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# MAGAZINE masterinvestor

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# BLACK GOLD

## WHY THE OIL MAJORS ARE HERE TO STAY

## PLUS...

### LAND OF THE RISING STOCK MARKET
THE BEST FUNDS AND TRUSTS FOR INVESTING IN JAPAN

### INSIDER TRADING
FOLLOW THE INSIDERS TO PROFIT

### EMERGING MARKETS
HOW TO RIDE THE RECOVERY

### GOLD RUSH
IS THIS THE START OF SOMETHING BIG?

# WELCOME

Dear Reader,

As I write, the UK is preparing to leave the EU after 47 years as a member state. Whatever your view might be, it is clear that leaving the EU will bring with it a raft of new opportunities and challenges for the UK, some of which have already been brought into sharp focus by recent events.

The outbreak of the coronavirus in China has served up a stark reminder that we live in a global, interconnected world, where threats such as this need to be tackled with a concerted international response. If the UK is to stand tall as an independent global player, it must reconnect with some of the global institutions where it has been outsourcing much of its role to the EU.

At the same time, the UK must reach out to the Anglosphere – the United States, Canada, Australia and New Zealand – where our common heritage and values set us in good stead to forge closer economic relationships. However, already Prime Minister Johnson is beginning to realise that this is not all that straightforward, a point illustrated by the Americans' disappointment with the decision to include Huawei in the rollout of the UK's 5G network.

This has opened up some of the contradictions in the UK's new position in the world. The warning from the US that it may have to review its intelligence-sharing with the UK in the light of the Huawei decision casts doubt over our ability to forge those closer relationships if we are reliant on securing investment from all and sundry – including the Chinese. It could also weaken our hand when it comes to negotiating a trade deal with the US. Prime Minister Johnson is treading a very fine line – and he knows it.

"May you live in interesting times" is an English expression which purports to be a translation of a traditional Chinese curse. While seemingly a blessing, the expression is normally used ironically; life is better in "uninteresting times" of peace and tranquillity than in "interesting" ones, which are usually times of trouble. Perhaps some of us thought that life would settle down after Brexit and become a little more uneventful. Somehow, I think we're only just getting started...

### Master Investor Show 2020

Join me and the team at the Master Investor Show in Islington on Saturday 28 March. Readers of Master Investor Magazine can receive a complimentary ticket by using the code: JAMESF. Click HERE to secure your ticket.

Best regards,
J Faulkner
Editor

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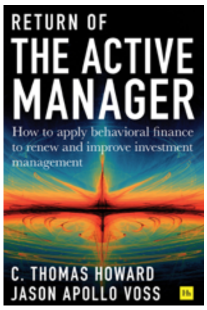


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## FEATURE



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BY JIM MELLON

# MELLON ON THE MARKETS

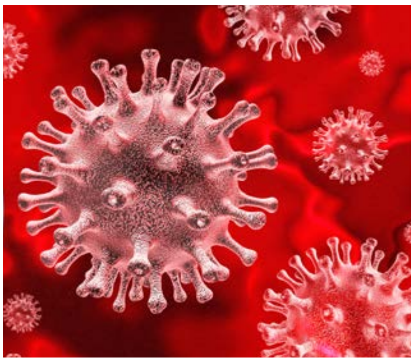
**Inside the mind of the Master Investor: influential British investor Jim Mellon reveals his latest thoughts on the markets.**

As I write, I'm sitting at Brussels Nord railway station waiting for the Eurostar (what a wonderful service – really!) and heading to London. Next, I'm off to the Middle East for a couple of weeks. I need to then go to Hong Kong for a day, to renew my ID card, as they are moving to a biometric system. My luggage will therefore include face masks, models of which were recently used in riots and demonstrations, and now for protective anti-coronavirus purposes.

This coronavirus – seemingly beginning to get worse, not better – is a vivid demonstration of how animal farming is causing harm, not just to the environment, but to humans. With animals in close proximity to people, dosed up with antibiotics and hormones, more and more of these pandemics – (for, despite what the World Health Organisation says, this is what it is) will occur. Check out **Agronomics (LON:ANIC)** in this regard, diligently run by my colleagues Anthony Chow and Laura Turner.

In the same way that noxious environmental emissions (much of which is generated by animal husbandry) affect everyone everywhere, no matter where they are generated, the denizens of Wuhan are not the only ones to be affected by the deadly virus. Global travel means that viruses get all around the world very quickly, and since this disease is asymptomatic for the first few days, this could be a biggie.

Lots of analysts are talking about how SARS etc were just blips on the investment radar, and to a certain extent that is true. But I do remember the Hong Kong property market, admittedly highly inflated, falling 75% at the time of SARS, which in my book is a pretty big blip. I have a feeling this one is going to be much worse, judging by the now very anxious responses of the Chinese authorities.



Partly as a result, we are now seeing gold going once again for multi-year highs, and I expect it to be firmly over $1,700 an ounce by March, trailed, and possibly surpassed in performance terms by its poorer cousin, silver, in due but rapid course.

This will not be good for equity markets, which are now firmly in the 'greed' sector of the 'greed and fear' index. Positioning of hedge funds and others into equities is very aggressive, and I have written before about how US markets are increasingly buoyed by dangerous levels of buybacks, unsupported by earnings growth – in fact none, in the case of the Russell 3000 for six years.

Veteran hedge-fund manager, Paul Tudor Jones, has recently written of his concerns about the overstretched valuations of many US stocks, but he says that if the party is in full swing, he doesn't want to leave the dance, or words to that effect. He's pretty damn smart, but I prefer to get the night bus now and be cautiously prepared, holding cash (not US dollars) gold, silver and equivalents, and of course, high-quality dividend stocks, particularly in the UK.

**"I HAVE A FEELING THIS ONE IS GOING TO BE MUCH WORSE, JUDGING BY THE NOW VERY ANXIOUS RESPONSES OF THE CHINESE AUTHORITIES."**

**"I HAVE LIVED LONG ENOUGH AND SEEN SUFFICIENT MARKET CYCLES TO KNOW THE SIGNS OF THE "THIS TIME IT'S DIFFERENT" BRIGADE, AND THE TREBLING OF TESLA (NASDAQ:TSLA) SHARES IN THE PAST YEAR IS A VERY GOOD ILLUSTRATION OF THIS."**


*valentinphotography / Shutterstock.com*

I have lived long enough and seen sufficient market cycles to know the signs of the "this time it's different" brigade, and the trebling of **Tesla (NASDAQ:TSLA)** shares in the past year is a very good illustration of this. If Tesla is worth more than **Volkswagen (FRA:VOW)** in a year's time – and it is, currently and nominally, despite making only 1% of the cars Volkswagen does – then I am prepared to eat six (vegan) bratwursts for breakfast under the Brandenburg Gate in Berlin.

Tesla is a good example of market-concentration risk; momentum investors, which include many institutional behemoths and passive tracking funds, jump on a bandwagon despite all the signals telling them NO! The 'Nifty Fifty' of the 1960s was similar, and it didn't end well.

I read Terry Smith's Fundsmith letter this week; what an outstanding piece, full of sage advice. My view is that he deserves all of his remarkable success but is in a difficult place; being cautious with a very large fund is quite difficult as you can't really have huge amounts of cash.

While I am in the Gulf, I will be thinking of my speech at the Master Investor event – and some preliminary views include novel ways of playing the climate-change investment boom, as well as trajectory plotting for longevity and clean-meat sciences. I am very excited about all three, and I am also considering how we might be able to play the financial aspects of the super-long lives that I am increasingly sure are coming. All to be discussed at the show.

Meantime, we are just hours away from the UK's exit from the EU, and thank heavens most of the hot air, vitriol, spite and churlishness that has characterised both sides of the debate seems to have gone. There are a few 'Remainiacs' and hard-core, no-deal Brexiters still around, but the battlefield appears to be emptying rapidly. UK assets are really attractive in many cases, and I note foreign purchases have been increasing. The lamentable selection of opposition-leader candidates hopefully indicates that the Tories will stay in power beyond their current term, probably aided by a little gerrymandering as boundaries are redrawn, certainly not in a way that benefits Labour.

