdone it with its incremental interest rate hikes over the past two years. Personally, I don't think the banking system has

outperforming value stocks on earnings growth and share price total return. The Bankers portfolio reflected that with good growth names in the US, Europe and Asia, but last year growth stocks became very expensive. Earnings growth has been decelerating on average for the largest growth companies in the past 12 months and so it looks like a sea change could be coming.

QT favours value

Our belief at Bankers is that there is probably going to be a shift towards the end of 2019 with value stocks beginning to outperform against growth. This could be even more likely if central banks – the likes of the ECB, US Federal Reserve and Bank of England – extend their tightening measures, colloquially known as quantitative tightening (QT), which in simple terms refers to a number of monetary policy actions that aim to normalise interest rates and mitigate rising inflation. The US Federal Reserve has indicated it has paused its increases in interest rates but a resumption in global growth could mean a reversal of this policy.

QT would mark a significant shift from the past 10 years during which central banks dominated asset prices by driving down the cost of long-term money to support businesses and keep employment high. Once quantitative tightening measures begin to roll out and money becomes more expensive, there will be a shift in market sentiment.

We are positioning the Bankers portfolio to benefit in this scenario, while also maintaining a healthy balance and di-

been lending aggressively so I discount this risk, but the tools to get another recovery going are relatively limited from here, so we should be careful about this scenario.

The US is still the single most dominant economy in the world and the largest market in stock market terms. The Federal Reserve in the US has maintained a loose monetary policy stance in recent years but it's probably as good as it's going to get. There are worries that we will shortly witness a US economic slump and a dramatic one at that, but I don't buy that. I don't see a recession coming in the US but I'm also struggling to see how it gets any better.

This brings me back to the central view we hold at Bankers, to which I give about a 50% likelihood of playing out this year. In this scenario, the long business cycle continues with the ongoing global economic slowdown bottoming in the summer months before picking up gradually in the latter part of the year. It might sound a bit dull but it's not a bad world to be in and it's one we can position ourselves for. Essentially, it rests on the notion that the economy is not broken and that markets will pick up as we get more clarity on the questions alluded to earlier.

A broad value church

As fund managers, it is our job to look for opportunities where the market has over-discounted bad news and where prices could recover. We've already seen a bit of that in the year-to-date. For example, Chinese equities endured a rough ride in 2018 and share prices came down as the trade war rumbled on, but they have recovered well in the New Year. Our direct exposure to China (c. 9%) has been creeping up in the past 12 months as more value-driven opportunities became available over the course of 2018.

I am at heart a value investor and I like to think of it as a church; you can either follow religiously buying rock bottom price-to-earnings (P/E) and price-to-book (P/B) metrics; or take account of wider measures of value. I tend to prefer looking for companies with growth opportunities but am careful not to overpay for these investments. I also look for companies with potential to grow their free cashflow and therefore hopefully deliver dividend growth.

Since the financial crisis it has largely been one-way traffic with growth stocks

Glossary

Price to earnings (P/E): A popular ratio used to value a company's *shares*. It is calculated by dividing the current share price by its earnings per share. In general, a high P/E ratio indicates that investors expect strong earnings growth in the future, although a (temporary) collapse in earnings can also lead to a high P/E ratio.

Price to book (P/B): The ratio of market value of a company's shares (share price) over its book value of equity. The book value of equity, in turn, is the value of a company's assets expressed on the balance sheet. This number is defined as the difference between the book value of assets and the book value of liabilities.

"OUR BELIEF AT BANKERS IS THAT THERE IS PROBABLY GOING TO BE A SHIFT TOWARDS THE END OF 2019 WITH VALUE STOCKS BEGINNING TO OUTPERFORM AGAINST GROWTH."

versification across styles, sectors and geographies. We are overweight relative to the benchmark on consumer goods and services because we think the very low levels of unemployment will be persistent and wage growth will pick up in the US and UK, as it has in Asia and China.

We have topped up our position in premium cosmetics group Estée Lauder Companies, which is now the Trust's joint-largest position at 2% of the portfolio along with Microsoft; and we are finding more value-driven opportunities in European companies, where market sentiment is low and share prices are depressed.

All in all, I am of the belief that the global economy is not broken and the future is bright. Without a significant trigger I don't see a dramatic recession coming but rather a gradual contraction and subsequent expansion towards the end of the year. Once we get some clarity on the macroeconomic and political questions hanging over markets, it's quite probable confidence will be restored and some of the fantastic value opportunities of today will be gone.

About Alex

Alex Crooke is Co-Head of Equities – EMEA and Asia Pacific at Janus Henderson Investors, a position he has held since 2018. Alex is responsible for equities in the EMEA and APAC regions and is a Portfolio Manager for The Bankers Investment Trust, a position he has held since 2003. In addition, he is a member of the Janus Henderson Executive Committee. Previously, he was head of Global Equity Income and Specialist Equities Teams from 2013. Alex began his investment career with Equitable Life Assurance Society in 1990 as a US investment analyst. Alex holds a BSc degree (Hons) in physics and astrophysics from Manchester University. He is an associate member of the Society of Investment Professionals (ASIP) and has 29 years of financial industry experience.

BY FILIPE R. COSTA

THE MACRO INVESTOR

HOW TO BUILD A LATE-CYCLE PORTFOLIO

Filipe R. Costa explains why softening economic conditions demand a more defensive investment strategy.

There is broad agreement among economists and analysts that we are in a late-cycle economy, which corresponds to the last phase of economic growth and stock market gains before a recession and a bear market. The global economy is still healthy, but growth is decelerating, while profit margins, sales and stock multiples may have already peaked. Behind us are nine years of economic expansion in the US, which, if it continues until July, will mark the longest expansion in the country's history. In the UK and in the eurozone, the expansion has been more modest but still long. After such a prolonged period, marked by years of quantitative easing and near-zero interest rates, equity valuations look stretched.

There is still upside potential for global equities, but the risks are mounting, as toppy valuations make equity prices highly sensitive to cuts in projected growth. To minimise the risk, investors need to look for high quality equities that offer income to complement returns. These stocks should carry more conservative valuations, operate on lower leverage levels, and be able to weather tougher economic conditions.

The situation for bond investors isn't much better, as the market carries a large duration risk, mainly due to low interest rates. Investors looking for yield are unable to find it on short maturities and may be attracted to longer maturities. But the unfortunate reality shows that the potential loss due to an interest rate hike isn't adequately offset by the higher yield when investing in longer-dated maturities. Alternatively, jumping into high yield debt to boost yield may not be the solution either, as corporate debt levels are higher than ever. A massive rise in corporate leverage since the financial crisis has helped to boost profits. But leverage can also help derail companies if economic conditions deteriorate.

Caution is needed in both equity and fixed income markets.

A strong start for stocks

After a poor Christmas, equities started the year on a very strong footing. Most equity indices are deep in profit territory on a year-to-date basis. The Chinese CSI 300 and SSE Composite are at the top of the list, having risen 33.7% and 28.9% respectively at the time of writing. These indices are trailed by the tech-driven Nasdaq, which is up 21.9%. The S&P 500 and the Dow are also up, but more modestly (16.0% and 13.6%, respectively). In continental Europe, the Euronext 100 is up by 18.2% and in the UK, the FTSE 250

"CAUTION IS NEEDED IN BOTH EQUITY AND FIXED INCOME MARKETS."

IA SECTORS TOP & BOTTOM PERFORMERS

TOP			
Sector	YTD %	1-Month %	52-Week Strength
China/Greater China	20.0	6.0	
Technology and Telecom	19.4	3.9	
North American Smaller Comp.	18.1	4.4	
North America	14.5	3.6	
European Smaller Comp.	13.7	5.7	
BOTTOM			
Sector	YTD %	1-Month %	52-Week Strength
Short Term Money Market	0.2	-0.1	
Money Market	0.2	0.0	
UK Direct Property	0.4	-0.2	
UK Gilts	1.5	-1.9	
Global Bonds	2.0	1.0	

Source: Sharescope

SPDR SELECT SECTOR ETFS TOP & BOTTOM PERFORMERS

TOP			
Sector	YTD %	1-Month %	52-Week Strength
Technology	27.0	7.4	
Industrial	22.5	8.2	
Consumer Discretionary	21.6	7.9	
Communication Services	21.5	6.6	
Energy	19.7	4.9	
BOTTOM			
Sector	YTD %	1-Month %	52-Week Strength
Health Care	1.3	-3.4	
Utilities	8.2	-2.1	
Consumer Staples	11.9	3.2	
Materials	14.5	6.5	
Real Estate	14.8	-0.6	

Source: Sharescope

leads the way with a rise of 13.3%. Exposed to the Brexit ups and downs, the FTSE 100 is a little behind, but has still gained 11.3% so far this year. All these numbers seem to confirm a strongly bullish market.

There is a wider risk-on sentiment that is pushing equities higher and bonds lower. Chinese and smaller company stocks lead the gains while short-term debt leads the losses. The risk-on sentiment is also well reflected in sector performance. If we take the Select Sector SPDR ETFs as benchmarks for sector performance, we see that the top rank for year-to-date performance is occupied by the technology fund, which is up by 27.0%. Next on the list are the industrial and consumer discretionary funds. Even though all sectors are higher so far this year, healthcare, utilities and consumer staples are the worst performers. However, these sectors are usually the top performers in a late-cycle economy. They offer upside potential in all phases of the business cycle and protect a portfolio for a potential repricing of risk. These are the sectors to which I would tilt a portfolio at this point. The generalised rise in stocks during the first quarter of the year is not well supported by fundamentals.

Soft economic data and projections

After rising 20% in 2018, profits are expected to grow by just 1.5% in 2019 in the US. Analysts expect a decline in profits in the first quarter (now reporting) and they have been cutting full-year estimates. If they cut profit estimates further, stocks will appear to trade on very high price multiples, meaning they would be vulnerable to deep price corrections. Profit growth may have peaked in the third quarter of 2018, as wage inflation, softer economic activity and an exhaustion of the effects of monetary easing weigh negatively. While the Trump administration may still push for further tax cut stimulus, the effects deriving from it will be counterbalanced by increasing margin pressure from higher input costs, moderating sales growth and escalating trade tensions.

The US economy is healthy but deteriorating. The IHS Markit Flash US Composite Output Index was reported at 52.8 in April. Although still in ex-

"IN A LATE-CYCLE ECONOMY THERE ARE FOUR SECTORS THAT TEND TO OUTPERFORM THE BROAD MARKET: THEY ARE UTILITIES, CONSUMER STAPLES, HEALTHCARE AND ENERGY."

pansion territory (above 50.0), it is at a 31-month low. The 3-month T-Bill is yielding more than one-year, two-year, five-year and seven-year bonds, which is a sign of recession ahead. Inversions along the Treasury curve are exceptionally reliable in forecasting recessionary pressures. These represent expectations for future lower interest rates, which would be the result of central bank cuts in response to a weaker economy.

While the U.S. economy shows signs of softening, Europe shows signs of stagnation but with the prospect of mild improvement The Markit Composite for the eurozone has been reported at 51.3 in April, a 3-month low, but at one of the lowest levels since 2014. The figures for GDP growth confirm the picture. From 2.4% in 2017, GDP growth came down to 1.9% in 2018 and is expected to further deteriorate this year to 1.3%.

> *Overall, the GDP growth forecast for the euro area in 2019 has been revised down by 0.6 pps. since the autumn forecast to 1.3%. This revision mirrors a weaker carry-over from the last quarters of 2018 and a slightly weaker momentum in 2019. Next year, economic growth is expected to settle at 1.6%, i.e. 0.1 pps. lower compared to the autumn forecast.*
>
> – European Commission, Winter 2019 Economic Forecast

The situation in the UK isn't much better. The uncertainty surrounding Brexit is escalating, as Theresa May seems unable to find a meaningful consensus to negotiate the future of the UK in Brussels. Additionally, GDP grew by just 1.8% in 2017 and 1.4% in 2018, with this last number being the slowest rate since 2012.

In addition to the economic data, there are a few other aspects related to corporate activity that may be worrying. Monetary easing, which central bankers so vividly praised for its virtues, may be delivering some side-effects. Faced with declining borrowing costs, corporations around the world took the opportunity to buy back their own shares with borrowed money. This helped inflate profits on a per share basis and increased overall business leverage. While leverage boosts profits when economic conditions are favourable, it also magnifies losses under harsher conditions.

> *Companies from advanced economies, which hold 79% of the total global outstanding amount [of corporate bonds] as of 2018, have seen their corporate bond volume grow by 70%, from USD 5.97 trillion in 2008 to USD 10.17 trillion in 2018.*
>
> – OECD, Corporate bond markets in a time of unconventional monetary policy

The rise in corporate debt has been huge not only in advanced economies but also in emerging markets. The OECD notes that the share of non-investment grade issues now stands at 54%, a historical high, which may help precipitate sales of debt in the event of a downturn. In such a case, highly leveraged companies would face difficulties in servicing their debt, which in turn, through lower investment and higher default rates may amplify the effects of a downturn.

When it comes to this massive rise in corporate debt, the key point to bear in mind is that some companies will encounter trouble under softer economic conditions. From an investor's perspective, the opportunity comes from screening stocks that exhibit healthier, higher-quality balance sheets. That means looking for companies carrying lower debt levels, operating with lower leverage, with the ability to generate enough cash flow to service the outstanding debt obligations and still have money to pay dividends to investors.

Building the portfolios

After depicting the current state of the US, eurozone and UK economies, it's time to unveil an investment strategy that matches the macroeconomic developments. The key points can be summarised by restating that we currently live in a late-cycle economy where the leverage taken by companies has increased significantly. From this point on, it's likely that economic conditions further soften, resulting in declines in corporate profits and in the ability of some companies to repay debt and deliver income to investors. Taking these conditions into consideration, I have selected a few different portfolios that I believe are well equipped for the near future.

A simple four-asset sector-tilted portfolio

In a late-cycle economy there are four sectors that tend to outperform the broad market: they are utilities, consumer staples, healthcare and energy. This outperformance has been studied several times in the past and confirmed recently in a study conducted by Invesco US. From this observation, one simple strategy can be deployed by selecting ETFs that are tilted towards those sectors. Four ETFs are good candidates (albeit tailored for the US market):

- **SPDR Select Sector Utilities Fund (NYSEARCA:XLU)**
  Utility companies are less exposed to the business cycle in general and usually trade on low price-to-book and price-to-earnings ratios, carrying more conservative valuations. The SPDR Utilities fund holds 28 US companies from the sector.

- **SPDR Select Sector Consumer Staples Fund (NYSEARCA:XLP)**
  At a time when input costs are rising, companies within the consumer staples sector are attractive because they can usually pass the increase in input costs to consumers and thereby maintain operating margins. Additionally, these companies historically exhibit high and stable returns on equity, as well as sufficient free cash flow to service debt. The SPDR Consumer Staples fund holds 34 US companies from the sector.

- **SPDR Select Sector Health Care Fund (NYSEARCA:XLV)**
  The health care sector is non-cyclical and thus provides better returns during downturns than the rest of the market. The SPDR selection holds 61 companies from the sector.

- **SPDR Select Sector Energy (NYSEARCA:XLE)**
  The energy sector is also non-cyclical, but highly dependent on the evolution of energy prices, in particular oil prices. This last feature makes the sector a little less reliable than the previous three for a late-cycle play. Still, it has historically performed well during this phase. This SPDR holds 30 companies.

