ISSUE 57 – DECEMBER 2019

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GREGGS ON THE GO

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THE BEST AND WORST FUNDS OF 2019

CAN THEY PROVIDE ANY POINTERS FOR 2020?

I'M AN INVESTOR GET ME OUT OF HERE!

CAN ITV'S WOES BE OVERCOME?

MELLON ON THE MARKETS

WHY THE MASTER INVESTOR IS BUYING DIVIDEND STOCKS

WELCOME

Dear Reader,

Last month, I was lucky enough to be able to interview Lord Lee of Trafford, the UK's first recorded ISA millionaire. Before switching to the Lib Dems and becoming a peer, Lord Lee was a minister in Margaret Thatcher's government, and outside politics he has had a very interesting and successful career in finance and investment. A lifelong investor, Lord Lee is also probably one of the most successful private investors I've ever met.

I would heartily recommend Lord Lee's book, *How to Make a Million Slowly*, to anyone who is serious about investing. Lee reminds us that investing – real investing as opposed to day trading or speculating – is a marathon not a sprint. Moreover, and perhaps most encouragingly for those of us who struggle with numbers, one needn't be overly clever to be a successful investor; but what is needed is patience and common sense – in that order, says Lee.

Lord Lee favours what he terms "proprietorial" businesses where management and/or the founding family have a large shareholding and can help "steward" the business through good times and bad. The implication is that owner-managers with "skin in the game" often do a much better job when it comes to making decisions in the long-term interests of shareholders – with whom their interests are obviously very well aligned.

To me, Lord Lee's investing style is a reminder that as investors we should play the long game and try not to get distracted by short-term movements, fads or indeed political gyrations. Understand what you're investing in, what makes it special and why you're holding it; buy at a good price; and sit back, relax and wait for value to out.

You can listen to the full interview with Lord Lee here.

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

Best regards,

J Faulkner
Editor

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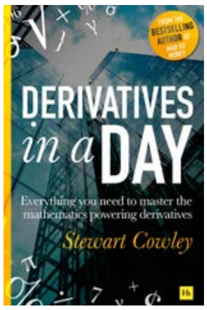

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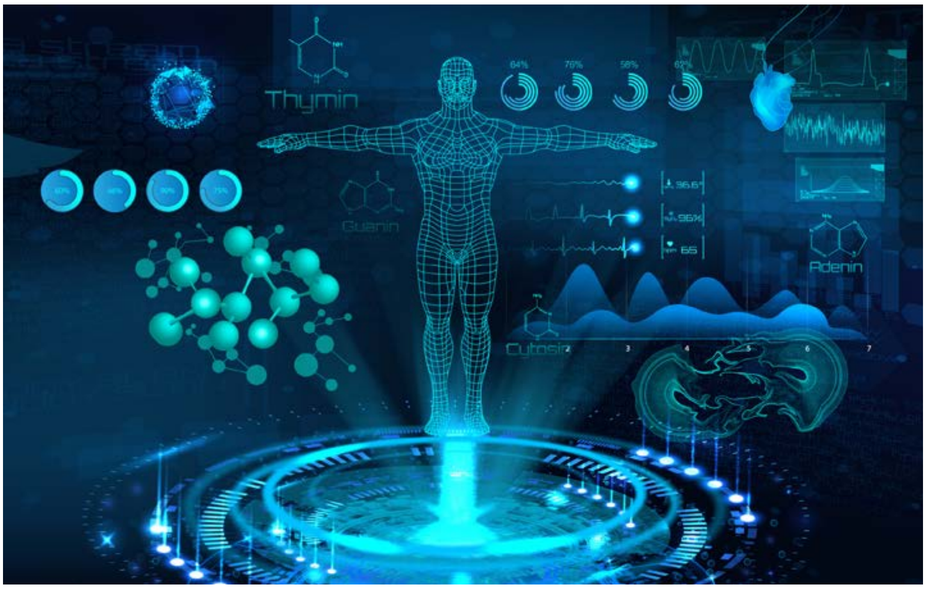

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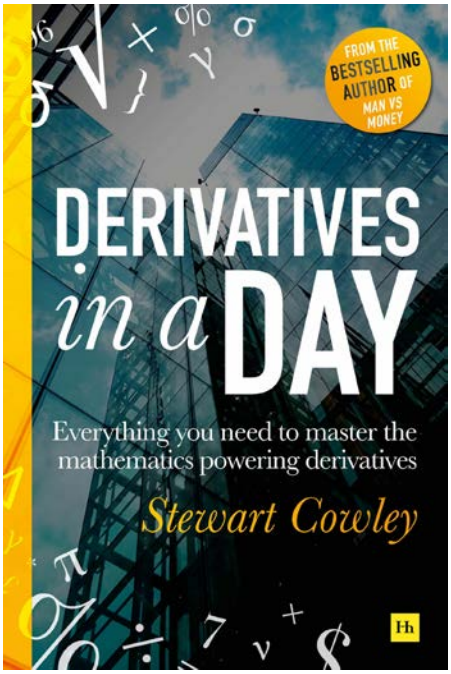


BY JIM MELLON

MELLON ON THE MARKETS

Inside the mind of the Master Investor: influential British investor, Jim Mellon, reveals his latest thoughts on the markets.

It's been a busy old month, what with Longevity Week and in particular the Longevity Forum in London, the MoneyWeek Wealth Summit and a shareholder meeting for Juvenescence. Coupled with some stuff on Agronomics, it's been exhausting and I am looking forward to a week of gentle book editing in Berlin. After that, I'm off to the US for two conferences – then the Christmas round of joy and (mostly) happiness!

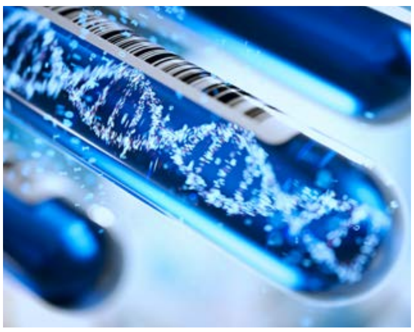
At the MoneyWeek summit, and at our own company's quarterly meeting in Berlin, I explained that I am becoming particularly keen on thematic investment, with the three major investible themes being climate change, clean meat and the modern agricultural revolution – as well as, of course, the biggie which is likely to affect everything – the science of longevity.

Climate change is hard, because returns are being compressed, but the other two should be included in everyone's portfolio. As part of London Longevity Week, Master Investor held a sold-out day on longevity, and they will be doing one on agritech and clean meat in the near future.

But while we wait for sufficient companies to become investible in these areas – and they will – we need to make some money for our daily bread.

Earning our daily bread

Regular readers will know that I favour dividend yielding stocks over internet-based growth stocks currently; that I disdain low yielding bonds; and that I am a big fan of gold and silver. Unless there is a collapse in earnings across the board, due to some massive economic recession (and although there are macro clouds, this isn't likely in the short term), most big companies with juicy dividend yields should be able to maintain their payouts, and are therefore a good buy.



Janus Henderson, the fund managers, have pointed out that global dividends have continued to rise, even as earnings have stalled. Globally, they forecast that dividends will grow a shade under 9% in 2019, to £1.1 trillion – approximately a payout of 46% of total global earnings. This is a comfortable ratio but disguises some examples of companies where so-called dividend cover, which is the capacity of companies to continue paying generous dividends, is perilously close to being exhausted. In fact, in the UK, the ratio isn't particularly wonderful, which is why investors have to be careful.

Companies with ridiculously high yields are usually (not always) stressed and likely to cut their payouts – or even get rid of them. Companies with excessively high debt are to be avoided, especially if the debt is keyed to adverse macro trends (eg to retail property).

This will narrow the field considerably – even amongst the biggest companies. It is instructive that over a quarter of FTSE 100 companies yield over 6%, indicating either massive mispricing of

“WE ARE GRADUALLY BUILDING UP OUR DIVIDEND PORTFOLIO, WITH A MIXTURE OF UK AND OVERSEAS SHARES.”

"NO, YOU WON'T GET RICH WITH THEM, BUT YOU SHOULD GET A RETURN THAT IS SIGNIFICANTLY ABOVE INFLATION AND A BIT OF CAPITAL GAIN THROWN IN."

equities versus bonds, or something fundamentally wrong with the companies. Most likely, it's a bit of both.

For our own part, we are gradually building up our dividend portfolio, with a mixture of UK and overseas shares. We bear in mind that many UK big companies get the bulk of their earnings overseas so are effectively international. It should also be noted that on holdings in US stocks, there is a withholding tax of 30% on dividends – on Japanese stocks it's 15% – which should be taken into account when making your final cut.

Building a dividend portfolio

AJ Bell suggests that the FTSE 100 currently yields 4.8% and is covered about 1.6x, which is a little tight. This is a significant reduction in coverage over the past few years. But there are still safe havens with dividends of significance out there, and I will give you a few examples which I favour.

BP (LON:BP.) is one, as is Lloyd's Bank. We are not going totally green any time soon and BP looks the best of the oil majors to me, with a near 6% yield. **Lloyds (LON:LLOY)** has a similar yield and with PPI almost behind it, and both a very strong balance sheet and position in the UK domestic market, along with almost no overseas exposure, I am a happy holder.

Delta Airlines (NYSE:DAL) in the US (with a very valuable frequent-flyer franchise business – selling points

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effectively) is cheap, well-run and although uncomfortable to fly on, a good place to park cash. Similarly, **IAG (LON:IAG)**, owner of BA, is cheap and is at long last getting better planes and, hopefully, an improved service. Many is the time I have vowed to never fly BA again, only to have to trot back onto one of their aircraft due to a lack of viable alternatives. I'm not keen on long detours.

Marston's (LON:MARS), the pub company, looks similar to Greene King (recently acquired) to me, and with a yield above 6% and surely the prospect of a takeover, it is an interesting one to hold. Other US holdings include **GM (NYSE:GM)** and **Gilead (NASDAQ:GILD)**, the big drug company with a yield approaching 4%. I also retain a position in **Avation (LON:AVAP)**, the aircraft-leasing company listed in the UK.

I think all of these, along with **BT (LON:BT.A), Shell (LON:RDSA), British Land (LON:BLND)** and **Great Portland Estates (LON:GPOR)** are useful 'bankers'. No, you won't get rich

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with them, but you should get a return that is significantly above inflation and a bit of capital gain thrown in.

Rio Tinto (LON:RIO) and **BHP (LON:BHP)** are excellent dividend yielders and I would hold them, as inflation is surely going to rise. But the main thing for inflation is – you guessed it – gold, and any opportunity to load up on it, its derivatives or anything related to it that isn't run by fraudsters – well, I'd go for it.

I would also load up on sterling, particularly against the US dollar. Boris will romp the election and the pound will go up 5% overnight.

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

MEDICAL TECHNOLOGY IN THE AGE OF AI

Victor Hill explains how the future of healthcare might belong to the engineers rather than the medics.

New approaches to old maladies

New technologies are emerging rapidly to help us improve our understanding of what is going on inside our bodies – and then to treat what is wrong.

Dr George Frodsham, founder and chief executive of MediSieve – a spin-off from University College, London, has proposed a revolutionary new approach to the treatment of a range of conditions, including leukaemia, sepsis and malaria. While studying how magnetic nanoparticles can be bound to cells in the body so that they can show up on scanners, he realised that if it were possible to magnetise cells for imaging, it might also be possible to suck them out of human blood.

The first human trials of this medical technology are currently awaiting approval from the UK's Medicines and Healthcare Products Regulatory Agency. According to one report, these are likely to start next year. Tests will begin in 2020, followed by trials to see if the device can eliminate sepsis-causing bacteria. But, in principle, anything that can bind to the magnetic nanoparticles, such as poisons, pathogens, viruses and bacteria could be removed from the bloodstream in a process akin to dialysis.

Essentially, the patient's blood would be extracted and infused with microscopic magnetic particles which bind to target disease cells. Those substances are then extracted and the purified blood is pumped back into the patient's body. The whole process would be likely to take between two to four hours and would not have any of the toxic side effects associated with radiotherapy and chemotherapy.

Malaria naturally becomes magnetic when it enters the body because it targets iron-rich red blood cells. But cancer cells do not all circulate in the blood, as some reside in bone marrow and lymph nodes. The only way to cure blood cancers such as leukaemia is to eliminate these cells completely.

Dr Frodsham won the Biotechnology and Biological Sciences Research Council Innovation of the Year award. He hopes that a new generation of engineers will find technological solutions to medical problems rather than simply relying on pharmacology. So, the future of healthcare might belong to the engineers rather than the medics.

"THE FUTURE OF HEALTHCARE THEN MIGHT BELONG TO THE ENGINEERS RATHER THAN THE MEDICS."

The African swine fever pandemic: a UK biotech player is on the case

Animal healthcare never attracts the same level of publicity as the human type. It hasn't been headline news in the UK but it has dominated the media across Asia. The outbreak of so-called African swine fever has caused mayhem in China and Vietnam. Last month the World Health Organisation (WHO) warned that one in four pigs worldwide might die in this epidemic. Fortunately for us, unlike in the case of bird flu, African swine fever poses no risk to humans. (Or so we are told: genetically speaking, humans have much in common with pigs).

The mortality rate for infected pigs is 100 percent and there is no available vaccine. It is easily transmitted via live animals or through parasites but can even survive several months in processed meats. The animals die within a few days of being infected.

China has, or rather had, an estimated 700 million pigs – many of which are kept in the back yards of rural households. Pork is the main source of animal protein in the Chinese diet. The price of pork in China has nearly tripled in the last 12 months, as about 45 percent of the pig population has perished.

The disease has manifested itself in 50 countries across Europe and Asia, including Belgium and Northern Ireland. British biotech company **Genus** **(LON:GNS)**, based in Hampshire, is on the case. Genus specialises in improving the quality of breeding herds. Its website states: "We provide farmers with superior genetics that enable them to produce higher quality animal protein more efficiently". They do that by analysing animals' DNA and looking for markers linked to desirable characteristics. They then select animals with the strongest genetic profile and breed them to produce better offspring, in a continuous cycle. They distribute these genetically superior animals to customers in the form of breeding animals, semen or embryos.

Getting the Chinese pig population back to where it was will take at least three years. When Russia was afflicted by an equivalent outbreak 10 years ago, the authorities used the crisis to modernise the industry and to raise standards. If the Chinese take the same approach, that could be good news for Genus and others.

Google enters the healthcare data bonanza

Last month it was revealed that Google has been collecting the personal healthcare information of millions of Americans under a scheme called *Project Nightingale* (presumably named after the iconic 19th century clinician, Florence Nightingale). Google has partnered with Ascension, the second-largest healthcare provider in the US, to gather data on 20 million patients in 21 states. Another 30 million patient records may be next. One outcome of Project Nightingale is likely to be that Google will be able to build a healthcare search engine for hospitals.

The controversy arises because patients and doctors were not told that the data was being passed on. According to the *Wall Street Journal*, at least 150 Google employees have access to this data. A cache of documents relating to the project was anonymously posted on the internet by a whistle-blower who stated that: "Google is secretly transferring data to its own servers without patient knowledge or consent". But Google and Ascension issued a joint statement to the effect that the project did not breach the Health Insurance Portability and Accountability Act, which governs the management of medical data in the US. Google added that patient information "cannot and will not be combined with any Google customer data".

"LAST MONTH IT WAS REVEALED THAT GOOGLE HAS BEEN COLLECTING THE PERSONAL HEALTHCARE INFORMATION OF MILLIONS OF AMERICANS UNDER A SCHEME CALLED *PROJECT NIGHTINGALE*."

What makes these revelations more concerning is that they follow on from Google's purchase of **Fitbit (NYSE:FIT)** for $2.1 billion, announced on 1 November. When Google bought the smartphone company Nest five years ago it made no mention of what it would do with customers' data. But, on buying Fitbit, Google thought it necessary to go to lengths to dispel

"DEEPMIND USED THE MEDICAL RECORDS OF OVER 700,000 US VETERANS TO DEVELOP AN ALGORITHM THAT SPOTS 60 PERCENT OF THOSE WHO WILL GO ON TO DEVELOP AKI."

users' fears that the medical data collected by their smartwatches would not be used inappropriately.

Also of concern: last year Google announced plans to absorb the health division of DeepMind Technologies, the British AI laboratory that it bought in 2014, into a new unit called Google Health. This move broke a previous promise that patient data would never be integrated with Google's other services.

DeepMind has collaborated with the Royal Free Hospital in London, amongst others, in order to develop an app called *Streams* that detects kidney injury two days before it happens. The app texts the patient's doctor an alert if there is any imminent deterioration in the patient's condition. That could save the lives of up to 30,000 British citizens a year given that around 100,000 people in the UK die each year from Acute Kidney Injury (AKI). This occurs when organs stop functioning correctly and there is a build-up of waste material in the blood.

DeepMind used the medical records of over 700,000 US veterans to develop an algorithm that spots 60 percent of those who will go on to develop AKI. The NHS reckons that 30 percent of AKI deaths are preventable if caught early – hence the 30,000 figure. The DeepMind team is now working with Imperial College, London to devise a similar alert app for sepsis (formerly termed blood poisoning). The number of people developing sepsis is increasing, with around 123,000 cases each year in England and an estimated 37,000 deaths according to NHS England.

DeepMind has also worked with Moorfields Eye Hospital, in London, to develop a system that can anticipate the onset of macular degeneration. In July 2017, however, the UK Information Commissioner ruled that the agreement between DeepMind and the Royal Free did not comply with the UK's Data Protection Act.

Google is notoriously ruthless about changing strategy or closing down projects which are not working. One example was the tech giant's disastrous acquisition of Motorola in 2011. Google sold the company three years later for a fraction of the $12.5 billion that it paid. For this reason, consumers should be cautious about Google's purchase of Fitbit.

Fitbit was one of the first players in the wearable-technology space and has possibly the most vibrant brand. Fitbit grew partially through acquisition – it bought Silicon Valley 'star' Pebble and then Vector, a Romanian rival. But it suffered after **Apple (NASDAQ:AAPL), Samsung (KRX: 005930)** and **Huawei** brought out competing devices. By the time that Google swooped, Fitbit's shares had fallen to just over $3 – down from a peak of around $50 in 2015. If Google had not made the move, no doubt one of the other tech behemoths would have bought the company. Indeed, Fitbit tells a cautionary tale for any investor interested in the tech sector.

It is probable that Google may wish to integrate some of Fitbit's fitness-tracking technology into its Android smartphone operating system. In that way, smartphones of the future will no doubt collect all kind of health metrics – from blood pressure to body composition – in real time. The big question is what the company will do with all the data generated thereby.

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Why medical data is valuable

Today a test for Parkinson's disease developed by Medopad, a London-based start-up and Chinese technology giant **Tencent (SEHK:700)** takes just a few minutes. A smartphone camera can scan a patient's hand and body movements. Then an algorithm will determine if the disease is present based on those movements.

But in order to develop that algorithm, it was necessary to analyse millions of images of how people with Parkinson's disease move. In this case, the data did not come from the NHS; rather it was collected by Tencent in China. Furthermore, a drug called Terazosin was also found to prevent or mitigate the death of nerve cells during the progression of Parkinson's − even though this drug was originally developed to treat benign prostate enlargement.

Yet the NHS, potentially, could be the greatest repository of medical data on the planet. It has been maintaining patient records by the million since it was first set up in 1948 – and digitally for more than 20 years. Few countries have large numbers of cradle-to-grave health records that could be used for medical research. If this data could be effectively mined, then it could be established precisely which risk factors are associated with particular health outcomes. And the relative effectiveness of pharmaceutical products could be exactly evaluated.

According to a recent report from consultants EY, the NHS could generate £10 billion a year in revenues and cost savings, by opening up its 55 million plus medical records to researchers. This, however, is controversial. Although any such data would naturally be anonymised, opinion polls suggest that many NHS patients do not trust the NHS to keep their data safe as a result of past leaks. Further, some people fear the consequences of medical data getting into the hands of insurance companies. I can quite imagine that by using our medical data, each one of us could be attributed an estimated life expectancy. No doubt pension companies (especially annuity providers) would be keen to see such data.

Given that there is a general election underway in the UK as I write this, and with the NHS being one of the dominant campaign issues, the idea that the NHS might sell data to third parties would offend those whose mantra is that the NHS is "not for sale" (and especially not to the Americans!). And who owns that data? Does it really belong to the NHS, or to its patients?

The UK's NHS: poor outcomes

A recent World Health Organisation report placed Great Britain at the bottom of the league of seven advanced nations in terms of cancer survival rates. The study looked at cancers affecting the oesophagus, stomach, colon, rectum, lungs and ovaries in Australia, Canada, New Zealand, Norway, Denmark, Ireland and the UK. It is regrettable that this in not more to the fore in the current general-election campaign.

One factor behind the underperformance of the NHS is that cancer care must compete with other maladies. There is now an epidemic of Type 2 Diabetes driven partially by a rise in obesity. One eighth of the entire NHS drugs budget in 2018-19 was spent on diabetes drugs. That amounted to £540 million. One in 10 of all patients now admitted to hospital suffer from Type 2 diabetes. As a result, hundreds of thousands of people have been put on the Diabetes Prevention Programme.

> **"THE NHS, POTENTIALLY, COULD BE THE GREATEST REPOSITORY OF MEDICAL DATA ON THE PLANET."**

Last month *New Scientist* revealed, following a Freedom of Information request, that numerous NHS trusts (which are the operators of one or more hospitals in each locality) had agreed to sign five-year data-sharing agreements with Google. It is likely that under these agreements, Google will make its *Streams* kidney-disease detecting app available for free (up to a certain use limit).

Amazon (NASDAQ:AMZN) secured a deal with the NHS in July this year, to enable patients to answer simple health questions (probably over the telephone) posed by an Alexa-type virtual assistant.

Under the pro-tech Health Secretary Matt Hancock, the NHS has launched a new technology programme called NHSX which will, in due course, operate an AI lab. The sum of £250 million in funding has been pledged towards this end. Prospectively, NHSX will try to generate revenues by cooperating with the private sector. These would be reinvested in front-line services. One issue, voiced by some insiders, is that NHS management is not equal in

Fitness trackers and the fight against diabetes

In August, the NHS announced that overweight patients at risk of developing diabetes are to be given Fitbit-style tracker devices to help stave off the disease. Over 40,000 people were provided Nujjer wristband trackers as part of the Diabetes Prevention Programme. These devices monitor activity, sleep patterns and eating frequency. Nearly four million people in England alone suffer from diabetes and the condition is responsible for over 9,000 limb amputations per year.

negotiating skills to the slick execs of the tech titans. Their main concern is to avoid any controversy that would open the NHS up to criticism.

But the potential is huge. Soon diagnostic apps will be able to predict how long patients are likely to remain in hospital and, in the case of for example a flu epidemic, how many admissions will take place over coming weeks and months. In this way hospital management will become much more efficient and cost-effective.

Neuropeptides – an alternative to drugs?

Neuropeptide dihexa (ND) was developed by Washington State University to combat Alzheimer's disease and cognitive impairment. It works by slowing cell death and suppressing enzymes that destroy the brain chemicals which are associated with memory and learning. It has been granted initial approval by the Food and Drug Administration (FDA) in the US further to clinical trials. The peptide, which consists of just six amino acids, can be rubbed into the skin. Neuropeptides are small protein-like molecules which help neurons in the brain to communicate with one another. They are the focus of a new branch of medicine called biologics which uses small molecules, particularly strings of amino acids, which are already present in the human metabolism. Using these, the body can heal itself without resorting to drugs.

While ND was developed to treat dementia and traumatic brain injury, it has also been shown to increase the cognitive power of normally abled people. For example, if you are learning to play a new musical instrument or learning a new language, they could help you make more rapid progress.