David Smith of the *Sunday Times*, a dedicated Remainer, wrote recently about the positive effect the EU has had on British relative growth. However, I suspect the best is yet to come, and it is a fair assumption that in the next 20 years the UK will emerge (partly due to immigration and partly due to growth) as the largest European economy, overtaking Germany.

I remember as a child when we were the 'poor cousins', but that has all changed in the past 30 years. It's going to get better, and it will be pleasant to watch smiles being wiped off certain smug European faces as we once again emerge as top dogs in Europe.

**Happy hunting!**

**Jim Mellon**

## Master Investor Show 2020

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Claim your free ticket with the code: JIM here.

### 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.

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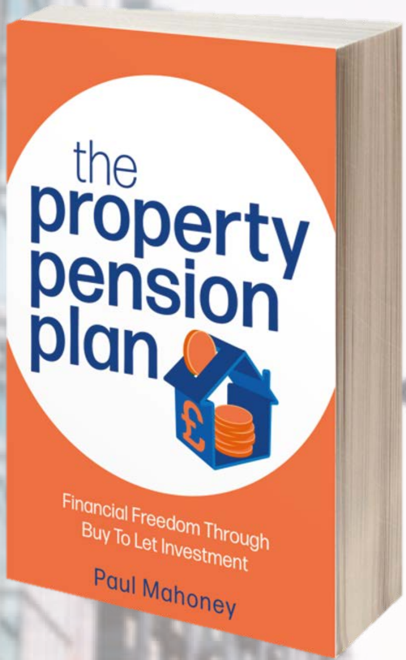


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BY VICTOR HILL

FEATURE

# THE OIL MAJORS ARE HERE TO STAY

**There is now evidence that the unpopular oil majors are oversold. That spells opportunity for canny investors, writes Victor Hill.**

The conventional wisdom is that the oil majors are doomed since, thanks to the "climate crisis", mankind is transitioning to renewable energy. Green energy, they say, represents an existential threat to the oil industry because oil is the mega business of the past – a 'dinosaur' play. Furthermore, the outgoing governor of the Bank of England, Mark Carney, made headlines after Christmas by predicting that almost £100 billion of UK pension-holder's assets could be made worthless by climate change.

Except that, as I often tell my readers, the conventional wisdom is almost always wrong. While there will be a relative decline in the clout of the oil industry in the global economy, it will continue to thrive. Indeed, we shall continue to use hydrocarbons, though in modestly declining quantities, long after the electrification revolution has been completed.

What's more, as I have explained here previously, oil companies are investing in renewables so as to become diversified energy companies. There is now some evidence that the unpopular (or at least PR-challenged) oil majors are oversold. That means an opportunity for canny investors.

> **"IN 2018, THE WORLD CONSUMED MORE THAN 100 BARRELS PER DAY FOR THE FIRST TIME."**

## The global economy will continue to need oil

The oil industry still lies at the heart of the global economy. Despite the rise of renewables (and nuclear energy) in response to the climate crisis, global demand for oil remains robust. In 2018, the world consumed more than 100 barrels per day for the first time. According to some studies, consumption is expected to continue rising until some point between 2030 and 2040, when it is likely to begin to decline. Beyond about 2050, demand for oil is tricky to predict.


A4
A4

**"WHILE THERE WILL BE SOME ELECTRIC-POWERED AIRCRAFT IN OPERATION ON SHORT HAUL ROUTES (EG 'ISLAND HOPPING') AVIATION WILL REMAIN OVERWHELMINGLY DEPENDENT ON FOSSIL FUELS."**

Close to 70 percent of global greenhouse-gas emissions are generated by the energy industry and oil still makes up the largest part of the global energy mix. Further to the dramatic rise in US shale output, which has transformed the composition of the global oil market, the US is pretty much self-sufficient in oil and gas for the first time. That has huge geopolitical consequences – not least of which is that America can imagine withdrawing from the Middle East altogether. It also means that one of the key factors in the determination of future oil demand is the stance that the US government takes.

Oil demand has increased by 30 percent over the past 20 years. The next two decades are likely to be pivotal for the oil industry, with reliance on oil expected to peak between 2030 and 2035. That is if developed countries such as the UK and France stick to their pledges to complete electrification of transportation by 2040 (though there will still be petrol and diesel-powered cars in developing countries long after that). In one scenario, the peak could come as soon as 2025 if the world accelerates the process of reducing carbon emissions.

Last year Barclays Bank Global Research (BGR) published a study analysing the potential evolution of oil demand. Barclays set out three broad scenarios which it called the "3Ds": Deadlock, Development and Dynamism.

The Deadlock scenario envisages that plans to cut CO2 emissions will stall. It also envisages that consumption of oil will peak in 2040 and will flatline to 2050 at about 126 million barrels per day. Under the Development scenario, oil consumption will peak in 2030 and will have fallen to just over 105 million barrels per day in 2050 (still higher than today). Under the Dynamism scenario, the 'disciples' of Greta Thunberg will have things their way: consumption will peak in the late 2020s and will have declined to 69.6 million barrels per day by 2050 – a 30 percent reduction on today's levels, despite a larger global population. But it will only bring global demand back to its 2000 level.

These models assume that the global population will be nine billion in 2040 and 9.7 billion in 2050 as compared with 7.7 billion today; that global GDP will rise by an average of 2.6 percent per annum; and that the number of people not connected to the electric grid will fall from about one billion today to 200 million in

## Barclays Global Research – key conclusions

* Oil consumption is likely to peak between 2030 and 2035, with a long "plateau period" thereafter.
* In a world in which controlling emissions is paramount, this peak could come earlier, possibly as soon as 2025.
* Depending on the scenario, oil demand could range between 70 million barrels per day to 130 million barrels per day in 2050. This compares to current demand of around 100 million barrels per day.
* Oil is expected to remain a very significant part of the energy mix, even under the most optimistic low-emissions scenario.

*Source: Barclays Global Research. Available at:* www.investmentbank.barclays.com/content/dam/barclaysmicrosites/ibpublic/documents/our-insights/oil/oil-in-3d.pdf

## Climate change – time to start worrying?

The Intergovernmental Panel on Climate Change has identified the need to limit temperature increases to less than two degrees Celsius above pre-industrial levels, but has set a target to limit increases to 1.5 degrees Celsius in order to mitigate the risks associated with climate change, such as coastal flooding caused by rising sea levels. Therefore, the need to reduce CO2 and other greenhouse-gas emissions is now at the top of the agenda – as was evidenced at the Davos gathering in January 2020.

President Trump tells us we should be optimistic and close our ears to the prophets of doom. Yet sea-level rise is already apparent in the US. I was recently in the Florida Keys, where climate experts are predicting a sea-level rise of 10-17 inches (25-43 centimetres) by 2040. Sugarloaf Key has already experienced a 10-inch sea-level rise over the last century. A sea-level marker dating from the 1930s is now about one foot under water. Monroe County recently alarmed residents by announcing that it does not have the cash to build flood defences.

Since late September last year, about 30 people, not to mention an estimated one billion animals, have perished in the bushfires that have ravaged Australia. Twenty-five million acres of forest and bush have been burnt. About 8-9,000 insurance claims have been lodged, amounting to A$650 million. Last year was Australia's hottest and driest since records began in 1910. Significantly, food-price increases have hiked inflation in Australia, with meat prices up by about 15 percent. Australia still does not have a target for net zero carbon emissions and is one of the world's largest exporters of coal and gas.

2050. Total energy demand is set to rise by between 40 and 75 percent between 2019 and 2050. More of this needs to be provided by renewable sources in order to limit global warming to two degrees Celsius, and renewables could make up 30 percent of the global energy mix by 2050.

Passenger cars will consume much less oil thanks to electrification. However, BGR reckons that 97 percent of the global trucking fleet will still use the internal combustion engine running on gasoline and diesel. The assumption here is that battery technology will not advance sufficiently to make electric trucks viable over medium distances. The increase in oil demand from the global trucking industry will be partially offset by the application of AI to logistics, making routing much more efficient.

While there will be some electric-powered aircraft in operation on short haul routes (eg 'island hopping') aviation will remain overwhelmingly dependent on fossil fuels. Demand for petrochemicals used, for example, in the production of plastics will continue to grow apace and will be 50 percent higher in 2050 than today.