While there's always some correlation between sectors, the correlation between each pair of the above four ETFs ranges between 0.46 and 0.57, which is a relatively low figure, meaning there is not much overlap. Investors may start with an equal weighted portfolio, or eventually underweight the Energy ETF because of its exposure to oil prices.

A simple factor-tilted portfolio

When the economy enters a period of deceleration, investors tend to espouse more rigorous criteria when it comes to their holdings. As profit forecasts get trimmed, growth companies tend to underperform. Meanwhile, investors may rotate their holdings towards the well-established enterprises, which offer quality balance sheets, and stable profit and dividend growth. These companies are usually represented by factors like (high) quality, (low) volatility, and (large) size.

Additionally, at a time when investors become pickier, trend-following strategies come to an end, which means that the momentum factor is expected to underperform, while the value factor is expected to outperform. Still, I would remain cautious on the value factor, and maybe wait a little longer before diving in there. For now, choosing factors representing the higher quality companies, with low volatility and higher market capitalisations may give the tilt we need for the late-cycle phase.

A simple factor-tilted ETF can be composed of the following three ETFs:

- **iShares Edge MSCI International Quality Factor (NYSEARCA:IQLT)**
  IQLT offers exposure to large- and mid-cap developed international stocks exhibiting positive fundamentals (high return on equity, stable year-over-year earnings growth and low financial leverage).

- **iShares Edge MSCI Min Vol Global ETF (BATS:ACWV)**
  ACWV offers exposure to more than 400 stocks with potentially less risk.

- **iShares International Select Dividend (BATS:IDV)**
  IDV offers exposure to established, high-quality international companies that have provided consistently high dividend yields over time.

IQLT and IDV don't offer exposure to US companies. Investors willing to complement the exposure can additionally purchase the **iShares Edge MSCI Min Vol USA ETF (BATS:USMV)** and the **iShares Edge MSCI USA Quality Factor ETF (BATS:QUAL)**.

A portfolio of bonds

At a time when the risks are mounting for equities, some investors want to increase their exposure to fixed income to protect their portfolios. Nevertheless, they still face some risks. Since interest rates are low (and rising) and duration risk is at a high, a strategy of extending the maturity of bond holdings to get a juicier yield might not necessarily work well. Rate hikes reduce bond values more than the extended yield can compensate for. The best strategy is to follow a short-duration strategy, investing in fixed income with maturities between one and three years, while avoiding anything above five years. Alternatively, for longer maturities, investors may opt for floating rate notes, which have their coupon payments adjusted quarterly to reflect interest rate changes.

One option to build such a portfolio would be:

- **SPDR Bloomberg Barclays Investment Grade Floating Rate (NYSEARCA:FLRN)**

PERFORMANCE STATISTICS FOR PORTFOLIO COMPONENTS

Analysis for the period Jan 2012 – Mar 2019

Ticker	Asset	CAGR	Stdev	Best Year	Worst Year	Max. Drawdown	Sharpe Ratio	US Mkt Correlation
FLRN	SPDR Blmbg Barclays Inv Grd Flt Rt ETF	1.46%	2.28%	2.92%	-0.09%	-4.10%	0.44	0.16
SPSB	SPDR Portfolio Short Term Corp Bd ETF	1.88%	1.01%	3.62%	0.86%	-0.78%	1.39	0.33
SPTS	SPDR Portfolio Short Term Treasury ETF	0.82%	3.27%	1.19%	-0.37%	-5.19%	0.12	0.05
ISHG	iShares 1-3 Year International TrsBd ETF	-2.20%	6.35%	10.91%	-10.08%	-22.36%	-0.39	0.23
XLP	Consumer Staples Select Sector SPDR ETF	10.74%	10.84%	26.30%	-8.07%	-13.63%	0.95	0.61
XLV	Health Care Select Sector SPDR ETF	16.22%	12.46%	41.40%	-2.76%	-13.21%	1.24	0.83
XLE	Energy Select Sector SPDR ETF	1.92%	18.15%	28.02%	-21.47%	-41.10%	0.17	0.69
XLU	Utilities Select Sector SPDR ETF	10.72%	12.55%	28.73%	-4.91%	-12.73%	0.84	0.19

Source: Portfolio Visualizer

This is a floating rate ETF which mitigates duration-induced price declines as coupons adjust quarterly.

- **SPDR Portfolio Short Term Corporate Bond (NYSEARCA:SPSB)**
  SPSB focus on 1-3 year corporate bond issues.

- **SPDR Portfolio Short Term Treasury ETF (NYSEARCA:SPTS)**
  SPTS provides exposure to the short-term spectrum of the US Treasury market, between one and three years.

- **iShares 1-3 Year International Treasury Bond ETF (NASDAQ:ISHG)**
  ISHG focus on international Treasuries.

A portfolio composed of the above four ETFs would have a correlation with the US market of just 0.27, providing insurance against a rise in volatility and uncertainty.

A bullet-proof portfolio

One last option worth considering is to build a stock-bond portfolio that combines an equity strategy with a fixed income strategy. For this, I will use the sector-tilted portfolio and the bond portfolio depicted above. The exact allocations can be tweaked at will. For an equal-weight allocation, each ETF would weight 12.5% in the final portfolio, which would result in a 50/50 stock-bond setting. Such a portfolio would underperform the broad market under expansion phases but would better protect for downside risks under more volatile conditions. In my back tests for the period January 2012 to March 2019 (data is not available for longer periods), the maximum drawdown experienced by this portfolio would have been 4.8% against 13.5% for the S&P 500. If we tested this portfolio in more turbulent periods, we would see that the downside protection relative to the broad market would be even stronger.

Conclusion: investors need an alternative plan

After more than nine years of expansion, global equity markets are now in a late-cycle phase. While positive returns are still widely expected this year, investors need an alternative plan for a potential increase in volatility, as economic data has been pointing to a softening of conditions since the beginning of 2018. Some investors may wish to cut most of their equity holdings and overweight fixed income in their portfolios. Still, there are risks, as duration risk is at a high, which means investors need to concentrate on the short-term part of the bond market if they want to effectively reduce risk. For less risk-averse investors, there are still good opportunities in the equity market. Sectors like utilities, consumer staples, healthcare and energy historically perform well when markets in general are under pressure. At the same time, those companies with sound balance sheets and a record of stable growth are also well positioned to outpace the broader market.

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 IS WONDERFUL

SO WHY DO SO MANY PEOPLE STILL LOSE MONEY?

Ex-IG Chief Market Strategist David Jones asks why so many people lose money when they trade, with examples of how not to lose money when trading the S&P 500.

For this month's section on charting and technical analysis, I thought I would come at it from a different – but in my view, very useful – angle. Over the months, we have looked at various aspects of charting and technical analysis: the idea of patterns such as double tops; simple mechanical approaches like moving averages; and the world of the various technical indicators such as stochastics. And of course, my own personal favourite – which is a message I regularly try to bang home – trading and investing with the trend.

I think it's fair to say I am a big fan of the charts – whether it is trading or investing, I don't make a decision without consulting them. For the past 15 years or so, I have worked in the financial trading business, for companies that provide instruments such as contracts for difference (CFDs) and spread betting. These products allow you to take speculative positions on a whole range of financial assets from around the world – whether it is individual shares, indices, commodities or currencies. But it's no great secret (particularly now, since the regulator requires that companies disclose what percentage of clients have lost money) that most people are not profitable when it comes to financial trading.

In this month's article I am going to look at a way of using charts that can hopefully help to tip this balance in your favour, if your experience has not been a positive one.

The number one reason most people lose money when trading

In my experience, many short-term traders using CFDs and spread betting also use charts when it comes to deciding whether they are going to buy or sell. And most of them are losing, ergo charting must be rubbish.

Not so fast. There was a very interesting study done by a US foreign exchange broker between 2009 and 2010. This looked at 12 million trades carried out by its clients, who were retail traders like you and me. As an average, more than 50% of these trades were closed out for a profit. To pick on a popular currency pair, the euro/US dollar rate (EUR/USD), the success rate of trades was 59%. So almost six out of ten were closed for a profit.

At this point you may be scratching your head. If most trades are being closed for a profit, where are all these losing traders coming from? Well, being profitable is not about

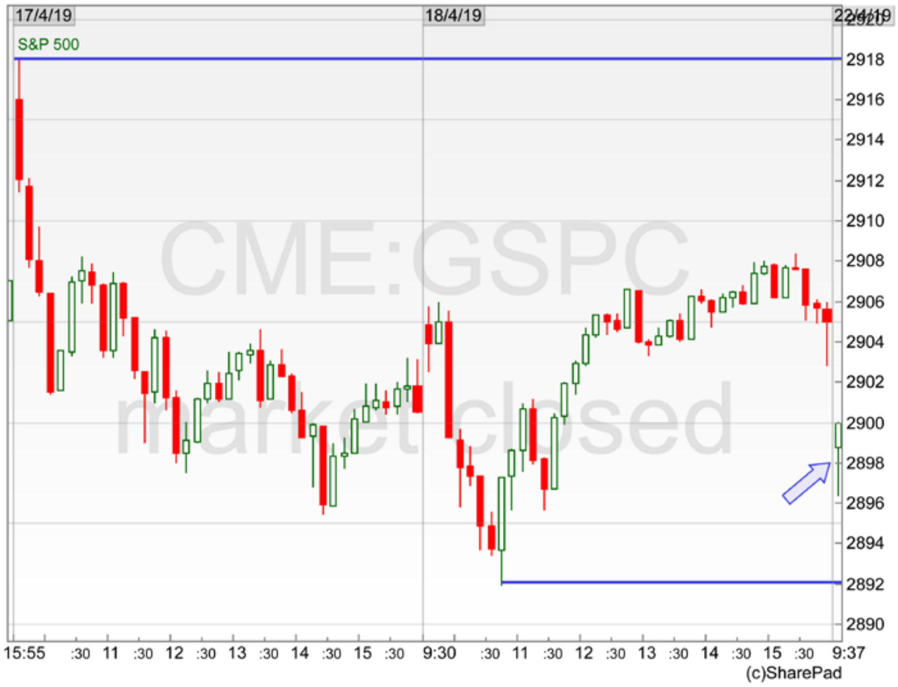

Currencies
$1=
Change
%Change
British POUND 0.6529 +0.0001 +0.012%
Czech KORUNA 20.1790 -0.0440 -0.218%
Danish KRONE 5.8659 +0.0005 +0.009%
European EURO 0.7889 +0.0002 +0.028%
Hungarian FORINT 244.9750 -0.4150 -0.169%
Norwegian KRONE 6.0616 +0.0023 +0.038%
Polish ZLOTY 3.4800 -0.0056 -0.161%
Russian RUBLE 31.8485 -0.0307 -0.096%
Swedish KRONA 6.9936 +0.0019 +0.027%
Swiss FRANC 0.9535 +0.0018 +0.188%
96.87$
3 Month % Change
-0.86%
+5.65%
+2.88%
+6.41%
+2.53%
+6.61%
+5.52%
+11.73%
20 Wk
High
Low
T/N
Return
MktVol.
Nov

being right most of the time. Of course, if your profits and losses were equal, you would still come out ahead – but that is not the case in the real world. This study found that, on average, if a trader made £100 on a winning trade, the average loss on a losing trade was £180. You have to be right an awful lot more often than half the time to make that work.

How can charts help us tip the balance?

I have mentioned this concept a few times in the past, but it always bears repeating. As the numbers above show, trading is not an intellectual game where you get a prize for being right more often than you are wrong. It's about making a profit. So, when looking for opportunities we should be trying to identify trades where the potential profit is a multiple of our potential risk. This is just as true for investing, just probably more so in the shorter-term world of trading where there is usually more activity – and clients can see their account balance diminish much more quickly. Here's an example of a recent trade I did:

S&P500 Chart 17-18 April 2019



"WHEN LOOKING FOR OPPORTUNITIES WE SHOULD BE TRYING TO IDENTIFY TRADES WHERE THE POTENTIAL PROFIT IS A MULTIPLE OF OUR POTENTIAL RISK."

I think we all know the markets have been on something of a rip higher this year, staging a frankly incredible comeback since the lows set in December. Buying into the odd sell-off has been something of a no-brainer strategy so far – and of course it is trading with the trend in the market.

On 22 April the S&P500 index opened lower but held above the lows for the last couple of days in the first half hour. These lows were an obvious reference point for a stop-loss for a short-term trade – if the lows were taken out then the trade could be closed for a manageable loss and wait to see what happens next. I ended up buying in at 2,900 with a stop loss at 2,890, just the other side of those lows. If the uptrend was going to continue then a target that was not too audacious was for a run back up to the highs of a couple of days ago, at 2,918. This is using simple support and resistance levels to weigh up whether a trade is really worth taking, regardless of your overall view of the market.

In this example, the risk on the trade was 10 points, and the initial potential profit was 18 points. It's not the greatest risk versus reward set up – but at least the potential profit is a multiple of the risk, rather than the other way around. Let's see what happened next.

On the day the trade was placed, the market recovered slightly but nothing too dramatic. The same can't be said of the day after! I will hold my hands up to this being something of a fluke – but it is a real trade I did based on the risk/reward being initially attractive. In the end the trade realised a profit just slightly more than three times the initial risk.

"WAITING FOR THE RIGHT OPPORTUNITY, THEN RIGIDLY STICKING TO A STOP LOSS AND LETTING THE PROFIT RUN TAKES DISCIPLINE AND PATIENCE."

How the trade worked out

Unfortunately for my bank balance, not all trades turn out this way. But by avoiding the 50/50 "bets", for want of a better word, you can help tilt the probabilities in your favour, from an investing or trading point of view. So, if it is this straightforward, why are so many people still losing when it comes to trading? I think there is more than one reason for this, but the fundamental problem (as covered at the beginning) is that the average person takes profits too quickly, and lets losses run too far. They are a fugitive from the laws of mathematics!

Waiting for the right opportunity, then rigidly sticking to a stop loss and letting the profit run takes discipline and patience – something that tends to be in short supply, particularly amongst newer entrants to the world of trading and investing. Focussing on these two points will deliver real benefits – far more than worrying about what colour moving averages to use or how many Fibonacci lines you should have on a chart!

Chart of the Month – S&P500

I thought we would continue our US index theme when it comes to the chart of the month, as it is near a really key level. I really like the S&P as an index to watch – it's a great US benchmark and it consists of 500 stocks rather than just the 30 that make up the Dow Jones. Let's remind ourselves of the bigger picture.

This chart starts at the lows of the financial crisis – remember that? And can you spot a trend? What is interesting here is that the plunge in the last quarter of 2018 still held above that longer-term uptrend which is currently coming in just below the 2,400 mark. The index has had a remarkable bounce back since then.

If you had been living off the grid since last summer, upon checking the price of the S&P you would think it had been an incredibly uneventful time. Of course, nothing could be further from the truth. Markets experienced a significant decline into the end of 2018 – the Dow had its worst December since the Great Depression! The subsequent recovery has been just as relentless and has brought the S&P back to within a whisker, at the time of writing, of its all-time high at 2,941.

Put bluntly, it is break or bust time. A sustained move through this old high would be the classic "chart breakout". An old barrier has been breached and the expectation would be for a new trend to be underway. The flipside of this is that the market is back to an area where last time around, in September, the sellers came out taking the view that the market was overvalued and down it went. Either way, it should be an interesting few weeks ahead – place your bets.