A biotech company by the name of Apeiron Biologics is working on this product. Apeiron is a privately held European biotech company based in Vienna. It focuses on the discovery and development of novel cancer immunotherapies. Currently, peptides are only legally prescribed in the US. They are illegal in the UK and Europe.

As well as ND, other neuropeptides prescribed to boost brain power include cerebrolysin which is apparently derived from pigs' brains. This is claimed to reduce amyloid beta – the sticky plaques found in the brains of Alzheimer sufferers. A neuropeptide nasal spray, FGL, is currently in second-phase clinical trials. This can help repair the myelin sheaths around nerve cells which are

Facebook, Apple and the newbies...

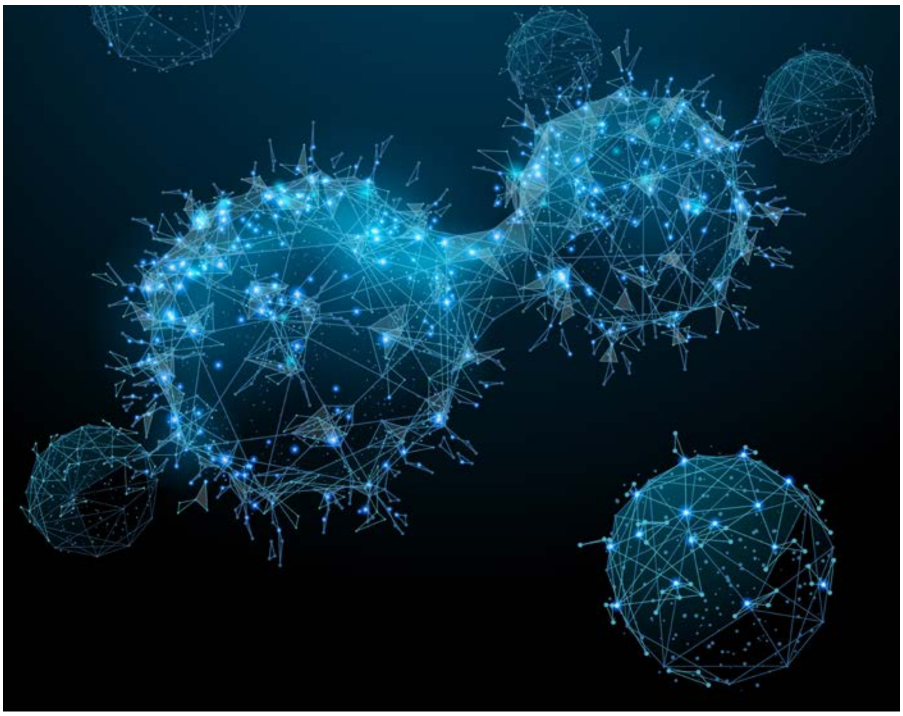
Facebook recently launched its own "preventive healthcare" mobile app in the US. And Apple has added health-detection features to its Apple Watch which give users, amongst other things, the ability to conduct their own electrocardiogram (ECG) test.

The 'wearables' market – which covers fitness wristbands, smartwatches and smart clothing (including a MasterCard inserted in a cufflink – yes, it's happening thanks to a start-up called DressCode) is expected to be worth £40 billion worldwide in 2022 – up from £16 billion in 2016. At a recent Master Investor event in London I asked the audience which of them were wearing a wearable device to track their fitness and health. More than half of the audience put up their hands. US sports manufacturer Under Armour is one of many providers which are integrating gym wear with gadgets – for example, T-shirts that measure your fitness levels and running shoes that analyse your gait. Sensoria, a start-up based in Redmond, Washington state, in the US, has developed smart socks for joggers which provide real-time feedback on your running style. (This writer would find that most irritating – I just need a device which congratulates me for running at all!).

Seriously, though, e-textiles (ie garments that measure muscle activity, body temperature and respiration, and which send that data to a central database) are surely just around the corner. Check out Id TechX.

Sensyne

The health-technology firm **Sensyne Health PLC (LON:SENS)** was launched on AIM last year where it raised £60 million. Sensyme was founded by serial medical-technology entrepreneur Paul (Lord) Drayson who was also the founder of PowderJect Pharmaceuticals, which was acquired by Chiron Corp in 2003. (Chiron was acquired by **Novartis (VXP:NOV)** in 2006). Sensyne has developed a technology 'sandbox' where patient data from NHS trusts can be used to develop new apps or research projects by third parties. NHS trusts which sign up with Sensyme receive a share of any revenues generated by their data. They also become shareholders in Sensyme (about 10 percent of the shares are owned by NHS trusts). Lord Drayson claims that Sensyne is already a world leader in computer science and artificial intelligence. The initial launch price in November 2018 was 185 pence. At the time of writing, the shares are trading at 102.5 pence.



damaged by multiple sclerosis. Also, the brain molecule RG3 increases the body's ability to manage free radicals – unstable atoms that damage cells, causing illness and ageing.

Fabian Foelsch of BRAINEFFECT, a company that sells supplements which enhance mental capacity, told the Biohackers Summit in Helsinki last month that people will increasingly need brain drugs in the future, in order to keep up with the pace of change of technology.

The little known biotech hub blazing a trail in cancer research

When we think about the biotech sector in the UK we think of Cambridge (which is home to about 430 life-science companies) – not Stevenage. But Stevenage for the last year has been home to the Cell and Gene Therapy Catapult. This body has been tasked by government, to the tune of £50 million, to facilitate the commercialisation of cell-and-gene therapy (CGT) treatments, many of which have been in development for decades. There are already five companies using the centre – four British and one American (the US-listed **TCR2 Therapeutics (NASDAQ:TCRR),** which has its headquarters in Boston). More are likely to follow.

Gene therapy, cell therapy and gene editing are three different techniques which share the same goal; to cure diseases by altering our genomes. While gene editing is still in the early stages and will use new advances in CRISPR technology, gene and cell therapy are now taking off. In fact, both the FDA and the European Medicines Agency have boosted staff numbers in order to cope with the expected flood of new applications.

Babylon Healthcare

Babylon provides an online consultation service and an app that evaluates symptoms. It sells its services to the NHS through a business called GP at Hand. Although the service has been praised by UK Health Secretary Matt Hancock, others have claimed that Babylon is creating a funding imbalance.

"IT IS ESTIMATED THAT IN EUROPE, CGT ATTRACTED $2.2 BILLION IN INVESTMENT LAST YEAR – A 40 PERCENT RISE ON THE PREVIOUS YEAR. THERE ARE NOW 241 GENE-THERAPY DEVELOPERS ACROSS THE EU, 70 OF WHICH ARE HEADQUARTERED IN THE UK."

Cambridge UK: an international biotech hub

As a biotech hub, Cambridge is surpassed only by Silicon Valley and Boston. The Babraham Research Campus is home to a host of start-ups which work alongside Cambridge's two great research hospitals (Addenbrooke's and Papworth). The biggest near-unicorn at Babraham is Kymab which is working on antibody-based therapies. On a smaller scale, Closed Loop Medicine has developed technology that tracks how a drug affects a patient and evaluates whether the prescription should be altered.

It is estimated that in Europe, CGT attracted $2.2 billion in investment last year – a 40 percent rise on the previous year. There are now 241 gene-therapy developers across the EU, 70 of which are headquartered in the UK. Their targets are firstly people who suffer from debilitating genetic conditions (cystic fibrosis, Huntingdon's etc.) and secondly cancer patients. At present, the focus in Stevenage is on research and the challenge will be to scale up for production.

Many of those CGT-therapy developers will be snapped up by the pharmaceutical giants as their therapies get closer to commercialisation. Last year **Novartis (VTX:NOVN)** paid $9 billion to acquire **Avexis**, the producer of Zolgensma, a gene therapy for children with spinal muscular atrophy. That therapy was approved by the FDA in May. Analysts believe that it could generate revenues of $2 billion a year for Novartis. Similarly, earlier this year, **Bristol Myers Squib**

The Hundred Thousand Genome Project

The UK government has sponsored a project called the *100,000 Genomes Project*. This is sequencing the genomes that have been decoded for a similar number of NHS patients (with their consent). The database is open only to approved scientists. Dame Sally Davies, Chief Medical Officer, has described it as "a reading library, not a lending library".

IBM: Now a healthcare play, too

Possibly the biggest medical database of all is the **IBM (NYSE:IBM)** Watson database which contains about 240 million medical records. This was deployed to compare the path of 2,880 Parkinson's sufferers who took Terazosin (see previous reference) and compared their progress to those who took another drug. Terazosin won out.

In America there is – arguably – more widespread popular support for the systematic data mining of healthcare databases than in the UK and in Europe. This is because there is a strong perception that, over time, this will benefit healthcare outcomes. That said, a lot of Americans are ultra-sensitive (quite naturally) about admitting to a drug habit and particularly opioid abuse (which is rife). Many Americans argue that you cannot anonymise health records – each one identifies its owner as does a fingerprint. Even your vaccination history will place you in time and space in ways that the algorithms will interpret.

The other problem is that, as we know, cyber-security risks are one of the major challenges of our time and will only get worse. However securely we construct our healthcare databases, we can be sure that someone out there will try to hack them.

(NYSE:BMY) paid $74 billion to buy Celgene which has numerous cancer cell therapies in the pipeline. **Roche (VTX:RO)** of Switzerland and **Biogen (NASDAQ:BIIB)** in the US have also purchased gene-therapy developers this year.

Here in the UK, there are a number of companies with exciting CGT pipelines. Freeline Therapeutics, based at the Catapult in Stevenage, is developing gene therapy for haemophilia. **Autolus (NASDAQ:AUTL)** (a spin-out of UCL), **Adaptimmune (NASDAQ:ADAP)** (a spin-out of Oxford University) and Cell Medica are all developing cancer cell therapies. Another British unicorn is Oxford Biomedica which supplies the virus vectors that Novartis uses for its gene therapies. All told, the UK is well-positioned to ride the wave of regenerative medicine which I have written about recently.

The AI blood test that can detect brain tumours more quickly

Scientists at the University of Edinburgh have developed a blood test which detects tumours, and which might first be used to identify brain cancer much sooner than is currently possible. The research team applied the test to blood samples taken from 400 patients with suspected brain tumours at the Western General Hospital in Edinburgh. In the case of the most common form of brain tumour, glioma, the test was 92 percent accurate.

Unfortunately, brain cancer is most often diagnosed in the emergency department. However, this test

"PHARMACEUTICAL COMPANIES WILL HAVE TO REINVENT THEMSELVES AS MEDICAL-TECHNOLOGY COMPANIES – AND THAT IS ALREADY UNDERWAY."

enhances an existing technique called infrared spectroscopy which analyses the chemical make-up of a patient's blood. Combined with AI, this technique can identify chemical clues which, cumulatively, may indicate a brain tumour. The technique has the potential to be applied to ovarian, pancreatic, bowel and prostate cancer.

Action

As usual, the early-stage gains in CGT-therapy developers will be harvested by the most adept venture capital and private equity companies. There are a number of listed entities in this space (see the table of companies).

BB Biotech is a Swiss-based investment fund which allocates to companies engaged in gene therapy and cell therapy. Don't overlook the mature medical technology companies such as **Smith & Nephew (LON:SN)** and **Intuitive Surgical (NASDAQ:ISRG)**. Companies which collect medical data like Google, Facebook and Amazon are now, by that very fact, healthcare companies.

Over the medium to long term the rise of gene therapy, cell therapy, gene editing and biologics may entail a significant shift away from classic pharmacology (ie the production of drugs). That could be bad news for the pharmaceutical giants – but we already knew that this was a mature sector and that returns on capital in that space are in long-term decline. Therefore, pharmaceutical companies will have to reinvent themselves as medical-technology companies – and that is already underway.

Suspended animation has arrived

New Scientist reported in late November that doctors have placed humans in suspended animation for the first time as part of a trial in the US that aims to make it possible to fix traumatic injuries. The University of Maryland School of Medicine, told *New Scientist* that a team of medics had placed at least one patient in suspended animation. The technique, officially called emergency preservation and resuscitation (EPR), is being carried out on people who arrive at the Medical Centre in Baltimore with acute trauma – eg a gunshot or stab wound – and have experienced cardiac arrest and lost more than half their blood.

Companies cited in this article

Company	Ticker/status
MediSieve	Start-up
Genus	LON:GNS
Alphabet Inc. (Google)	NASDAQ:GOOGL
Apple Inc.	NASDAQ:AAPL
MedoPad	Start-up
Tencent	SEHK:700
Amazon	NASDAQ:AMZN
Apeiron Biologics	Private
Facebook	NASDAQ:FB
Babylon Healthcare	Private
Sensyne	LON:SENS
TCR2 Therapeutics	NASDAQ:TCRR
Novartis	VTX:NOVN
BB Biotech (investment fund)	VTX:BION
Bristol Myers Squibb	NYSE:BMI
Roche	VTX:RO
Freeline Therapeutics	Private
Autolus	NASDAQ:AUTL
Adaptimmune	NASDAQ:ADAP
Closed Loop Medicine	Start-up
IBM	NYSE:IBM
Kymab/ Under Armour/ Sensoria/ Id TechX	Start-ups

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.

BY MARK WATSON-MITCHELL

PORTFOLIO INTELLIGENCE

THE IPO MARKET

ALIVE AND KICKING OR BARELY BREATHING?

The IPO market has had a tough time of late. But there are some interesting goings-on that investors should be aware of. Mark Watson-Mitchell investigates.

With the world's biggest float now underway, there is a fresh focus on how the market for Initial Public Offerings (IPOs) is faring.

Just looking at the funds raised on the Alternative Investment Market (AIM) in the third quarter of this year shows a lack of investor interest or appetite.

New and further issues on AIM in Q3 totalled £638m, which was 52% below the corresponding figure in 2018. In fact, for the period from January to end-September only £2.84bn was raised, a massive 42% down on the corresponding period in 2018.

What is the IPO process?

A company informs the market that it is intending to float either through an IPO or as a new issue.

A prospectus is prepared and verified before release. This should carry total details of the company and its markets, directors, potential and risks etc. It will also contain details of the company's capital structure, and its corporate and profit history, as well as information on how and why the funds are expected to be raised.

Alongside the document's release, a period of publicity will help the investing public to gauge the investment possibilities.

The IPO will then be open for application, within a specific time period, before the offer period closes, and ahead of allocation.

The first day of dealings sees the shares then admitted to the market, often called the secondary market.

From then onwards, the value of the shares are subject to the vagaries of investor fashion and reaction.

Prices can go up or down

There are no guarantees of making profits. Investors can so often be sucked into new issues through either heavy financial-press activity or fee-earning advisers over-egging values – or even a combination of both.

Unfortunately, it is very common for a company to raise funds on pricing levels that may never be seen again. Price recovery to subscription levels can take months, years or may never happen.

There is, of course, a high dependence on the corporate performance of the floated companies.

Hoped-for profit levels upon which new issue pricing is based may not be achieved. Suddenly turnover may fall within months of the float and profits forecasts will then be slashed, with investors being left high and dry.

Win or lose

Recent UK floats that are well under water include **Aston Martin (LON:AML), Airtel Africa (LON:AAF)** and **Funding Circle (LON:FCH)**, while others have swum away from their float price – just like online stockbroking company, AJ Bell.

Conversely, a big performer in the last year has been one of my February profile companies – **Manolete Partners (LON:MANO)**, which floated last December at 180p and subsequently peaked at 620p.

IPOs are not just a way of getting in

Do remember that companies float their shares not only to raise development or working capital, but also to let existing shareholders get out of or reduce their positions in the float company's equity.

Of late, a number of private equity houses have been taking advantage of public floats to unload all or part of their funding positions.

It is always worth checking to see how much new stock is being marketed on issue, compared to existing holdings. Also, reading finer details in the prospectus will identify whether the vending shareholders are paying part or the whole of the new issue costs.

But there has been a sign of investor lethargy of late. It certainly inspired stockbroking group Shore Capital to scrap any current ideas that it had for maintaining its London listing. It had been listed for some 20 years, but recently it has not enjoyed good stock liquidity and its valuation was poor enough for its board to delist from London, while maintaining its Bermuda listing.

Just look at Aramco

The mega-float of Saudi-Arabian energy company, Aramco, is quite defying in all its aspects. It all feels too manufactured to me.

Since 2016, it has been touting itself around the world's leading markets, tickling corporate-banker appetites with big fees in the offing. Tokyo, Hong Kong, New York, London and other European capitals were standing on tiptoe trying to be seen as the only place to float such a monolith. Far and away the Aramco issue was predicted to be the world's biggest IPO.

"FAR AND AWAY THE ARAMCO ISSUE WAS PREDICTED TO BE THE WORLD'S BIGGEST IPO."

The valuations being put on the company by the Saudis themselves was north of $2tn. The Crown Prince, Mohammed bin Salman, was pumping the presentation, emphasising that it must rate a valuation at a premium to the marketplace.

The world's lowest-cost scale producer

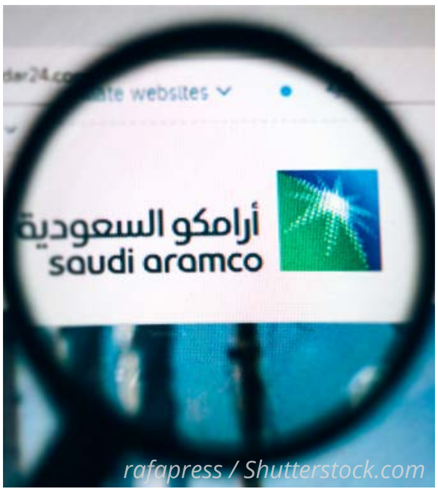
Aramco has some 227bn barrels of oil reserves declared and it is one of the lowest-cost producers in the world.

It is the world's most profitable company, with a net income of $111bn in 2018, which is bigger than that of Google and Facebook combined.

Estimates of its proved conventional oil reserves are even as high as 261bn barrels. Its production capacity is 12.5m barrels a day and it is actually producing 10.3m a day.

It is already assumed that the demand for oil will peak some time in the next decade, with estimates suggesting that by 2030 to 2040 it will be showing a real tail off.

But that does not seem to worry Aramco. It has around 15% of the world market, which, because of its cheaper production, may well see that figure swelling to 20% of the global market, especially as the higher-cost competitors start to pull back from the market. Those reserves are said to last some 52 years, based on the company's own acquired research.



$1tn or $2.5tn valuation?

When the company was marketing the possibility of a float around the world's capital markets, it was said to be looking to float 5% of its capital with a $2.5tn valuation.

To put that into some comparative context, the biggest IPOs to date would be dwarfed. Alibaba was $21.8bn of stock, ABC Bank was $19.2bn, ICBC Bank raised $19bn, NTT DoCoMo was $18bn, Visa $17.8bn, Facebook $16bn, General Motors $15.7bn and Nippon Tel was $15.3bn.

In terms of its profitability, its net income is almost twice that of Apple; three times that of Samsung, Alphabet and JP Morgan Chase; and five times that of Shell and also Exxon Mobil.

Yes, Aramco is mega in everything.

Too clever?

Is Aramco being too clever, though? Certainly, its valuation is staggering, so many oil industry analysts and other players are finding it hard to get their minds around the anticipated numbers. Several of their estimates hover around $1tn, while fees-inspired bankers are saying that perhaps $2.5tn is the right figure.

We have already seen that its net profits fell by the third quarter to just $21.3bn, compared to $30.3bn a year earlier. Already the company has promised to pay $75bn in dividend over the next five years and it is believed that the Saudi state reduced its royalty income from $20 down to $15 per barrel – another measure to make its investment appeal that much more alluring.

But will it be enough to pull in the buyers?

Bad feelings

The murder of a journalist in Turkey, corruption in the purchase of arms and defence equipment, together with involvement in battles in Yemen, do not help engender good feelings towards the Saudi Arabian state.

And attacks on its oil facilities in September do not help balance ill-feeling, but instead create big doubts as to the company's stability.

Morgan Stanley, Goldman Sachs and HSBC are amongst the corporate advisers in on the fee division from the IPO. I understand that as the Kingdom owns Aramco, it is underwriting all of the fees itself and will reimburse the company on the float.

The funds raised through the IPO, expected to be more than $25bn, will be used to help to diversify the Saudi Arabian economy's dependence upon oil, as part of the Crown Prince's 2030 plan for the future.

First a local quote then the world?

The way the IPO is being handled provides us with an indication of the company's intentions. First of all, it is being floated on the Tadawul, Saudi Arabia's own stock exchange.

In due course, I would expect the company will seek listings in one or two of the international capital markets. That is when the Kingdom could sell down another 3%, 5% or 7% of the equity, raising over $100bn in the process.

Massive prospectus short on detail

The 658-page prospectus issued in mid-November was declared to be quite short on detail.

Retail investors were given the opportunity to invest, from 17 November to 28 November. Assuming say, at a $1.5tn valuation, retail investors, were offered 0.5% of the company's equity – well, that alone is a whopping $7.5bn of funding. Just think of that amount of money draining out of capital markets.

The institutional investors had until 4 December to make up their minds.

In total, around 2% of the company's equity is up for sale. Thursday 5 December is the day that final pricing will be announced. And that is four times more money draining out of global markets.

But who will invest?

There have been strong whispers that the Chinese are prepared to invest up to $10bn in the Aramco IPO, while the Japanese are said to be reluctant to invest due to transparency about contract and reserve issues.

I can foresee several sovereign wealth funds needing to be big investors in Aramco, either for investment potential or diplomatic calm.

On looking at this IPO and the way that it is being handled, I must say that I have some very strong doubts.

I do realise, however, that given the way that the global investment institutions work today, it means that it is almost compulsory that they have a sizeable holding of their portfolios invested in what will be the world's biggest and most profitable publicly quoted company.

Other London IPOs being considered

I am grateful to Hargreaves Lansdown for a list of IPOs that could be due to be launched. Those companies are listed below:

Jaguar Land Rover Automotive − the UK's largest vehicle manufacturer, which sells more than one car every minute.

Tesco Bank is rumoured to be considering an IPO, following the supermarket group's decision to focus on its core business − either an IPO or a straight sale of its banking operation.

Vue Cinema, which has over 200 cinemas across the globe, could be seeking to float. Some 85 of its cinemas are in the UK and Ireland. The company entertains 90m filmgoers annually.

Crawford Healthcare, the advanced wound-care maker has apparently been inspired to look at an IPO after ConvaTec successfully listed.

Darktrace, the cybersecurity start-up that was set up by some Cambridge academics and GCHQ 'spooks', has been informing early-stage investors that it will be seeking a quote.

CompareTheMarket.com is rumoured to be considering an early quote. As one of the UK's largest price-comparison sites it would certainly gain attention.

McLaren, the premium, high-performance vehicle maker, could well be looking to go public in the next few years.

O2, which has over 25m customers, is one of the UK's largest mobile operators. It also owns 50% of Tesco Mobile. It is suggested that an early listing is on the cards.

Some international London quotes

On the international front, Hargreaves Lansdown is suggesting that the following companies could be considering quotes in London, as well as on other markets:

Air Astana, the Kazakh national carrier, is said to be looking for either a London or a Hong Kong IPO.

IMG Worlds, the owner of the world's largest indoor theme parks, may either seek a London quote or a listing in Dubai.

Sadia, the Halal meat producer, which is owned by Brazil's BRF, is also thinking of listing on London, on Dubai or quotes on both.

KazMunaiGas, which is one of the three top Kazakh oil producers, is already quoted on the Kazakhstan Stock Exchange, but it is believed to be thinking about listings on London and Hong Kong.

I also understand that Aberdeen-based Ithaca Energy could be listing its shares on the market, probably AIM, in the fairly near future.