To put the problem the other way round, electricity is expected to surge from about 18 percent to 40 percent of global energy consumption by 2040 and could reach 50 percent by 2050, according to Shell. That still leaves about half of global energy supplied by fossil fuels.

## Green gas? Is that possible?

The Barclays study makes clear that gas will remain a significant part of the global energy mix, particularly for household heating. Currently, burning gas, mostly domestically, creates 35 percent of the UK greenhouse-gas emissions – with demand rising in the UK by 4.6 percent in 2018. But greener gas is now in prospect.

**Centrica PLC (LON:CNA)**, which owns British Gas, has a target of reducing its carbon emissions by 25 percent by 2030, as a result distributing 'cleaner' gas. The company has taken a 50 percent stake in Barrow Green Gas which generates and distributes

## Oil majors harness AI

The Azeri-Chirag Gunashli (ACG) oil field lies about 60 miles off of Baku in the Caspian Sea. It is operated by **BP (LON:BP.)** which pumps an average of 584,000 barrels per day. The main problem for this important field is that it has a tendency to produce sand. In large quantities, sand can damage equipment and impede production. BP's solution was to apply AI to the problem.

Back in 2017, BP's investment arm took a $20 million stake in US-based AI firm Beyond Limits. Their software is helping BP to undertake more precision drilling and to avoid drill holes which are prone to sanding up. By using machine learning, operational risk can be minimised both upstream and downstream. Overall, oil companies are getting cleverer at what they do.

## Oil as an industrial commodity rather than a fuel

More efficient renewable-energy technology – principally solar and wind power – will increasingly replace the use of oil as a combustible fuel. One view is that this will free up supplies to be used to produce more sophisticated carbon products, hydrocarbons and polymers. In this way oil will become more of an industrial commodity rather than just a fuel. Furthermore, the ability to chemically synthesise oil and gas from various plant materials will blur the line between renewable and fossil fuels.

**"THERE ARE ABUNDANT EXAMPLES OF HOW ESTABLISHED OIL COMPANIES HAVE BEEN DIVERSIFYING INTO GREEN ENERGY."**

biomethane. Biomethane can be produced from sewage treatment plants and anaerobic digesters; the latter is now commonplace on larger modern farms.

The argument for biomethane is that the CO2 that it produces when ignited was already taken out of the atmosphere when the plant material used was grown, so it is carbon neutral over the entire cycle. The main objection to biofuels is that plants grown specifically for biofuels occupy land that is needed to produce food.

Natural gas is likely to remain an important source of energy – despite the efforts of the UK government which will outlaw the installation of gas boilers in new-build homes after 2025. Natural gas is still relatively cheap. Electricity costs roughly two-and-a-half times the cost of natural gas per unit of energy produced. And biomass boilers are very expensive: Bright Blue has suggested that a British home would need to spend £7,000-£13,000 to install one.

## Supply and demand

Oil and gas fields have what analysts term a "natural decline rate". As oil is extracted from a field, so the pressure drops; as a result, each year output from that field falls. As such, if new investment were to cease today and no new fields developed, the industry's existing capacity could be depleted to an estimated level of only 20 million barrels per day by 2050.

That implies that a supply-demand imbalance could be in prospect, even under Barclays' Dynamism scenario which sees oil demand fall by more than 30 percent by 2050. Without ongoing exploration and investment (ie new oil wells), Barclays expects that there will not be enough supply to satisfy demand. In order to avoid a price spike, investment in oil and gas production is still needed so as to replace the output lost due to natural decline. With this in mind, it is reasonable to expect the industry to continue with business as usual for the foreseeable future.

## Royal Dutch Shell and others: a diversification strategy

There are abundant examples of how established oil companies have been diversifying into green energy. Indeed, most of the annual reports these days carry pictures of windmills.

In December 2017, **Shell (LON:RDSB)** bought the Dutch-headquartered company NewMotion which rolls out electric-car charging points for homes and workplaces. It bought First Utility (now rebranded Shell Energy) shortly thereafter which supplies electricity and gas to 800,000

## The impact of the blockchain on the oil business

Simon Tucker, head of energy and commodities at **Infosys Consulting (NYSE:INFY)**, thinks that blockchain technology – the technology that powers bitcoin and the other cryptocurrencies – is set to transform the oil and gas sector. Blockchain will have huge benefits both upstream and downstream. From scheduling equipment maintenance to managing exploration acreage records, blockchain offers a single, unalterable record of transactions and documentation between numerous parties. Distributed ledgers also create more efficient and transparent downstream activities, such as exchanging products, secondary distribution delivery documentation, demurrage and claims management. Mid-stream, it will revolutionise joint ventures, risk management, contracting and regulatory compliance according to Infosys.

## Oil is not one commodity, but many

The global oil market consists of a huge variety of crude oils, from Canadian tar sands extracted with the help of steam and sand, to the lightest US condensates, the colour of which suggests a glass of fine white wine. Each crude stream possesses its own unique characteristics, and when refined, yields varying proportions of different refined products.

The oil industry consulting firm S&P Global Platts Analytics has created a kind of periodic table of oil, cataloguing 120 of the most important grades available on the international markets. Like the periodic table of the elements, the list starts with the lightest crudes and ends with the heaviest. The grades are classified by their specific gravity or density and sulphur content. Light crude oils have an American Petroleum Institute (API) gravity of 34 degrees or more, medium crudes have a gravity between API 25-34 degrees, and heavy grades are API 25 degrees or lower. Oil grades which have sulphur content lower than 0.6 percent are considered 'sweet', while those with sulphur content above this level are classed as 'sour'.

homes. It then purchased a 44 percent stake in Silicon Ranch Corporation which operates about 100 solar power arrays in the US. Shell's renewable-energy division already included a 20 percent stake in in the massive Borssele wind-turbine array off the Dutch coast.

Similarly, **Total SA (LON:TTA)** acquired the battery manufacturer Saft in order to bolster its renewables business in 2016. **BP (LON:BP.)** bought a large minority stake in UK solar-power developer Lightsource for $200 million.

## Saudi Aramco: expect the kingdom to sell down further

Last year Saudi Arabia revealed that it had enough crude oil in reserves to keep pumping at current rates for at least another 70 years. At the end of 2017, Saudi Arabia was sitting on an estimated 268 billion barrels of oil. By comparison, the UK's remaining stock of oil under the North Sea will be entirely exhausted within two decades.

In his acclaimed 2005 book *Twilight in the Desert*, Matthew R Simmons predicted that Saudi Arabia's oil wells were about to run dry. His analysis was based on the ageing status of several gigantic Saudi Arabian oilfields. But the kingdom's oil industry and **Saudi Arabian Oil Co. (TADAWUL:2222)** always kept the figures secret. Aramco's flotation in December last year – the largest IPO in history − has forced the kingdom to become more transparent about its output figures. Aramco typically pumps more than 10 million barrels a day, making it the world's largest producer by far.

By selling five percent of the world's largest oil producer, the Saudi state is cashing in on its huge reserves. The worst-case scenario would be to wait until demand for oil is in sharp decline; that might result in leaving much of its wealth stuck in the ground. Therefore, it is likely that the kingdom will sell off additional tranches of Aramco stock.

Interestingly, Saudi Arabia only overtook the Soviet Union as the number one oil producer in 1991 – the year the USSR dissolved. It maintained that position until 2015 since when the US has pumped more oil than anyone else.

## Occidental Petroleum and friends – 'negative oil'

Greta Thunberg claims that "nothing is being done" about climate change. Houston-based **Occidental Petroleum (NYSE:OXY)** begs to differ. They are talking about 'negative oil'. This is the idea that the CO2 emissions produced by burning oil can at least partially be offset by the sequestration of carbon dioxide when the oil is drilled. Occidental claims to be injecting 20 million tonnes of CO2 annually back into rock formations in the Permian Basin (a shale field in Texas). This is equivalent to taking four million cars off the road. The Permian Basin has the capacity to store 150 gigatonnes of CO2. That is equivalent to 28 years of US emissions.

Occidental chief executive Vicki Holub, who was a leading light at Davos in January, claims that more CO2 is now sequestered in the process of oil recovery than is subsequently burned by cars and aeroplanes. This represents a massive expansion of carbon-capture and storage (CCS) technology which I predicted last year would become one of the leading industries of the 2020s.