Ten years of the S&P500

The last eight months

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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FUNDS & TRUSTS IN FOCUS

DIVERSIFYING THROUGH ALTERNATIVE INVESTMENT TRUSTS

Nick Sudbury explains how investors can dampen the impact of market volatility through taking advantage of alternative assets via investment trusts.

It has been more than a decade since the financial crisis with the low interest rates and loose monetary policy driving up the value of traditional asset classes such as equities and bonds. The high prices in these areas are beginning to look increasingly vulnerable as the global economy starts to slow down. This could mean that investors who are overly exposed could experience large capital losses right across the board.

One of the most effective strategies to reduce this risk is to allocate part of your portfolio to alternative investments. These typically have a lower correlation to more mainstream assets and will dampen the impact of market volatility.

For most retail investors the easiest way to do this is to take advantage of the growing number of alternative investment trusts that are available in areas such as infrastructure, renewable energy, specialist property, and listed hedge funds. Alternative investment trusts account for the majority of new capital raised in recent years and now have a collective market capitalisation of £77bn, which represents around 47% of the total investment trust universe by value.

Last year was more challenging with the alternatives sector only attracting £5.1bn of new money, down from £9bn in 2017, although this still represented 60% of the total capital raised. Out of this figure the thirteen IPOs accounted for £1.27bn – the remainder being secondary issuance from existing funds – with just two of them meeting or exceeding their targets. They were **Tritax Eurobox (LON:BOXE)**, which invests in continental European logistics assets; and **Hipgno-**

"ALTERNATIVE INVESTMENT TRUSTS ACCOUNT FOR THE MAJORITY OF NEW CAPITAL RAISED IN RECENT YEARS AND NOW HAVE A COLLECTIVE MARKET CAPITALISATION OF £77BN, WHICH REPRESENTS AROUND 47% OF THE TOTAL INVESTMENT TRUST UNIVERSE BY VALUE."

sis Songs (LON:SONG), which provides exposure to music royalties.

Most mainstream asset classes lost money in 2018, with the more economically sensitive alternatives like property and specialist debt also typically losing ground. The main bright spots were the renewable energy sector, which delivered some steady performance in line with its return targets, and infrastructure where the funds produced some decent numbers.

Infrastructure

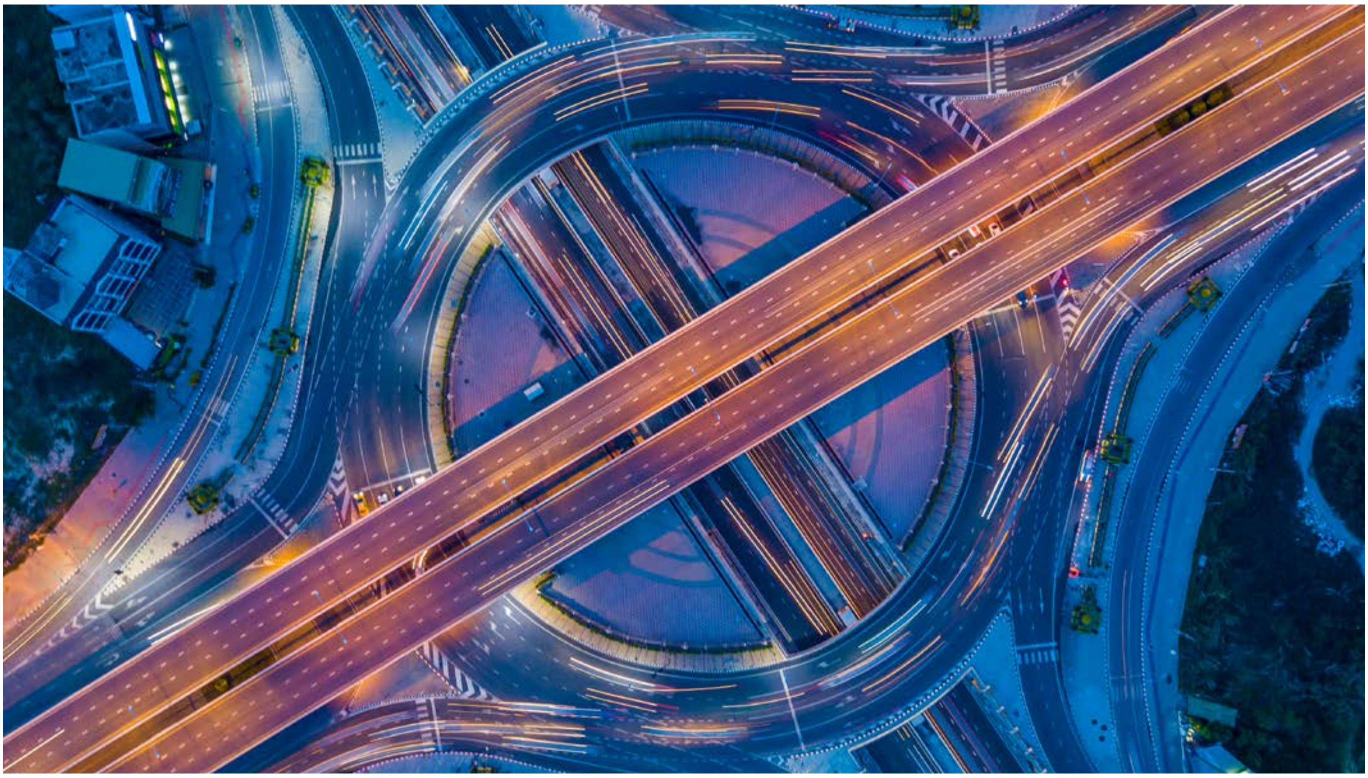
Sentiment towards the infrastructure sector was undermined in the first half of last year by political concerns about the impact of a possible Labour government and increased counterparty risk following the collapse of the services provider Carillion. Things then improved with the takeover of John Laing Infrastructure at a 20% premium to NAV leading to a positive re-rating of the sector as a whole.

Infrastructure funds provide exposure to a whole range of different assets, including schools, hospitals and roads, as well as energy transmission systems and oil storage facilities, both in the UK and overseas. The portfolios are typically well diversified and actively managed with target returns varying between 7%-10% per annum and yields of 4%-7%.

The analysts at Canaccord Genuity and Numis both recommend **HICL Infrastructure (LON:HICL)**. At the end of September the £2.7bn fund provided exposure to a diversified portfolio of 117 investments, of which 70% by value were the politically sensitive PFI/PPP projects with a further 22% allocated to demand-based assets.

In the six months to the end of September, HICL delivered an impressive total return of 7% including the dividends. It has an attractive prospective yield of just over 5% and offers excellent protection against inflation with each 1% increase resulting in a 0.8% uplift in portfolio revenues. The shares are trading on an 8% premium to NAV.

“SENTIMENT TOWARDS THE INFRASTRUCTURE SECTOR WAS UNDERMINED IN THE FIRST HALF OF LAST YEAR BY POLITICAL CONCERNS ABOUT THE IMPACT OF A POSSIBLE LABOUR GOVERNMENT.”



Both firms also recommend the £2bn **International Public Partnerships (LON:INPP)**, which they say has an advantage over its peers due to its primary origination capability. The manager has a proven track record of sourcing a broad range of assets, often direct from public sector counterparties, as the first owner of equity.

INPP's portfolio is the most diversified by asset type in the sector with the 130 assets providing exposure to educational buildings, healthcare facilities, energy transmission, gas distribution, waste water and transport. It also has the highest inflation correlation and offers a prospective yield of 4.5%. The shares are currently trading on a premium of 10%.

"2018 WAS A DECENT YEAR FOR THE RENEWABLE ENERGY SECTOR WITH AN IMPROVEMENT IN POWER PRICES HELPING THE FUNDS TO PRODUCE SOME STRONG RETURNS."

Renewable Energy

2018 was a decent year for the renewable energy sector with an improvement in power prices helping the funds to produce some strong returns. The majority of these vehicles aim to generate energy from wind farms or solar farms, or a combination of the two. They typically invest in assets that produce long-dated income of around 20 years through inflation-linked subsidies or by selling power at the prevailing market price. Target returns are in the range of 7%-9% per annum, including yields of 6%-7%.

Numis recommend **Bluefield Solar Income (LON:BSIF)**, which delivered the sector's strongest share price total return of 11.4% in 2018. The manager exercises strict pricing discipline and this has enabled him to build up a high quality portfolio without having to raise substantial new amounts of capital. BSIF generates strong cash flows and at 6% it has one of the highest yields in the peer group.

When they first launched, most of these funds assumed a useful economic life of the underlying assets of around 25 years, but the latest technical advice suggests that they could be expected to last longer. Bluefield has not yet assumed any extension and has therefore not benefited from the uplift of its NAV.

The only fund to have assumed an asset life extension across the whole of its portfolio is **Greencoat UK Wind (LON:UKW)**, which has moved from 25 years to 30, although the managers are keen to stress that they have taken a conservative approach to the net cash flow assumptions in the extra 5 years. Numis regard it as a high quality business and have included it in their model portfolio for the year, although they suggest waiting until the 15% premium falls back, possibly after the next capital raise. It is currently yielding 5%.

The analysts at Winterflood prefer **John Laing Environmental Assets (LON:JLEN)** because it provides exposure to a range of renewable energy technologies and environmental projects including wind, solar, anaerobic digestion, waste and wastewater. This means it has the lowest sensitivity to changes in the long-term forecast for power prices in the sector.

Since the fund was launched in March 2014 it has delivered an annualised NAV total return of 6.2% per annum and is currently yielding 6%. It has high cash dividend cover of 1.2x with the managers committed to raising the pay-out in line with inflation. The shares are trading on a premium of 11.7%.

"MANY UK COMMERCIAL PROPERTY FUNDS WERE DE-RATED LAST YEAR BECAUSE OF THE WEAK OUTLOOK FOR CAPITAL GROWTH AND SPECIFIC CONCERNS ABOUT THE RETAIL SECTOR."

Specialist property

Many UK commercial property funds were de-rated last year because of the weak outlook for capital growth and specific concerns about the retail sector. These fears are less of an issue for some of the more specialist mandates, especially those that offer reliable long-term inflation-linked revenue streams.

Numis like the **Secure Income REIT (LON:SIR)** that invests in a portfolio of long-lease assets in the Hotel, Healthcare and Leisure sectors. These include: 20 freehold private hospitals, four well-known visitor attractions and 131 Travelodge hotels. All of the leases benefit from either inflation or fixed uplifts with the fund yielding around 4%.

They also recommend the **LXI REIT (LON:LXI)**, which has built up a diversified portfolio of secure, long-dated and inflation-linked leases across a range of subsectors. The fund managers have been successful at crystallising uplifts and quickly recycling the capital. It is one of the most attractive opportunities amongst the long-lease peer group, and although the shares are trading on a 19% premium they continue to offer an attractive 4.2% yield.

The team at Winterflood prefer the **Tritax Big Box REIT (LON:BBOX)**, which invests in very large logistics facilities in the UK. They say that it has performed well since the launch in December 2013 and has generated an annualised NAV total return of 13% that is well ahead of its 9% per annum target. It offers a fully covered prospective yield of 5% and operates in an area that should benefit from high occupational demand for its assets.

Listed hedge funds

There was a mixed performance from the listed hedge fund sector last year with the event-driven funds like **Boussard & Gavaudan (LON:BGHL), Third Point Offshore (LON:TPOU)** and **Pershing Square (LON:PSH)** all struggling, while the macro trading funds managed by Brevan Howard – **BH Global (LON:BHGG)** and **BH Macro (LON:BHMG)** – profited from the more volatile market conditions.

In the year to the end of December 2018 BH Macro generated an impressive NAV total return of 12.4% from the sterling-hedged share class. It was particularly successful at exploiting the volatility in May, with the sell-off in Italian bonds helping the NAV to rise by 8.2%, and although the rest of the year was a lot quieter the manager was still able to protect investors' capital during the market weakness in the fourth quarter.

The analysts at Numis and Winterflood both have the fund as a core recommendation this year. They describe it as an interesting portfolio diversifier with the potential to deliver consistent NAV returns with low volatility and little correlation to the equity markets.

Uncorrelated doesn't mean low risk

The principal attraction of alternatives is that they have a lower correlation with mainstream assets, which means that they could continue to deliver positive returns when other areas sell-off, but this doesn't make them low risk. In fact over the last few years there have been a number of problems in this area with one fund after another running into difficulties.

A case in point is the **Ground Rents Income Fund (LON:GRIO)**, which suffered a major sell-off in 2017 when its share price moved from a 6% premium to an 11% discount after the government announced a review of the ground rents sector following allegations of unfair practice.

Investors in **CATCo Reinsurance Opportunities (LON:CAT)** have fared even worse, with massive losses in the last 12 months. The fund's Catastrophe Reinsurance Bonds have been hit by a series of natural disasters including Hurricane Michael and Typhoon Jebi and it is now running down its portfolio.

Those with money in the aircraft leasing funds such as **Doric Nimrod Air One (LON:DNA), Doric Nimrod Air Two (LON:DNA2)** and **Doric Nimrod Air Three (LON:DNA3)** suffered losses of up to 10% on 14 February when it was announced that Emirates Airline was going to reduce its A380 Airbus order book by 39 aircraft. All of these funds invest in A380s leased to Emirates with the news raising concerns about their residual value at the end of the lease.

FUND OF THE MONTH

BH Global (LON:BHGG) had a steady 2018 with a NAV total return of 5.4% from the sterling share class. It has been recommended by the analysts at Canaccord Genuity, who say that last year's positive performance when most asset classes lost value demonstrates the fund's core purpose to be a low volatility, risk-controlled diversifier and a building block in portfolio construction.

During 2018 the exposure to the flagship Brevan Howard Master Fund was increased from 21% to 46%. This aims to deliver consistent risk-adjusted returns in different market conditions via a range of trading strategies. It had a fantastic 12 months with a gross return of 16.6% as some of the more traditional strategies returned to profitability after many years of distortion caused by QE.

Most of the rest of the assets are allocated to individual traders in what is known as the Single Manager Portfolio. Last year the weighting in this area was cut from 63% to 44% and it currently consists of exposure to six different trading books or individual traders' funds.

Brevan Howard expects better conditions for macro trading in the period ahead, including higher volatility and a normalisation of interest rate policies. If they are right then BH Global would be well-positioned to benefit from its asymmetric payoff profile thanks to its options, and option-like positions. The shares are currently trading on a 3% discount to NAV.

Fund Facts

Name:	BH Global (LON:BHGG)
Type:	Investment Trust
Sector:	Hedge Funds
Total Assets:	£340m
Launch Date:	May 2008
Current Yield:	0%
Gearing:	0%
Ongoing Charges:	2.13%
Website:	www.bhglobal.com

There have also been problems experienced by some of the peer-to-peer lenders that have been de-rated because they have failed to meet their target returns, with those affected including **P2P Global Investments (LON:P2P)**, **Funding Circle (LON:FCIF)** and **Ranger Direct Lending (LON:RDL)**, and with the last two now being in realisation mode.

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

DOES RECKITT BENCKISER'S 30% PRICE DECLINE MAKE IT GOOD VALUE?