The company is an independent oil and gas enterprise with production, development and exploration operations focused on the UK North Sea.

Founded in 2004, it has subsequently grown through a combination of acquisitions and new field developments. Its strategy is focused on establishing itself as a leading North Sea operator, delivering sustainable growth in free cash-flow generation, underpinned by operational excellence and financial discipline.

Ithaca Energy is a wholly owned subsidiary of Israel's leading integrated energy company, the Tel Aviv stock-exchange listed Delek Group Limited.

In the middle of November, the Scottish company completed its $2bn acquisition of Chevron North Sea Limited. The deal will scale it up strongly by adding 10 additional producing field interests to its existing portfolio, together with a wider portfolio of investment opportunities that will scale up its cash flow considerably.

The company is fast becoming a leading UK North Sea oil and gas operator, with a strong outlook.

Delek could well be now contemplating an early float of Ithaca Energy, helping it to reduce its debts taken on by the acquisition.

Georgina Energy IPO could be a real gas

You may not have realised it, but helium is a very important industrial gas. It's not just for making voices sound strange and of a far higher octave – it has much more serious uses.

It is in continual demand from the medical, industrial and technology industries. However, it is of limited global supply and has no direct substitute.

A couple of weeks ago I saw an investor presentation on an energy company that will offer investors exposure to the increasingly supply-constrained commodity.

A Main Market listing is in sight for Georgina Energy, which is in the process of acquiring a licence on a major project in the Northern Territory in Australia.

This project already boasts of substantial helium potential and the £10m funds that will be sought in the listing will be used to complete the licence acquisition and then proceed to develop the project.

Demand drivers for helium emanate from MRI scanners used in medical diagnostics, applications in electronics manufacture, aerospace and space technology.

Currently 75% of the world's supply of helium is from three main sources: Ras Laffan Industrial City in Qatar; Exxon Mobil in Wyoming; and the US Federal Helium Reserve in Amarillo, Texas.

Supply from the latter is running down fairly fast and could well be depleted within two years or so. The Wyoming site is also on the wane. While the Qatar supply, which is a spin-off from the extraction of natural gas, of which Qatar is the world's largest producer, is of a much lower concentration than the planned Georgina Energy source in Australia.

I have to say that I did like what I saw in the presentation and the potential for Georgina Energy looks very interesting. I keenly await the IPO prospectus.

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

CHOICE IPOs TO BOOST YOUR PORTFOLIO

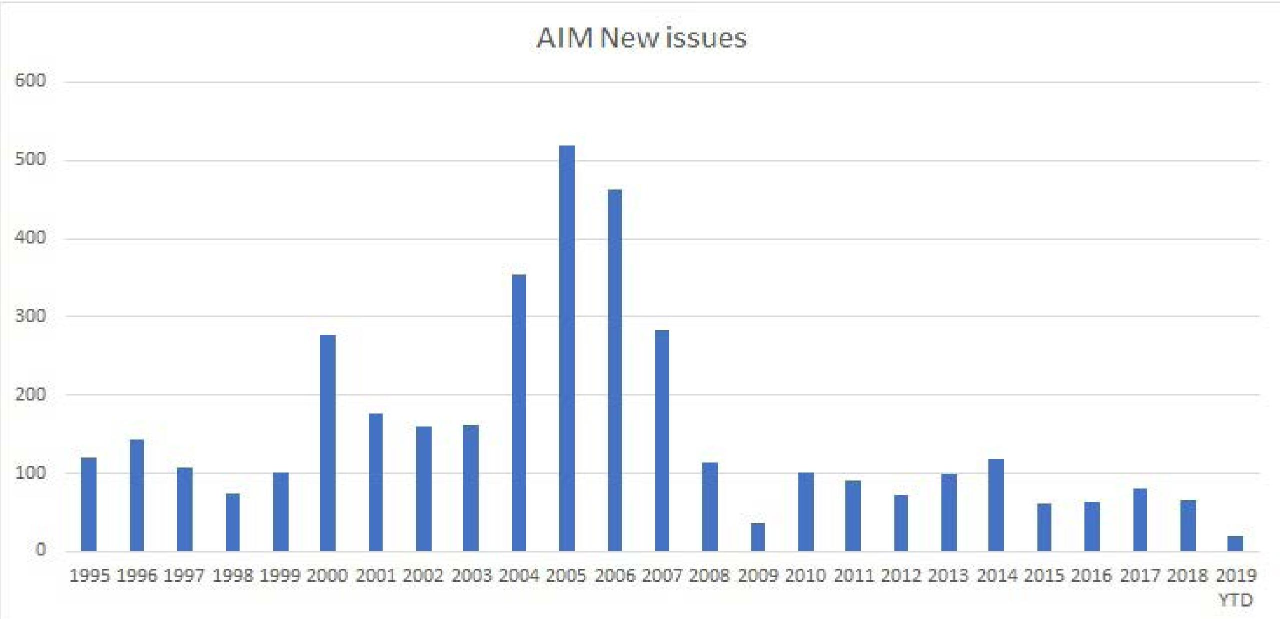
Despite the dearth of new listings, there are still a number of recent issues which are worthy of consideration. Richard Gill, CFA, looks at two of them.

As we enter the last few weeks of what has been an eventful year, it looks like 2019 is going to go down in history as one of the worst for new issues in living memory – in the small-cap markets, at least. In the absence of an unexpected surge in the coming month, AIM is on course to have its worst year for new issues since the junior market was formed in 1995.

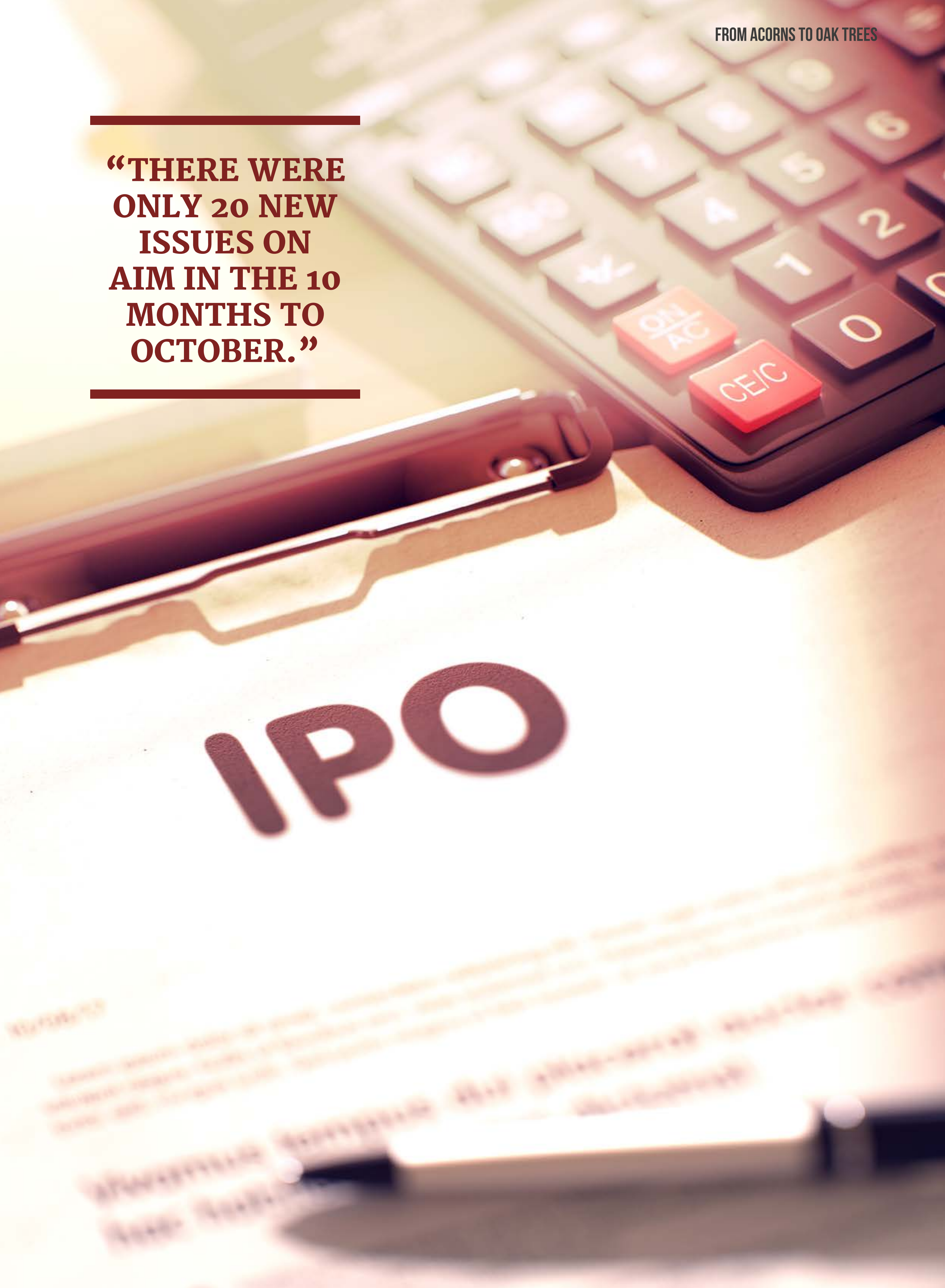
According to recent statistics from the London Stock Exchange, there were only 20 new issues on AIM in the 10 months to October. This compares to 65 in the whole of 2018, is a mere fraction of the 519 seen in 2005 and is just over only half of the 36 new listings which were seen in 2009, in the aftermath of the financial crisis. Two months this year, January and October, saw no new listings whatsoever.

Of those completed so far this year, only seven new issues have been traditional IPOs, with six re-admissions (ie reverse takeovers), five transfers to AIM from other markets and two basic introductions (no money raised). Unsurprisingly, new money raised is also down markedly, with only £371.1 million raised from new issues so far in 2019. This is down from £1.56 billion last year and is the lowest level seen since 1999.

Various commentators have suggested a number of reasons for the decline in IPOs, including



Data Source: London Stock Exchange



"THERE WERE ONLY 20 NEW ISSUES ON AIM IN THE 10 MONTHS TO OCTOBER."

the ubiquitous "political uncertainty" surrounding Brexit and the upcoming general election. This could well be the case, with companies waiting for a deal to eventually be done and to enjoy more stable market conditions. Other less vague excuses include low valuations being applied to UK companies compared to the US, especially in the burgeoning tech sector; companies increasingly preferring to stay private, given the time and costs involved with a public listing; and well-funded private-equity firms providing growth companies with an alternative and more attractive route to finance.

Despite the dearth of new listings, there are still a number of recent issues which I believe should look attractive to the private investor. Here are two of them:

BRICKABILITY GROUP

Despite its simple nature, the humble brick has been key to the advancement of our civilisation, estimated to have been used by humans in some form or another since around 7500 BC. From simple mud-brick dwellings, to more grandiose constructions such as the Taj Mahal, the oblong block is the foundation of basic shelter, the global construction industry and the Wonders of the World. According to the Brick Development Association, over two billion bricks were manufactured in the UK in 2018, with this next company being one of the main beneficiaries.

Building business

The most recent IPO on AIM, at the end of August, was that of **Brickability Group (LON:BRCK)** a leading construction-materials distributor. The company raised a decent total of £57 million on listing via a placing at 65p per share, with around £43 million being used to pay off debt and the rest for advancing growth and acquisitions.

Founded in 1984 in South Wales, Brickability now operates through 19 companies, all of which bring together specialist products and services to meet the needs of the building and construction market. Since formation it has grown both organically and through acquisitions, and now has a nationwide presence of 25 sites throughout the UK. As well as the general public, customers include the likes of national housebuilders, developers, contractors, housing associations and general builders. In contrast to a builder's merchant, the group is known as a building-material factor – a specialist distributor, acting as suppliers and technical advisers, which offers a wider specialist range of and has better access to manufacturers of products.

From its foundation as a distributor of bricks, Brickability has diversified its revenue streams and now operates through three divisions. The largest division, Bricks, supplies facing bricks and paving goods sourced directly from primary manufacturers and suppliers. Other related products include blocks, bricks and rainscreen cladding systems, natural stone walling and architectural masonry. Its Heating, Plumbing and Joinery division supplies and fits windows and underfloor heating as well as towel rails, radiators and high-end internal doors. The roofing division supplies and fits a comprehensive range of concrete and clay roofing tiles and ancillary roofing products.

> **"THE COMPANY RAISED A DECENT TOTAL OF £57 MILLION ON LISTING."**

Cementing growth

Brickability came to market with a good recent track record. The admission document reported revenues growing from £120.7 million to £163.3 million and EBITDA up from £12.4 million to £17.7 million from 2017 to 2019. Interims for the six months to September 2019 showed a continuation of these trends, with revenues up by 20% to £97.9 million and pre-tax profits up by a more pronounced 33% to £6.8 million. As a result of the strong financial performance, a maiden interim dividend of 0.87p per share was declared.

The results were delivered against the backdrop of a robust housing market, with market conditions in new-build housing remaining stable, albeit subject to regional variations. As well as the August IPO, highlights of the period included new products being added to the flooring, specialist brick, facades and extended brick ranges. Four acquisitions were made in the period – DSH Flooring, Bespoke Brick, LBT Facades and Brickmongers, which added around 15% to group revenue growth, with all said to be performing in line with expectations.

On the balance sheet, net debt was £1.9 million at the period end, down by £17.9 million six months previously due to the repayment of borrowings using the proceeds of the IPO. In October, a remaining £5.4 million of investor loan notes plus interest were repaid.

On future trading, Brickability commented that the outlook for its markets is positive and it remains confident of meeting full-year expectations. The acquisition pipeline is said to remain strong, with the company being in discussions with a number of potential businesses that would both enhance and broaden its operations.

Mortar come

Brickability shares have had a slow start to life on the markets, rising to a peak of 68.25p on listing before settling to the current 64.5p, just below the IPO placing price. Analysts at the house broker Cenkos are currently looking for pre-tax profits of £17.5 million for the full year to March and earnings of 6.2p per share, rising to £20.9 million and 7.4p respectively in 2021. That puts the shares on a current year earnings multiple of just over 10 times, falling to 8.7 times next year.

In terms of a dividend, adding to the interim payment, Brickability says it will implement a progressive policy, targeting a dividend cover of approximately three times earnings. Assuming the house broker's forecasts are met, that implies a total payment of around 2.47p for 2021 – that's a yield of 3.82%.

So on an earnings and income basis, Brickability looks good value in my opinion, especially given the strong recent track record and demonstrated ability to successfully integrate complementary businesses. The company's core UK housebuilding market, which is chronically undersupplied, remains robust, with housing starts having grown from around 115,000 in 2009 to approximately 192,000 in 2018, and estimated to reach something like 197,000 in 2019. As part of their recent manifestos, all the main political parties have made substantial commitments to build more houses, but whether this becomes reality is another matter. My advice is to buy.

LOUNGERS

One of the largest IPOs of recent times came in the form of **Loungers (LON:LGRS)**, the operator of 157 café/bar restaurants across England and Wales, which trade under the Lounge and Cosy Club brands. The company raised £61.6 million for itself in April this year, at a price of 200p per share, with another £21.7 million raised for selling shareholders. Like Brickability, while the operations have continued to perform well, the current share price is now below the IPO price.

LOUNGERS

Loafing around

Loungers was founded in Bristol in 2002 by three friends who wanted to create a neighbourhood café-bar that they would want to go to. Unlike other 'faceless' chain establishments, the focus is on creating unique, homely and individual environments, with sites offering something for everyone regardless of age, gender or demographic. One key strength is that sites are open all day, with the company's pricing strategy aiming to fill the middle ground between value-pub and national restaurant brands/independents. With a good-quality meal priced at less than £10 and coffee priced in line with other national coffee chains, this provides a degree of resilience in a sector which can be exposed to pressures on consumer spending.

The Lounge brand is a neighbourhood café/bar combining elements of a restaurant, British pub and coffee shop, with the same menu served from 9.00am to 10.00pm. Sites are mainly located in secondary suburban high streets and small town centres, characterised by informal, unique interiors, with an emphasis on creating a convivial atmosphere. To enhance the local focus, staff are encouraged to engage with the local community through events, charity and community groups.

Meanwhile, Cosy Club is a more formal bar/restaurant offering reservations and table service. They share many similarities with the Lounges in terms of their all-day offering and focus on hospitality and culture. Cosy Clubs are typically located in city centres and large market towns and target a more occasion-led clientele.

Expansion of the existing portfolio is a key strategic objective for the business, which aims to establish 25 new sites per year over the medium term. Independent analysis by location-planning consultants, CACI, has identified the potential for more than 400 Lounges and more than 100 Cosy Clubs in England and Wales, implying the current estate could more than treble.

No slacking

Bucking the trend of most of the high street, Loungers has been growing its operations steadily over the past

"EXPANSION OF THE EXISTING PORTFOLIO IS A KEY STRATEGIC OBJECTIVE FOR THE BUSINESS."

"ANALYSTS AT LIBERUM ARE LOOKING FOR EARNINGS TO GROW BY AROUND 30% PER ANNUM OVER THE NEXT FEW YEARS."

few years. Since 2014, around 20 new sites have been added to the portfolio each year. In turn, this has driven a rapid increase in the financials, with sales up by a CAGR of 33% between 24 April 2016 and 22 April 2018. Adjusted EBITDA grew at a CAGR of 39% over the same period and like-for-like sales have consistently outperformed the Coffer Peach Business Tracker; this research is seen as a barometer for the wider UK hospitality sector.

Results for the 52 weeks to 21 April 2019 were again bountiful, showing the top line growing by 26.4% to £153 million. This was driven by impressive like-for-like growth figures of 6.9% and boosted by another 25 sites opening over the year. While adjusted EBITDA grew by 24% to £20.6 million, the statutory loss for the period was £5.7 million, largely due to preference-share dividends of £8.4 million. However, the net cash flow from operations (which added back the preference-share interest) was an impressive £21.4 million.

On that point, it should be noted that as part of the IPO process the preference shares and accrued dividends were exchanged for equity. Subsequent sets of results will be much cleaner, with a pro-forma balance sheet (assuming the IPO occurred before the period end) showing net debt of £26.7 million. A term loan of £32.5 million and a revolving credit facility of £10 million provide the funds for further expansion.

More recently, a trading update covering the 24 weeks ended 6 October 2019 was largely ignored by the market, despite revealing that total revenues grew by 22% to £79.8 million, with like-for-like sales growth of 5.4%. Ten new sites were opened during the period (eight Lounges and two Cosy Clubs) with one more site added since the period end. Another three were also scheduled to do business before the end of October. The company confirmed that it is on track to open 25 new sites in the current financial year and that the pipeline remains strong.

Rising dough

Loungers' financials are a bit messy at present as they reflect the pre-IPO, private-equity owned structure. However, analysts at Liberum are looking for earnings to grow by around 30% per annum over the next few years, to 16.4p per share by 2022. With the shares currently lagging below the IPO price at 188.5p, that puts them on a multiple of 11.5 times, which is not expensive, given growth seen and forecast. The more relevant price to earnings growth (PEG) ratio is a more attractive 0.38 times for 2022, with a figure of one traditionally considered to be fair value.

There are obvious risks here, especially concerning the company's exposure to consumer spending. But the firm has a value proposition and performance seems resilient so far. The risks associated with the expansion strategy should also be considered. But with analysts at Liberum Capital and Peel Hunt having respective target prices on the stock of 275p and 285p, it looks like there is decent upside to be had. The company is sensibly retaining income for its expansion strategy in the short term but has said that its ultimate intention is to pursue a progressive dividend policy.

Ahead of the half year results on 4 December, Loungers shares are a buy.

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 JAMES HENDERSON

IS THE UK DOOMED WITHOUT BIG TECH PLAYERS?

James Henderson, Co-Fund Manager of Lowland Investment Company (LON:LWI), challenges the consensus that the UK is destined to lag behind the US, owing to the absence of large-cap tech companies.

The main US index, the S&P 500, has a 22% weighting in tech companies, while the UK FTSE All Share, by contrast, has only 1%. The companies driving change and expanding quickly in recent years have been the tech giants, such as Apple, Google and Amazon. These companies, among others, have been central to the outperformance of US equities over UK stocks in the past five years-plus, which has fuelled a belief among some that the UK will be a continual underperformer.

The strange thing is, the UK has generated many of the great tech advances, yet they have rarely been commercialised into successful tech companies. The reasons are much debated and there are many contributing factors. The lack of an investor audience with suitably deep pockets and the patience for the long-term investment in tech can be a factor. Many UK equity investors have wanted to see cash generation and resulting dividends from the companies they invest in, but tech companies in the early days absorb cash and often need to return to investors for further capital injections. When these injections are not forthcoming, the business may be sold to an overseas company that then takes the technology forward.

The management team has often been an issue with start-ups. A very good inventor bursting with ideas may not have the management qualities needed to grow a business beyond the early stages. There is a lack of models to copy in the UK, of tech entrepreneurs that have taken companies all the way and some, such as Dyson, have done it away from the gaze of the stock market.

Off the beaten track

UK investors should not despair at the minimal tech weighting in the index – there is plenty of cutting-edge technology in the UK that will create real value in the future. However, these companies do not reside in the tech sector. Take **Rolls-Royce (LON:RR.)** (a holding in the Lowland Investment Company portfolio); the development of the Trent engine took many years of innovative design and testing. Boeing and Airbus will be using this great technology for years to come. The technology in British Aerospace is world leading in their area. **AstraZeneca (LON:AZN)**, another Lowland holding, is a world leader in oncology and respiratory research. This list goes on.

A good investment strategy is to find a company with an excellent product that has not been recognised by the market. For instance, one of the most instructive company visits I have made was to chemicals company, **Croda (LON:CRDA)** in the early 1990s. The company had experience and understood the importance and qualities of lanolin. This know-how led them to develop the ingredients behind many personal-care products. The share price at the time of the visit was 180p; it was around 4,800p at the time of writing.

Companies are successful because they have an excellent product – and the successful application of technology is often the vital ingredient. UK investors need to find companies with robust products that are globally competitive, and that is exactly what we try to do for the Lowland Investment Company portfolio.

Technology and service

Service is also important. A company that applies technology and service to a very high level will have a winning formula. An example of this in the UK is **Hiscox (LON:HSX)**, the insurance company, which has been in the Lowland portfolio for nearly two decades. Its application of technology to the underwriting process, combined with a service culture has led to very strong growth and the company has created a large retail-insurance business in the US. As a result, the share price has gone from 140p to 1,600p over the last 20 years, with very good dividend payments along the way.

Investing in early-stage technology is very difficult. Good ideas alone will not make for a good company as there are many other ingredients required, including luck. So few succeed because the pure technology space is very competitive, while the life cycle of a successful technology may be short because there is always something new coming along. The winner in new technology often takes all and the rewards for the winners are massive. However, there is another way of investing and that is to look for companies that are using a technology they really understand, to create an excellent, competitive company. The UK, fortunately, has another generation of these companies coming through. It is finding these companies and building a portfolio around them that will future-proof your investments.

Glossary

Dividend: A payment made by a company to its shareholders. The amount is variable, and is paid as a portion of the company's profits.

About James

James Henderson is Director of UK Investment Trusts and a Portfolio Manager at Janus Henderson Investors, a position he has held since 2003. He joined Henderson in 1983 as a trainee fund manager and has successfully managed a number of investment trusts since 1990. Prior to this, he was an accountant trainee at Binder Hamlyn.

James graduated with an MA (Hons) in economics from Cambridge University. He has 37 years of financial industry experience.