In January, Swedish oil and gas firm **Lundin Petroleum AB (STO:LUPE)** launched its decarbonisation strategy − a roadmap for becoming carbon neutral by 2030. The strategy seeks to improve energy efficiency by cutting emissions from operations and developing advanced CCS systems.

Lundin also plans to invest in renewable-energy projects as a means to generate its own net electricity consumption. It plans to limit carbon emissions and has set a target of below four kilograms of CO2 per barrel of oil equivalent (BOE) from 2020. It has set a further target of below two kilograms of CO2 per BOE from 2023.


## The outlook for the oil price

As I write this in the last week of January, the newsflow is dominated by the development of the corona virus in China. Oil prices fell during the week of 27 January on concerns that a potential pandemic could drive a reduction in demand. According to Reuters, Brent crude futures fell by $1.28 to $59.41 a barrel, while US West Texas Intermediate (WTI) crude was down by $1.24 to $52.95 a barrel on 27 January. Saudi Arabia's energy minister, Prince Abdulaziz bin Salman Al-Saud, expressed the view that the virus would swiftly be contained. A similar wave of pessimism hit the oil market back in 2003 during the SARS outbreak though in the event this did not cause a significant reduction in oil demand.

On the other hand, the oil price firmed in Q4 2019 on fears of a possible US-Iran conflict and the deteriorating civil war underway in Libya. On 20 July 2019, Libya's National Oil Corporation reported the closure of the country's largest oilfield, El Sharara, the previous day, resulting in a production loss of 290,000 barrels per day.

Brazil's President Jair Bolsonaro announced last month that the country plans to boost oil production but that it has no plans to join OPEC. Mr Modi's government in India signed a memorandum of understanding with Brazil to cooperate in the oil and gas sector.

Over the medium to long term, uncertainty concerning the long-run demand levels will have the potential to exacerbate price volatility.

## Action

Greg (now Lord) Barker who used to run the UK's climate-change strategy in the Cameron government, told an audience in Davos last month that there are going to be spectacular winners and losers in the 2020s, as the need to adapt to the climate emergency becomes a matter of urgent reality. He warned that we should expect 'stranded assets', price shocks and more explicit carbon pricing: "Those companies which don't recognise the carbon intensity of their business are going to be left on the sidelines", he declared.

It is still not clear how proposed future carbon taxes (such as those envisaged in the sustainable markets initiative launched by Prince Charles) will impact on the oil industry. Any such taxes will ultimately be passed on to consumers who will continue to live in a global economy where oil and gas is a substantial component of the energy mix. What is clear is that we have entered a decade or two which could be even more disruptive to conventional business models than the last two – especially in the energy sector. Some oil majors won't make it to 2040 – others, who tread wisely, will.

Oil majors will increasingly have their work cut out to manage their public relations. Last October the National Theatre in London dropped Shell as a sponsor in response to agitation by indignant climate warriors. But investors should look beyond this kind of short-term noise.

The fact is that, the oil majors are likely to survive quite a bit longer in a world that still needs oil. From an investor's point of view, oil stocks offer relatively low earnings volatility and mostly a decent dividend yield. There is a strong case to continue to hold at least one oil major in a diversified equity portfolio.

## Companies cited in this article

| Company | Status |
|---|---|
| Barclays Bank | LON:BARC |
| Centrica PLC | LON:CNA |
| BP | LON:BP |
| Infosys Consulting | NYSE:INFY |
| Royal Dutch Shell | LON:RDSB |
| Total SA | Euronext:FB/ LON:TTA/ NYSE:TOT |
| Saudi Arabian Oil Co. | TADAWUL:2222 |
| Occidental Petroleum | NYSE:OXY |
| Lundin Petroleum AB | STO:LUPE |

**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 INSIDERS – THE GOOD AND THE BAD

**Not all insider dealing is illegal. Sometimes it can give a useful indication of what 'insiders' think about the future prospects of a company, writes Mark Watson-Mitchell.**

It only takes a little whisper here or there to get people interested – whether it is the latest bit of scandal or a piece of information that no-one else knows.

Even with fairly strict laws in place, the authorities in the UK are still convinced that there are individuals or dealing rings taking advantage of 'inside information' and taking profits away from others.

Under the Market Abuse Regulation 2016, such behaviour is defined as market abuse.

This is not just about market manipulation – such as major short positions being taken in certain stocks ahead of negative research information being put out into the marketplace – or even unlawful disclosure, but instead about insider dealing.

## Insider trading

Insider trading is most definitely an example of market abuse.

The simplest definition is trading in equities or other instruments, using inside information to gain or give an unfair advantage on the securities market.

Since 1985, insider dealing has been a criminal offence. As such you can commit the criminal offence of insider dealing by dealing in securities when you have inside information which may affect their price; encouraging someone else to deal in securities when you have information which may affect their price; or disclosing inside information other than properly as part of your employment.

## The penalties

As a criminal offence, insider trading carries a penalty of either an unlimited fine or a prison term of up to seven years – it could also mean both. Proving such abuse needs distinct evidence.

Insider trading is also considered a civil offence. This means that guilty parties could be banned from involvement in any regulated activities. Furthermore, even if you are not being charged with criminal insider dealing, or even if you have been acquitted, you may still be subject to penalties for market abuse.

And as it is classed as a civil offence, the threshold is much lower for proving market abuse.

## Exactly what is inside information?

Inside information is that information relating to a particular company that would, if published, be likely to have a significant effect on the price of shares in that company.

**“EVEN WITH FAIRLY STRICT LAWS IN PLACE, THE AUTHORITIES IN THE UK ARE STILL CONVINCED THAT THERE ARE INDIVIDUALS OR DEALING RINGS TAKING ADVANTAGE OF ‘INSIDE INFORMATION’ AND TAKING PROFITS AWAY FROM OTHERS.”**

## Some notable insider dealing cases

**Case 1 – Christopher McQuoid**
Solicitor Christopher McQuoid was employed by TTP Communications. In May 2006 he was confidentially told that Motorola was about to bid for the company. He passed on that information to James Melbourne, his father-in-law.

A couple of days before the bid was made, Melbourne paid 13p a share for a line of TTP shares.

The bid came out at 45p and the father-in-law made £50,000 profit on his dealing. Three months later, he gave McQuoid a cheque for exactly half that sum.

Melbourne's trade was identified as being suspicious and the FSA (as the FCA was then known) was informed. A prosecution followed, McQuoid got eight months inside and Melbourne, who was 75, was given a suspended sentence.

**Case 2 – Matthew and Neel Uberoi**
Matthew Uberoi was working for stockbrokers Hoare Govett, where he became party to various pieces of confidential information about imminent takeovers.

Matthew started to feed such information over to his dentist father, Neel.

The duo made a number of trading profits using the inside information and they were caught. The dentist got two years and the son just one.

Matt Uberoi stood as Labour's candidate for the London constituency of Chelsea and Fulham in last December's general election.

**Case 3 – Messrs Dodgson, Harrison, Hind, Parvizi and Anderson**
Accountant Martyn Dodgson had a career in investment banking, working at Cazenove, UBS, Lehman Brothers and Deutsche Bank.

While he was at Lehman Brothers, he passed on to accountant Andrew Hind a number of tips concerning the details of the takeovers of Scottish & Newcastle and the Paragon Group. It was alleged that Hind then passed on the tips to day trader and 'professional gambler', Iraj Parvizi, and his stockbroker colleague Ben Anderson.

It was alleged that the information was circulated by using encrypted memory sticks, the use of nicknames and pay-as-you-go 'burner' mobile phones. Those various devices were used to cover up insider dealing.

Lawyer Andrew Harrison, who worked at UBS, Panmure Gordon, Lloyds Banking and Altium Capital, became a member of the 'ring'. He met Hind through Dodgson, with whom he had worked at UBS.

Harrison, it was alleged, told Hind of a bid for internet-security company nCipher. Panmure Gordon was advising on the bid.

All five men were prosecuted in 2016 in what was then headlined as the UK's biggest insider-dealing-ring case – Dodgson and Hind were found guilty, and Harrison Parvizi and Anderson were acquitted.