Does a lower share price and higher yield mean Reckitt Benckiser is good value again, or is it just an overpriced seller of disposable goods? John Kingham investigates.

Reckitt Benckiser (LON:RB.) (which I'll refer to as RB) is one of the world's leading fast-moving consumer goods (FMCG) companies. In plain English that means it develops and sells familiar branded health and hygiene products like Dettol, Durex, Nurofen, Vanish and Cillit Bang. In recent years RB and similar companies like Unilever have become very popular with investors, largely because they offered a seemingly low risk way to invest in shares whilst still achieving attractive returns.

For a long time, RB lived up to that promise, with dividends increasing by more than 70% since the financial crisis and a share price which tripled between 2009 and 2017. More recently though, things have become less certain and RB's share price has declined by almost a third since its 2017 high.

This share price decline has driven the company's dividend yield up to 3%, which is below average but still much better than the sub-2% yield RB was offering a couple of years ago. So, does this lower share price and higher yield mean RB is good value again, or is it just an overpriced seller of disposable goods?

Generating consistent growth is not always easy

One of the reasons why investors love consumer goods companies is that they have a long history of steady growth and a plausible case for long-term future growth. As the world's population has become larger and richer through the 20th and now the 21st century, more and more people want, and can afford to buy, branded consumer goods such as dishwasher tablets (and the dishwashers they go in), headache pills and detergent.

Companies like RB and Unilever have benefited from this tail wind for decades, making them a no-brainer option for many dividend growth investors. But investing and capitalism are not always that easy, and in recent years RB's steady growth train has come off the rails.

It started in 2012, a few years after RB sailed through the financial crisis as if it wasn't there. Revenues and earnings began to go sideways rather than upwards, and the dividend growth fell from a consistent 10% per year to low single digits and finally to zero in 2015. RB's performance picked up again in 2016, but that was mostly due to Brexit and the related decline in the value of

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"I THINK RB'S MANAGEMENT WERE GETTING DESPERATE AS THE COMPANY'S LACK OF GROWTH IN 2015 AND 2016 THREATENED TO UNDERMINE THE CEO'S POSITION."

the pound (RB generates most of its revenues in other currencies but reports its results in GBP, so when the pound went down, RB's results went up). If we ignore currency movements then Reckitt Benckiser had pretty much ground to a halt.

Shortly after these disappointing results, RB's share price peaked in mid-2017 at 8,100p, giving the company a dividend yield of just 1.9%. Clearly there was a dislocation between the growth rate expected by investors (with a sub-2% yield I assume investors were looking for long-term dividend growth of at least 6% to 8% per year) and the almost non-existent growth the company was producing.

At this point there were two possible outcomes (or some combination thereof): Either RB would return to growth, or the share price would collapse when investors demanded a higher dividend yield to offset the lack of growth. What we actually got was a little bit of both.

RB loads up on debt to acquire growth

In the last couple of years RB's revenues, earnings and dividends have all surged forwards once again. Was this the result of a massive increase in the number of people using Dettol, Durex and Nurofen? No, it was primarily down to one very large acquisition.

As a general rule, I prefer companies to generate most of their growth organically rather than by acquisition. There are lots of reasons why, but one of them is that acquisitions are the growth mechanism of choice for desperate companies whose core business has stalled or started to decline. Desperate buyers tend to overpay, and they often buy companies whose main business has only a fleeting resemblance to their existing core business. In the worst case, the acquirer borrows vast sums to buy a mediocre company operating in an unrelated sector, and investors are sold on the deal with promises of vast synergies, cost savings and cross-selling opportunities.

Some of that applies to RB and some of it doesn't. I think RB's management were getting desperate as the company's lack of growth in 2015 and 2016 threatened to undermine the CEO's position. Unable to generate much organic growth, RB's management decided to go out and buy growth instead. They did this by spending a whopping £12.3 billion buying Mead Johnson Nutrition, maker of the Enfamil infant formula and owner of world-leading child nutrition brands.

This acquisition was funded by debt rather than equity, and at first glance the economics make an awful lot of sense. If you can borrow say £100 million at 4% interest (costing you £4 million per year) to by a company generating profits of £10 million per year, you get an extra £6 million in profit per year essentially for free.

But there's a snag, which is that corporate profits and cash flows are variable, while debt interest payments are fixed. If the acquired company has a bad year or two then its profits may fail to cover the debt interest payments. If that goes on for too long then you could

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> **"FOR A COMPANY WITH A MARKET CAP OF AROUND £40 BILLION, ADDING BUSINESSES WORTH £16.5 BILLION AND REMOVING OTHER BUSINESSES WORTH MORE THAN £5 BILLION IS A SIGNIFICANT AMOUNT OF CHANGE."**

be in serious trouble with the banks, and that's never a good idea. So, while debt-funded acquisitions should lead to increased profits, they also lead to increased risk.

In RB's case, it primarily funded the acquisition of Mead Johnson with approximately £16 billion of debt. That's ten-times RB's pre-acquisition net profits of around £1.6 billion, which is a bit like taking out a loan for ten-times your annual net income. It's a big financial obligation and a big risk if your income falters.

What really matters though is the ratio of debt to post-acquisition profits. Mead Johnson was generating net profits of about £0.5 billion before the acquisition, so add that to RB's £1.6 billion profits and we get a post-acquisition expected net profit figure of £2.1 billion and that's exactly what the combined businesses generated in 2018.

However, £16 billion of debt is still almost eight-times £2.1 billion, and a debt to profit ratio of eight is, in my experience, a recipe for disaster. Thankfully RB's management seemed to agree. Soon after the completion of the Mead Johnson acquisition, RB sold off its food business for £3.2 billion and the proceeds were quite sensibly used to reduce the company's enormous debt pile.

In addition, the removal of the food business (including famous brands like French's Mustard), continued a long process of restructuring which has significantly reshaped RB in recent years.

RB has changed significantly over the last decade

One of the nice things about consumer goods companies is that the best of them don't really change much over the years. That's why investors like the companies that sell Coca Cola, Gillette razors, Johnnie Walker whisky or Dettol. These products don't change much, so they don't require expensive R&D to improve them every year, and yet their sales continue to grow as more and more 'middle class' consumers around the world aspire to consume these branded products.

This slow pace of change does apply to many of RB's core health and hygiene Powerbrands. However, the list of brands that make up that core, as well as the list of brands outside that core, has been through a significant amount of change in the last decade or so.

For example, RB spent around £16.5 billion acquiring the companies behind leading brands over the last ten years. During that time, it generated net profits of £18.7 billion, so the amount spent on acquisitions was almost equal to the amount earned in profit.

That's a problem for several reasons: 1) Large acquisitions can be disruptive and distracting while systems, processes and cultures are integrated and aligned; 2) They are often misjudged, with hoped for synergies, cost savings and expansion opportunities failing to appear; 3) Large acquisitions make it difficult for investors to understand a company's performance. That's because the acquirer can end up as a confusing collection of recently acquired businesses, rather than a single entity with a long and coherent history.

On a more positive note, RB's recent acquisitions seem to be closely related to its core health and hygiene business. For example, RB purchased Boots Healthcare International (maker of Strepsils, Clearasil and Sweetex) for £1.9 billion in 2006, and SSL (the company behind Durex) for £2.5 billion in 2010, and of course Mead Johnson (maker of Enfamil infant formula) for £12.3 billion in 2017.

In addition to spending over £16.5 billion in the last ten years acquiring other brands, RB has been busy offloading 'non-core' brands, partly to fund acquisitions and partly to increase the company's focus on its Health and Hygiene Home Powerbrands. Notable among the disposals were RB's pharmaceutical business (reorganised as Indivior PLC and listed on the stock exchange in 2014 at around £2 billion) and its food business (sold for £3.2 billion in 2017).

For a company with a market cap of around £40 billion, adding businesses worth £16.5 billion and removing other businesses worth more than £5 billion is a significant amount of change. My point is that while consumer goods businesses are supposed to be stable and low risk in theory, in practice they can be just as full of change and uncertainty as any other company.

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“AS WITH THE ACQUISITIONS AND DISPOSALS, SPLITTING RB IN TWO MAY BE A GOOD IDEA, BUT IT DOES ADD YET MORE UNCERTAINTY AND RISK.”

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And the change and uncertainty aren't over yet. The next phase of RB's reorganisation is called RB 2.0 and it involves splitting the company into two largely separate and independent businesses, RB Health and RB Hygiene Home, in order to "reignite growth". As with the acquisitions and disposals, splitting RB in two may be a good idea, but it does add yet more uncertainty and risk. Speaking of uncertainty and risk, that leads me onto the most important point, which is:

Is RB good value today?

So far, I've been somewhat negative about Reckitt Benckiser, partly to counter some of the relentless enthusiasm many investors have for fast moving consumer goods companies like RB and Unilever.

Yes, these companies have benefited from a growing global 'middle class' who want to buy their high margin and relatively defensive products such as headache pills and detergent. But no, they don't have a Golden Ticket which allows them to be perpetual growth machines, churning out 10% growth year in year out from here to infinity.

They are real companies operating in the real world, with real competitors who can do them serious damage and real customers who can change their minds about which brands they like.

Capitalism is tough, and that is precisely why RB has had to work so hard over the last decade to reposition itself away from just home cleaning products and towards emerging markets, health and hygiene. And despite all that work, its growth rate still ground to a halt in 2015 and 2016.

In summary then, RB is a defensive business with a reasonable track record of success, but it's undergoing a significant amount of restructuring to stay competitive. Over the last ten years its revenue and dividend growth rates have averaged close to 5% per year, although by 2016 growth has virtually stopped. The company has grown again in the last couple of years, but mostly because it's leveraged up its balance sheet and acquired growth. How sustainable this new growth spurt will turn out to be is unknown.

As for the future, I don't have a crystal ball, but RB's own estimates for long-term annual revenue growth are in the 3% to 5% ballpark. Some profit margin expansion is always possible, so perhaps earnings and dividends could grow a little faster than 5% over the medium-term. However, I'd rather err on the side of caution and set my expected long-term dividend growth rate for RB at 5% per year.

With an expected dividend growth rate of 5% and a current dividend yield of 3% (at a share price of 5850p), RB has an expected total return (i.e. dividend yield plus dividend growth) of 8% per year.

That's not bad, but it isn't especially interesting either. The UK stock market has historically returned something in the region of 7% to 9% over the long-term, so an expected 8% return from RB is no better than the market average (the FTSE 100's dividend yield is currently just north of 4%). To put it another way, at 5,850p RB is probably trading at something close to fair value, and as a value investor I'm only looking to invest in companies when they appear to be trading significantly below fair value.

My 'good value' price for Reckitt Benckiser

I wouldn't buy RB at 5,850p because I don't find the combination of dividend yield and expected dividend growth is attractive enough. I also don't like its

Zety Akhzar / Shutterstock.com

£12 billion debt mountain and I would want to see that debt pile cut to £8 billion or less before I'd invest. But let's ignore those debts for now and focus on price.

With an expected dividend growth rate of 5%, I would want to see that combined with a dividend yield of around 4% at the very least. With a 4% yield the stock would offer an expected annualised return close to my 10% target, and the shares could be set for a rebound if RB manages to exceed that 5% dividend growth rate.

For RB to have a 4% dividend yield, its share price would have to fall to about 4,200p at some point in the next year. That would be a drop of about 28% from today's price, which

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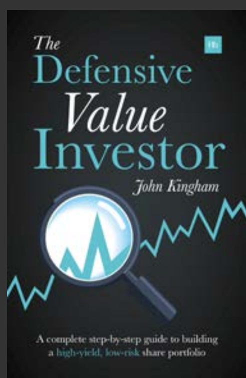
some investors might think is impossible. I would disagree, and I'm sure that investors who bought RB at 8,000p in 2017 didn't expect the shares to fall by 30% over the following two years. But they did.

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

AGAINST THE ODDS

THE POUND CONFOUNDS THE BEARS

The pound's performance has been nothing short of heroic in the face of Brexit. But a strong performance in the first quarter of 2019 could be about to give way to further weakness, writes David Jones.

It's been a few months since we last looked at the fortunes of the pound, and in the fast-moving world of Brexit negotiations, anything could have happened since then. Just kidding – the molasses-like progress of the UK's plans to exit the EU appears to have sucked the will to live out of the British currency, and much of April was characterised by a distinct lack of volatility. The long Easter holiday taken by our hard-working politicians left the pound in limbo for much of the second half of April, so it seems worthwhile taking a look at what the months to come may hold.

The proud pound beats all-comers

The casual observer of the world's foreign exchange markets would probably struggle to guess the best performing major currency in the first quarter of 2019. Yes, it was the pound. It notched up a gain of around 2.3% versus the US dollar and increased by 4.5% against the euro. This left it the winner out of the G10 clutch of world currencies – all in spite of Brexit!

GBP/EUR year to date


ONE POUND

"In spite of Brexit" is pushing the truth a little here. As the UK crept closer to the planned date for leaving, it continued to look like the country was not going to end up with a hard Brexit. There was talk of an extension, a second referendum, or maybe even no Brexit at all. This raised the hopes of financial markets and subsequently gave the pound a boost in the run up to the end of March. The extension by the EU to 31 October has perhaps taken some of the wind out of the sails of that momentum, but still leaves the pound higher now than it was at the beginning of the year.

What does the rest of 2019 have in store?

Like a few of us, I occasionally trade currencies. The first few months of this year saw a clear trend for the pound – it didn't outperform the other world currencies by going sideways. As I have often said in these pages, following the trend is at the core of my medium-term trading strategies. But at the moment, the pound is a special case, and I think this is going to make it a very difficult market to call in the months ahead.

"NOW THERE IS THE EXTENSION IN PLACE I THINK THE FUTURE LOOKS DECIDEDLY MURKY WHEN IT COMES TO FORECASTING THIS PARTICULAR CURRENCY."

Coming into 2019, it was a reasonable bet that a lot of the bad news for Brexit was already factored into the value of the pound. I would have argued the downside was relatively limited and the surprises that could come would probably be more positive than negative. This is how the first three months of the year played out – but now there is the extension in place I think the future looks decidedly murky when it comes to forecasting this particular currency.

GBP/USD Past 12 months

At the moment it does feel like it is a market taking very little notice of what would have previously been major economic announcements. Inflation, GDP, unemployment – they cause small ripples in the likes of GBP/USD when they get released, but attention swiftly switches back to the political world and a casual utterance from a government minister can cause far more excitement. Let's look at what we do know, and some of the major levels to watch.

The last year has been anything but dull – but it is not all about Brexit. In April 2018, one pound would buy just over $1.43, but by the beginning of this year it briefly traded below $1.25. That

"IF THE DOLLAR CONTINUES TO RISE, THEN THE LIKES OF THE POUND AND THE EURO ARE GOING TO FEEL THE PINCH."

recent three-month recovery is clear to see – but so is the lack of momentum that has dogged the pound through much of April.

Perhaps the risk now is for surprises to be negative, in the short-term at least. There are the European elections coming up later in May, in which the UK may or may not take part. If they do go ahead, it looks as if voters could deliver a blow to the Conservative government, with the new Brexit party being used as a protest vote. This further public dissatisfaction with the country's leaders is probably not going to instill confidence in the pound.

The government has had almost three years to sort out Brexit. Will something be done before the May elections? If not, will we actually see a resolution before the end of the extension in October? Any hiccups along the way will probably not be seen as positive for the currency.