BY FILIPE R. COSTA

THE MACRO INVESTOR

HOW TO PLAY THE STEEPENING OF THE YIELD CURVE

As the cycle lengthens, investors should prepare to jump ship from the uncertain equity market towards the safety of bonds. And in the meantime, they can set a curve-steepener trade, writes Filipe R. Costa.

"The FOMC has considerable control over short-term interest rates. We have much less influence over long-term rates, which are set in the marketplace"

— Jerome Powell, Chair of the Federal Reserve

We are at a very important juncture in the business cycle, which requires patience and careful portfolio management. After more than 10 years of growth, US equities are showing signs of over-valuation. More importantly, the US economy seems to have topped out and, while it's still growing, many industrial production and consumer-confidence metrics are eroding. The yield curve, which is always closely monitored by investors and policy makers, anticipates a recession and, while there is still time left, investors should prepare to jump ship from the uncertain equity market towards the safety of bonds. And in the meantime, they can set a curve-steepener trade.

The 70/30 (if not 80/20) equity-bond portfolios are being scaled down on their equity part and scaled up on their bond one. Not even the bravest can bear the risk, as the 10-year bull market is becoming old. Additionally, there is the strange case of what seems like an eternal Brexit; the UK election; the China-US trade deal; President Trump's impeachment; and the US election next year, adding to an already foggy backdrop.

But today I write, not to advise on any flight to quality, but rather to shed some light on a side-trade opportunity that is arising in the yield curve. This is not exactly what I would call investment but a side speculation while we wait for fundamental factors to set a clearer direction. The flat/inverted yield curve is steepening as the result of central-bank intervention and investors' changing expectations about the future. This has happened many times in the past and opens up an opportunity to speculate on the steepening of the yield curve. All we need to


1936

“IF THE YIELD CURVE FLATTENS TO THE POINT THAT SHORT-TERM RATES BECOME HIGHER THAN LONG-TERM RATES, THE CURVE INVERTS. INVESTORS HAVE ALWAYS BEEN SCARED OF INVERTED YIELD CURVES, AS IN MOST CASES IT PRECEDES A PERIOD OF RECESSION.”

do is to translate the steepening of the curve into a tradeable opportunity.

The worrying inverted yield curve

The yield curve is a plot of the yields (interest rates) on bonds with different terms to maturity but the same risk, liquidity and tax considerations. It reflects the term structure of interest rates. Most of the time, the curve is upwards-sloping, as investors often require a premium to invest in longer maturities to compensate for interest-rate risk. Thus, even if expectations about future short-term interest rates were flat, the curve would slope upwards.

At the short end, the yield curve is determined by expectations about monetary-policy action. If investors expect the Federal Reserve (or other central bank) to raise rates, the curve rises; if investors expect rate cuts, the curve falls. At the long end, the yield curve is determined by a myriad of factors, including expectations about economic growth and inflation, as well as supply and demand for long-term securities.

When expectations about future economic growth and inflation erode, as has been the case during this year, investors no longer demand such a high interest rate. Expected future short-term rates decline accordingly and the yield curve falls at the long end. If the Federal Reserve doesn't take action, the yield curve flattens, which is a sign that investors see monetary policy as being too tight for current and expected economic conditions. If the yield curve flattens to the point that short-term rates become higher than long-term rates, the curve inverts. Investors have always been scared of inverted yield curves, as in most cases it precedes a period of recession.

One way of measuring how flat (or steep) a yield curve is, is by means of calculating a spread between a long-term yield and a short-term yield. Two common spreads are the 10-year minus 2-year Treasury spread and the 10-year minus 3-month Treasury spread, which are plotted on the US Treasury Yield Spreads chart. This spread just takes the short-term yield from the long-term one. Currently, the yields for 3-month, 2-year and 10-year notes are 1.57%, 1.63% and 1.88%, respectively. These values lead to a 10-year minus 2-year spread of 0.25% and a 10-year minus 3-month spread of 0.31%. The curve is upwards-sloping. But before reverting to an upwards slope, the yield curve was inverted several times in the year. Using the 10-year minus 2-year spread as the relevant metric, we can say that the curve inverted for a few days in August. If we instead use the 10-year minus 3-month spread, we end with a darker picture, as the curve first inverted for a few days in March but then remained inverted for a long period between May and October.

The steepening of the yield curve

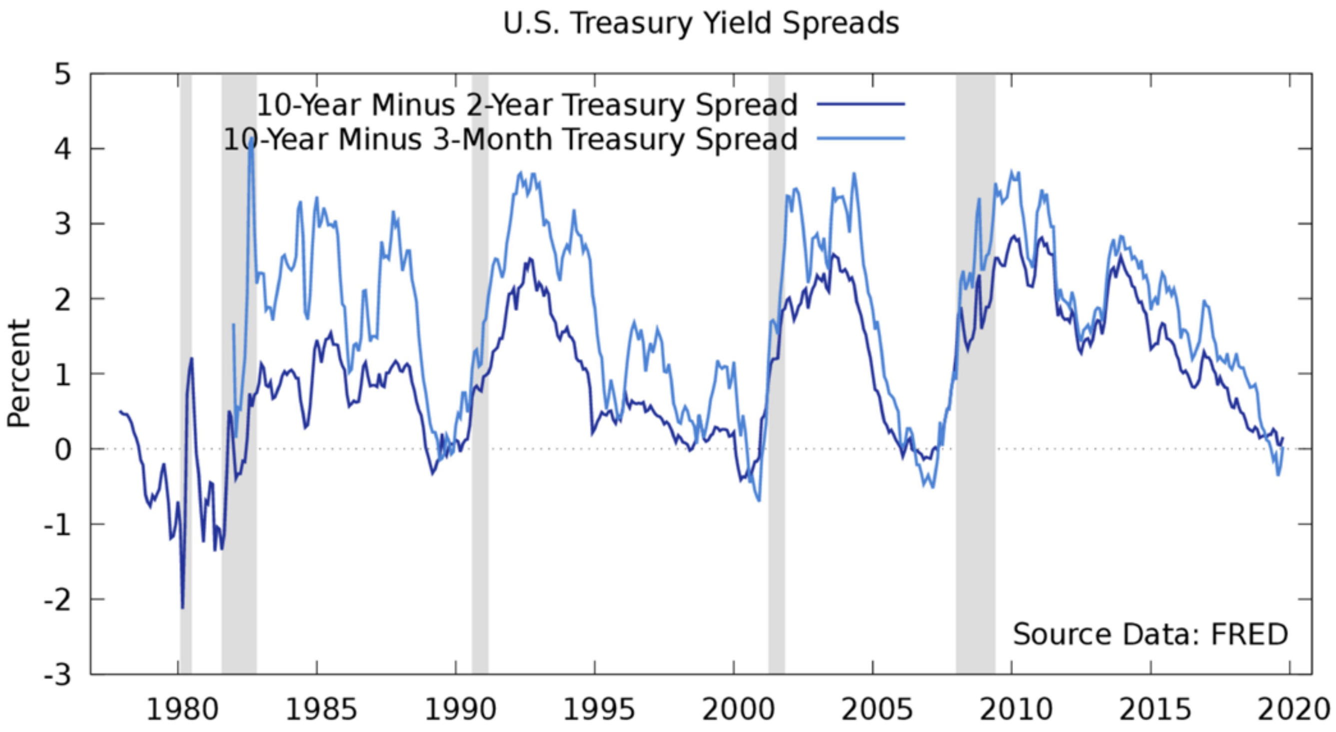
The Federal Reserve was certainly worried about the situation, as policymakers cut the Fed funds rate from a band of 2.25-2.50 to 2.00-2.25 in July, then to 1.75-2.00 in September and again to 1.50-1.75 in October. While the Fed has labelled the three interest-rate cuts as mid-cycle adjustments, given the inversion of the yield curve and the number of cuts, they seem more like the start of a new easing cycle than anything else.

Additionally, the Fed is buying $60bn of Treasury bills per month, thereby contributing to falling yields in the short end of the curve. This intervention led to a steepening of the yield curve and put an end to its inversion. Investors now see monetary policy as more appropriate to the current economic conditions and expect an improvement in economic conditions, not least as they foresee further interest-rate cuts. These conditions help build our case for a yield-curve steepener trade.

Before going on to discuss our investment case and how to place the trade, I want to mention that, while the steepening of the curve restores the more common upwards-sloping curve, the steepening that comes after an inversion is still worrisome. If we look again at the US Treasury Yield Spreads chart, we can easily see why.

In the period between 1977-2019, there isn't a single case in which an inversion of the yield curve didn't precede a recession (grey areas). The steepening of the curve seems to be a troubling prelude to a coming recession. Steepening comes from sharply expanding spreads, which come from rising expectations for rate cuts, which in turn come from rising recession expectations.

The last time we saw an inversion was between mid 2006 and mid 2007 just before the collapse of Lehman's and the subsequent financial crisis. In all these cases the yield curve experienced a substantial steepening after an inversion, which helps our trading case.



The steepening of the yield curve after an inversion comes way before a recession and a bear market. We can still observe upcoming rising equity values for another year before the worst sets in. So, this may not be the best time to either buy or sell equities; this is a wait-and-see period. The steepener trade seems a good way of exploiting the upcoming turbulence. However, there are some risks. The curve may still invert again if the Federal Reserve resists further cuts or if it fails to live up to investors' expectations. But, judging by the current odds for further easing reflected in the Fed Watch Tool, I would say there's a good chance for positive surprises. Currently, further cuts in interest rates until the end of 2020 are 61.3% likely, according to the Fed Watch Tool. But, if recent history is worth anything, I would say that the odds are somewhat higher than reflected in the market.

How to set a curve-steepener trade

A curve-steepener strategy consists of setting a trade with derivatives to benefit from escalating yield differences between two Treasury notes of different maturities. The trade usually consists of trading a spread of futures contracts, under which a short-term Treasury note is bought, and a long-term Treasury note is sold, at the same time and in appropriate proportions such that the trader is insured against parallel shifts of the yield curve. Besides trading futures, there is also the option of using ETFs to create the spread. All that is needed is to find an ETF composed of long-term bonds and another composed of short-term bonds. However, there are even simpler options, where the trader buys just one instrument and gets the desired exposure. Let's take a look at the options available.

Target Rate Probabilities for 16/Dec/2020 Federal Reserve Meeting

Target Rate (bps)	Current	1 Month Ago
25-50	0.10%	0.20%
50-75	0.70%	1.50%
75-100	4.20%	6.90%
100-125	16.90%	20.30%
125-150	38.90%	34.90%
150-175 (current)	39.30%	29.40%
175-200	0.00%	6.90%

Source: CME Group, Fed Watch Tool

Trading the futures market

The futures market is an obvious candidate because what we really want is to trade a spread, which has a lot less risk than an outright trade in one direction. When this happens, derivative products often allow for way more leverage than other products.

Besides requiring some knowledge about how derivatives work, this kind of trade may require you, the trader, to find the appropriate hedge ratio – that is the ratio of short-term to long-term contracts that should be implemented in order to avoid directional effects and become solely exposed to changes in the shape of the curve, as desired. This is needed to determine to how many dollars correspond to a change of one basis point in the yield of both the short-term and the long-term bond before allocating funds. A simple example

"THERE ARE SOME OPTIONS THAT ARE NOT ONLY THE SIMPLEST BUT ALSO THE MOST EFFECTIVE."

helps us to understand. Let's say you are willing to buy/sell a 2-year note and a 10-year note. You find out that for a one basis point change in yield, the 2-year note moves $23 while the 10-year note moves $74. You should then buy 3.22 ($74/$23) 2-year note futures for each 10-year note futures you sell.

While being a very effective trade, the steepener strategy using futures is certainly not for everyone. For those willing to know more on the topic, the Chicago Mercantile Exchange (CME) offers pre-built flattener and steepener spreads, as well as a good explanation on how the trade works.

Setting a spread using ETFs

Another option is to create a spread using ETFs. There are many fixed-income ETFs, most of them offering high liquidity for very low expense fees. To set the trade, an investor needs to choose one ETF featuring the short end of the yield curve and another featuring the long end of the curve. Two common options are the **iShares 1-3 Year Treasury Bond ETF (NASDAQ:SHY)** and the iShares 20+ Year Treasury Bond. But, while each of the above instruments is great for getting exposure to the fixed-income market, their 0.15% expense fee is not the best of all. For someone placing a spread trade, this is crucial. Therefore, there is a better option from Schwab Funds. The **Schwab Short-Term US Treasury ETF (NYSEARCA:SCHO)** runs on expense fees of just 0.06%. In October, Schwab launched a long-term ETF, the **Schwab Long-Term US Treasury ETF (NYSEARCA:SCHQ)**, which offers the long leg on Treasuries and also runs on a 0.06% expense ratio.

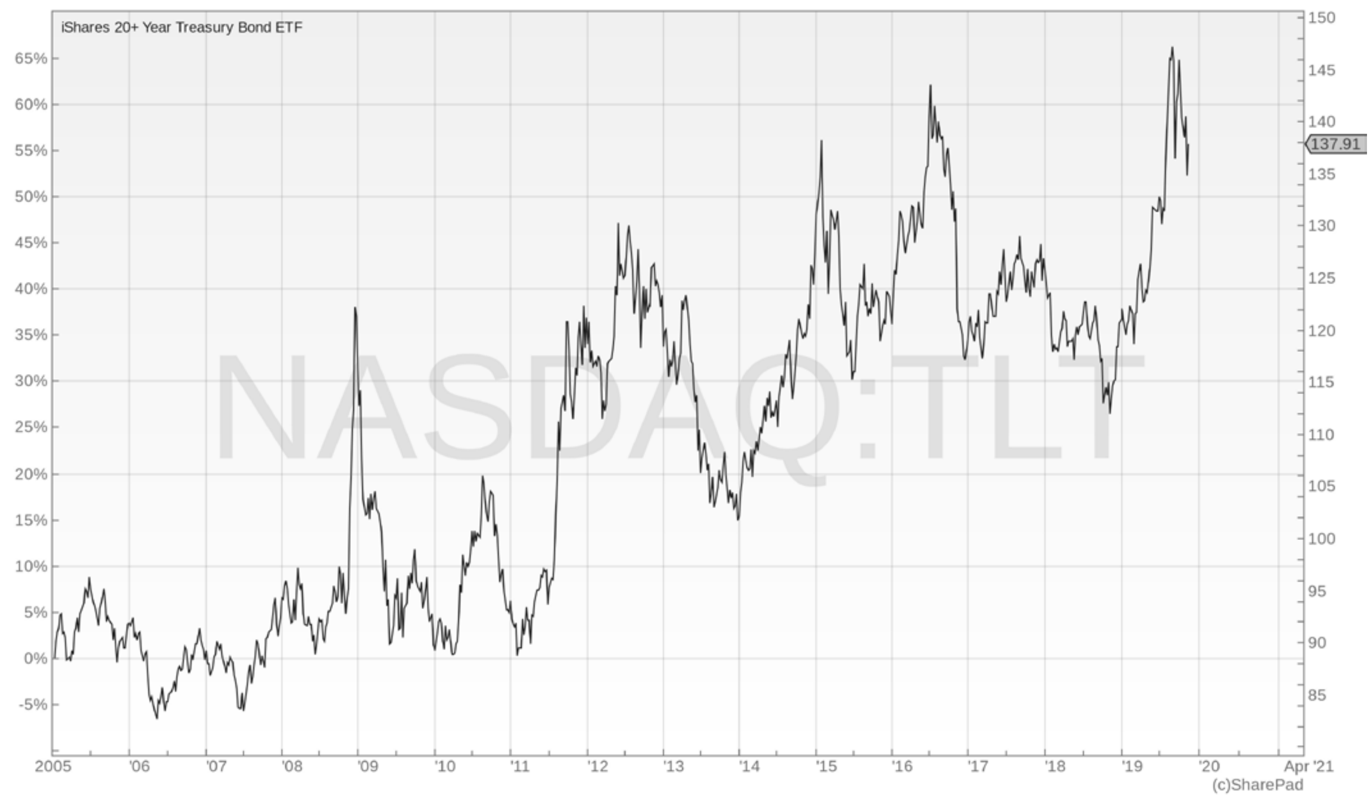
For the sake of setting the steepener trade, an investor would have to buy the short-term ETF and sell the long-term ETF. However, as well as in the futures case, there's a need to calculate the hedge ratio. While the duration of the SCHQ is not reported by the company, the final portfolio would consist of something like eight shares of SCHO to one of SCHQ. While this trade is not very difficult to set up, it is inefficient because it wastes capital. Unlike the futures spread trade that is based on margin, this ETF trade would likely not be.

A single-instrument option

For the trader looking to buy or sell just one asset, there is still hope. In fact, there are some options that are not only the simplest but also the most effective. I review three different instruments that can be used alone to set a curve-steepener trade:

- **Lyxor U.S. Curve Steepening 2-10 UCITS ETF (STPU)** This ETF was recently launched by Lyxor to target European investors. It's traded in London, Germany, the Euronext and a few other markets.

Country Gate Productions / Shutterstock.com



The ETF tracks the Solactive USD Daily (x7) Steepener 2-10 Index and therefore has its returns directly matched against changes in the yield curve. In this particular case, one basis point change in the steepness of the curve leads to an increase of around seven times in the index. In essence, this ETF consists of a long position in the 2-year US Treasury bond futures and a short position in the 10-year US Treasury ultra bond futures. While its expense ratio is not low at 0.30%, this option is much more efficient in terms of capital use than the previous with the two ETFs. This is something new in the market, as Lyxor launched the ETF just a few months ago, precisely to allow investors to benefit from an arising opportunity.

- **iPath US Treasury Steepener ETN (BATS:STPP)** This option has been available since 2010. It has a much longer track record than the Lyxor ETF for investors to check. The ETN is invested 77% in the 2-year Treasury futures and 23% in the 10-year Treasury futures. In essence, this option offers the same kind of trade, but it comes with a few significant shortcomings. First of all, its expense fee is 0.75% which is very high. Second, this is an ETN and not an ETF, which means that investors incur the credit risk of the issuing institution. Additionally, this ETN has low liquidity, which may lead to high transaction costs at the time of trading.
- **Quadratic Interest Rate Volatility and Inflation Hedge ETF (NYSEARCA:IVOL)** This is a more idiosyncratic option, which is worth mentioning. The idea of this fund is to hedge and benefit investors during periods of fixed-income volatility and increasing inflation expectations. Additionally, it is structured in a way to benefit from yield-curve steepening.

IVOL holds a combination of Treasury Inflation-Protected Securities (TIPS) and dynamically managed OTC options, which add upside potential during periods of market volatility and steeper interest-rate curves. While this instrument is not a direct play on the steepening curve like the Lyxor ETF, it is ideal for a situation of rising volatility, where recession is expected. It benefits the most in a situation where the central bank is expected to cut rates and induce an increase in future inflation expectations.

A few final words

In the absence of much upside potential in the equity market and in the presence of clear weakening signs, investors may lack real opportunities to put their money to work. Reducing the risk of portfolios may be a wise option by now, but there's no reason to completely abandon equities just yet.

However, the inversion of the yield curve in the US is one of the strongest leading bearish signs that can be observed, which is almost always followed by central-bank intervention and a steepening of the yield curve. With the help of new ETF instruments like the Lyxor US Curve Steepening 2-10 ETF, investors can place some juicy side bets.

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

HOW TO READ THE MOST BASIC OF CHARTING SIGNALS

Trend following is the core principle of charting but so many traders and investors seem to forget just how powerful it can be, writes David Jones.

Once again, US stock-market indices are at all-time highs – at the time of writing, the Dow Jones had just hit its ninth all-time high for 2019. This month, we will look at a straightforward way of trying to capitalise on this momentum.

Follow the market – the breakout

At the absolute core of charting and technical analysis is the idea of trend following. The market 'knows' more than we do, so we should take our lead from what is happening with the price. If, for example, a share is moving higher, then we should look for buying opportunities. If the opposite applies, then we should not try to 'catch the bottom'.

It could be argued that buying a breakout is the most basic type of following a trend – particularly

“BUYING A BREAKOUT IS THE MOST BASIC TYPE OF FOLLOWING A TREND – PARTICULARLY IF THAT ALSO INVOLVES A MOVE OUT TO ALL-TIME HIGHS.”

if that also involves a move out to all-time highs. Taking the US stock-market indices as our example, the S&P 500 has more than quadrupled since the financial crisis, and it is still going up. The move out to all-time highs, once again, shows that investors are happy to continue to pay ever-increasing prices.

So, what is a breakout? Let's take a look at an example using a UK share.

My first charts refer to the FTSE 250 real estate business, Big Yellow Group – the self-storage company. From April through to September this year, the price twice ran out of steam ahead of the 1,075p per share level. If we take a moment to think about what is happening here, it is illustrating where the market as a whole considers the share price too expensive. Prices move because of the actions of buyers and sellers – I think we can all agree on that. Whether they are buying or selling on a rumour, because of company results or are just reshuffling their portfolios, it is this activity that causes price changes. If buyers are consistently happy to pay more for a share, then that price will keep moving up.

We can see that investors clearly felt that around the 1,075p mark, the share price of Big Yellow had gone far enough. The share price ran out of steam and turned around – the sellers were pushing the price lower and any potential buyers were waiting for lower prices. But this changed in early October.

This is the breakout highlighted on the chart. There was a change in sentiment towards the share and this time around buyers were quite happy to continue paying more. Big Yellow Group broke through its old barrier of 1,075p and moved around 10% higher in short order. Of course, breakouts do not work like this all the time, but the basic principle is the same. A level that has previously been a barrier gets broken; this can be a suggestion that a new trend is underway. Incidentally, Big Yellow Group has had a habit of breaking out through previous highs and pushing on as the last eight years shows. It will be interesting to see if a similar move results with this latest breakout.

Big Yellow Group – July 2011 to present

“IF WE THINK OF TRADING OR INVESTING AS A GAME OF PROBABILITIES, THEN BUYING INTO BREAKOUTS DOES, I FEEL, TILT THE ODDS SLIGHTLY IN OUR FAVOUR, AS WE ARE BUYING INTO STRENGTH.”

Big Yellow Group – December 2018 to present

Risk management and patience

A word of caution: nothing works all the time. If we think of trading or investing as a game of probabilities, then buying into breakouts does, I feel, tilt the odds slightly in our favour, as we are buying into strength. But there is such a thing as the failed breakout, which it is why it is important to have a strategy to exit if the share price starts to turn lower.

Just do not be too hasty – markets do not suddenly take off just because the price has broken through an old high. Perhaps something like a 10-15% stop loss from the breakout point is a good compromise here, to give the share enough wiggle room to try to form a new trend.

The next chart showing one of my own holdings, is a good example of why patience is important.

FTSE 100 contract-catering business, Compass Group, broke out in February 2019. The 1,700p level had been a problem since September of the previous year but it was finally cracked – so surely it was time for the Compass price to start rocketing? It can be seen that this was not the case. It spent the next four months chopping around the breakout level before finally starting a new trend higher. At the time of writing, it is 15% higher than the breakout point.

Compass Group – September 2018 to present

Compass Group is a good example of how breakouts usually go in the real world – assuming they do end up being valid breakouts. This is why risk management is so important. A successful strategy involves cutting the ones that do not work out – and keeping those like Compass.

I do like this methodology – although many may dismiss it due to its simplicity. I think many people are guilty of over-complicating charting and technical analysis. When all is said and done, a market can only do one of three things: go up, go down or go sideways. The simple approach of breakouts – particularly in strong trending markets like we have had recently – can be an effective way of identifying shares that have real momentum behind them and where there has quite possibly been a fundamental shift in sentiment. They incorporate all of this plus the all-important principle of trading with the trend. This approach is not a guaranteed winner, as mentioned a few times, but it can be another effective way of tilting the laws of probability ever so slightly in your favour, which hopefully leads to some profitable trading and investing opportunities.