**Case 4 – Fabiana Abdel-Malek and Walid Anis Choucair**
Former UBS compliance executive Abdel-Malek received a three-year jail sentence for passing on insider details to family friend and former trader Choucair. He was sentenced to three years in prison.

Using burner phones Abdel-Malek had passed on information about a number of potential mergers to Choucair.

Some five different deals, between 2013 and 2014, were featured by the FCA in their case early last year.

*"The life blood of all well-functioning markets is the timely dissemination of information, without which effective price formation cannot take place. The malignant form of that same life blood is the misuse or inappropriate dissemination of that information."*

Julia Hoggett, Director of Market Oversight at the FCA

It will not necessarily be about the company for which the insider works. Instead it might be about a supplier or even a competitor – where, for example, there is unpublished news of the winning or loss of a big contract.

The insider will not commit the offence if they pass on general information about the market in which a company operates, however confidential that information might be.

As an example, if an insurance-company director tells a fellow golf-club member that the company's profits are going to be better than market expectations – then such an act leaves that individual liable.

But if the golf-club colleague was told that the whole of the insurance sector was enjoying good times – that individual would not be imparting inside information.

So, for the basis of this article we can define insider information as a non-public fact regarding the plans or condition of a publicly traded company that could provide a financial advantage when used to buy or sell shares of that or another company's securities.

> *"Wherever we have individuals in possession of highly valuable inside information, we should always be mindful that there is a risk of those individuals acting unlawfully with that information – for any number of reasons."*
>
> Julia Hoggett, Director of Market Oversight at the FCA

## What defences might be considered

Several defences may be available to someone charged with insider dealing, if they can prove that they did not expect the dealing to result in a profit by virtue of the price-sensitive information; they reasonably believed that the information had been disclosed widely enough to avoid prejudicing other parties to the share transaction; or the person who bought or sold the shares would have done so without the information – for instance, because they needed to sell the shares to raise the cash.

If you can prove that your case falls into one of the situations outlined as a defence, you will not be found guilty of the criminal offence.

If you are accused of dealing in securities or encouraging someone else to deal in securities based on inside information, the possible defences include the following:

- You did not think that you or the person doing the dealing would profit as a result of your having the inside information. For instance, you may have thought that what you knew would have no impact on the price of the securities being dealt.
- You did not realise that you were acting on inside information; eg because you thought this information was already in the public domain.
- You or the person doing the dealing would have acted the same way without the inside information.
- It was reasonable for someone in your position to act the way you did in relation to inside information.

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## Disclosure of inside information

If you are accused of disclosing inside information, defences include stating that you did not expect the person to whom you disclosed the information to deal in securities as a result of your disclosure; or declaring that if you did expect that person to deal in securities as a result of your disclosure, you did not expect that the information you gave them would affect the price of the securities in which they were dealing.

## Insider trading is not always illegal

A company's directors, officers and its senior employees – those who could

be open to accessing confidential information, who are classed as 'corporate insiders' – are able to buy or sell shares in the company as long as they stay in line with Stock Exchange and legal regulations.

There are set dealing guidelines for corporate insiders and such dealings can be made public.

Reporting those dealings is a compulsory function of both the company and the individual concerned.

## How does the Stock Exchange monitor insider dealings?

There various ways that the market tracks insiders, including market surveillance: this is probably one of the most important ways of identifying insider trading. The use of sophisticated tools helps to detect such trading, especially around the time of important events such as trading updates, result reports and other key corporate developments. Particularly large orders, over the average dealing numbers, are also easily identified and create flags as to whether they are 'suspicious trades' and worthy of further investigation. Tips and complaints are another way to track insider dealings. Several insider-trading cases have been started by a telephone call from a market professional wrong-footed by an insider's dealing. There has also been an increase in the number of aggrieved whistleblowers – those who have knowledge of others' dealings but regret not being involved in such transactions. Instead they can gain by identifying to the authorities those dealers and their dealings and receive some form of information reward. Furthermore, with the advanced software-analysis programmes available nowadays, brokers and market makers have the ability to identify unusual trades or trading patterns. After their own initial investigation, they are obliged to inform the Stock Exchange and the FCA of anything that concerns them.

However, those methods of discovering market abuse are just the start of building up an insider-trading case. Such proof is nearly always circumstantial – but 'joining the dots' helps to get a prosecution underway.

## Following the insiders – do your homework

It is quite understandable that many investors hunt down the significance, if any, of 'corporate insider' dealings.

It is always worth paying attention to directors' dealings, especially because their dealing periods are limited, as they are governed by the timing of company announcements, such as interim and final results, trading updates ahead of those results, AGM statements and, obviously, contract news, appointments or departures.

So, are the directors buying or selling? Is it just one dealing or is it two or more? Three buys, for example, can be a very useful signal of insider confidence. Similarly, the opposite if there are sellers.

I always take note when the finance directors 'tuck into' stock, even more so when the chief executive is doing so. Those two individuals generally know more about what is going on inside their company, than others on the board.

Obviously, if they are sellers, is there a reason why they are selling? A divorce, a tax payment or a family event, ahead of retirement from the board are all totally acceptable reasons for such disposals.

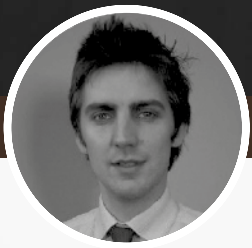
But it is always worth paying attention to the size of the individual's holding in the company prior to dealings. For instance, a sale of 10,000 shares out of a 500,000 shareholding is of little note – but if it were 300,000, then dig a bit further as to why.

However, I would not be in rush to get excited about an initial purchase of shares by a new director – generally such a deal is an expected part of the director's contract.


**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

# INCOME MATTERS

## THREE SMALL CAPS OFFERING DECENT AND RELIABLE DIVIDENDS

**For those seeking an income from small-cap companies, Richard Gill reveals three firms which he believes should continue to provide a decent and reliable payment for years to come.**

Given the kind of share-price rises seen on the small-cap markets over the past 10 years, it's no wonder that, when analysing a stock, investors are mainly looking for growth potential. The table on the right shows that over the decade of the 2010s the top-10 best-performing AIM-listed stocks generated an average gain of 2,143%. That's a compound annual gain of 36.48% – well ahead of the returns even Warren Buffett has delivered. In other words, if you'd put £100 into each of the 10 shares at the start of 2010, your portfolio would now be worth £22,430.

| Code | Company | Market Cap (m) | 2010s gain (%) |
|---|---|---|---|
| JDG | Judges Scientific | £345 | 4,630 |
| GBG | GB Group | £1,443 | 3,610 |
| DTG | Dart Group | £2,670 | 3,320 |
| HCM | Hutchison China Meditech | £2,688 | 1,800 |
| RST | Restore | £600 | 1,730 |
| SOM | Somero Enterprises | £165 | 1,730 |
| BMT | Braime (T F & J H) (Holdings) | £23 | 1,540 |
| AAZ | Anglo Asian Mining | £167 | 1,540 |
| SOLI | Solid State | £57 | 1,530 |
| | | AVERAGE | 2,143 |

In contrast, dividends often play second fiddle to growth in the small-cap markets. After all, few investors get can excited by a return which is usually in the low single digits. What's more, companies at the growth stage of their life cycle usually retain their excess earnings

**"'UK PLC' IS EXPECTED TO YIELD 4.4% OVER THE NEXT 12 MONTHS."**

to invest in expansion. According to my analysis, only around 30% of AIM companies currently make a dividend payment, although this rises to 82% of FTSE Small Cap listed firms.

Dividends should not be underestimated however. Not only can they provide a regular source of income, reinvested in shares they can act to compound returns over time. According to analysts at Link Asset Services, UK dividends rose by 6.9% on a headline basis in Q3 2019 to £35.5 billion, with an estimated £110.3 billion expected for the full year. 'UK plc' is expected to yield 4.4% over the next 12 months, close to historic highs and well ahead of other asset classes such as bonds.

For those seeking an income from small-cap companies, here are three firms which I believe should continue to provide a decent and reliable payment for years to come.

## APPRECIATE GROUP

Listed companies can change their name for a number of reasons. A quite common reason on the small-cap markets is a change of business strategy, often because the previous strategy failed and management want to disassociate themselves from the previous business name. I note one particular AIM company which has undergone no less than four name changes in the past 10 years! However, Appreciate Group, which recently changed its name, has been performing very well indeed.