To compound matters, the US dollar has been enjoying a resurgence in recent months. A more resilient American economy, coupled with a slow down for the likes of Germany, has increased the appeal of the greenback. If the dollar continues to rise, then the likes of the pound and the euro are going to feel the pinch.

Weakness could bring opportunity

But there could still be opportunity. The $1.24/$1.27 area has proved to be a reasonable area of demand for GBP/USD over the last 8 months. If the pound were to come under more pressure in the weeks and months ahead, it doesn't seem too unreasonable an expectation that this could present a buying opportunity for the more patient trader. In my view, as far as markets are concerned the absolute worst case of a hard Brexit is known and I think it is too easy to get carried away with very pessimistic projections of the pound going into free-fall. Again, from a markets point of view, the UK could end up with something better than that. Knee-jerk sell-offs into this area of demand could be an opportunity to buy the pound, looking for calmer times to return. The only thing that would negate this from a charting point of view would be if the market did slip below those extremes around 1.24 – then I admit it could be a case of "look out below".

As ever, the foreign exchange markets are set to be anything but dull for the rest of 2019. But for the patient trader, short-term panics may end up delivering medium-term profits.

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 BASSET & GOLD

CONNECTING WITH INVESTORS

Spring is traditionally associated with images of lambs leaping through fields of daffodils, while chickens lay colourful chocolate eggs which are delivered to children by rabbits in bows. However, there are other associations you might be less aware of, as every spring, thousands of people travel into London to attend the UK's largest event for private investors.

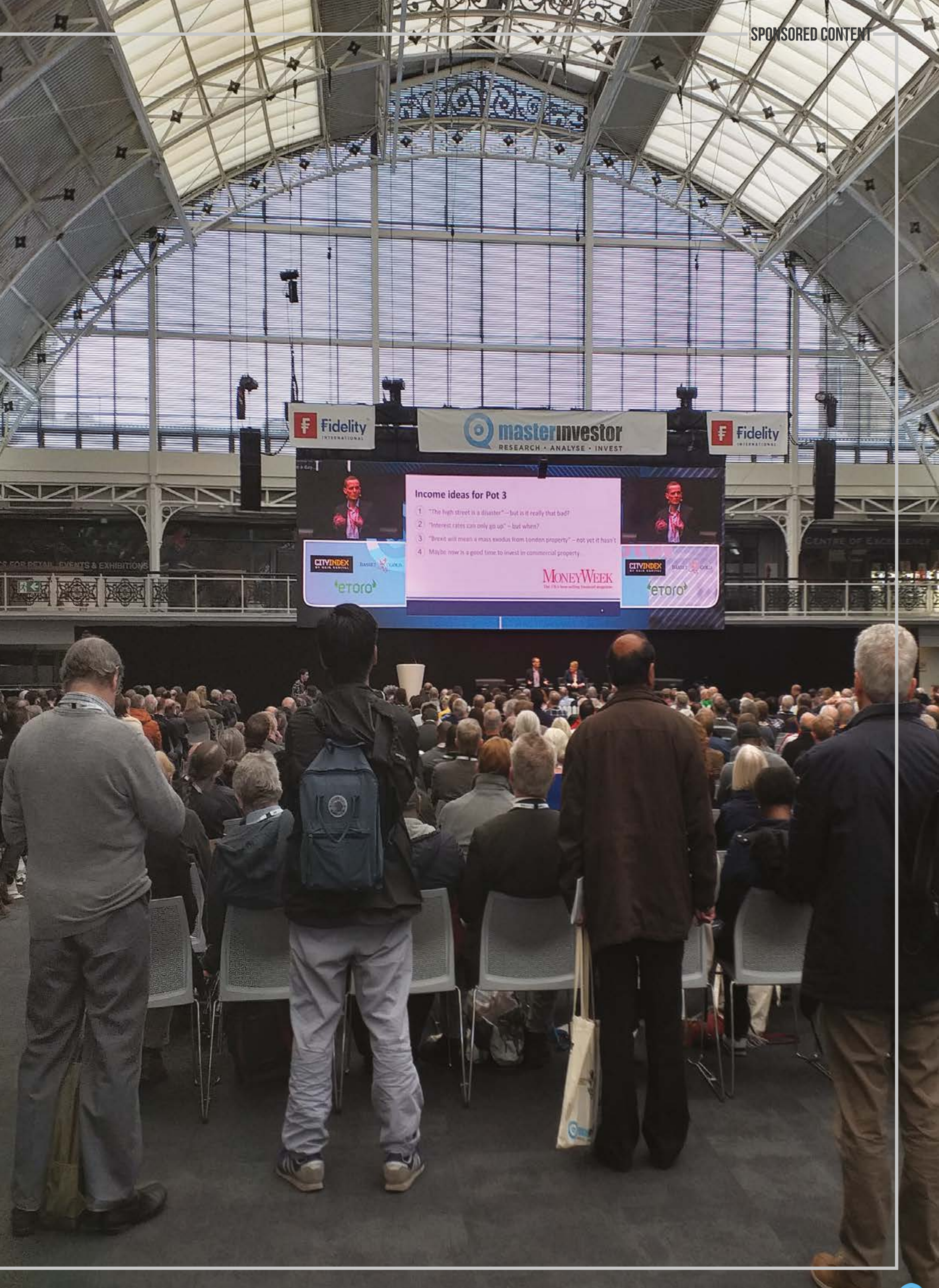
The Master Investor Show took place at the Business Design Centre on Saturday 6 April 2019. Now in its 17th year, the flagship event of the year was attended by almost 5,000 private investors who wanted to connect with companies offering a wide range of investment opportunities.

Almost 40 guest speakers took to the stage to share their investment insights and business cases. By all accounts, this was the best Master Investor Show to date and the atmosphere was electric throughout the day – we know, because we were there.

Our Inaugural Master Investor Show

Basset & Gold was established in 2015, with a view to providing access to innovative investment opportunities previously only available to institutions. Since then, we have gone from strength to strength, with thousands of investors coming aboard. Exceptional customer service should be (and is) a given for any public-facing company, so every single one of our investors receives the same high level of service from beginning to end.

In our time operating within the alternative finance investment space, we have repeatedly heard good things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"I THINK WE HELPED A LOT OF PEOPLE, BUT MY TEAM CAME AWAY WITH A GREATER UNDERSTANDING OF WHAT INVESTORS ARE LOOKING FOR TOO."

about the Master Investor Show, so this year we decided to exhibit there and sponsor the event. We took a team made up of our investment experts, as well as some of our dedicated relationship managers, to meet some of the savvy investors, have a chat and answer any questions they might have about our product offering.

For some of us, it was the first time we had come face-to-face with our audience and it was a genuine pleasure to see so many enthusiastic and knowledgeable people all in one place. "We have been to many investors shows and events before, but nothing on this scale," says Daniel Smith, Director at Basset & Gold. "The excitement was palpable throughout the day and our stand was busy from beginning to end. I think we helped a lot of people, but my team came away with a greater understanding of what investors are looking for too."

Here's To Next Year's Event

It is fair to say that the Master Investor Show 2019 exceeded our expectations (and we had high expectations). We had a very successful event, and look forward to working closely with the people we met on the day. By the end, we were all pretty exhausted, but it was most certainly worth it; we were there for hours, but the day passed in the blink of an eye (time flies when you're having fun). Next year's Master Investor Show 2020 will take place on 28th March 2020 and is set to be staged at the same location as this year's.

Why Choose Basset & Gold?

The range of products we offer have been created to help investors reach a variety of financial goals. Our bonds offer the potential for higher returns and are designed for investors with a higher risk appetite.

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Basset & Gold is an alternative finance provider and we are always looking for new and innovative investment areas.

Our main focus today is consumer lending and commercial property finance, but our investment experts are always on the lookout for other investment opportunities.

To find out more about Basset & Gold and the available investment opportunities, please visit www.bassetgold.co.uk or give us a call on 0800 249 4555.

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BY ANDREW LATTO

QUALITY INVESTOR

LINDSELL TRAIN'S OFFBEAT BETS

Andrew Latto, CFA, takes an in-depth look at some of star fund manager Lindsell Train's more unusual investments.

Quality investors tend to invest in businesses generating high returns and with established track records. Some of them, though, are willing to bet on stocks with "franchise potential." The boutique fund manager Lindsell Train is one of them.

Stocks held in Lindsell Train funds include World Wrestling Entertainment (WWE), Juventus FC and Manchester United. The Lindsell Train Global Equity fund first started buying shares in WWE at $12 in 2011 – they currently trade at $98.

Juventus Football Club has also done well with the shares up from €20 in 2012 to €126 today. The passion that fans have for WWE and football clubs is something that other consumer-facing companies would love to have.

Whether offbeat investments are worth making is difficult to say – some have done well but some may prove to be duds. They do, however, illustrate how Lindsell Train invests and are interesting to evaluate.

Lindsell Train's approach

Michael Lindsell and Nick Train founded Lindsell Train Ltd (LTL) in 2000. The firm appears to be the longest established quality-focused investor in the UK. The investment philosophy is that:

> *"We believe that durable, cash generative franchises are rare and undervalued by most investors for most of the time."*

The first stage is to identify a universe of companies that have durable and cash generative franchises. After the fund manager invests in a business it is "extremely reluctant to sell," with portfolio turnover running at less than 5%.

Identifying powerful franchises

It is not difficult to identify companies that have generated high returns in the past. It is harder to identify low-return companies that will generate high returns in future – frogs can turn into princes, but it doesn't happen very often.

Lindsell Train's offbeat bets

Lindsell Train Fund	Company
Global Equity Fund	WWE, Juventus, International Speedway, Nintendo, Celtic.
Finsbury Income & Growth	Manchester United, Celtic, AG Barr
Lindsell Train Investment Trust	Lindsell Train Limited, Nintendo, A.G. Barr, Laurent-Perrier
UK Equity Fund	Celtic, Manchester United, A.G. Barr
Japanese Equity Fund	Nintendo, Square Enix, Cannon

Source: Lindsell Train

"THE PASSION THAT FANS HAVE FOR WWE AND FOOTBALL CLUBS IS SOMETHING THAT OTHER CONSUMER-FACING COMPANIES WOULD LOVE TO HAVE."

Lindsell Train's live entertainment bets

Company	Market cap	EBIT margin*	Forecast P/E		
			Year 1	Year 2	Year 3
World Wrestling Entertainment	$7.5bn	13.1%	84.8X	31.3X	27X
International Speedway	$1.9bn	18.2%	21.5X	20.3X	19.6X
Manchester United FC	$3.3bn	4.1%	96.1X	132X	140X
Juventus FC	$1.5bn	(1.1%)	-	-	-

*Source: SharePad (share prices on 18th April close). *Last annual reported*

Lindsell Train finds the majority of its candidate investments in the following sectors: Consumer Branded Goods, Internet/Media/Software, Pharmaceuticals and Financials.

Entertainment content rights

The demand for content was previously driven by cable/satellite TV but is now underpinned by the online streaming giants. Netflix recently paid $100 million to keep showing the *Friends* series for another year.

Live entertainment franchises are in particularly high demand as cable TV battles struggle to keep hold of customers. They are often watched socially and the adverts are hard to skip over – they can even be part of the experience.

Nick Train told Citywire in February 2012 that:

> *"Sport represents the largest, most loyal and valuable audience of all. Hence the high inflation in the cost of advertising on sport – exemplified by the value of a 30 second advertisement during the Super Bowl in the USA that has risen more than 10% pa since 1971."*

World Wrestling Entertainment (NYSE:WWE)

World Wrestling Entertainment is the dominant player in the entertainment-wrestling segment. This has reduced the negotiating power of wrestlers who are employed as independent contractors.

WWE used to have competition in the form of World Championship Wrestling (WCW) but the business became defunct in March 2001. More recently, All Elite Wrestling (AEW) was founded in 2019 to provide an alternative to WWE.

WWE's business

WWE creates and owns its content and 66% of 2018 revenue was generated in North America. WWE is now able to bypass cable TV distribution and go direct to its fans through the internet (WWE Network at $9.99 a month).

The increasing value of live entertainment has made media the main revenue and margin driver for WWE. Media generated 73% of total revenue in 2018, live events were 16% of revenue and consumer products were 11% of revenue.

The business earned an EBIT profit margin of 13% in 2018 but it is expected to hit 30% by 2021. This would make the business the most profitable it has been since listing in 1999 at $17 a share.

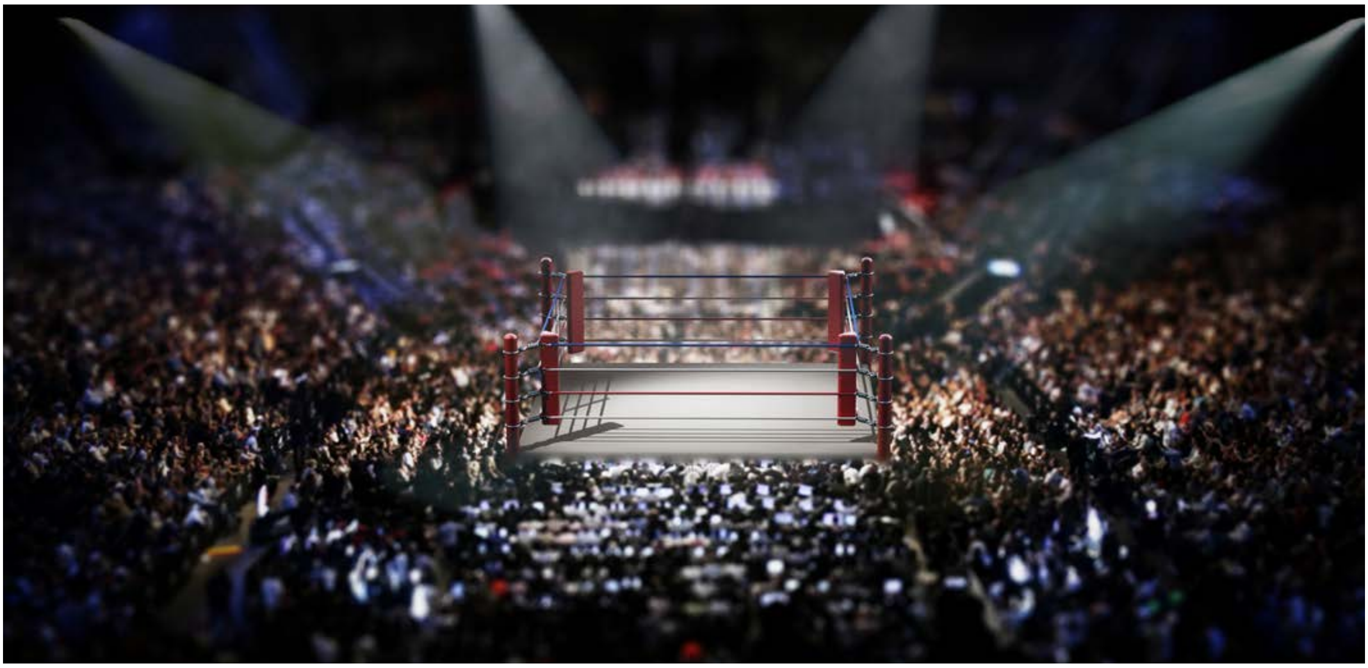
Lindsell Train and WWE

Lindsell Train Ltd is currently the largest shareholder in WWE with a 7.7% stake that is worth $590 million. The position was 5.62% of the Global Equity Fund at June 2018.