Charts of the month

With stock markets so strong at the moment, I thought I would highlight a couple of these potential breakout opportunities for the charts of the month.

As this month's article started by mentioning the breakout in US indices, let's take a look at the 'grand-daddy' of all of them, the Dow Jones Industrial Average.

What is interesting here (see chart opposite) is that this is not the "well-chosen example" that shows a perfect breakout. In October 2018, the Dow Jones set a fresh all-time high just 50 points shy of the 27,000 mark. Seasoned investors will know what happened next – markets plummeted in the last quarter of last year and the Dow plunged by 5,000 points. But by July of this year, the Dow had staged an

Dow Jones Industrial Average

impressive comeback and broke out through that previous high. As you can see, it was not the cleanest of breakouts and it spent the next three months trading in a sideways range of around 2,000 points. This demonstrates the importance of being patient and giving the breakout time to play out.

At the time of writing, the Dow had started a new trend and was setting fresh all-time highs through 28,000. When it comes to targets for breakouts to all-time highs, I would have to admit that here there is an element of guesswork. One way favoured by some chartists is to look at the typical range before the breakout, and project that up from the breakout point. In this example, because the breakout took some time to be confirmed, I would look at the range set after the initial break. Following the first move to a new high, the market then traded in a range of 2,000 points. Projecting this from the breakout point of 27,000 gives a target of 29,000, which does not seem over-ambitious given the US stock market's current momentum.

It is early days for the breakout by the online property portal, **Rightmove (LON:RMV)**, which makes it an interesting one to watch over the next few weeks. In June this year, it traded up to 590p and it is clear that investor sentiment switched, with the price dropping back to 500p (see chart below). But since then, it is another market that has staged an impressive comeback; it has broken through that old barrier and hit fresh all-time highs.

When it comes to setting a target, again we can look at the range previous to the breakout which is around 90p. Projecting that upwards from the break point gives a target of 680p. It will be an interesting share to watch into 2020.

Rightmove

About David

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

FUNDS AND TRUSTS IN FOCUS

THE BEST AND WORST PERFORMING FUNDS OF 2019

After another roller coaster year, Nick Sudbury examines the best and worst performing funds of 2019 to see if they can provide any pointers for 2020.

It has been another roller coaster year, but despite all the geopolitical concerns, each of the main asset classes has made healthy gains. This has enabled the vast majority of funds to generate positive returns, yet it's always worth looking at the leaders and laggards to see if they can provide any pointers for what might lie ahead.

The FTSE World index of global shares has had an impressive 2019, with a year-to-date return of 21.5%[1] when measured in sterling. The US stock market, which makes up a large element of the index, was a key contributor, with the S&P 500 up 24.3%. Most of the different regions made double-digit gains, with MSCI Russia leading the way (an increase of 49.7%). The Indian Nifty 50 index is bringing up the rear with a return of just 9.5%.

Gold, silver and oil – three of the world's most important commodities – also had a successful time of it, with price increases of 15.1%, 9.8% and 23.7% (Brent crude) respectively, although they have each been volatile. It has been a positive year all round with the main fixed-income categories making decent gains as well.

Looking at the list of best and worst performing funds can be a heartening or dispiriting experience, depending on how your own holdings fared, but it can also be enlightening. In some cases, the winners and losers can give an indication of which areas could do well or which could struggle in 2020.

It would certainly make a huge difference if you could tell the one from the other. For example, in 2019, the best performing investment trust YTD[2] was **Golden Prospect Precious Metals (LON:GPM)** with a gain of 51%, while the worst was **Woodford Patient Capital Trust (LON:WPCT)** with a loss of 61.6%.

All that glitters

Several of the top performing trusts and funds invest in gold-mining companies. The precious metal started the year priced at $1,279 per troy ounce and by 11 November had rallied to $1,453, an increase of 13.6%. However, many of the stocks in this area have risen much further. This is because they benefit from high operating leverage, with a small rise in the gold price having a much bigger impact on their net income.

One of the main beneficiaries has been Golden Prospect Precious Metals with a year-to-date gain of 51%. It has a highly concentrated portfolio, with the 10 largest holdings accounting for just over 60% of the assets. It is a small and volatile fund, with gross AUM of just £26m and typically trades at a discount to NAV of more than 20%. Despite the strong year, the shares are still down around 65% from the issue price in December 2006.

> **"IT HAS BEEN A GOOD YEAR FOR INVESTORS IN RUSSIA AND CHINA, WITH MSCI RUSSIA UP 49.7% IN STERLING TERMS AND THE SHANGHAI COMPOSITE INCREASING BY 16.6%."**

Amongst the best performing open-ended funds is the £1bn **LF Ruffer Gold** fund with a year-to-date return of 40%. It has a much more diversified portfolio than GPM, with 131 different holdings. The manager believes that the higher gold price is yet to be reflected in the majority of gold-mining stocks, which suggests that there is plenty of upside potential if gold holds on to its current level.

Gold has benefited from increased concerns about the impact of the US-China trade war and possible global economic slowdown. This has led to cuts in interest rates in the US, which reduces the opportunity cost of holding gold, but it will always divide investor opinion.

Russia and China

It has been a good year for investors in Russia and China, with MSCI Russia up 49.7% in sterling terms and the Shanghai Composite increasing by 16.6%. This has made it possible for some of the single country funds investing in these areas to make it near the top of the leader board.

Pictet Russia Index, a £40m fund that tracks MSCI Russia, rose by 43.4% year-to-date, while the actively managed £356m **JPMorgan Russian Securities (LON:JRS)** investment trust returned 49.3%. The country's stock market has bounced back from the shock of having extra sanctions imposed last year, with the rise in the price of oil enabling it to deliver strong gains that have been further boosted by an increase in the value of the currency.

Mainland China has also been a good place to be invested, with **Allianz China A-Shares** up 46%, **Allianz All China Equity** 34.6%, **First State All China** 33.7% and the **JPMorgan Chinese Investment Trust (LON:JMC)** 41.7%. Last year was the worst in a decade for the local stock market, but it has rebounded strongly in 2019, despite concerns about the trade war with the US.

China is moving from a manufacturing to a consumer-focused economy, but has much further to go, with an urbanisation rate that is still far behind countries like the US and the UK. This should provide a supportive backdrop for further growth once the trade war reaches some sort of favourable resolution.

Technology

Despite concerns about valuations, some of the technology funds have continued to do well this year. The best performing open-ended vehicles in this area were **Wellington FinTech Unhedged GBP** (+38.2%), **Fidelity Global Technology** (+35.6%), **Smith & Williamson Artificial Intelligence** (+35.4%) and **L&G Global Technology Index** (+35.2%).

Wellington FinTech is a $137m fund investing in companies that aim to use technology to disrupt or enhance traditional financial services. It was launched in October 2018 and has a concentrated 39-stock portfolio that includes many lesser-known names alongside the likes of Equifax, Visa and PayPal.

As the name suggests, Smith & Williamson Artificial Intelligence invests in companies that develop AI technologies or the products or services that use them. It was launched in June 2017 and has £206m of AUM that it has used to build a 39-stock portfolio. The largest holdings consist of relatively unfamiliar businesses, as well as tech giants like Alphabet, Microsoft and Alibaba.

With assets of £3bn, Fidelity Global Technology is a much larger fund, that invests right across the tech sector and was launched in 1999 at the height of the dot-com bubble. It provides a very different exposure to L&G Global Technology Index, which is an index tracker that replicates the performance of the FTSE World-Technology Index.

Brexit Bounce

It has been another volatile year for funds exposed to UK domestically oriented stocks, but recent progress towards ending the uncertainty has sparked a recovery amongst the small-and-mid-cap investment trusts. The chief beneficiaries include **BlackRock Throgmorton (LON:THRG)** with a year-to-date return of 40.5%, **Mercantile (LON:MRC)** (+34.4%) and **Schroder UK Mid Cap (LON:SCP)** (+29.3%). This is obviously a volatile area and could still go either way.

"ANYONE UNFORTUNATE ENOUGH TO HAVE MONEY INVESTED IN ANY OF FORMER MANAGER NEIL WOODFORD'S FUNDS WILL NOT BE SURPRISED TO LEARN THAT THEY FEATURE AMONGST THE WORST PERFORMERS FOR THE YEAR."

Crash and burn

Anyone unfortunate enough to have money invested in any of former manager Neil Woodford's funds will not be surprised to learn that they feature amongst the worst performers for the year. Woodford Patient Capital is the worst performing investment trust of the lot with a year-to-date loss of 61.6%: there is still a huge amount of uncertainty over how much its unlisted holdings are worth.

His open-ended funds haven't fared much better with **Woodford Equity Income** down 24.2% and **Woodford Income Focus** posting a loss of 14.2%. The former is now in realisation mode and the latter has been suspended until a decision is made about its future.

The absolute return sector has seen further large investor outflows as it continues to disappoint and many of these vehicles languish amongst the worst performers. Examples include the now defunct **VT Garraway Absolute Equity** with a loss of 63.2%, **Merian Global Equity Absolute Return Hedged** (-11.6%) and **Quilter Investors Global Equity Absolute Return** (-11.5%).

Some of the energy-related funds have also suffered, despite the increase in the price of oil. For example, **Schroder ISF Global Energy** has lost nine percent this year, while **MFM Junior Oils** is down 9.5%, but the worst of all is the **Riverstone Energy (LON:RSE)** investment trust: its share price has collapsed by 56.4%.

Riverstone Energy recently announced that the gross value of its largely unlisted portfolio fell by 26% in the third quarter of the year, with only one of the underlying holdings actually appreciating. The declines are due to lower future production estimates and a reduction in the price/earnings multiples of their listed peers that are used to value them. It seems as though drastic action may be required to turn things around.

2020 vision

Perhaps the most surprising laggards are the various single-country funds that invest in India. **Alquity Indian Subcontinent** was down 5.6%, while **Liontrust India** lost 6.3% year-to-date, with the **India Capital Growth (LON:IGC)** investment trust falling 13.5%. The latter is currently available on a wider than normal discount of 16% (see fund of the month).

India has been through a tough time recently with the economy experiencing a cyclical downturn, but the landslide re-election of Prime Minister Modi earlier in the year has prompted various policy measures to stimulate growth.

Interest rates have been cut several times and there has also been a large reduction in corporate-tax rates, while Modi's "Make in India" campaign is aimed at making the country a global manufacturing hub. There is a decent chance that the funds that invest in India will bounce back strongly in 2020.

The list of best and worst performing funds can give a valuable insight into what has been happening and in some cases can provide an indication of the areas to follow or avoid in 2020. Markets like Russia, China and gold tend to fluctuate wildly from one year to the next, whereas technology has been a lot more consistent. India could be the big winner as it claws back its recent losses.

Solid year for popular growth managers

It has been another good year for Lindsell Train and Fundsmith, with all their flagship funds posting healthy gains. The star performers included **Lindsell Train UK Equity**, which was up 18.6% year-to-date, as well as its **Global Equity** fund, rising by 17.1%. Terry Smith's funds had an even better time of it, with Fundsmith Equity returning 22.1% and his new investment trust, **Smithson (LON:SSON)** gaining 22%.

FUND OF THE MONTH: India Capital Growth

The India Capital Growth investment trust mainly invests in mid-and-small-cap Indian companies. These have had a tough year and have suffered disproportionately as the country's stock market has de-rated. As a result of this, the share price has fallen 13.5% year-to-date and the shares are now available on a wider than normal discount of 16%, but there is a decent chance that they could bounce back strongly.

One of the main issues facing the country has been a liquidity crisis that emerged following the collapse of a major unlisted infrastructure finance company in September 2018. This caused a sharp fall in the stock market and required central-bank intervention. The problem was created by ill-disciplined lending practices that have made the banks more reluctant to lend.

Since the re-election of Prime Minster Modi, there have been several important policy measures put in place to stimulate economic growth, including a number of interest-rate cuts and a reduction in the effective rate of corporation tax from around 35% to 25%. These are significant steps, but the reforms still have a long way to go.

IGC is managed by Ocean Dial, with the six-strong investment team divided between London and Mumbai. At the end of August, the fund's portfolio was trading on 12 times estimated earnings for the year ended 31 March 2021. According to the manager, the last time it hit that level was in August 2013 and afterwards the fund went on to deliver a 197% return in sterling over the next three years.

India Capital Growth targets mid-and-small-cap companies, as these should benefit the most from India's long-term growth potential. It uses a bottom-up stock-picking approach to identify businesses with pricing power, credible management teams and which are generating high cash returns on capital employed. The fund will inevitably experience periods of volatility, but for risk-tolerant investors, the current dip could be a good long-term buying opportunity.

Fund Facts

Name:	India Capital Growth (LON:IGC)
Type:	Investment Trust
Sector:	Country specialist – Asia Pacific
Total assets:	£100m
Launch date:	December 2005
Current yield:	0%
Gearing:	0%
Ongoing charges:	2.02%
Website:	www.indiacapitalgrowth.com

1 Index and commodities returns data to 7 November unless otherwise stated
2 Fund and trust returns data to 11 November unless otherwise stated

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

MARKS & SPENCER

THE DESTROYER OF SHAREHOLDER VALUE

John Kingham of UK Value Investor explains why Marks & Spencer has been a long-term destroyer of shareholder value and reveals how you can avoid investing in similar situations.

I like Marks & Spencer. No, really, I do. I used to buy most of my clothes from M&S back in the late 1980s and early 1990s, when I was in my late teens and early twenties. The clothes were well-made, the designs were fashionable and the consistency of quality and sizing was second to none (at least on my local high street).

But that was a very long time ago and since then M&S has lurched from crisis to crisis, carrying out what seems to be an endless transformation project to 'make M&S special again'.

The latest attempt to turn M&S around includes a £750 million joint venture with the UK's leading online-only grocer (Ocado) to enable customers to do their M&S food shopping from the comfort of their own home. This venture has been funded largely by a rights issue in which shareholders pumped an additional £600 million into the company, and that £600 million is just the tip of the iceberg.

Over the last 20 years, M&S has retained about £2.5 billion of shareholders' earnings to invest in the existing business, to make acquisitions, buy back shares and so on. And yet, after all that hard work and investment of cold hard (shareholders') cash, the company's share price is lower today than it was 20 years ago.

For most shareholders then, M&S has been a disaster for at least two decades. So, in the rest of this article I want to explore two 'red flags' which, for many years, have suggested that M&S was a no-go area for long-term investors.

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Red flag 1: consistently weak returns

Companies exist to produce adequate or better returns on capital raised from shareholders. Shareholder capital, also known as shareholder equity, can be supplemented with debt capital (debt liabilities or borrowings) and leased capital (lease liabilities, eg for rented stores). Regardless of the source of capital, returns on that capital must be sufficient to offset the risk that shareholders are taking.

If a company can consistently produce returns on capital which are above the market rate of return (around 7% to 10% in the UK) then it makes sense for that company to reinvest some of those returns. Reinvested earnings will increase the size of the company's capital base and that will, hopefully, lead to revenue, earnings and dividend growth in the future.

On the other hand, if a company cannot consistently produce returns on capital employed which match the market average, then that company should focus on returning capital to shareholders through dividends. In more extreme cases, it will make sense to sell off parts of the business or even close the whole business, in order to return capital to shareholders so that they can reinvest it more productively.

It's a bit like putting money into a savings account. If the interest rate is 15%, then it's probably a good idea to reinvest the interest back into that same account because you're unlikely to get a 15% rate of return anywhere else. But if the interest rate is 2% then you might be better off withdrawing the interest – and perhaps the rest of your savings – and investing it somewhere else.

So, what does that have to do with M&S? Quite a lot, as it turns out.

Over the 10 years from 2000 to 2009, M&S employed an average of £2.5 billion of shareholder equity, £2.3 billion of borrowings and £1.6 billion of lease liabilities (discounted at 5% per annum), giving it an average lease-adjusted capital employed of £6.4 billion. Over the same period, it generated average revenues of £8.3 billion and, after deducting all expenses, average earnings of £0.4 billion. That gives M&S an average net return on lease-adjusted capital employed (net ROLACE) of just 6.7%, well below the 10% rate of return I typically look for.

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"IN 1971 M&S AGREED TO LEASE A STORE IN STOCKTON HIGH STREET FOR AN INCREDIBLE 283 YEARS."

In the most recent decade, from 2010 to 2019, things have got worse. Lease-adjusted capital employed has increased to £8 billion, thanks in part to the reinvestment of retained earnings, but average earnings have fallen below £0.4 billion. As a result, M&S's average net ROLACE has decreased to just 4.6%, which is extremely low.

There are many reasons why a company might have weak profitability, but in M&S's case it is at least partly due to its habit of leasing stores on extremely long terms. This may be seen as a sign of confidence in the company's future, but when the retail market is evolving as quickly as it is today, it can also be seen as carelessness or even arrogance. For example, in 1971 M&S agreed to lease a store in Stockton high street for an incredible 283 years. This lease alone gives M&S a liability of around £33 million. And the most unbelievable thing is that the store is now closed, so M&S could be paying rent on an empty store until the middle of the twenty-third century.

There are also clear differences in performance between M&S's clothing and food businesses, with food consistently outperforming clothing. However, until M&S separates its clothing and food operations into two entirely separate companies owned by the group (which I think it should do) there simply isn't enough accounting information to calculate separate ROLACE figures for each business. This means I have to assume that each is as bad as the other.

In summary then, M&S's consistently low returns on capital suggest that the company is competitively weak and is at risk of being rendered obsolete by competitors (especially the clothing business). This is an important red flag and it's why I haven't invested in M&S, despite its attractive dividend yield in recent years.

In my opinion, management should have focused on improving returns on capital, and if that was impossible, then they should have focused on returning capital to shareholders by favouring dividends over reinvestment. Instead, shareholders were subjected to an endless round of turnaround and transformation projects aimed at returning the company to growth.

I think this was a mistake because reinvesting earnings to drive growth in a company that produces low returns on capital simply destroys rather than creates value for shareholders, just as reinvesting savings into a 2% savings account destroys value compared to withdrawing it and saving it elsewhere at 5% or 10%.

"M&S'S CONSISTENTLY LOW RETURNS ON CAPITAL SUGGEST THAT THE COMPANY IS COMPETITIVELY WEAK AND IS AT RISK OF BEING RENDERED OBSOLETE BY COMPETITORS."

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Red flag 2: high debts

For most companies that produce consistently low returns on capital, growth can be very hard. Here's an example:

Company A builds a factory for £100 million. The factory makes widgets and at the end of the year it has produced earnings of £5 million – a 5% return on the capital invested. Management decide they want to build another factory, but with earnings of just £5 million per year, it will take them 20 years to save up the money to build the second factory.

Company B also builds a factory for £100 million, but this factory produces earnings of £20 million, giving a 20% return on capital employed. Company B also wants to build another factory, but because of the higher rate of return, it only has to save up its earnings for five years before it has the £100 million required to build that second factory.

As you can see, low-return businesses have a much harder time growing by reinvesting earnings, because their earnings are so low relative to the cost of their assets. However, it's easy to get around this problem by borrowing the money from a bank, and this is why many low-return businesses also have high levels of debt.

Using borrowed money to invest in productive assets will boost returns on shareholder equity, so some shareholders and managers are happy to load a company up with debt in order to boost growth. But funding growth with borrowed money doesn't really create value, it simply redistributes who has a claim on those returns (ie debtholders now as well as shareholders) while increasing risk within the business.

In M&S's case, it had average borrowings of £2.3 billion between 2000 and 2009 compared to average earnings of £0.4 billion. This gave it an average debt-to-earnings ratio of 5.4, whereas my preferred maximum for cyclical companies such as retailers, is 4.0. So, M&S had at least 30% too much debt in my opinion, and given its weak returns, its debts should probably have been less than half their actual amount.

And things haven't improved in the last decade. From 2010 to 2019, M&S had average borrowings of £2.2 billion and average earnings of just under £0.4 billion, giving the company a debt ratio of 5.9. That's almost 50% higher than my preferred limit.

Somewhat more positively, the company has at least reduced its debts to around £1.8 billion today, which is a start. But its earnings have also collapsed to almost nothing over the last three years, so even this reduced level of debt is far too much for my liking.

Long-term financial results are important

I realise I haven't spoken about what's going on with M&S today, or what might happen in the future if its current transformation project bears fruit, of if the deal with Ocado really does revolutionise the online grocery world. It's not that those things are not important, because they could be. But for me, the process of selecting an investment starts with a detailed look at the company's long-term financial results.

First and foremost, I'm looking for companies that can consistently produce above-average returns on lease-adjusted capital employed. And of those, I'm looking for companies that can consistently grow their capital base by reinvesting retained earnings at similarly attractive rates of return.

M&S doesn't pass either of those tests, which is why I haven't gone into the details about its deal with Ocado. There is just no evidence that M&S can transform itself without destroying billions of pounds of shareholder value along the way.

“WHEN YOU’RE LOOKING FOR YOUR NEXT LONG-TERM DIVIDEND-PAYING INVESTMENT, I SUGGEST YOU START WITH NET RETURNS ON LEASE-ADJUSTED CAPITAL EMPLOYED.”

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Next: high returns, low debts

Some investors are avoiding retail altogether because of the online shopping revolution. That's a reasonable position to take, but I still own some retail investments, including Next. I would describe it as a clothing/fashion retailer which is (sort of) like M&S – but for younger people and without the odd combination of clothing and food in one business. It's also a good example of a highly profitable retailer.

Looking at the last decade, Next had average shareholder equity of £0.3 billion, average borrowings of £0.8 billion and average lease liabilities (discounted at 5% per annum) of £1.4 billion, giving the company an average lease-adjusted capital employed of £2.5 billion. That capital was invested in stores, stock and other assets to produce average revenues of £3.8 billion and average net earnings of £0.5 billion.

An average return of just over £0.5 billion from average capital employed of £2.5 billion means that Next produced average net returns on lease-adjusted capital employed of 21%, which is more than four times the rate of return achieved by M&S over the same period. Just as importantly, Next's ROLACE was well above 10% in every single year, showing that high levels of profitability were the norm rather than the exception.

These higher rates of return have allowed Next to reinvest earnings at a rate of return of 21% or so, and that has fuelled a growth rate across revenues, capital employed and dividends per share of about 8% per year for the last decade. In contrast, and despite much reinvestment of earnings, M&S has not grown at all over the same period.

And because Next's returns are so much higher relative to the cost of its assets, it hasn't had to borrow much to fund that growth. So, unlike M&S's average debt-to-earnings ratio of 5.9 over the last decade, Next has got by with average debts of just 1.6 times its average earnings.

This lower level of borrowing, along with Next's far shorter leases, means that Next's cost base is significantly more flexible at a time when flexibility is critical if retailers are to survive the digital transformation of retail.

For long-term investors, profitability comes first

There are, of course, many other things we'd need to look at before investing in any business. However, for long-term investors, profitability is the single most important factor.

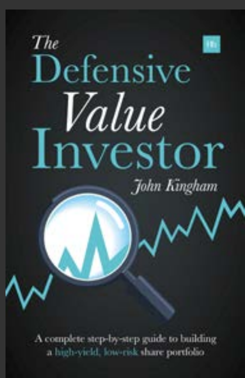
So, when you're looking for your next long-term dividend-paying investment, I suggest you start with net returns on lease-adjusted capital employed. Look at the average over 10 years and focus on those companies where returns are consistently above 7%, and preferably above 10%.

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

HAS GOLD LOST ITS SHINE?

The summer saw some sharp moves in precious metals, as investors fretted about economic uncertainty – but since then these markets have drifted. Is there still a reason for investors to buy gold?