**Appreciate Group (LON:APP)**, previously known as Park Group, is a provider of value-added pre-paid gift, reward and savings products to the corporate and consumer markets, with sales coming through a direct sales force, a network of agents and, increasingly, digital channels. This is a market which according to the UK Giftcard & Voucher Association is worth around £6 billion per year. Trading is split between two divisions; consumer and corporate.

In the consumer division, the company has been helping people across the UK to budget for Christmas since 1967, via its savings schemes, with 426,000 customers using its services in the last financial year. In the corporate division, under the brand Love2shop Business Services, the firm is the UK's largest provider of multi-redemption gift cards, vouchers and digital reward propositions, principally to the incentive and reward markets. It serves around 37,000 business customers, with market-leading incentive, recognition and rewards options for an estimated two million recipients through 189 retail partners with over 25,000 outlets.

Appreciate earns income from service fees paid by partner retailers, leisure and other service providers based on the face value of money spent via its cards and vouchers, as well as from interest on all pre-paid cash until the obligation to the redeemers has been settled.

**Gaining pounds at Christmas**

With a strong focus on the Christmas savings market, Appreciate Group's financials have always been weighted heavily to the second half of its financial year, when three quarters of annual revenues come in. As a result, the numbers must be read on a full-year basis to get a full picture of how trading is progressing. Those for the last full year, to March 2019, reported revenues relatively flat at £110.4 million and adjusted pre-tax profits again round about £12.5 million.

More recently, numbers for the six months to September 2019 (the company's 'quiet' half) reported a strong performance. Revenues for the period were up by 21.3% to £33.2 million, benefiting from increased demand and the addition of new clients, with the traditional first-half loss down by £0.2 million at £1.3 million. As a result, the interim dividend payment was held flat at 1.05p

The first half saw investment in a new strategic plan, with expenses incurred on new technology, new products and the move to a new head office. Enhancing the investment case, the business is decently cash generative for the full year as a whole, with a debt-free balance sheet. At the interim stage, net cash to the company (it holds customer cash on the balance sheet in trust) was £7.7 million. This was down from £36.9 million six months previously but as usual should improve markedly by the financial year end.

**Appreciate the returns**

Investors in Appreciate Group had an excellent decade, with the shares

rising from 18.75p to 56.5p between 2010 and the end of 2019. That's a total capital gain of 199%, or an 11.7% compound annual return. But this is a perfect example of how dividends can sharply magnify returns. Over the last decade, Appreciate paid out 23.73p worth of dividends, taking the total 10-year return to 328%. The payment was increased every year, from 1.32p in 2010 to 3.2p in 2019.

At the current price of 60.25p, shares in Appreciate Group trade on a historic earnings multiple of 11 times, which looks good value in my view, given the company's strong trading history. With a progressive dividend policy, linked to business performance, I think we can be reasonably confident that the previous year's payment will at least be maintained for 2020. The debt-free balance sheet and reasonable earnings cover reinforce that confidence. On this basis, we are looking at an attractive yield of 5.3% at the current share price. What's more, analysts at Edison have an 87p valuation for the shares, which implies capital upside of 44%.

**"WE ARE LOOKING AT AN ATTRACTIVE YIELD OF 5.3% AT THE CURRENT SHARE PRICE."**


## REAL ESTATE INVESTORS

Investors looking for income often flock to the property sector as companies managing property portfolios are generally stable businesses, enjoying regular and predictable earnings streams through rental agreements. Indeed, a certain part of the property sector has been created with a legal obligation to pay dividends to investors.

A REIT (real estate investment trust), is a property-owning entity which is exempt from corporation tax on profits and gains from property-rental businesses, as long as it distributes at least 90% of taxable income to investors. Technically, income is treated as property-rental income rather than dividends. The structure provides an attractive way for investors to access the risks and rewards of holding property assets without having to buy them directly.

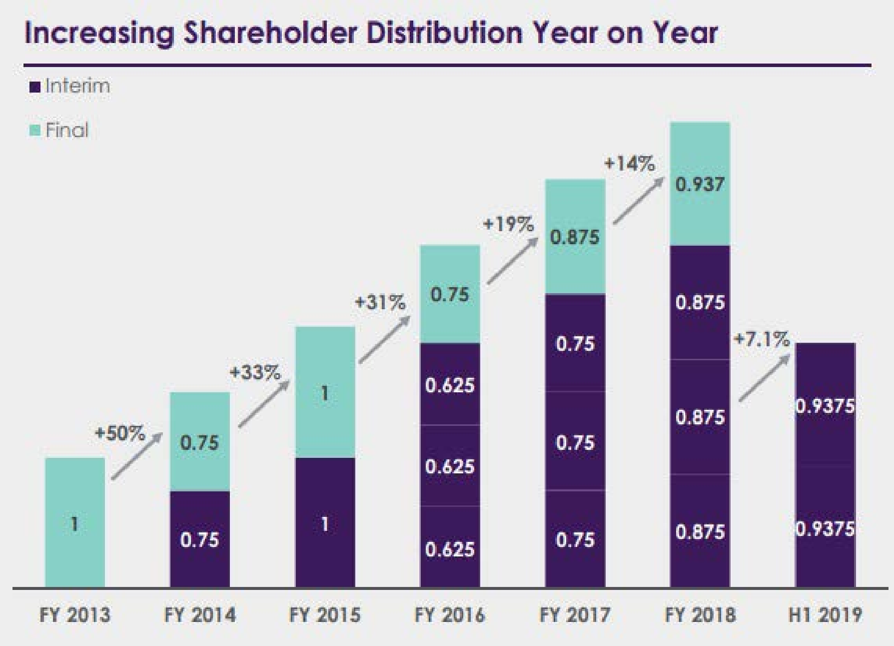
One such company is the appropriately named **Real Estate Investors (LON:RLE)**, the UK's only Midlands-focused REIT, with a portfolio of 1.59m square feet of commercial property including offices, retail outlets and restaurants. The company's strategy is to invest in well-located real-estate assets in the established and proven markets of central Birmingham and the Midlands, realising value through rental agreements and opportunities for capital appreciation. Overall, the total £221m portfolio is well-balanced, with no major reliance on any one tenant or industry, with the top 10 tenants representing only 22% of contracted income.

Birmingham and the surrounding areas are vibrant places for business (especially manufacturing and engineering, education and tourism), with the region set to benefit from numerous infrastructure investments over the coming years, maybe including HS2. In the nearer-term horizon, last year the government announced its intention to invest £778 million in Birmingham and the West Midlands in advance of staging the 2022 Commonwealth Games.

**Brummie money**

The six-month period to June 2019 was a good one for the company, with the all-important contracted rental income growing by 7.6% to an annualised £17 million. That helped underlying pre-tax profits grow by 18% to £4 million, with earnings up by 19% at 2.15p per share. At the period end, the portfolio had 268 tenants across 51 assets, with a weighted average unexpired lease term of 4.04 years, providing good earnings visibility. However, the EPRA NAV per share (an industry measure of net worth) slipped by 0.7% to 68.8p, mainly as a result of a £2.8 million reduction in the value of retail assets.

Real Estate Investors kicked off 2020 with a positive update covering trading in the previous 12 months. Contracted rents rose further, to £17.66 million by the end of December, up 3.85% over the year, following 44 new lettings and nine lease renewals. The company now has 280 occupiers across 53 assets and retains no material reliance on any single occupier, asset or sector. Occupancy levels are said to be in excess of 96% and the overall cost of debt has reduced to 3.4%, with 72% of the debt now fixed. The outlook for the current year was positive, with chief executive, Paul Bassi expecting pent-up demand to stimulate trading potential in the markets, with £15 million of cash and bank facilities available to take advantage of any opportunities.




*Source: Company presentation*


**REIT good investment**

Shares in Real Estate Investors currently trade at 55p, capitalising the company at £102.5 million. For starters, that is a 20% discount to the EPRA NAV per share as at 30 June last year. Looking at recent acquisition activity in the listed property sector that discount looks attractive, with A&J Mucklow acquired by LondonMetric last summer at an 11% premium to NAV and Hansteen Holdings recently agreeing a cash deal at around a 12% premium.