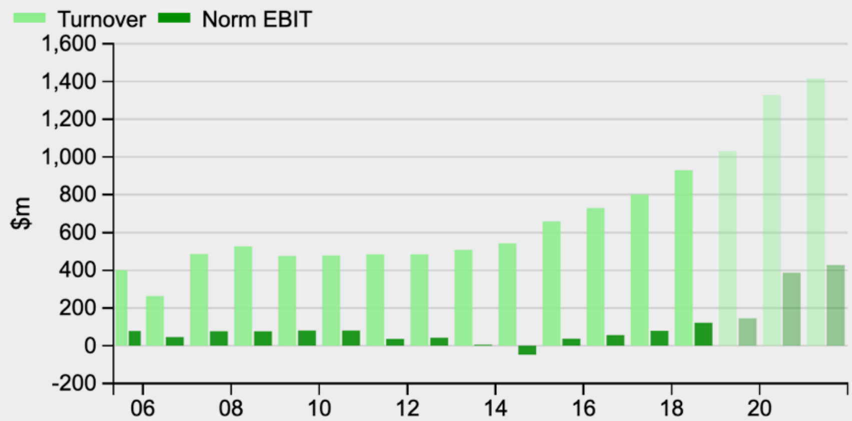
The Global Equity Fund started buying WWE shares in early 2011 at $12 and they hit $8 in early 2013. Three years after the initial purchase, in May 2014, the shares were trading at $11 – just below Lindsell Train's book cost.

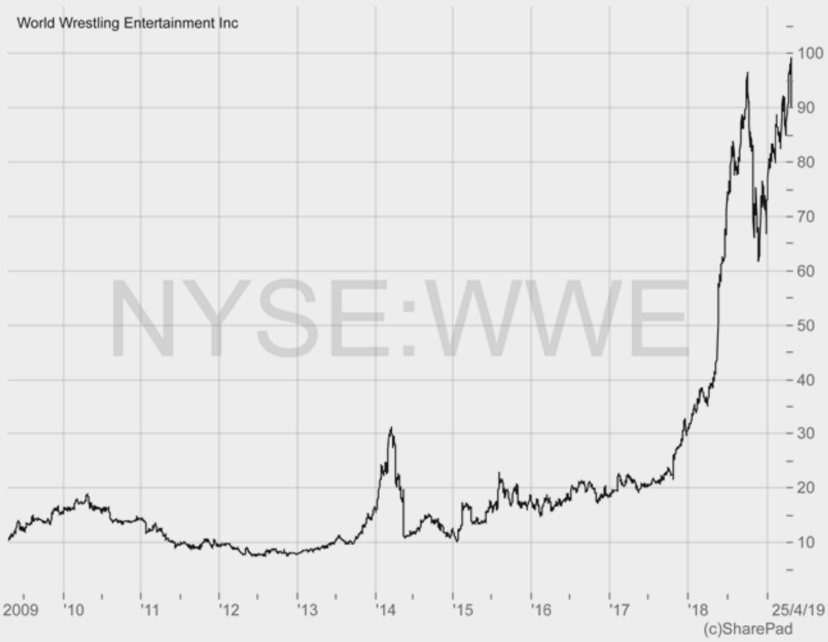
WWE shows that it is not easy to invest in franchises with potential. However, the shares are currently trading at $98, which gives the Global Equity Fund an 800% return to date excluding dividends.

"THE INCREASING VALUE OF LIVE ENTERTAINMENT HAS MADE MEDIA THE MAIN REVENUE AND MARGIN DRIVER FOR WWE."



World Wrestling Entertainment (WWE) – a frog turns into a prince





International Speedway (NASDAQ:ISCA)

International Speedway, $1.8 billion market cap, promotes motorsports-themed entertainment in the US. ISCA makes 90% of its revenue from NASCAR, which is an American auto racing body known for stock-car racing.

According to ISCA, NASCAR is "the second highest-rated season sport on television." The most famous ISCA track is the Daytona 500, which is the 9th most valuable event brand (Forbes).

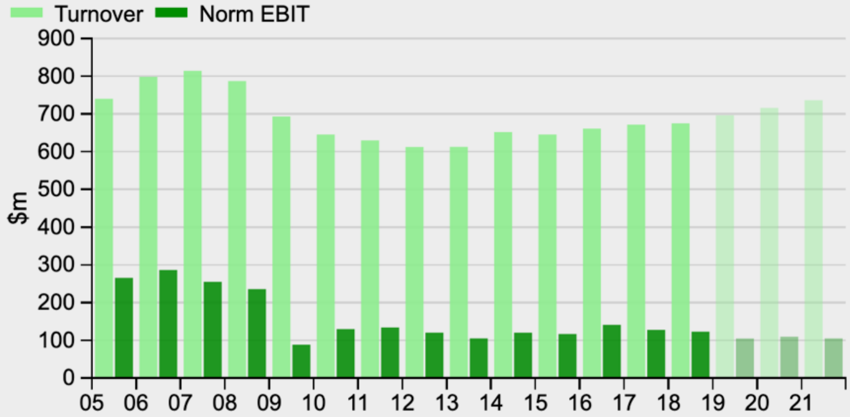
NASCAR broadcast rights generate 52% of ISCA revenue and are contracted through to 2024. The current deal sees 4% compound annual rights-related revenue growth over the 10-year contracted period.

ISCA financials

ISCA revenue and profit have made little progress in the last five years. Earnings per share in 2018 did rise to $1.85 from $1.61 in 2017. But the EBIT margin of 18.2% in 2018 is expected to decline to 14.2% in 2021.

All of the group's revenue is generated in the United States and the France family own the majority of ISCA voting rights. The bull case for the shares is that the next 10-year NASCAR broadcast rights from 2025 could be more lucrative.

International Speedway – a frog waiting to become a prince?



Lindsell Train and ISCA

The Lindsell Train Global Equity Fund owns 2.5% of ISCA and it accounted for 0.57% of the fund at June 2018. The fund has held a position in ISCA since at least mid-2014.

The share price of the company has increased from around $25 in 2012 to around $42 today. ISCA recently received a non-binding takeover offer at $42 a share from NASCAR in November 2018.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Manchester United (NASDAQ:MANU)

Manchester United FC was added to Finsbury Growth & Income Investment Trust (FGT) in the second half of 2017. Nick Train has stated that he made a 30 times return the last time Manchester United was listed on the stock market in the 1990s.

Lindsell Train currently owns 6.6% of the club and with the market value $3.3 billion the stake is worth $217m. Train told Citywire at the time of the purchase in 2017 that the football club's valuation was low:

> *"...relative to the global following and fascination with the Manchester United franchise and to the priceless (virtually) strategic value to broadcasters of live sports rights."*

Manchester United was the first new holding for FGT in two years in 2017 and the amount paid at the time was $17 a share. The shares are currently trading at $20 a share and the forecast P/E for 2019 is a punchy 95.4X.

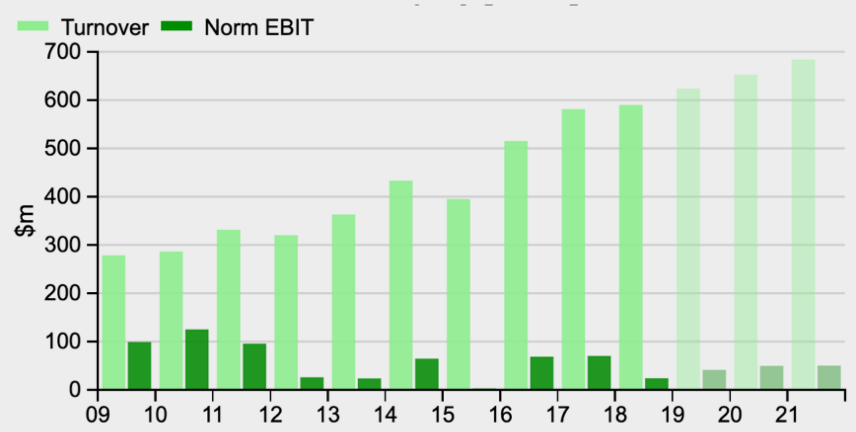
Manchester United's financials

Revenue at the business is expected to make good progress but profit margins are relatively modest. The EIBT profit margin was 4.1% in fiscal 2018 and is expected to hit 7.3% in fiscal 2021.

The negotiating power of football players may mean that they are the ones doing well from sports rights inflation. Nick Train appears to believe that Manchester United will continue to attract high spending fans in Asia.

charnsitr / Shutterstock.com

Manchester United – growth with modest margins

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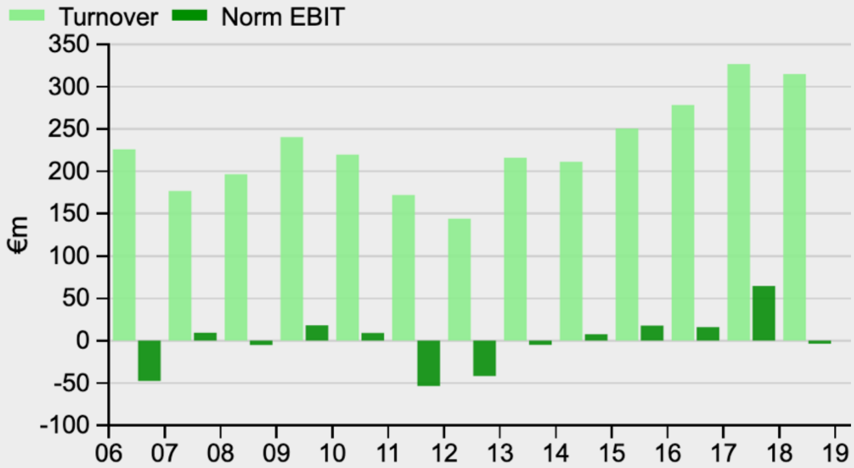
Juventus – a mixed track record



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Juventus Football Club (BIT:JUVE)

The Italian football club Juventus has performed well for the Lindsell Train Global Equity Fund. At the end of March 2019, the manager had a 10.3% stake in the business that was worth €135 million.

It is not a big position with it accounting for only 1.29% of fund assets at mid-2018. The shares have been held since at least 2012 when they traded at €20 versus €126 today – a recent set-back on the pitch has seen the shares sell-off.

Juventus FC financials

Juventus revenue jumped by 39.6% in the half year to December 2018 to €330 million with ticket sales only 11.6% of the mix. However, operating costs jumped by 48.1% and profit for the period only came in at €7.5 million.

A look at the financial history of Juventus doesn't suggest it is a financially stable business. The company has generated a loss in six of the last thirteen years and total borrowing was €329 million at mid-2018.

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Lindsell Train Limited (LTL)

The best performing investment by Lindsell Train is probably a stake in the fund manager itself. The **Lindsell Train Investment Trust (LON:LTI)** has delivered a 16X return since 2001 largely due to its shareholding in Lindsell Train Limited (LTL).

LTI's 25% stake in LTL at March 2010 was valued at £3.3 million and accounted for 8.38% of LTI's net assets. At September 2018 LTI's 24.23% stake in LTL was valued at £75.7 million and accounted for 45% of LTI's net assets.

The increase in the value of LTI has been due to the growth of assets under management (AUM). Lindsell Train Limited had £102 million of assets under management (AUM) at the end of 2002 versus £16.1 billion at September 2018.

What is Lindsell Train Limited (LTL) worth?

In the March 2018 annual report, LTI directors stated that: "the board may seem conservative in assessing the value of LTL." Shareholders agree, with LTI shares trading at £1,677 versus the 12th April NAV of £901 – an 86% premium.

LTL was estimated by directors to be worth £312.4 million at September 2018, with this being 1.94% of the AUM. According to Companies House, Lindsell Train Ltd generated a post-tax profit of £30.6 million in the year to January 2018.

The valuation would put the fund manager on a historic P/E ratio of 10.2X for the year to January 2018. Both valuation ratios are undemanding for a growing fund manager that has performed well.

The Lindsell Train Investment Trust's current valuation is £344.5 million versus £180m net assets – a £164.5m premium. If we assume the premium is entirely due to LTL then LTI shareholders are valuing the fund manager at £991 million.

Other offbeat bets

Other offbeat bets in Japan include **Nintendo (TYO:7974)**, the game maker **Square Enix (TYO:9684)** and the camera maker **Canon (TYO:7751)**. Nintendo recently formed a partnership with Tencent to sell the Switch console in China – the world's largest gaming market.

Offbeat beverages companies in the portfolio include Irn Bru, maker **A.G.Barr (LON:BAG)**, and the French Champagne group **Laurent-Perrier (EPA:LPE)**. The group also owns an 18% stake in football club **Celtic (LON:CCP)**, which has a patchy financial track record.

Summary

Lindsell Train Limited runs five concentrated investment funds and has been willing to invest in companies that raise eyebrows. World Wrestling Entertainment and Juventus have worked out well. WWE is set to become a high margin business with the group capturing the increasing value of content rights. Football clubs, by contrast, have to pay ever-increasing sums to attract the best players.

“THE BEST PERFORMING INVESTMENT BY LINDSELL TRAIN IS PROBABLY A STAKE IN THE FUND MANAGER ITSELF.”

Lindsell Train Ltd valuation

	Reported Sept 2018	Implied valuation of LTL (adding LTI premium)
Value of LTL 24.23% stake	£75.7 m	£240.2m
Total LTL valuation	£312.4 m	£991m

Source: SharePad, LTL

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 IMPERIAL BRANDS COULD BE A GREAT RECOVERY PLAY

Robert Stephens discusses why a changing business model could lead to improving growth prospects for Imperial Brands.

Nothing stands still in the investment world. However, the changes that are currently ongoing in the tobacco industry are perhaps the greatest and most significant in a generation.

The release of innovative next-generation products such as e-cigarettes has caused a shift in demand among consumers towards less-harmful alternatives to cigarettes. This has contributed to a continued decline in cigarette volumes globally, with increasing demand for reduced-risk products being a contributing factor as consumers become increasingly health conscious.

Amidst this change, shares such as Imperial Brands now appear to lack the defensive appeal that has been a cornerstone of their investment case for many years. In response, investor sentiment has declined, and the stock now trades on a low earnings multiple and a high yield.

What has been lost in defensive appeal, though, could be made up for in growth potential. Imperial Brands is driving through efficiencies in order to become leaner and more flexible as it seeks to expand its next-generation product capacity. Although there are regulatory risks ahead for products such as e-cigarettes, reduced-risk products could lead the company's sales and profitability higher over the long run.

Therefore, after a period of disappointing share price performance, the stock could offer investment appeal. With pricing power still high across its cigarette brands, the company may have the time and resources required to successfully transition into a next-generation products business. Although its evolution may not be smooth, it could be highly profitable for long-term investors in my opinion.

Product innovation potential

While there have been attempts in past decades to offer less-harmful nicotine-based products to consumers, e-cigarettes have proven to be a breakthrough product in recent years. According to Public Health England, they are at least 95% less harmful than cigarettes. For this reason, they are viewed as a positive product by regulators in a number of countries, where they are generally considered to be a means of quitting smoking.