Trade war boosted gold

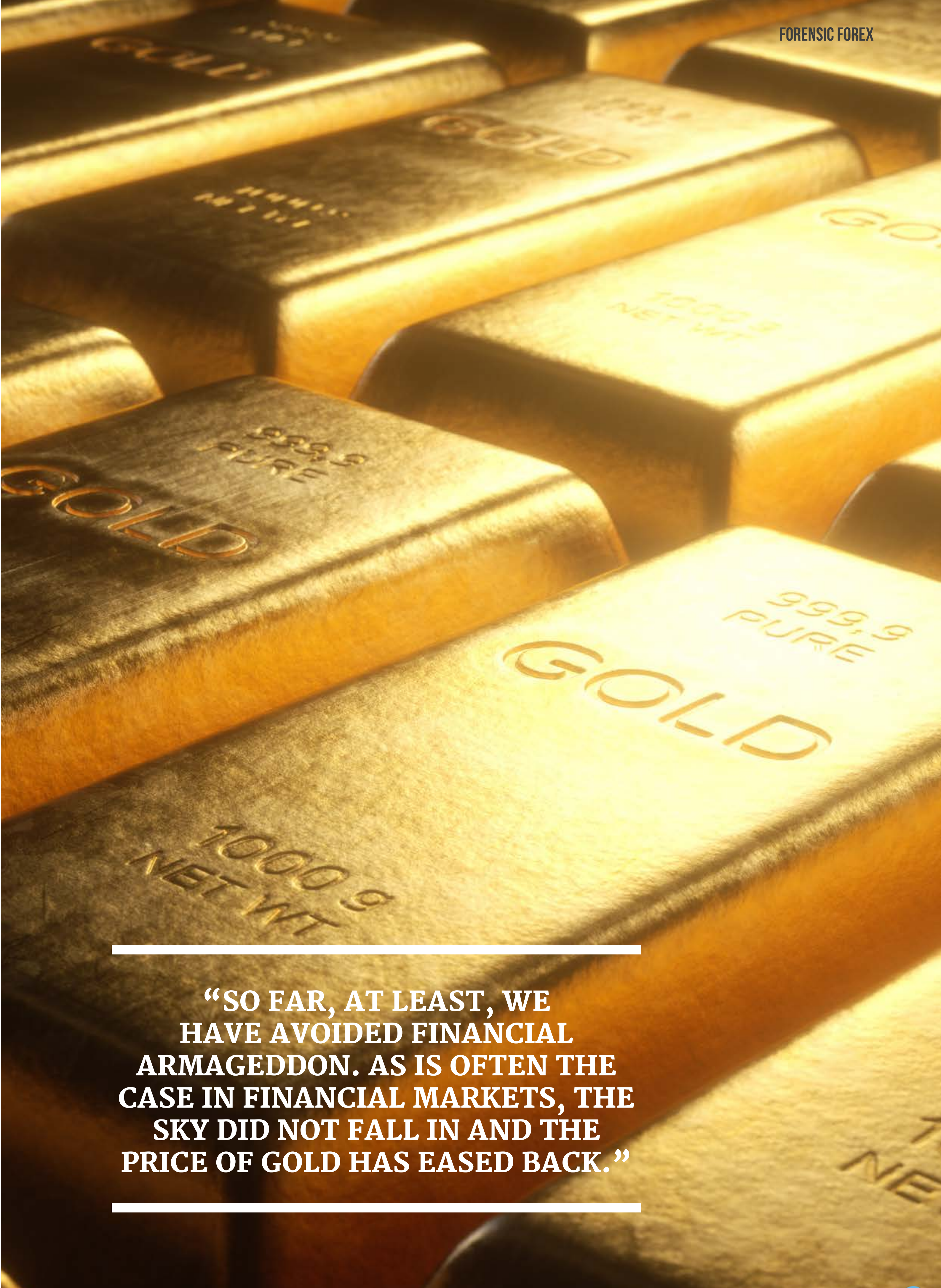
We last looked at the gold price at the beginning of the summer when it was trading just above $1,400 an ounce. By early September, it had risen sharply and was 10% higher, with the price almost reaching $1,560.

There were a number of factors helping to lift gold – most of them to do with economic uncertainty. In times of trouble, gold is considered a safe-haven asset – perhaps the grandfather of all locations where investors traditionally look to park their cash when the global outlook appears somewhat wobbly. Much of investors' focus was on the trade-war threats between the US and China. These two economic titans played out a game of tit-for-tat on imposing tariffs on imported goods. With the prospects of these nations' economies slowing down, the potential threat for the global economy loomed large. Safer destinations such as gold (and its poorer relation, silver) enjoyed a boost off the back of these concerns.

Gold price May to September 2019

Recession concerns

Although August is traditionally the time where we all hope to take it a little easier, financial markets often have a different view. That was the case again in August 2019. It did seem that whatever you read, four words loomed large on a regular basis. And they were: "inverted bond yield curve".



"SO FAR, AT LEAST, WE HAVE AVOIDED FINANCIAL ARMAGEDDON. AS IS OFTEN THE CASE IN FINANCIAL MARKETS, THE SKY DID NOT FALL IN AND THE PRICE OF GOLD HAS EASED BACK."

On the face of it, perhaps not the scariest collection of words. But make no mistake, markets were very concerned about this phrase. To put it in layman's terms, the interest rate on 10-year US government bonds had dropped below the rate on the two-year (shorter) bonds. The punchline for this dry fact is a little more attention-grabbing – historically this has happened ahead of seven previous recessions. This, coupled with the aforementioned trade war spat, unnerved global investors and further helped boost the case for gold.

What happened next?

So far, at least, we have avoided financial Armageddon. As is often the case in financial markets, the sky did not fall in and the price of gold has eased back.

Since its peak in September – incidentally, the highest price for gold in more than six years – the price has dropped by around $100. Some of the fears around an economic slowdown have faded. I also think that some of the later buyers of gold, looking to make a quick turn, became frustrated with the lack of progress and sold out of their speculative positions.

So, is that it for gold? The summer saw a brief spark of excitement; is it now going to continue to drift back to what the market considers a fairer value?

Gold September to present

The case for gold

Those trade-war concerns have died down to a certain extent over recent months. The US government continues to make optimistic noises that a so called "phase one" of agreement is near, representing at least a step in the right direction in resolving its disagreements with China. But this conclusion has already been delayed and the next round of tariffs is due to kick in around mid-December. If there is further postponement, expect those old investor worries to raise their heads once again.

Die-hard gold bugs will probably not agree, but it seems reasonable to view gold as just another currency against the US dollar, which is the

US Dollar Index, 2018 to present

main currency in which it is quoted on international financial markets. And as with other currencies, it typically moves in the opposite direction to the greenback. The last couple of years have been strong ones for the dollar.

The dollar index (DXY) is a very useful way of tracking the US dollar against a basket of other currencies. Over the past couple of years, the dollar index has risen about six percent. If the dollar were to continue this strength it would be expected to put some pressure on the gold price.

But the US central bank, the Federal Reserve, has recently cut interest rates and suggested it might be minded to again. Further cuts to rates and perhaps additional measures to stimulate the American economy could well change sentiment towards its currency, providing a lift to the price of gold.

Recovery is still intact

Looking at gold in isolation, and just focusing on the price trend, at the moment any weakness looks to be just a buying opportunity.

It is clear that gold made a base in the summer of 2018 and even before this summer's excitement, the price was in overall recovery, marking out a regular procession of higher highs and lows. This showed investors' keen appetite to be buyers on dips. The size of the run from June represents a sharp move away from that longer-term trend. There is definitely further scope for deeper gold weakness from here – but for now at least it would just knock the price back to its recovery trend that has been in place for the past 18 months. From a trend-following perspective, a slide to the $1,350/$1,400 zone would be seen as relatively normal and another opportunity to buy into that recovery.

Markets overshoot in both directions – on extremes of pessimism or optimism. I think that this definitely played its part in the summer surge for precious metals. For now, with stock markets in the US setting fresh all-time highs on a regular basis, many investors may shun the safe haven of shiny metals – which could mean that gold has further to slide in the short term. But medium to longer term, it looks too early to write off the possibility of a return to those six-year highs at $1,500 an ounce.

Gold price, August 2018 to present

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 ANDREW LATTO

QUALITY INVESTOR

GREGGS ON THE GO

Greggs has shown a remarkable trading and share-price performance of late – but can it continue? Andrew Latto investigates.

Greggs (LON:GRG) offers a remarkable story of self-improvement. It wasn't long ago that like-for-like sales fell for two consecutive years. A shift towards food-on-the-go (FOTG) has enabled Greggs to get back on track and outpace rivals.

In October 2012, the chief executive of Greggs, Ken McMeikan, hosted an open day for investors. The vision he outlined was one of expansion into new areas, including a coffee-shop brand, Greggs Moments.

The company had also started to wholesale products to supermarkets and franchise the brand. The pace of store openings was being accelerated at a time when a quarter of the stores were branded as Greggs The Bakery.

Behind the confident veneer, Greggs was in trouble. Like-for-like sales increased at a marginal pace from 2009 to 2011. The group then reported a 2.3% drop in like-for-like sales in the first half of 2012.

On 10 December 2012, Ken McMeikan announced he would leave Greggs to join Brakes Group. Roger Whiteside took over as chief executive on 4 February 2013, having had a long career in the UK retail sector.

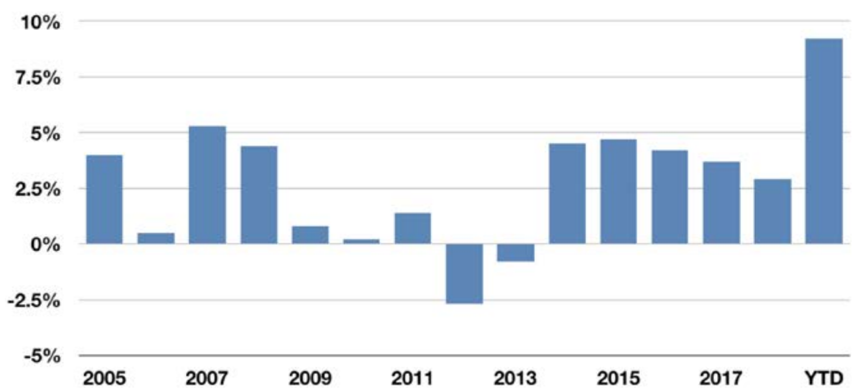
Recent trading has been strong, with five years of record profits and positive like-for-like sales growth. Like-for-like sales year-to-date (1 January 2019 to 7 November) have increased by an impressive 9.2%.

Quality investors

The largest investor in Greggs is MFS Investment Management with a 9.9% stake. MFS believes that holding securities for the long term underpins investment performance, with its website stating that:

"Strong fundamentals don't change as often as stock prices. So it's worth a little patience to let the markets reward companies with lasting competitive strengths. And we think quality creates more value over time."

Greggs-owned store like-for-like sales



Source: Greggs

Ceri Breeze / Shutterstock.com

"THE COMPETITIVE POSITION OF GREGGS HAS BEEN UNDERPINNED BY VERTICAL INTEGRATION – THE GROUP MAKES AND SELLS ITS FOOD."

Key investment takeaways

Greggs highlights the power of a leadership change to re-energise a brand. The scope for improvement is greatest after a period of underperformance.

Another lesson is the power of strategic reviews to simplify and refocus a business. Roger Whiteside announced that Greggs would pursue a new strategy when he announced interim results in 2013. It has served shareholders well.

Greggs also highlights the value of key business indicators. Like-for-like sales indicate whether stores are attracting more customers. Greggs reported the strongest like-for-like sales growth since 2007 in the years 2014 and 2015.

The competitive position of Greggs has been underpinned by vertical integration – the group makes and sells its food. This offers a cost and quality advantage over rivals and can help a business succeed.

Finally, Greggs demonstrates the power of word of mouth. The results of trading improvements were evident, with queues often heading out of the door. Breakfast deals, coffee, pizza slices and afternoon deals all proved to be hits.

Some of Greggs' popular offerings

Source: Greggs

Greggs The Bakery and Greggs Moments

Source: Greggs

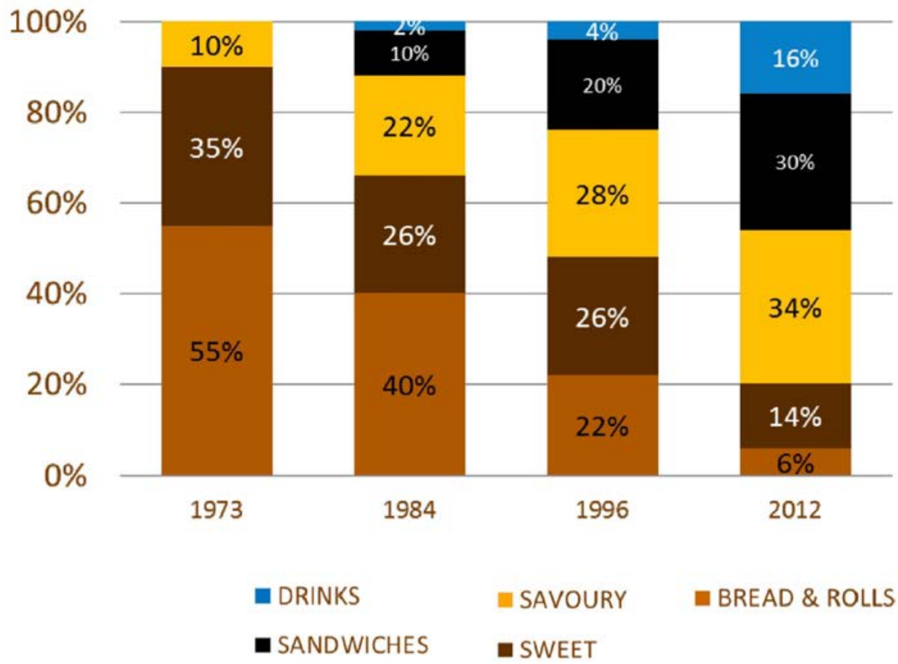
Greggs in 2012: full steam ahead

At 30 June 2012, Greggs had 1,604 shops, with 75% operating as FOTG outlets and 25% operating as Greggs The Bakery outlets. The group also ran five stores under the Greggs Moments coffee-shop brand.

The company was wholesaling its products to frozen-food store, Iceland and was looking to supply British military bases around the world. Motorway service-station franchising was announced in 2011, in partnership with Moto Hospitality.

The number of new store openings had increased from 68 in 2010 to 84 in 2011 and then 100 in 2012. The business appeared to be pursuing all the growth avenues that it could find.

Greggs' changing revenue mix



Source: Greggs

Failing to adapt

The market that Greggs served has been undergoing significant change, in large part due to the growth of supermarkets. Bread and rolls generated 55% of revenue for Greggs in 1973 but this figure fell to only 6% in 2012.

It made little sense for Greggs to operate a standalone bakery-store brand in the face of declining bread sales. The Greggs Moment coffee-shop concept was also launched into a highly competitive market.

In addition, the store estate was poorly positioned in light of the ongoing decline in the high street. In short, the roots of the business as a high-street baker had become a liability. The appeal of Greggs was in decline.

Greggs' 2013 strategic review

Roger Whiteside's 2013 strategic review identified the following issues: rapidly expanding new entrants and existing competitor shops; exposure to declining bakery categories eg bread; and exposure to locations unsuitable for FOTG.

The new strategy saw the group abandon both the coffee-shop concept and the Greggs The Bakery brand. Greggs would only take forward its mainstay FOTG brand. The strategic review stated that:

"Greggs must complete the transition from a traditional bakery retailer to the growing 'food on the go' market."

The medium-term priority for the estate was to increase the rate of shop relocations and limited net shop additions for two-three years. Developing new markets for the business was no longer a priority.

Store refits were undertaken to allow better use of space, to improve customer flow and offer a small seating area. Greggs' share of the UK FOTG market had fallen to 12% in 2012; it was time to fight back.

Changes in the product mix

The key growth segments for Greggs in recent years have been hot drinks, breakfast, hot food and dietary choice. New strategic categories accounted for 36% of revenue in 2018 versus 15% in 2013.

Breakfast-on-the-go is the fastest-growing part of daytime sales with fresh porridge and hot-breakfast boxes being rolled out. Vegan-friendly sausage rolls were launched in January 2019 and have been a big success.

Greggs before the store refresh

Source: Greggs

After the store refresh: Greggs with seats

Source: Greggs

Greggs' Mexican bean wrap

Source: Greggs

The group's Mexican bean wrap won the 'Best Vegan Sandwich' at the PETA Vegan Food Awards 2018. Greggs has also benefited from the success of its gluten-free soup and its healthy and low-calorie Balanced Choice range.

The chain is now in third place in the UK coffee market and its focaccia-style pizza slices have been a hit. Customers can purchase a pizza slice and a drink for only £2 after 4pm.

Greggs recently extended a 'click & collect' pilot scheme to seven cities and is trialling a delivery service with Just Eat and Deliveroo. An ongoing trial of late store-opening hours is benefiting from an extended range of 'post-4pm' deals.

Checking it out

In my hometown of Shrewsbury, a large Pret a Manger has recently opened next to an existing Greggs store. It appears to have had no impact, with queues for Greggs still heading out of the door at lunchtime.

The focaccia-style pizza slices from Greggs taste great but the Fairtrade coffee has been hit and miss. The pricing of Greggs' products is meaningfully lower than rivals, not least for meal deals.

The new Greggs format appears to work in locations that we might not associate with the brand. There are now three Greggs stores in the City of London, and they have all attracted favourable Google reviews. There also appears to be scope for Greggs to increase the number of stores in London.

Greggs today: £1billion sales in 2018

Greggs increased revenue from £33 million in 1982 to over £1 billion for the first time in 2018. The FOTG format now accounts for 92% of stores, with 90% open by 7am from Monday to Friday.

The proportion of the store estate that is in travel-focused catchment areas now stands at 38%. Greggs wants to lift this figure to 50% over the long term, in order to reduce its exposure to the high street.

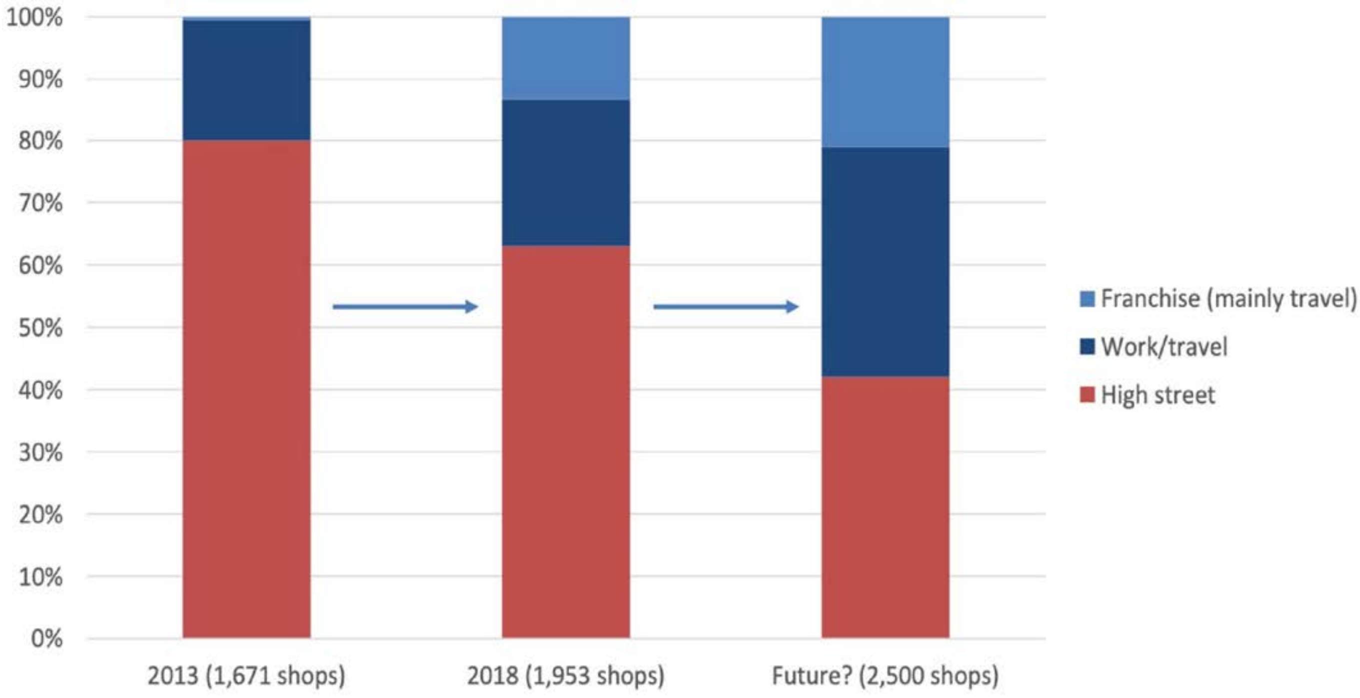
The group returned to store growth in 2015 and hit 1,984 stores at 29 June 2019, 14% (275 stores) of which were franchised. This compares to 1,319 stores in 2005 and 1,671 stores in 2012.

Greggs at 29 June 2019

Total number of outlets	1,984
Of which franchised (mainly in travel locations)	14%
Drive-through stores	4
Estate serving travel-focused catchments	38%
Greggs on the go format stores	92%

Source: Greggs

Greggs' store estate: retreat from the high street



Source: Greggs

Growth target: 2,500 shops

Greggs has a target for at least 2,500 shops, representing growth of 28% on the number of stores at the end of 2018. Travel represents a growth opportunity with a number of stores now operating inside London Underground stations.

Franchising is another avenue for growth. Greggs opened its two-hundredth franchise in 2017, having first franchised the brand in January 2012.

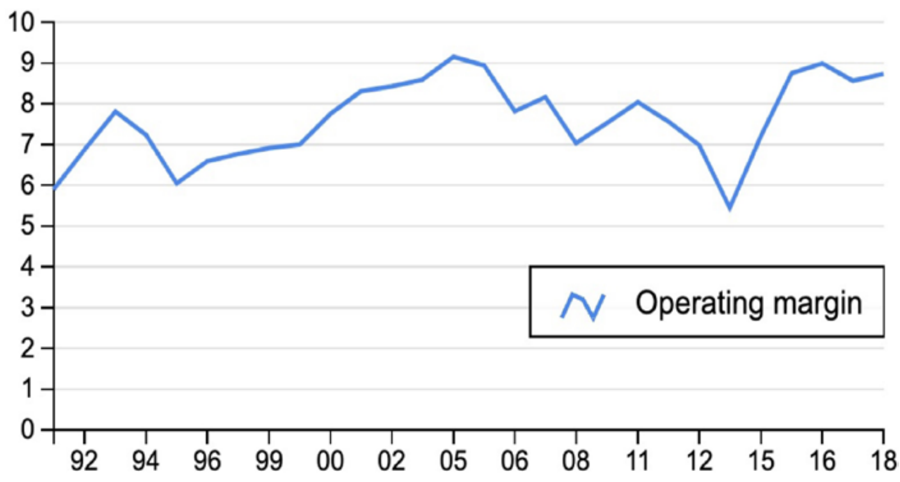
Improving the quality and range of products at Greggs has helped to attract a wider audience. Greggs sells Fairtrade coffee and all of the palm oil supplied to the group is from sustainable sources.

Stable margins

Greggs operates with relatively low profit margins, but they have proven to be stable during downturns. The financial crisis saw the operating profit margin dip to 7.1% in 2008, in comparison with 8.1% in 2007, but it bounced back to 7.9% in 2010.

The decline in like-for-like sales in 2012 and 2013 caused the operating profit margin to drop to only 5.4% in 2013. The key risk for Greggs is that it fails to remain relevant, resulting in fewer customers coming through the door.