Acquisition potential aside, the long-term attraction here is income. Real Estate Investors' dividend has now grown for seven consecutive years, with total dividends paid to date of £27.3 million. Providing a more frequent income stream than many other companies, the payment is made every three months. During 2019, the total pro rata dividend amounted to 3.75p per share, which equates to a yield of 6.8% if maintained. But with the recent trading statement pointing towards an increase this year, I don't think that a 1p per quarter payment would be too much of a stretch for 2020, meaning that a yield of 7.3% looks to be on the cards.

## WYNNSTAY

Finally, we look at a company which has had some troubles of late but still provides a decent, steady income and looks to be significantly oversold in my view. Founded in 1918 as a farmers' cooperative, **Wynnstay Group (LON:WYN)** today is a well-established manufacturer and supplier of agricultural products to farmers and the wider rural community across the UK.

The largest division in the group is agriculture, which contributed 73% of revenues in the last financial year. Here, via a number of brands and businesses, the company manufactures and supplies a comprehensive range of agricultural products to customers across many parts of the UK. In the feed division, Wynnstay operates two multi-species compound-feed mills and one blending plant, offering a range of animal-nutrition products to the agricultural market in bulk or bags. Meanwhile, the group's arable activities supply a wide range of products to arable and grassland farmers, including seed, fertiliser and agrochemicals. Also in agriculture, one of Wynnstay's other brands, Glasson, is a producer of blended fertiliser, a supplier of feed raw materials and a manufacturer of added-value products to specialist animal-feed retailers.

Secondly, the specialist agricultural merchanting division is a specialist supplier of agricultural and associated sundry products. The group operates 55 depots across Wales, the Midlands, north-west and south-west England, supplying to farmers, smallholders and rural dwellers. Additionally, Youngs Animal Feeds, which is also part of the group, sells a range of equine and small-animal feeds to wholesalers and retailers in Wales and the Midlands.

**Ewe won't believe it**

Wynnstay posted a record set of numbers for its 2018 financial year, growing revenues by 18.4% to £462.66 million and underlying pre-tax profits by 20.5% to £9.6 million for the 12 months to 31 October. However, the shares suffered following the company's announcement in March last year, that trading had weakened significantly during its second quarter and that profits would now be behind the previous year. This was blamed on abnormally warm weather during the winter months, which reduced the requirement for feed and other weather-related products, along with a weakening in farm-gate prices, partly believed to be the result of Brexit/ political uncertainties.

While the 2019 numbers were behind initial expectations, they weren't actually that bad. The bottom line showed underlying pre-tax profits of £8 million, down by £1.6 million compared to the record 2019 levels, but still slightly ahead of those posted in 2017. Despite the difficulties, the total annual dividend was increased by 4.8% to 14p per share. Notable was a strong cash-flow performance, with a net £12.9 million flowing in from operating activities after good inventory management. Net cash at the period end was £3.84 million, with the company only having £6.76 million of borrowings.

The outlook was of interest, with Wynnstay commenting that the trading environment for the agricultural-supplies sector remains challenging. Farm-gate prices are generally lower than a year ago and uncertainty remains about the impact on the agriculture sector of exiting the EU. Additionally, a high level of forage stocks on farms has reduced feed demand, and wet weather conditions over recent months have decreased the acreage of winter cereals that farmers have been able to plant. Nevertheless, the company remains confident in its medium and long-term prospects, helped by its wide spread of activities and strong balance sheet.

**Cheap as grain**

At a current price of 282.5p, Wynnstay shares are now trading at well under half of highs seen as recently as March 2017. Despite the inherent cyclicality of the business, that drop looks unfair to me given that record numbers were posted barely a year ago and that the business remains decently profitable.

On an earnings basis, the shares trade on a multiple of just over nine times, putting them well into value territory. Value also comes from the company's net assets, which as at 31 October amounted to 479p per share, 70% above the current price. Even stripping out intangible assets leaves a TNAV (tangible net asset value) of around 400p per share, representing 42% upside.

Regarding income, Wynnstay has an enviable dividend record, having increased its total annual payment every year since listing on AIM in 2004. With the shares now at a near 10-year low, the historic yield on offer is a shade under 5%. We can be reasonably assured that the payment will at least be maintained in 2020, barring any extreme change in trading conditions. This view is based on the strong balance sheet, long track record of dividend increases and comfortable earnings cover of 2.2 times. I note that investors who get on the shareholder register before 27 March will enjoy the 9.4p per share final dividend, which alone yields 3.3%.


**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 THERE A LIQUIDITY PROBLEM IN THE UK SMALL-CAP SECTOR?

**James Henderson, co-fund manager of Henderson Opportunities Trust, explains why liquidity concerns around UK smaller companies may be exaggerated; and why a rally could be around the corner.**

The smaller-company investor faces a new problem following the fallout from Woodford's funds; a focus on liquidity. How long would it take to liquidate a position at the quoted price?

This is the question portfolio managers are being asked by their risk departments and business managers. The usual answer is to say that if you take 20% of the average daily volume of a stock and divide that into the number of shares held, we get an idea of how many days it should take to sell.

The problem with this answer is that it does not necessarily reflect how the market for smaller companies works. The daily volume number is taken direct from figures published by the London Stock Exchange.

A trend in recent years has been for there to be more trades happening 'off market', in the so-called 'dark pools'. It is estimated that across the market as much as 40% of trades by value happen in this way. Therefore, using just LSE volumes overexaggerates the liquidity problem. Currently, small-cap trading volumes have been low as investors sit and watch macroeconomic developments. Activity will pick up as confidence returns and the current problems with small-cap investment will partially recede.

## Advantage investment trusts

Mid-cap companies are not suffering the same problem, so takeover activity by larger established companies is likely to be a feature of 2020. However, the current concerns over liquidity are an opportunity for funds with a mandate to invest in small companies.

It is closed-ended funds that are best suited to these mandates

> "THE CURRENT CONCERNS OVER LIQUIDITY ARE AN OPPORTUNITY FOR FUNDS WITH A MANDATE TO INVEST IN SMALL COMPANIES."


Sector 1
Sector 2
Sector 3
Sector 4
Sector 5

## Trust TV: *what would you ask a professional investor?*

Trust TV is an interactive show that offers private investors the chance to pick the brains of portfolio managers from Janus Henderson's stable of investment trusts.

Simply enter your question on the registration page to get an answer from an experienced professional investor.

This time we are joined by Ben Lofthouse, fund manager of **Henderson International Income Trust** and Mike Kerley, fund manager of **Henderson Far East Income Ltd**. Ben and Mike are focused on providing their shareholders with a sustainable and growing income stream through regular, quarterly dividend payments from a portfolio of international equities.

Ben and Mike will be answering your questions live from the London Stock Exchange on **Friday 28 February** from **3pm**. The deadline for questions is 11am on the day, but you can also submit questions live during the show – although we can't promise live questions will make it through, due to the volume of questions coming in.

Click here to register.

Click on the links below to watch highlights from the last episode:

>>> Can active fund managers beat the index?

>>> How to build a sustainable income portfolio

To find out more about Henderson International Income Trust, click here.

To find out more about Henderson Far East Income Ltd., click here.

because they do not have to meet redemptions in the same way that open-ended funds do, meaning a trust will not become a forced seller in times of stress. This is why the Henderson Opportunities Trust portfolio has more than 60% invested in AIM stocks.

The premium investors are paying for liquidity has expanded significantly. However, the earnings and dividend growth of large companies in comparison to the small companies is unlikely to justify this premium valuation.

Smaller companies are often tied more closely to the fortunes of the UK economy. The UK has been subdued as a result of the consumer drawing back and corporates putting spending plans on hold. These plans cannot be deferred indefinitely and a replacement cycle will start up with capital investment injecting momentum into economic growth.

Many UK small domestic companies have been focusing on cost savings, so when sales growth increases on this disciplined low cost base; operating profit margins will expand. The drop through of increased sales to profits usually surprises as an economy grows. The analyst upgrades will follow and this is the catalyst that will prompt investors to move money into UK shares in an 'unloved' sector.

## Glossary

**Liquidity:** the ability to buy or sell a particular security or asset in the market. Assets that can be easily traded in the market (without causing a major price move) are referred to as 'liquid'.