Imperial Brands has a strong position within the e-cigarette industry through its blu brand. It has been expanded into a variety of key markets, including the US and UK, and is expected to be available in 20 different countries by the end of the year. Next-generation products such as blu e-cigarettes are set to become a more important part of the com-

"IMPERIAL BRANDS IS DRIVING THROUGH EFFICIENCIES IN ORDER TO BECOME LEANER AND MORE FLEXIBLE AS IT SEEKS TO EXPAND ITS NEXT-GENERATION PRODUCT CAPACITY."

pany's financial future, with them expected to contribute positively to net profit this year.

Innovation is expected to become an increasingly important part of the reduced-risk products industry. Consumers are becoming increasingly health conscious, as well as increasingly demanding of the nicotine-delivery products they use. This could mean that an 'arms race' within the next-generation products segment takes hold over the long run, with the major tobacco companies all likely to invest heavily to find even less harmful products that provide incremental consumer satisfaction.

With Imperial Brands having acquired next-generation product innovation business Nerudia, it has plans to release a number of innovative new products. They include tobacco-free snus in Sweden, as well as a heated tobacco product called Pulze in a variety of countries. Heated tobacco products work by heating, rather than burning, tobacco in order to provide a similar consumer experience to cigarettes, but with reduced health risks. As such, they could appeal to a wider range of smokers than e-cigarettes.

Clearly, it is difficult to accurately predict which products will prove to be popular among consumers in the long run. But as one of the largest tobacco and nicotine-delivery companies in the world, Imperial Brands seems to be well-placed to develop its next-generation products in order to keep up with evolving consumer tastes.

Cashflow and dividends

Of course, Imperial Brands will continue to generate the vast majority of its revenue and profit from conventional cigarettes for the foreseeable future. Although cigarette volumes are falling across the industry, they are a highly price-inelastic product. This means that price rises have thus far more than offset volume declines, and this situation could remain in place over the medium term. This should provide the company with the cash flow and financial stability required to invest heavily in next-generation products that will eventually contribute the lion's share of its sales and profitability.

The company is continuing to improve its efficiency through cost optimisation programmes. The first programme was completed in the previous financial year, with it generating £300 million in annual cost savings. The second programme is set to deliver a further £300 million per year in cost savings from 2020.

“HAVING LIFTED DIVIDENDS PER SHARE BY 10% IN THE PREVIOUS FINANCIAL YEAR, IMPERIAL BRANDS IS EXPECTED TO INCREASE SHAREHOLDER PAYMENTS BY A FURTHER 8% THIS YEAR.”

Improved cash flow is not only expected to lead to reinvestment in next-generation products, but also in increasing dividends. Having lifted dividends per share by 10% in the previous financial year, Imperial Brands is expected to increase shareholder payments by a further 8% this year. Following its share price fall of a third in the last two years, it now has a forward dividend yield of 8%. As such, it could offer income investing potential – even as it continues to experience a period of rapid change from a business perspective. With dividends due to be covered 1.4x by profit this year, there could be further scope for rising dividends in future years.

Since the company's share price has fallen heavily in the last couple of years, it now trades on a P/E ratio of 9. This suggests that it could offer a wide margin of safety, and may have significant scope for an upward rerating should its investment in innovative new products lead to improving financial performance over the long run.

An increasingly onerous regulatory backdrop

As well as consumer tastes evolving as many people become increasingly health conscious, cigarette volumes may also be declining due to continued regulatory changes. In the UK, for example, plain packaging has been introduced in recent years, as well as a ban on smoking tobacco products in public places. In the US, the FDA is considering tougher rules on cigarettes, with it being mooted that a reduction in nicotine levels could be ahead over the long run.

E-cigarettes are also expected to become increasingly regulated over the medium term. Although they are viewed as a useful means for smokers to move away from more harmful tobacco products, there are concerns, particularly in the US, that they are becoming highly popular among teenagers and younger people. As a result, it is expected that there will be increasingly onerous rules on the fla-

"WITH THERE BEING AROUND 1 BILLION SMOKERS IN THE WORLD, THERE IS LIKELY TO REMAIN A HIGH DEMAND FOR CIGARETTES AND REDUCED-RISK PRODUCTS OVER THE LONG RUN."

vours that can be used in e-cigarettes in order for them to become less appealing to younger people. There may also be more stringent regulations on where and to whom e-cigarettes are sold.

Clearly, regulations have been changing for a sustained period of time within the tobacco industry. It would be unsurprising for this trend to continue, which could affect the prospects for the e-cigarette and wider next-generation product industry. It could mean that there is continued uncertainty surrounding the wider nicotine-products industry, and that some products ultimately prove to be more successful than others in what may become a highly fluid industry.

Outlook: looking beyond cigarettes

With there being around 1 billion smokers in the world, there is likely to remain a high demand for cigarettes and reduced-risk products over the long run. Investors appear to have factored in the potential risks facing the industry as it seeks to successfully evolve to take into account changing consumer tastes and increasingly onerous regulations. Although companies such as Imperial Brands may experience an uncertain outlook over the next few years, and their defensive appeal may ebb away, their growth potential could increase.

The company has a strong foothold in the e-cigarettes industry through its blu line of products. It is also investing heavily in product innovation, with it aiming to release further new products that are less harmful and increasingly authentic in terms of the consumer experience when compared to cigarettes. While it will take time for next-generation products to fully catch-on among consumers, they are likely to become an increasingly important part of the company's financial performance over future years.

With Imperial Brands having a relatively high dividend yield and a low valuation, it seems to offer a mix of income and value investing potential. The changes it is making to its business from a cost optimisation perspective could lead to improved efficiency. They may also provide greater resources to reinvest in future growth prospects, as well as pay a higher dividend.

For investors who have benefited from the stability and defensive characteristics of tobacco companies in the past, those attributes may fade away to a large extent over the medium term. While this may reduce the industry's appeal for some investors, others are likely to focus on the growth potential which next-generation products offer.

Therefore, there could be further volatility ahead for the Imperial Brands share price in the short run. In the long term, though, it may be able to generate significant growth. As a result, it appears to have investment appeal.

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

WAY OF THE TRADER

A COMPLETE GUIDE TO THE ART OF FINANCIAL TRADING

BY IAN MURPHY

Richard Gill, CFA, reviews *Way of the Trader*, a book offering advice and guidance to those who wish to leave behind the rat race and make a living out of trading.

When I was at school back in the mid-1990s, I remember completing a computer programme which was supposed to be able to predict your ideal future career based on your responses to a number of questions. For some reason the primitive PC decided to allocate to me the profession of fence erector. Based on what, I don't know – perhaps a like of the outdoors and creating things? In any case, what the world of fence erections has lost, small cap shares has gained.

One profession which I don't remember being on that list is financial trader. This is one which has grown rapidly in popularity over the past few decades as the deregulation of markets and improved technology has given anyone with a laptop access to a trillion dollar a day industry. It offers people from all walks of life the ability to make large amounts of money from the comfort of their own attics and, perhaps most attractive of all, to be their own boss. Yet, despite the allure, it's an often quoted fact that, for a multitude of reasons, most financial traders lose money.

> **"*WAY OF THE TRADER* IS AN IDEAL COMPANION FOR THOSE NEW TO THE WORLD OF FINANCIAL TRADING."**

In *Way of the Trader* author Ian Murphy takes a look at the world of financial trading, offering advice and guidance to those who wish to leave behind the rat race and make a living out of trading. Murphy is a successful private trader who trades his own account using trend-following, swing-trading and day-trading strategies. He has studied various facets of trading with a number of experienced traders, including psychology and trading methods with pro-trader Dr. Alexander Elder, who provides the foreword to this book.

Based on his many years of experience, Murphy shows how a mixture of patience, perseverance, hard work and having an open mind can open the door to a financially independent lifestyle and freedom from the daily grind.

Working 8 to 4:30 – what a way to make a living!

Way of the Trader is structured into three parts, with Part A looking at the nature of trading as a job and a trader's relationship with the market – their de facto workplace. Trading as a job is a bit like running a business, Murphy argues, with the key component being the trading of risk. And as in any business, cash is king. However, unlike a traditional business, trading can be done when it suits the owner, with no employees or huge admin expenses to fund and no time wasted on chasing invoices as trades are settled immediately. The distinction is also made between trading and gambling, with the former having a professional, profit motivated outlook and the latter being driven by addiction and always being a net loser in the long run.

The meat of the book comes in Part B which consists of ten numerically themed chapters covering the practicalities of trading and habits employed by serious professional traders. The first, One Rule, proclaims that the only rule of trading that matters is to preserve capital. As such, we must apply rules to our strategies to keep our trading pile intact.

Digging deeper, Three Styles looks at the trio of techniques which all trading boils down to – trend following, swing trading and day trading. Each have their own features, rewards and risks, with the author suggesting that beginners should start with the longer term trend following style before moving to shorter term strategies as their experience grows.

One of the most interesting chapters is Six Edges, which delves into the mix of psychological tools traders can use on their journey. These include the Six Paramitas, a series of "transcendent perfections" or states of mind that lead the way to liberation and enlightenment. We already possess these qualities (generosity, discipline, patience, diligence, concentration and wisdom) but need to hone them to make us better traders.

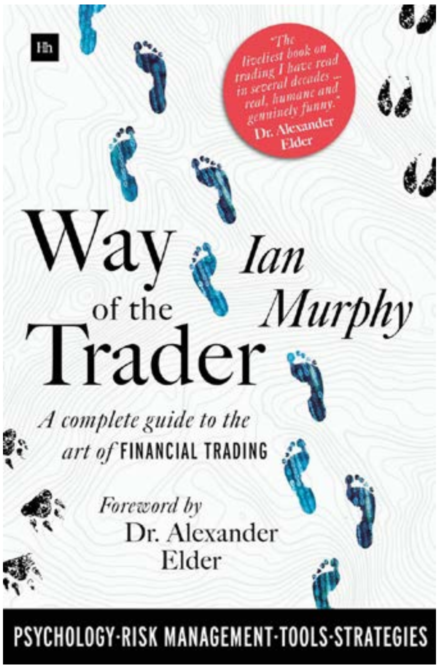
A recurring theme of the book is formalised in Seven Records, a look at the heptad of files a trader should keep to make sure their business is run professionally. These include important documents such as a trading diary, study notes and trading logs, all of which can be used as a reference when analysing success or failure.

Finally, Part C examines three trading strategies which Murphy argues have been consistently profitable and how to take advantage of these inherent opportunities. These approaches are supported with evidence and guidance including back-tested results and annotated charts.

My favourite strategy (the Wilde strategy) is based on the line from Irish popinjay Oscar Wilde, *"We are all in the gutter but some of us are looking at the stars."* This is based on trading shares in companies which used to be high flying but are now in the gutter, and taking advantage of when they breakout of their new trading range. Substantial gains can be made when they do break out but the challenge here is finding the stocks in the first place (Murphy tells you how) and then having the patience to wait and watch your holdings.

Top Trade

One of my esteemed colleagues once said to me, *"Those who can trade, trade; those who can't sell systems".* Ian Murphy is firmly in the former category, having crafted his art over many years



and experienced the many ups and downs that come with life as a financial trader. He comes across as a bit of a Robbie Burns character, a bloke you'd meet down the pub and chat to about the markets over a beer or a tea and a Twix. Unlike many other market operators, he isn't a self-proclaimed "guru" and won't charge you £10,000 for a training seminar based on cutting and pasting a technical analysis book.

Overall, *Way of the Trader* is an ideal companion for those new to the world of financial trading, as well as an indispensable guide for more experienced traders who also might find a few new ideas to apply to their methods. A mix of art, theory, experience and science, the book covers all the key areas to enable you to make a living from the markets.

EXCLUSIVE BOOK OFFER

Get 25% off RRP ***Way of the Trader***. Visit www.harriman-house.com/wayofthetrader and use **promo code**:

MASTERBOOK

Code can only be used on the Harriman House website. Minimum order of £5 required. P&P will be added at the checkout.

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

WHY GOLD MATTERS

Few assets are more misunderstood than gold. Central bankers quietly amass it, even as they publicly denounce it. It is widely regarded as redundant, what Keynes called "a barbarous relic", in a world of electronic money.

So why own gold at all? And more urgently, why own gold now?

Just over a century ago, the British art critic John Ruskin told the story of a merchant who went on a long sea journey. With him he carried his life savings in the form of a large bag of gold coins. Suddenly a terrible storm came up. The alarm went out to abandon ship. The man strapped the bag around his waist, hurried out on deck, jumped overboard – and promptly sank without a trace. As the man disappeared beneath the waves, Ruskin posed a question:

> *"Now, as he was sinking, did he have the gold? Or did the gold have him?"*

No other form of money carries the historical baggage of gold. But be under no illusion, money is precisely what we're talking about. As the banker JP Morgan put it, gold is money – everything else is credit.

"SINCE THE ESTABLISHMENT OF THE FEDERAL RESERVE IN 1913, THE US DOLLAR HAS LOST ROUGHLY 98% OF ITS PURCHASING POWER. STERLING HAS DONE EVEN WORSE."

Traditional economists assign money three characteristics. It is a unit of account – we can price things with it. It is a medium of exchange – we can use it as a helpful replacement to the barter system. And it is a store of value – it retains its purchasing power over time.

Our modern electronic money still retains the first two characteristics. But as for the third... Since the establishment of the Federal Reserve in 1913, the US dollar has lost roughly 98% of its purchasing power. Sterling has done even worse. Indeed, every unbacked paper currency in history has ultimately failed. The dollar will be no different. It is only a question of time.

Gold as money

The likes of gold and silver developed as money in a free market. Throughout human history we have used all kinds of things as money – cattle, shells, nails, tobacco, cotton, even giant stone slabs. But gold and silver always won out over the competition. People tended over time to favour the precious metals as money because of their scarcity, durability, malleability, and beauty. Their use arose without coercion. Gold is the money of freedom.

Gold is also scarce. And it is horribly expensive, in both capital and human terms, to dig out of the earth and process. To produce one ounce of fine gold requires thirty-eight man hours, 1400 gallons of water, enough electricity to run a large house for ten days, up to 565 cubic feet of air under straining pressure, and quantities of chemicals including cyanide, acids, lead, borax and lime.

Being chemically inert, gold lasts. The US author Peter L Bernstein points out that you can find a tooth bridge made of gold for an Egyptian 4500 years ago. Its condition is good enough that you could pop it into your mouth today.

And it is wonderfully malleable. If you have just an ounce of gold, you can beat it into a sheet covering one hundred square feet. Or if you prefer, you could draw it into a wire fifty miles in length.

In recent monetary history 1971 amounts to 'Year Zero' for gold, because that is when President Nixon finally took the US dollar "off gold". With the US economy straining under the twin demands of a "guns and butter" economic policy that began with its entry into the Vietnam War, foreign governments, led by the French, were queuing up to redeem their dollars and exchange them for gold.

But on August 15th 1971, Nixon went on national television and interrupted an episode of 'Bonanza' to announce that the dollar's convertibility into gold was being "temporarily" suspended.

That led to a 40 year-plus experiment in money that remains unprecedented. When Robert Mundell was made a Nobel Laureate in Economics in 1999, he pointed out that:

> *"The absence of gold as an intrinsic part of our monetary system today makes our century, the one that has just passed, unique in several thousand years."*

Gold now accounts for less than 2% of global assets – it is hardly over-owned.