Greggs has a stable operating profit margin



Source: SharePad

'Competitive moat': the supply chain

Greggs makes and sells its products, which enables it to capture all of the available profit margin. Vertically integrated firms can offer lower prices than competitors and also have greater control over their brand.

A disadvantage of vertical integration is that it can be capital intensive. It isn't cheap to lease stores and build production facilities. But in doing so, companies can build a competitive moat and increase their market share.

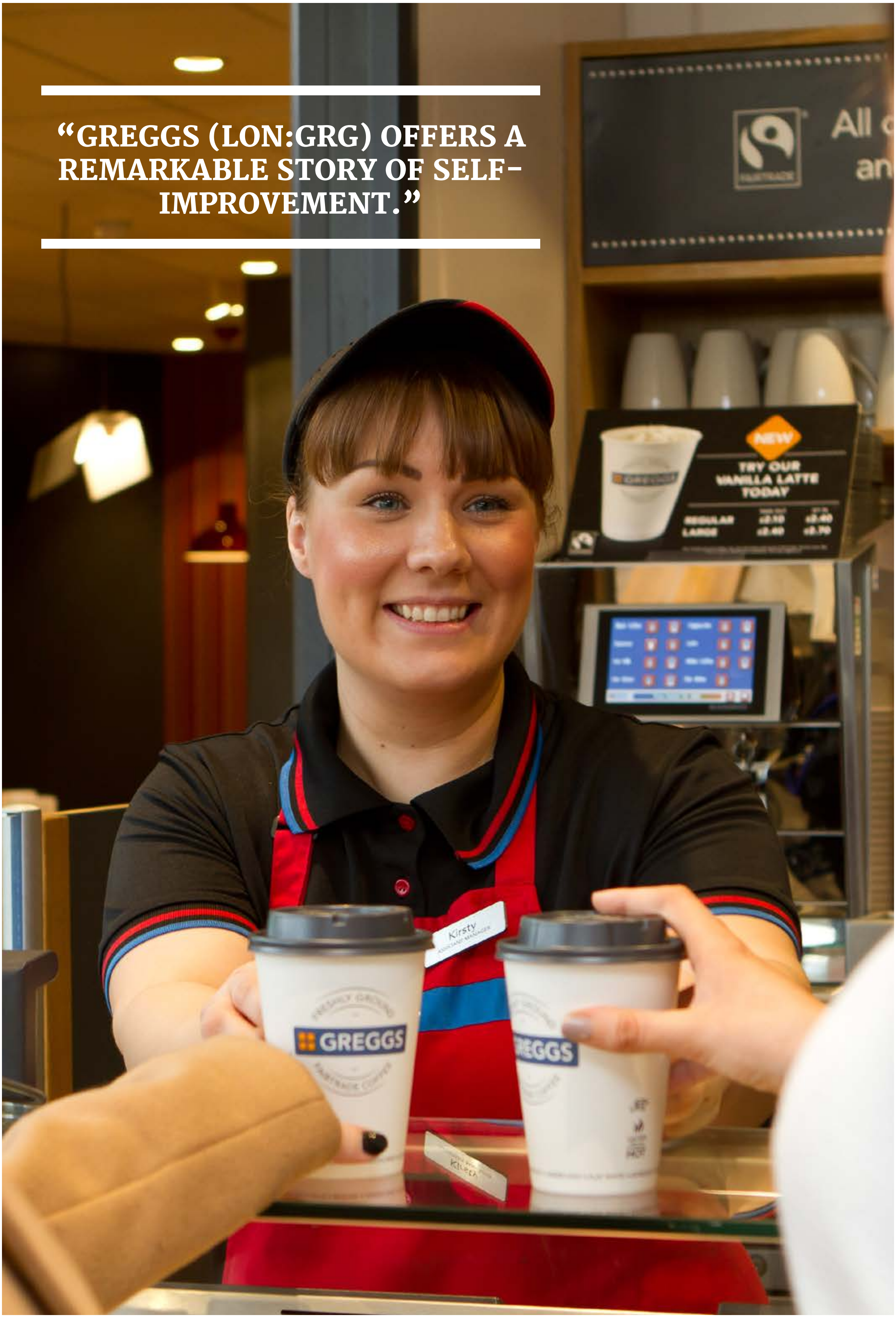
Additional competitive moats

As a national chain, Greggs benefits from strong brand awareness and the ability to advertise through multiple channels. The group can also invest in digital services such as a smartphone app and SAP supply-chain technology.

Greggs' distinctive culture may be unique, with 10% of annual profits distributed to staff – a total of £10m in 2018. Attracting and retaining staff in the food-service sector is easier said than done.

Greggs has scope to take market share from independent sandwich shops on the back of its low prices, good service and brand awareness. The company makes fresh sandwiches every day, giving it a superior offering to the supermarkets.

"GREGGS (LON:GRG) OFFERS A REMARKABLE STORY OF SELF-IMPROVEMENT."



Return on capital

Greggs hasn't cut its dividend payout since 1994 and paid out special dividends in 2015 and 2019. While the business doesn't generate a high return on capital, it has been able to deliver growth through store expansion.

The lease-adjusted return on capital employed (ROCE) came in at a respectable 16.7% in 2018. The cash-flow return on capital employed (CROCI) improved to 13.8% in 2018, the highest level since at least 2005.

Three factors should help Greggs improve the return on capital: increasing the percentage of franchisee shops; improving like-for-like sales; and renewing leases at lower rates.

Valuation

Greggs' share price has increased from £5 in 2014 to £20.56 on 15 November 2019. This has pushed the forecast P/E for 2020 to 22.3X. While the rating is 'punchy', the forecast free cash-flow yield is 5.1% in 2020.

The forecast dividend yield for 2020 is 2.4% with 1.9X dividend cover. On face value, much of the positive news is already in the price. But the recent trading momentum may see Greggs continue to outstrip profit forecasts.

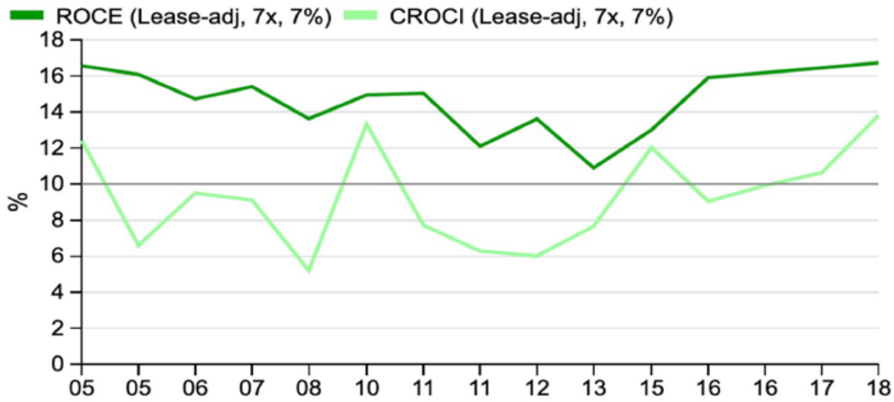
The long-term potential depends on whether Greggs can expand beyond its 2,500-store target. The success of new products and the new store format suggests that Greggs can continue to grow.

Summary

Greggs and its iconic sausage roll have withstood the test of time. John Gregg founded the eighty-year-old business in Newcastle back in 1939. There appears to be no reason why the group won't continue to thrive.

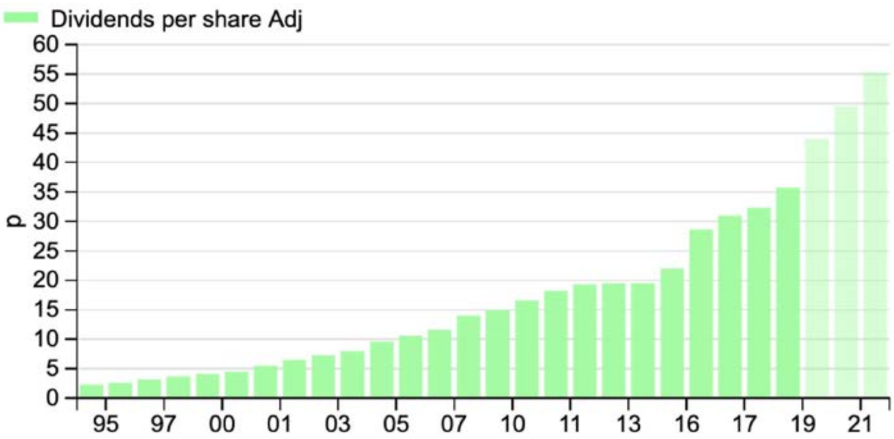
Greggs has a successful food-retail concept that delivers "good, honest food that our customers can trust, at affordable prices." The scope to improve profitability will be keenly watched by investors as the business evolves.

Greggs' financial returns are improving



Source: SharePad

Greggs has an outstanding dividend track record



Source: SharePad

About Andrew

Andrew Latto, CFA, is an independent analyst and the founder of www.fundhunter.co. Fund Hunter's mission is to identify the best investment funds. The Fund Hunter model portfolio has meaningfully outperformed the All-Share index since inception. Andrew previously worked for an investment management company and a research company. He also contributes to www.cube.investments.

BY ROBERT STEPHENS, CFA

STOCKS IN FOCUS

ITV

CHALLENGES AND OPPORTUNITIES

Robert Stephens discusses how ITV's ongoing financial challenges could provide long-term investors with a buying opportunity.

Buying a company that recently reported a 2% decline in revenue during the first nine months of 2019 may not sound like a great idea. However, ITV's ongoing financial challenges could provide long-term investors with a buying opportunity.

The media company faces two significant difficulties that, in time, it has the potential to overcome. First, it is experiencing challenging trading conditions brought on by the UK's persistent economic weakness. They contributed to a 13% decline in its first-half earnings per share (EPS), with its full-year EPS forecast to fall by 16%.

However, its valuation and plans to reduce costs could produce growth catalysts in its financial outlook, that lead to a higher share price. Meanwhile, its international growth potential may reduce its reliance on a struggling UK economy.

Second, the company is operating within a rapidly changing media industry. The growth in streaming services such as Netflix, as well as the increasing popularity of online advertising, have disrupted ITV's business model to some extent.

In response, it is investing in its direct-to-consumer channels, such as BritBox and in its Studios division. In addition, the ITV Hub offers advertisers a valuable younger demographic.

Trading on a low valuation and offering a generous income return, the company's investment appeal could be high for long-term investors who are comfortable with above-average share-price volatility in the short run.

Economic challenges

ITV's difficult trading conditions have contributed to a reduction in demand for TV advertising. For example, the UK's GDP growth rate has rarely been above 2% in the last three-four years. Its outlook continues to be downbeat, with UK GDP forecast to rise by 1.2% in 2019 and 1.4% in 2020.

Alongside weak economic growth, business and consumer confidence are at low levels. For instance, the GfK consumer confidence index has been below zero (which indicates pessimism) for the last four years. This may have caused advertisers to reduce their marketing budgets in what are difficult operating conditions.

As a cyclical business that relies upon the performance of the wider economy, weak economic growth and political uncertainty have contributed to a decline in ITV's bottom line. In 2017 and 2018, it has fallen by 6% and 4% respectively on a per share basis.

A changing strategy

In response to economic and political uncertainty, the company is aiming to become increasingly efficient. It previously set out plans to reduce its costs by around £40 million by 2022. However, it has increased that amount so that it now plans to cut costs by £60

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"THE COMPANY IS SEEKING TO DIVERSIFY ITS GEOGRAPHICAL EXPOSURE THROUGH ONGOING INVESTMENT IN ITS STUDIOS DIVISION."

million over the next three years. This amounts to around 13% of its fully addressable cost base, which could catalyse its profitability in an era of lacklustre revenue growth.

In addition, the company is seeking to diversify its geographical exposure through ongoing investment in its Studios division. It produces content for a variety of broadcasters and platform owners, such as the BBC and Netflix, and generates 56% of its revenue from non-UK markets. This could reduce ITV's reliance on the UK and increase its access to fast-growing markets. The division is expected to deliver an annual revenue growth rate of 5%, with an operating margin of between 14% and 16%. The company plans to invest in the fast-growing Drama segment, as well as advance its monetisation capabilities, to maximise the profitability of its Studios segment.

The task of overcoming a weak UK economic outlook could be made easier through the company's plans to drive more occasional viewers to its channels. It is investing in evolving its brand to become increasingly creative and modern, while it is also investing in off-air marketing to grow its share of viewers.

Industry changes

As well as political and economic uncertainty, ITV's financial performance has also been impacted by disruption in the wider media industry. The ways in which consumers are viewing content have changed significantly – especially among a younger demographic. They have contributed to an annualised growth rate in subscriber video on demand (SVOD) services, such as those provided by Netflix, of around 20% in the UK.

In addition, the increasing popularity of online advertising has put pressure on the TV advertising industry. Online advertising is much more accessible for a range of businesses, with the upfront capital cost generally being lower than for TV advertising. Online advertising may also have a short lead time for advertisers, which can allow them to be more responsive to changes in their industries and the evolution of consumer tastes. Online advertising is expected to account for 62% of total UK advertising spending in 2020.

Growth opportunities

In spite of the growing popularity of online advertising, TV advertising offers significant reach and scale. Research has shown that TV delivers the highest return of any form of advertising. For example, it offers a £4 return for every £1 spent, which is significantly higher than the £1 return per £1 spent online.

ITV's response to changing viewing habits could enable it to capitalise on a growing market. Notably, it launched a joint venture with the BBC – BritBox, in the UK in November 2019. This follows the streaming service's success in the US, where it has over 650,000 subscribers.

BritBox offers an extensive back catalogue of popular UK dramas, comedies and other shows that are likely to prove popular across a wide range of consumers. Since 34% of UK households currently subscribe to more than one streaming service, and 44% of all online homes are interested in a service focused on British content, the growth potential of BritBox seems to be high.

BritBox has significant differentiation when compared to existing streaming services such as Netflix and Amazon Prime. Their content is generally global, which could mean that BritBox becomes the de facto second-choice streaming service for many households, due to its UK focus. This may mean that while it operates in the same segment as major incumbents, it does not directly compete with them.

The company's online offering, ITV Hub, continues to grow in popularity. It is currently pre-installed on over 90% of all connected TVs sold in the UK, which has helped it to record a registration rate of 81% among the UK's 16-34-year-olds. They are attracted to ITV Hub as a result of its simulcast viewing, and its extensive catch-up features. Its popularity could increase as a new design is being rolled out that includes greater features, more personalisation and a simpler user interface. This could encourage greater cross-selling opportunities between different content segments.

ITV Hub allows the business to collect significant amounts of data on its viewers that, when combined with other data collected across its operations, means it can make personal recommendations and drive increased viewership. It also provides a more focused offer for the company's advertisers that may boost spending levels over the long run. This is being advanced through the company's development of science-led advertising products that could increase its revenue-growth opportunities.

Additionally, ITV Hub presents an upselling opportunity to an ad-free subscription version that offers download capabilities. Its number of subscribers doubled in the 12 months to July 2019, and provides a recurring income stream that may lead to an increasingly resilient financial outlook for the business. It intends to use a wealth of data to improve customer acquisition and retention to boost its online revenue-generating capabilities.

> **"ITV HUB PRESENTS AN UPSELLING OPPORTUNITY TO AN AD-FREE SUBSCRIPTION VERSION THAT OFFERS DOWNLOAD CAPABILITIES."**

Maksumov / Shutterstock.com

Investment potential

Overcoming the prospect of a weak UK economic outlook and a fast-changing media industry is likely to take time. Investors appear to be factoring this into the company's valuation, with ITV currently trading on a forward price-earnings ratio of 10.5. This factors in its forecast double-digit decline in EPS in the current year, while its expected 2% rise in EPS next year provides evidence that even with a sound growth strategy, the business is unlikely to produce a quick turnaround.

However, the changes it is making to its strategy could improve its market position over the long run. BritBox offers significant growth potential in what is an already popular market segment where the business lacks presence. Its lack of content overlap with existing players such as Netflix and Amazon Prime could work to its advantage at a time when many households are open to the idea of having multiple streaming service subscriptions.

Similarly, ITV Hub offers strong growth potential. Its focus on a younger demographic, as well as the data that it offers, could drive advertising spend higher at a time when online advertising has become increasingly popular. It also has the potential to upsell to a paid version that may prove to be increasingly popular among a wider range of consumers.

The uncertain outlook for the UK economy may continue to weigh on the company's financial performance, as well as its share price. This may dissuade short-term investors from buying shares in the business. However, its sound strategy and the cyclicality of the industry could mean that its current low valuation offers a buying opportunity for long-term investors.

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

DERIVATIVES IN A DAY

EVERYTHING YOU NEED TO MASTER THE MATHEMATICS POWERING DERIVATIVES

BY STEWART COWLEY

Richard Gill reviews *Derivatives in a Day*, a book which provides investors and finance professionals with an introduction into what can often be seen as a complicated market.

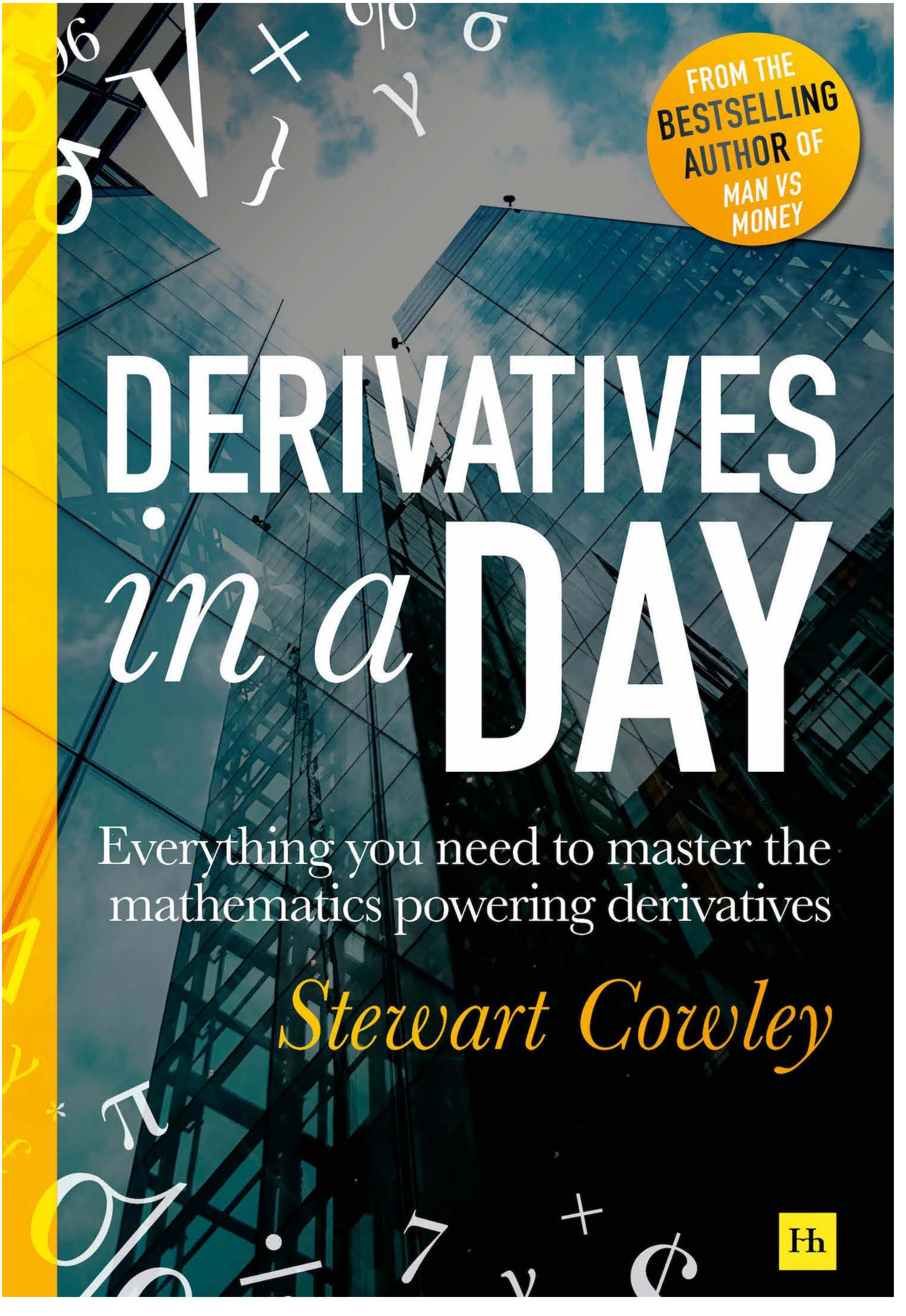
In his 2002 Chairman's letter to Berkshire Hathaway shareholders, Warren Buffett commented that *"... derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal."* He added, *"...these instruments will almost certainly multiply in variety and number until some event makes their toxicity clear."* The 'Sage' was proven to be right, as just a few years later the crisis in US mortgage-backed securities brought about the greatest global recession in a generation. But, despite their reputation, financial derivatives can be useful instruments for investors who want to minimise risks and improve returns in their portfolio.

To give a simple definition, a financial derivative is an instrument whose value is derived from an underlying asset such as a commodity, index, bond, currency or share. Some of the better-known ones include options, which give investors the right to buy or sell an underlying asset at a certain price, and futures, a contract to buy or sell a specific amount of an asset at a future date for a price agreed upon today. More exotic products include credit-default swaps and the commonly criticised collateralised-debt obligations.

"FINANCIAL DERIVATIVES CAN BE USEFUL INSTRUMENTS FOR INVESTORS WHO WANT TO MINIMISE RISKS AND IMPROVE RETURNS."

Futures have history

While many unfamiliar with the subject might think they are a recent invention, derivatives have in fact been around since the early days of human civilisation. In his paper *A Short History of Derivative Security Markets,* economist Ernst Juerg Weber suggests that derivative contracts emerged as soon as humans were able to make


FROM THE BESTSELLING AUTHOR OF MAN VS MONEY
DERIVATIVES in a DAY
Everything you need to master the mathematics powering derivatives
Stewart Cowley
Hh

credible promises and document these in writing.

The first such contracts were written in cuneiform script on clay tablets, so have lasted well to the present day. The earliest example Weber gives is of a 19th century BC wood supplier named Akshakshemi who promised to deliver 30 wooden planks (10 of 3.5 metres each and 20 of four metres each) at a future date to a client called Damqanum. I'm sure Fred Flintstone's employer, the Bedrock Quarrel and Gravel Company, had similar deals in place.

It is only in the past two decades, however, that the derivatives market has skyrocketed. According to the Bank for International Settlements, notional amounts of over the counter (OTC) derivatives rose to $640 trillion at the end of June 2019, up from $544 trillion at the end of 2018 and reaching their highest level since 2014. To put that in context, that's more than seven times the World Bank's estimation of global GDP for the whole of 2019.

For those looking to demystify this important financial market, *Derivatives in a Day* is a practical guide to the subject written by former fund manager Stewart Cowley. Beginning his financial career in 1987, Cowley is perhaps best known for his time as Head of Fixed Income and Macro at Old Mutual Global Investors, where he managed the £559 million Old Mutual Strategic Bond fund. He is one of a handful of people to have ever held a triple-A rating by Standard & Poor's and was awarded the prestigious Gold Medal for long-term investment performance by FE Trustnet. Previous books, *Man vs Money* and *Man vs Big Data*, have both been best-sellers.

Forward looking

Through eight chapters, *Derivatives in a Day* provides investors and finance professionals with an introduction to what can often be seen as a complicated market. The broader themes of the book look into what derivatives are, how you can alter the characteristics of a portfolio using derivatives, how you can protect a portfolio using derivatives and how you can increase returns to a portfolio using derivatives. The mathematics behind each element, while sometimes requiring some effort to understand, are laid out clearly and supported by simple spreadsheet examples and illustrations so investors can get a deeper understanding of how they work.

After a brief introduction, Chapter Two looks at the early development of derivatives, moving past the Stone Age example provided previously and into the slightly more recent past. Cowley discusses the first organised use of derivatives on the Dojima Rice Exchange in Japan in the 1700s, where traders could buy and sell standardised contracts for a set amount of rice at a prearranged price for settlement on a certain date. We then move onto some basic maths needed to understand how derivatives work, including the future value equation, critical in calculating how to price derivatives.

Two kinds of derivative are examined in detail in the book, with Chapter Three kicking off with futures. We learn more about how futures should be priced, along with how they can be used to minimise risk, how the markets work and common characteristics (including the difference between futures and forward contracts. Later, in Chapter Six, we learn how to use futures in a portfolio, Cowley covering equity, index and bond futures, along with some of the more in-depth financial theory.

The remaining chapters are largely dedicated to the wonderful world of options, an instrument arguably invented by ancient Greek mathematician Thales of Miletus, when he bought the rights to use olive presses just before a strong harvest. As well as using options as an instrument to buy an asset you can also use them to sell something at a certain price. A put option, giving the rights to sell a share at a certain (higher) price after it has plummeted in value, could be very lucrative. As with futures, Cowley describes the various option-market conventions, how profits can be made and how to work out what they're worth.

Good option

Futures, options and other derivatives are a large and often confusing market, often well beyond the usual consideration of a typical retail investor. But they can be used to good effect, minimising risks within a portfolio and, if used carefully, providing the opportunity for extra profits. *Derivatives in a Day* is an ideal book for those who want to enter this important area of finance, as it's a thorough, introductory guide, priming readers to further build their knowledge. After reading it you'll be offsetting your gamma risk and hedging your delta exposure in no time.

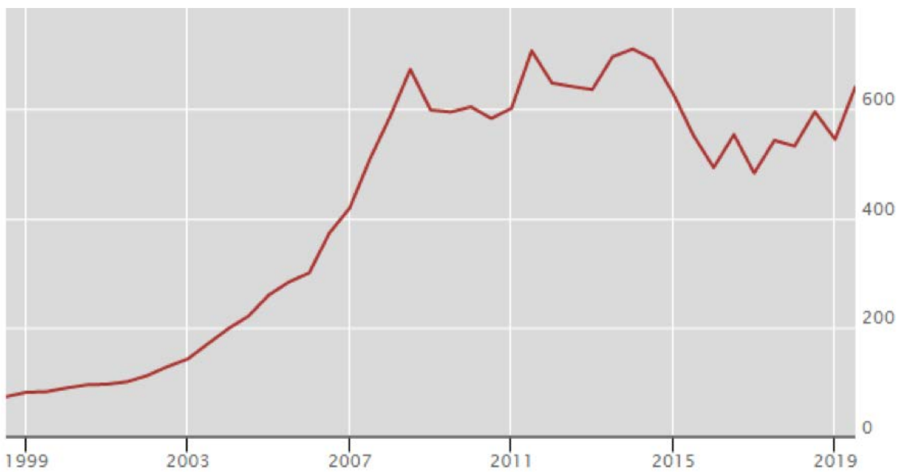


Chart: notional value of OTC derivatives. Source: Bank for International Settlements

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

A GREAT DEAL OF RUIN

The December General Election will arguably be the most important in our lifetime. Its implications, both economically and politically, will be profound, argues Tim Price.

"Hoping for a really FILTHY election campaign. I want to see proper threats, lawsuits, dirt, blackmail, galactic class hypocrisy, rent boy scandals, closet skeletons, the lot. Fleet Street, do your JOB."

— Tweet from Old Holborn QC (@Holbornlolz), October 30 2019.

The great economist, Adam Smith, once remarked that there's a great deal of ruin in a nation. The full context of his remark is intriguing. He was replying to a correspondent reporting on news of General Burgoyne's defeat at Saratoga in late 1777. The correspondent feared that Britain's war effort in America promised calamity, and Smith's stoic response was designed to settle his nerves.

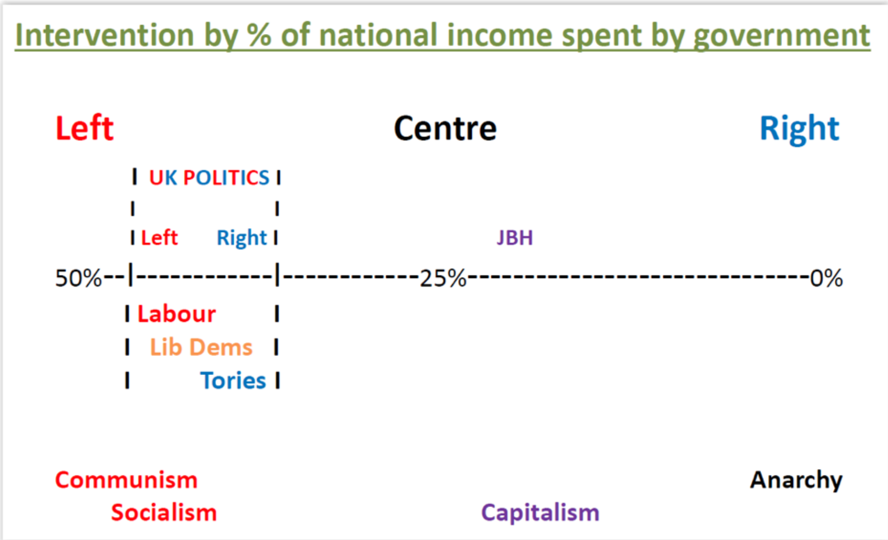
But once a country definitively hits the skids, it can be a long slide down. Argentina, for example, was, at the start of the twentieth century, one of the wealthiest countries in the world, blessed with an abundance of fertile agricultural land. But once a military junta seized power in 1930, the jig was up. Chronic political instability and a succession of incoherent economic policies created a 'basket-case' economy whose government would ultimately default on its debt nine times following its independence from Spain – three times since the turn of the millennium.

So, as we head towards one of the most fractious general elections in our country's recent history, there is some cause for concern. The die in favour of free-market capitalism was not definitively cast when Margaret Thatcher turned back the socialist tide in 1979. The country could yet take two steps backwards to the miserable economic conditions of the 1970s.

Indeed, for all the headline-making bluster of the three main British political parties, they have more in common economically than meets the eye. I am indebted to John Hearn of the London Institute of Banking and Finance for

"IN THE ABSENCE OF THE PROLONGED TORTURE OF ANOTHER HUNG PARLIAMENT, WE WILL SOON KNOW THE COMPOSITION OF A NEW GOVERNMENT, AND PERHAPS THE LIKELY FATE OF A COUNTRY STRUGGLING TO FREE ITSELF FROM THE EUROPEAN UNION."

"AS WE HEAD TOWARDS ONE OF THE MOST FRACTIOUS GENERAL ELECTIONS IN OUR COUNTRY'S RECENT HISTORY, THERE IS SOME CAUSE FOR CONCERN."



Source: London Institute of Banking and Finance / John Hearn

This chart, which highlights just how similar the 'tax and spend' policies of Labour, the Lib Dems and the Conservatives actually are. Each major party has pledged to spend something approaching half of our country's GDP on forming a government. John's own preference for government spending is just under 25% of national income, as denoted by that lonely looking 'JBH' on the chart.

It wasn't always like this. At the beginning of the twentieth century, the UK government was only spending approximately 10% of the nation's income. Then came two world wars and a long period of national decline, arguably reversed only by the 'shock economics' of the Thatcherite free-market revolution. Nevertheless, subsequent Conservative governments have shown no obvious enthusiasm for either balancing the country's books or taking the foot off the spending pedal.

It is as if all of our political parties have forgotten – if they ever even knew – how wealth is created. Without the risk-taking of the entrepreneur, there is no capital for government to redistribute in the first place. And there are only three ways of spending money. One is to spend one's own money on oneself. Such spending will likely be done well. Another is to spend one's own money on other people. Such altruistic spending will also likely be done well, and at least on a targeted basis. The last way is to spend other people's money on other people. That is what government does, and it is invariably done badly, and with unintended consequences.

In the absence of the prolonged torture of another hung parliament, we will soon know the composition of a new government, and perhaps the likely fate of a country struggling to free itself from the European Union – a classic example of Big State economics if ever there was one. The existential co-mingling of Brexit and a clear Conservative majority in parliament is what makes this December general election so critical for the country's future. An electoral failure to deliver both cleanly has a good chance of jeopardising our country's economic prospects in a profound way.

One of the stranger aspects of Brexit coverage within Britain's mainstream media has been the almost complete absence of any commentary about the failing nature of the eurozone's financial system. Analyst Russell Napier has been one of the few to point out the transparency of the EU 'Emperor's new clothes'. It was Russell, in August 2019, who highlighted the danger of the eurozone's Bank Resolution and Recovery Directive (BRRD), which was enshrined in eurozone law back in 2014. The BRRD explicitly removes any guarantee for large-scale banking depositors. It does, however, ensure that large-scale depositors at a failing eurozone bank will be bailed in as required in any future 'recovery' action.

The BRRD helps account for why institutional investors are taking money away from German banking

chrisdorney / Shutterstock.com

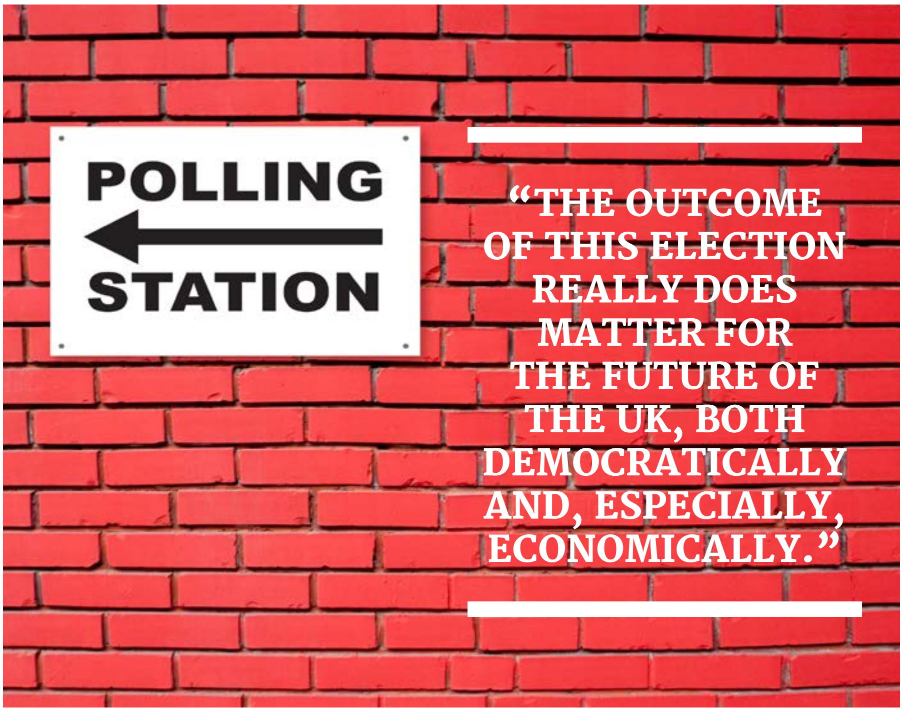
groups, for example, and reinvesting that capital in German government bonds. It is not because they have any great enthusiasm for negative yielding German government bonds, but primarily because they fear the consequences of a German bank becoming insolvent (the name of Deutsche Bank usually features at this point of the conversation between European financial gossips). It all comes down to counterparty risk. As Russell points out, there is a way of describing money being taken out of banks for fear of appropriation, and of losing it, in part or in whole. It is called a bank run. And it is already well under way in the eurozone. Still keen on 'Remaining'?

One of the reasons I have been such a passionate 'Leaver', both before and especially after the June 2016 referendum, is that I believe in democracy. But I also believe in sound economics. For me, the economic arguments trumped all others. Yes, there will inevitably be some short-term pain as the UK reconfigures its trading relationship with the rest of the EU. But that short-term pain has to be balanced against the opportunity of negotiating free-trade agreements with those parts of the world growing far more quickly than the eurozone. (There's a reason why the fund I co-manage has the lion's share of its investments in Asia.) And it also has to be weighed up against the long-term cost of having to participate – on an involuntary basis – in a bail-out (or even worse, a bail-in) of failing eurozone banks and financial institutions brought to the brink of insolvency in no small part by the ECB's monetary policies.

The democratic aspect of Brexit cannot, however, be overstated. Over three years ago, the UK as a whole voted to leave the EU. This was in the face of massive opposition from the Establishment, including the government of the day, the Bank of England, the US president, the IMF, the TUC, the BBC and just about every firm in the City of London. You cannot decide not to implement the outcome of a legitimate vote just because you happen to disagree with it after the fact. Only banana republics do that. For this reason, I have nothing but contempt for the official Brexit policy of the Liberal Democrats. Labour is not much better, with Jeremy Corbyn having sat on the Brexit fence for so long that the iron has entered his soul. And the less said about Labour's economic policy, the better. In any case, John Gray, the British philosopher, writing for *The New Statesman* on Brexit earlier this year, points out that the debate transcends 'mere' economics, and gets to the heart of what moves people politically and emotionally:

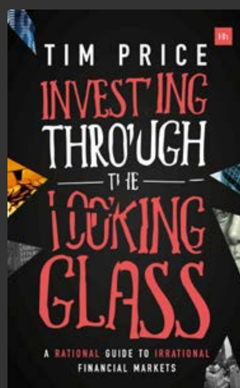
> "The British political classes have made the same mistake that Keynes ridiculed in his early self. They have failed to understand some of the most powerful human needs. If a majority in Sunderland continues to support Brexit despite the threat it poses to Nissan expanding its operations in the area, the reason can only be that they are irrational and stupid. The possibility that they and millions of others value some things more than economic gain is not considered. Persistently denying respect to Leave voters in this way can only bring to Britain the dangerous populism that is steadily marching across the European continent".

So, the outcome of this election really does matter for the future of the UK, both democratically and, especially, economically. I speak as a believer in democracy and free-market capitalism, and as an investor. Money goes naturally to where it is most respected. Take it for granted or treat it with contempt, and it will go somewhere else. If, as a by-product of our general election, Brexit is thwarted, or overturned, or watered down as to make it essentially pointless, the implications for our political and economic future are grave. I have no wish for Britain to emulate either Argentina or Zimbabwe.



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'.



DECEMBER 2019

INVESTOR EVENTS DIARY

EVERY WEDNESDAY | 12:30

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

MONDAY, 2 DECEMBER | 16:00-19:30

Event:	FinecoBank and WisdomTree: How ETP and ETF can improve your investment strategies
Organiser:	Fineco Bank
Place:	Fineco London hub (register and receive full details)
Tickets:	https://finecobank.com/uk/public/corsi-e-education

WEDNESDAY 4 DECEMBER | 16:00-17:30

Event:	Tips and Tricks for your first trade: Get started with Fineco
Organiser:	Fineco Bank
Place:	Fineco London hub (register and receive full details)
Tickets:	https://finecobank.com/uk/public/corsi-e-education

THURSDAY, 5 DECEMBER

Event:	Plan to Grow: The essential event to bring you up to date on trends in the EIS & BR markets.
Organiser:	EISA
Place:	The Great Hall, ICAEW, One Moorgate Place, London EC2R 6EA
Tickets:	https://eisa.org.uk/events

WEDNESDAY 11 DECEMBER | 12:30-13:15

Event:	Navigating your pension and the LTA
Organiser:	Netwealth
Place:	Webinar
Tickets:	https://register.gotowebinar.com/register/1265947303995322635

WEDNESDAY, 11 DECEMBER | 13:00-18:00

Event:	The Basics of Scalping Stock Indices
Organiser:	Fineco Bank
Place:	Fineco London hub (register and receive full details)
Tickets:	https://finecobank.com/uk/public/corsi-e-education

WEDNESDAY, 11 DECEMBER | 18:00-20:30

Event:	Funders & Founders; Christmas Networking Reception
Organiser:	Business Funding Show
Place:	WeWork Paddington
Tickets:	www.businessfundingshow.com/events

THURSDAY, 12 DECEMBER | 09:30-17:30

Event:	The Sustainable and Social Investing Conference
Organiser:	Investor Conferences (UK) Ltd
Place:	Novotel London West, 1 Shortlands, London W6 8DR
Tickets:	Code MI2019 for £20 off. www.eventbrite.co.uk/e/the-sustainable-social-investing-conference-tickets-65928069631

MONDAY, 16 DECEMBER | 16:00-19:00

Event:	Fineco Bank and L&G: Brexit and New Parliament. How the equity market is going to react?
Organiser:	Fineco Bank
Place:	Fineco London hub (register and receive full details)
Tickets:	https://finecobank.com/uk/public/corsi-e-education

TUESDAY 17 DECEMBER | 12:30-13:15

Event:	Income-only vs total return investing: where best to focus?
Organiser:	Netwealth
Place:	Webinar
Tickets:	https://register.gotowebinar.com/register/5118706416466771979

WEDNESDAY, 18 DECEMBER | 16:00-17:30

Event:	Fineco investing platform: sectors overview, assets breakdown and fund descriptions
Organiser:	Fineco Bank
Place:	Fineco London hub (register and receive full details)
Tickets:	https://finecobank.com/uk/public/corsi-e-education

THURSDAY, 20 FEBRUARY 2020 | 10:00-17:00

Event:	The Business Funding Show
Organiser:	Business Funding Show
Place:	East Wintergarden, 43 Bank St, London E14 5NX
Tickets:	www.businessfundingshow.com/events/the-business-funding-show-2020

FRIDAY, 28 FEBRUARY 2020 | 09:30-17:00

Event:	The London Trader Show
Organiser:	Investor Conferences (UK) Ltd
Place:	Novotel London West, 1 Shortlands, London W6 8DR
Tickets:	www.eventbrite.co.uk/e/london-trader-show-2020-tickets-59881575404

SATURDAY, 28 MARCH 2020 | 09:30-17:00

Event:	Master Investor Show
Organiser:	Master Investor
Place:	Business Design Centre, 52 Upper St, London N1 0QH
Tickets:	50% discount using code: MAG10 https://masterinvestorshow.eventbrite.co.uk

THURSDAY, 2 APRIL 2020 | 09:00-17:00

Event:	UK SPINE Annual Conference 2020
Organiser:	UK SPINE consortium (led by University of Oxford)
Place:	Jurys Inn Birmingham, 245 Broad Street, Birmingham B1 2HQ
Tickets:	www.kespine.org.uk/events/conference-2020-free-flow-knowledge-accelerate-innovation-healthy-ageing

MARKETS IN FOCUS

NOVEMBER 2019

GLOBAL EQUITIES

Index	Last Month %	YTD%	52-Week Strength
NASDAQ 100	4.0	32.8	
Dow Jones	3.7	20.3	
S&P 500	3.4	25.3	
CAC 40	3.1	24.8	
Euronext 100	2.9	23.3	
DAX Xetra	2.9	25.4	
S&P/ASX 200	2.7	21.2	
Swiss Market	2.7	24.5	
FTSE All-World	2.3	19.9	
Nikkei 225	1.6	16.4	
FTSE 100	1.4	9.2	
Russian TSI	1.1	34.6	
Bovespa	1.0	23.2	
CSI 300	-1.5	27.2	
Hang Seng	-2.1	1.9	

COMMODITIES

Commodity	Last Month %	YTD%	52-Week Strength
Coffee	16.2	16.3	
Cocoa	8.1	7.5	
Crude oil (Light Sweet)	7.3	26.9	
Palm Oil (Crude)	5.1	22.5	
Crude oil (Brent)	4.7	14.6	
Palladium	2.9	50.8	
Sugar (No. 11)	2.5	6.3	
Copper	2.2	2.5	
Gold	-3.6	13.7	
Cotton	-4.0	-14.3	
Platinum	-4.1	11.7	
Natural Gas	-5.0	-15.5	
Iron Ore	-5.1	19.1	
Silver	-5.6	9.6	
Bitcoin	-18.1	109.0	

FOREX

Pair/Cross	Last Month %	YTD%	52-Week Strength
GBP/AUD	1.6	5.7	
USD/JPY	1.4	-0.2	
USD/CHF	1.2	1.6	
USD/CAD	0.9	-2.4	
EUR/JPY	0.1	-4.1	
EUR/CHF	-0.1	-2.1	
GBP/USD	-0.2	1.4	
EUR/GBP	-1.1	-5.3	
EUR/USD	-1.3	-3.9	
AUD/USD	-1.8	-4.2	

CENTRAL BANKS – RATES & MEETINGS

Central Bank	Key Rate	Next	After
Bank of England (BoE)	0.75%	Dec 19	Jan 30
European Central Bank (ECB)	0.00%	Dec 12	Jan 23
Federal Reserve System (FED)	1.75%	Dec 11	Jan 29
Bank of Japan (BoJ)	-0.10%	Dec 19	Jan 21
Bank of Canada (BoC)	1.75%	Dec 04	Jan 22
Reserve Bank of Australia (RBA)	0.75%	Dec 03	Feb 04
Swiss National Bank (SNB)	-0.75%	Dec 12	Mar 19
Banco Central do Brasil (BCB)	5.00%	Dec 11	Feb 05
Central Bank of Russia (CBR)	6.50%	Dec 13	Feb 07
Reserve Bank of India (RBI)	5.15%	Dec 05	Feb 06

FTSE 350 TOP RISERS

Company	Last Month %	YTD%	52-Week Strength
FDM Group Holdings PLC	33.7	30.8	
Games Workshop Group PLC	30.8	88.5	
TI Fluid Systems PLC	28.3	35.6	
Sanne Group PLC	24.2	11.0	
Virgin Money UK PLC	23.7	-1.3	

FTSE 350 FALLERS

Company	Last Month %	YTD%	52-Week Strength
Tullow Oil PLC	-34.0	-26.9	
Intu Properties PLC	-21.2	-69.1	
Fresnillo PLC	-19.6	-32.8	
Kier Group PLC	-19.2	-78.3	
Hochschild Mining PLC	-17.9	4.5	

FTSE 350 SECTORS RISERS

Sector	Last Month %	YTD%	52-Week Strength
Automobiles & Parts	33.6	-24.9	
Leisure Goods	30.8	88.5	
Electronic & Electrical Equip	15.2	35.4	
Industrial Engineering	11.7	23.5	
Food Producers	11.5	22.1	

FTSE 350 SECTORS FALLERS

Sector	Last Month %	YTD%	52-Week Strength
Fixed Line Telecommunications	-4.9	-18.6	
Mobile Telecommunications	-1.7	2.5	
Personal Goods	-0.5	12.4	
Oil & Gas Producers	-0.4	-4.6	
Pharmaceuticals & Biotech	0.0	21.9	

IA SECTORS RISERS

Sector	Last Month %	YTD%	52-Week Strength
Technology and Telecom	5.3	30.0	
North American Smaller Comp	5.0	27.4	
UK Smaller Comp	4.7	16.9	
North America	4.4	25.0	
UK All Comp	3.7	18.1	

IA SECTORS FALLERS

Sector	Last Month %	YTD%	52-Week Strength
UK Index Linked Gilts	-2.2	6.4	
Global Emerging Markets Bond	-0.8	8.5	
UK Gilts	-0.7	8.9	
Global Bonds	-0.3	6.0	
UK Direct Property	0.0	-0.3	