The problem with this experiment in money is that an unbacked money allowed the world's central banks – all of them – effectively unlimited powers of credit creation and money issuance. If your printing of money is no longer constrained by a finite amount of bullion, you can print, and borrow, as much as you like.

"THE PROBLEM WITH THIS EXPERIMENT IN MONEY IS THAT AN UNBACKED MONEY ALLOWED THE WORLD'S CENTRAL BANKS – ALL OF THEM – EFFECTIVELY UNLIMITED POWERS OF CREDIT CREATION AND MONEY ISSUANCE."

Mundell could see the way the world was going. In March 1997, two years before receiving his Laureate, Mundell would remark, ominously,

> *"Gold will be part of the international monetary system in the twenty-first century."*

The author Nathan Lewis agrees. The title of his 2007 book on the subject? *Gold: the once and future money.*

The world, straightforwardly, is carrying too much debt. If you accept my thesis that the accumulated government debt burden of 'the West' is now effectively unpayable, you must, in turn, accept the thesis that there are three and only three ways in which that debt burden can be resolved.

How to escape the debt trap

Option 1 is for western governments to 'engineer' sufficient economic growth to service that debt. I doubt if this is possible anywhere, but I have the biggest misgivings when it comes to the eurozone, which feels to me like it is already in a depression.

Option 2 is for western governments to default; to repudiate their debt. Since we also operate within a debt-based monetary system, in which money is lent into being by banks, a sovereign default by any major government would equate to something

akin to Armageddon. Let's park that option for a second.

By a process of elimination, logic, and thousands of years of history, we get to Option 3. Option 3 is an explicit policy of state-sanctioned inflationism. Governments will choose to inflate the debt away.

Which is precisely what QE – Quantitative Easing – is all about.

But QE has failed.

Despite ten years, trillions of dollars' worth of collective money printing by western central banks, ZIRP, NIRP, and the most outrageous experimentation in monetary history, where's the inflation?

There has clearly been inflation in the prices of financial assets. That, in turn, has led to increasing inequality between the wealthy and the poor, and the rising social tension that accompanies it. But as defined in CPI or RPI terms, inflation remains stubbornly invisible. Indeed, QE has been such a failure that it has actually brought us deflation instead.

And a world of deflation is a world that bankrupts heavily indebted governments.

Here is what Russell Napier, a financial market historian, has said about our predicament:

> *"If central bankers' manipulation of prices fails to generate strong private demand and inflation, then the necessary debt to GDP reduction must come in highly destructive ways for the owners of capital. Society will have to choose between austerity, default, or the creation of a government demand-driven reflation. These are the only three options if central bankers fail to boost growth and also inflation. Austerity would bring depression; default would bring bankruptcy, and a government demand-driven reflation would bring some degree of suspension of the market economy. These are painful and difficult choices if central banks fail. [I] believe that society will most likely choose the apparently least painful route and thus we now face a massive structural shift away from a market-orientated economic system."*

"GOVERNMENTS WILL CHOOSE TO INFLATE THE DEBT AWAY."

In short, Russell predicts the reintroduction of capital controls, as governments simply elect to replace the central banks in the cause of stimulating inflation.

Let us consider for a moment the implications of Russell's warning.

> *"A shift to the conscription of capital by government to force a government-led investment cycle would be very positive for gold. Gold, the form of capital that is easiest to move without trace, is the most difficult form of capital for governments to conscript. Those qualities will produce many buyers as the nature of the authorities' response to our deflationary bust become ever more apparent. So how do we weigh up the negative impacts for gold of a rising US dollar and rising real interest rates with the positives associated with increased government intervention in markets? We wait for the gold price to rise even as the US dollar is rising. That should provide sufficient evidence that the threat of a government-instigated reflation is more than offsetting the negatives associated with the current deflation. Should that reflation succeed, then gold would likely be a major beneficiary as positive real rates of interest would turn into negative real rates that would be sustained by financial repression for perhaps a few decades."*

Why own gold?

Why own gold? Because it makes sense, within a properly diversified portfolio, to have portfolio insurance. If you own a home, it makes sense to have fire insurance. Your investments are no different. And gold is now back, more relevant than ever. Since the start of the millennium gold, as expressed across a wide variety of currencies, has generated average annualised returns of over 9%.

Within my wealth management business, we allocate client capital across four main asset classes:

- Cash and objectively high quality debt
- 'Value' equities, internationally
- Uncorrelated funds
- Real assets, notably the monetary metals, gold and silver

Our objective is not to maximise returns *per se*. Our clients are already wealthy. Rather, our objective is to try and generate a meaningful return on their capital while simultaneously ensuring that these portfolios are not subject to the risk of a catastrophic permanent loss of capital. That means, in part, genuine asset diversification.

Cash and debt are nominal assets. Equities and real assets, as the name implies, are real assets – claims on the real economy, and an inflation hedge of a sort. But in each case, the risks are different. Cash and bonds both come, inevitably, with credit and counterparty risk. A depositor in a bank is

"SINCE THE START OF THE MILLENNIUM GOLD, AS EXPRESSED ACROSS A WIDE VARIETY OF CURRENCIES, HAS GENERATED AVERAGE ANNUALISED RETURNS OF OVER 9%."

effectively an unsecured creditor to that bank. It comes as news to many depositors when they appreciate that they no longer have a legal claim to their money on deposit. Legally, it belongs to the bank. But the logic and natural fairness of this relationship clearly breaks down when depositors earn no money, or even incur negative interest rates, whilst taking the risk of being an unsecured creditor to the bank. Negative bank deposit rates are, logically, entirely consistent with a bank run.

But when it comes to credit and counterparty risk, gold comes with neither. Gold does not rely for its value on the solvency of some third party. It is not a claim against anything. Which is why gold is the perfect insurance against the failure of conventional money or the default of conventional debt. It is why gold is a more perfect form of money than any government-issued alternative.

One quotation from the world of economics fills me with more concern than any other. It comes from one of the founding fathers of the so-called Austrian school, namely Ludwig von Mises. As someone with first-hand experience of the notorious Weimar era hyperinflation, Mises warned:

> *"The credit expansion boom is built on the sands of banknotes and deposits. It must collapse... There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as a result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved."*

Our central bankers have made it abundantly clear that the credit expansion must and will continue. If Mises is correct, then the ultimate resolution of the crisis is also clear:

> *"...a final and total catastrophe of the currency system."*

Which is why you need to own gold now. You buy fire insurance *before* your house is already ablaze. It is too expensive, if it is even possible, to buy it once the conflagration has begun.

The time to buy insurance is before the house is ablaze

Faith in paper currencies, and in the governments that issue and consistently degrade them, doesn't follow a linear progression. Avalanches don't happen in tidy stages. Snow continues to pile up until the system tips from being stable to unstable, whereupon one random snowflake will cause the entire snow mass to collapse. We just don't know which snowflake it will be. Similarly, we don't know which act of monetary insanity will cause the financial system to implode. We just have to recognize that the system is no longer stable – if it ever has been.

If you elect for convenience's sake to own gold in the form of a fund, ensure that you own allocated gold – that is, gold owned outright by you and held in your name. You don't want exposure to unallocated gold – which is the property of the custodian. That's like being a depositor / unsecured creditor all over again. There are far too many paper claims on gold and simply not enough of the physical asset to support them. Paul Mylchreest, editor of 'The Thunder Road Report', a specialist gold publication, wrote several years ago warning of a potential short squeeze in the physical market:

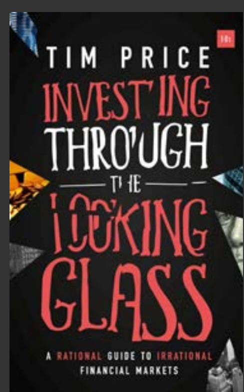
> *"The next major leg up in the gold price will prove to be a religious experience for those people unfortunate enough to find themselves short."*

And if you hold gold in the form of a fund, also ensure that that gold can't be lent out, or 'rehypothecated'. Again, there are too many people playing too many games in the 'fractional gold' physical market – and there is insufficient supply of the physical asset to support all the contingent claims upon it. You don't want to be caught short as and when the next 'run to gold' begins.

We face grave threats and growing uncertainties within the financial markets. Gold doesn't solve all of the world's problems and it would be silly to believe it does. But as an alternative to keeping flawed money in a flawed banking system, it's a useful start. It's a hedge against both inflation and systemic financial distress. And it's the best performing 'money' in counterparty risk and purchasing power terms that you can own. So, here's to gold – the once, and perhaps future, money.

About Tim

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



MAY 2019

INVESTOR EVENTS DIARY

EVERY WEDNESDAY

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

THURSDAY, 9 MAY

Event:	How to set FinecoBank's multichannel trading platforms at your need
Organiser:	FinecoBank
Time:	06:00-18:00
Place:	FinecoBank hub, 40 Gracechurch Street, London EC3V 0BT
Tickets:	https://finecobank.com/uk/public/corsi-e-education

WEDNESDAY, 8 MAY

Event:	Position and Portfolio Management with Rakesh Shah
Organiser:	FinecoBank
Time:	17:00-19:00
Place:	FinecoBank hub, 40 Gracechurch Street, London EC3V 0BT
Tickets:	https://finecobank.com/uk/public/corsi-e-education

WEDNESDAY, 22 MAY

Event:	Volatility and Risk with Rakesh Shah
Organiser:	FinecoBank
Time:	17:00-19:00
Place:	FinecoBank hub, 40 Gracechurch Street, London EC3V 0BT
Tickets:	https://finecobank.com/uk/public/corsi-e-education

THURSDAY, 23 MAY

Event:	Volatility and Risk with Rakesh Shah
Organiser:	FinecoBank
Time:	16:00-18:00
Place:	FinecoBank hub, 40 Gracechurch Street, London EC3V 0BT
Tickets:	https://finecobank.com/uk/public/corsi-e-education

TBC JULY

Event:	Master Investor Sheffield meetup
Organiser:	Master Investor
Time:	18:15-21:00
Place:	Jaywing, Albert Works, Sidney Street, Sheffield S1 4RG
Tickets:	Email info@masterinvestor.co.uk to register interest

TBC JUNE

Event:	Master Investor in focus: Investing in Medicinal Cannabis
Organiser:	Master Investor
Time:	18:15-21:00
Place:	DAC Beachcroft, 25 Walbrook, London EC4N 8AF
Tickets:	Email info@masterinvestor.co.uk to register interest

TUESDAY, 2 JULY

Event:	UKBAA Angel Investment Awards and Gala Dinner 2019
Organiser:	UKBAA
Time:	19:00-23:00
Place:	Illuminate at the Science Museum, London
Tickets or sponsor-ship:	http://awards.ukbaa.org.uk

TUESDAY, 11 JUNE

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

FRIDAY, 25 OCTOBER

Event:	London Investor Show
Organiser:	UK Investor Events
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

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

WEEK COMMENCING 11 NOVEMBER

Event:	Longevity Week
Organiser:	Master Investor and Longevity Forum
Place:	Various London locations
Tickets:	Email info@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:	https://www.womeninfinance.co.uk/london/the-awards

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

APRIL 2019

GLOBAL EQUITIES

Index	Last Month %	YTD%	52-Week Strength
DAX Xetra	7.1	16.9	
NASDAQ 100	5.5	23.8	
Nikkei 225	5.0	11.2	
CAC 40	4.4	18.1	
Euronext 100	4.2	18.5	
Russian TSI	4.0	16.5	
S&P 500	3.9	17.7	
FTSE All-World	3.2	15.2	
Swiss Market	3.1	15.9	
Dow Jones	2.6	14.3	
S&P/ASX 200	2.3	12.9	
Hang Seng	2.2	14.9	
FTSE 100	1.9	9.7	
CSI 300 Index	1.1	30.0	
Bovespa	1.0	9.6	

COMMODITIES

Commodity	Last Month %	YTD%	52-Week Strength
Bitcoin	28.8	45.1	
Iron Ore	12.4	31.3	
Crude oil (Brent)	6.1	32.2	
Crude oil (Light Sweet)	5.6	38.6	
Cocoa	4.5	-4.2	
Platinum	4.4	8.8	
Palladium	1.4	12.3	
Cotton	1.2	6.3	
Copper	1.2	6.7	
Silver	-0.9	-5.5	
Coffee	-0.9	-10.6	
Gold	-0.9	-0.5	
Sugar (No. 11)	-1.5	1.5	
Palm Oil (Crude)	-2.6	-1.2	
Natural Gas	-3.6	-11.8	

FOREX

Pair/Cross	Last Month %	YTD%	52-Week Strength
USD/CHF	2.4	3.0	
EUR/CHF	2.4	1.3	
GBP/AUD	0.6	2.7	
EUR/JPY	0.5	-0.6	
USD/JPY	0.5	1.4	
USD/CAD	0.4	-1.4	
EUR/GBP	0.0	-4.5	
EUR/USD	0.0	-1.9	
GBP/USD	0.0	2.6	
AUD/USD	-0.7	-0.2	

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%	Jun 06	Jul 25
Federal Reserve System (FED)	2.50%	May 01	Jun 19
Bank of Japan (BoJ)	-0.10%	Jun 20	Jul 30
Bank of Canada (BoC)	1.75%	May 29	Jul 10
Reserve Bank of Australia (RBA)	1.50%	May 07	Jun 04
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%	Jun 14	Jul 26
Reserve Bank of India (RBI)	6.00%	Jun 06	Aug 07

FTSE 350 TOP RISERS

Company	Last Month %	YTD%	52-Week Strength
Amigo Holdings PLC	38.1	-12.1	
IWG PLC	36.4	63.2	
Games Workshop Group PLC	32.1	35.4	
ContourGlobal PLC	26.3	19.3	
JD Sports Fashion PLC	25.2	78.0	

FTSE 350 FALLERS

Company	Last Month %	YTD%	52-Week Strength
Indivior PLC	-60.2	-66.3	
Saga PLC	-47.0	-42.8	
Plus500 Ltd	-29.8	-61.4	
Galliford Try PLC	-18.7	-11.0	
AA PLC	-18.5	-1.4	

FTSE 350 SECTORS RISERS

Sector	Last Month %	YTD%	52-Week Strength
Leisure Goods	32.1	35.5	
Technology Hardware & Equip	10.4	38.9	
Electronic & Electrical Equip	10.2	23.5	
Industrial Engineering	9.9	23.5	
Life Insurance	8.3	20.8	

FTSE 350 SECTORS FALLERS

Sector	Last Month %	YTD%	52-Week Strength
Oil Equipment, Services & Dist	-6.8	-3.5	
Tobacco	-6.6	12.5	
Pharmaceuticals & Biotech	-4.1	0.3	
Electricity	-3.6	4.9	
Mining	-2.4	13.4	

IA SECTORS RISERS

Sector	Last Month %	YTD%	52-Week Strength
Technology and Telecom	6.6	21.8	
UK Smaller Companies	5.8	13.1	
European Smaller Comp	5.5	13.9	
North American Smaller Comp	5.2	20.2	
Europe Excluding UK	4.9	12.8	

IA SECTORS FALLERS

Sector	Last Month %	YTD%	52-Week Strength
UK Index Linked Gilts	-1.9	4.0	
UK Gilts	-1.7	2.0	
UK Direct Property	0.0	0.3	
Short Term Money Market	0.1	0.2	
Standard Money Market	0.1	0.2	