**Mid cap:** a term used to describe medium-sized companies based on their market capitalisation.

**Small cap:** a term used to describe companies with small market capitalisations.

**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.

**These are the views of the author at the time of publication and may differ from the views of other individuals/teams at Janus Henderson Investors. Any securities, funds, sectors and indices mentioned within this article do not constitute or form part of any offer or solicitation to buy or sell them.**

**Past performance is not a guide to future performance. The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested.**

**The information in this article does not qualify as an investment recommendation.**

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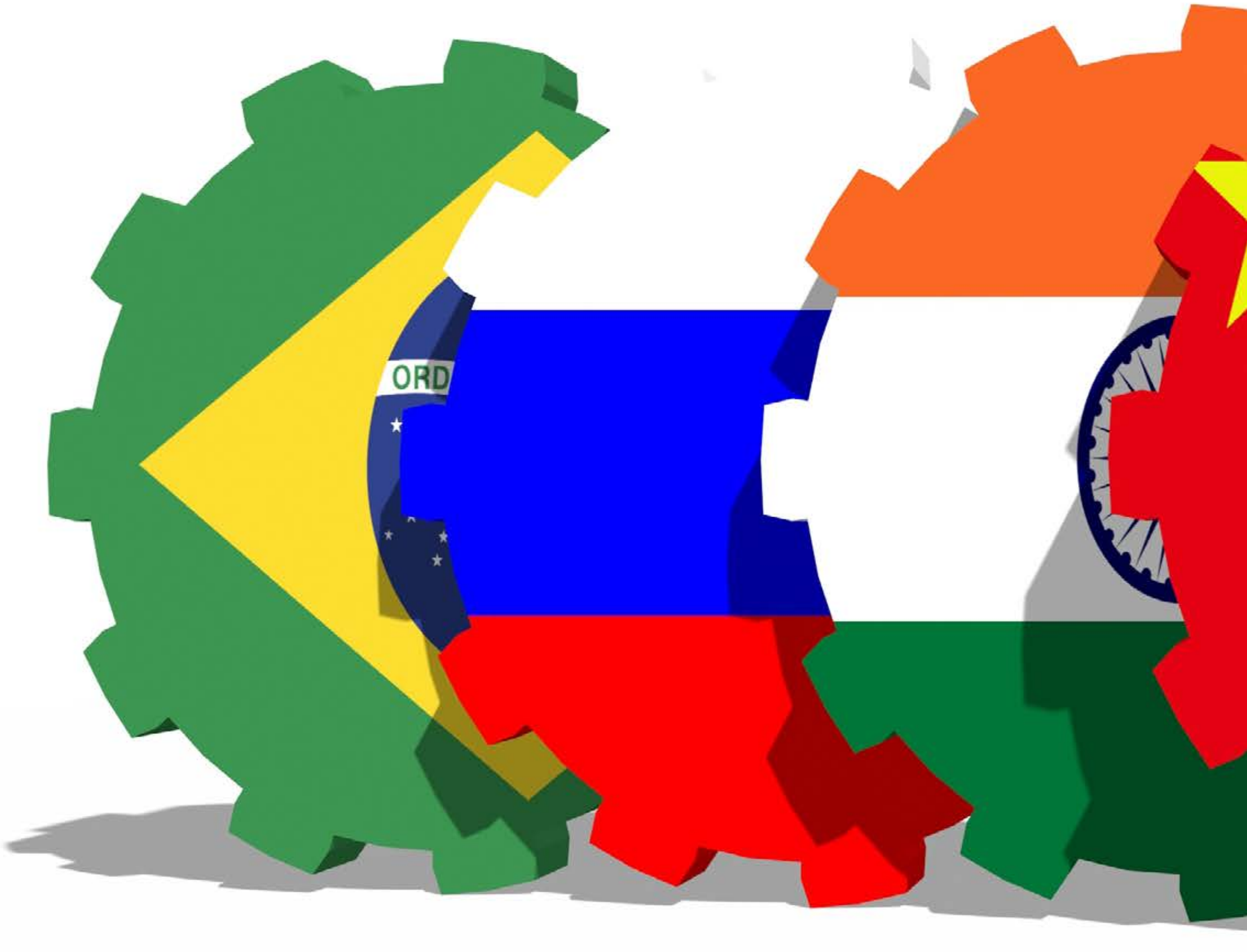
BY FILIPE R. COSTA

## THE MACRO INVESTOR

# HOW TO GRAB A SLICE OF EMERGING MARKETS



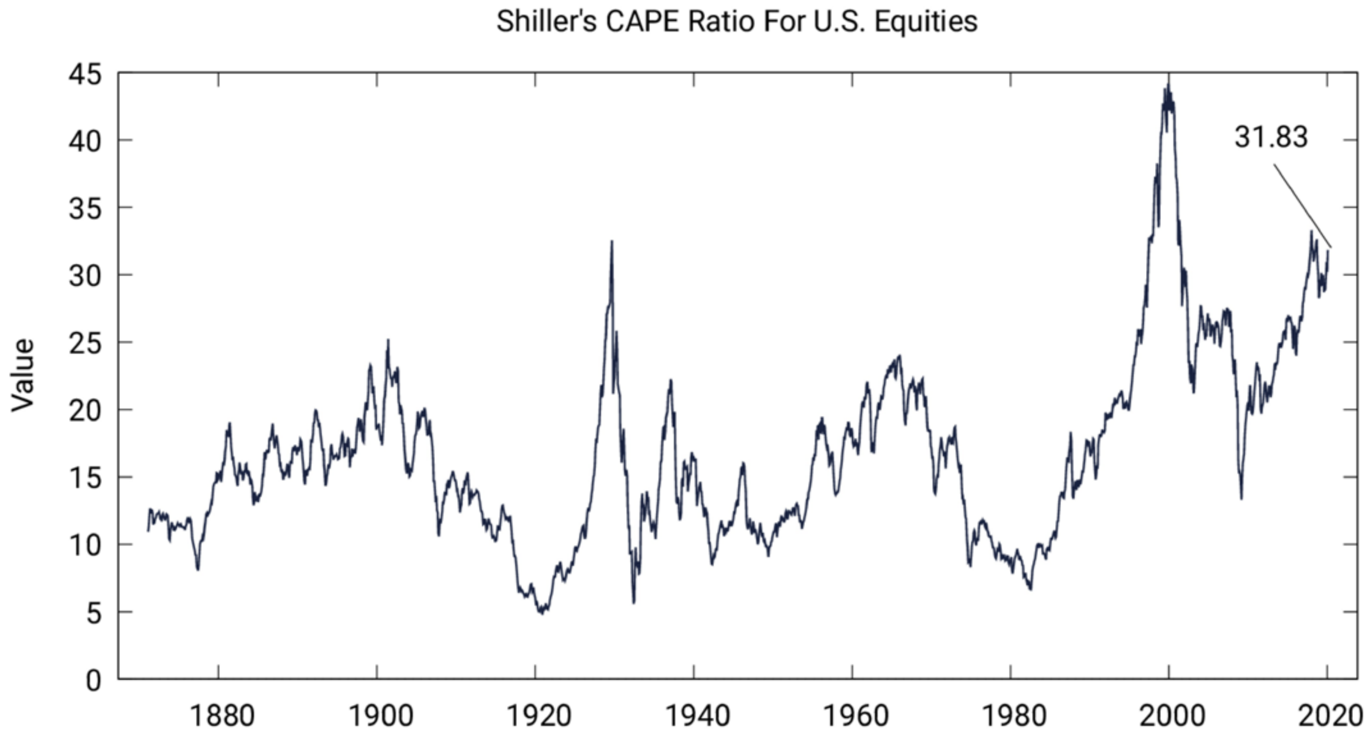
**Emerging and frontier markets still offer value for investors, writes Filipe Costa. Here's how to play them using a passive approach.**

Equity markets have rocketed over the last few years. After being decimated during the global financial crisis of 2007-2009, equities entered a golden period. Depressed share prices, low interest rates and bold quantitative easing paved the way for a stunning decade of returns. One hundred units invested on the S&P 500 10 years ago, would by now be worth 293 units − a spectacular annual increase of 11.3%.

But these fortunes haven't been replicated the world over. An investor in the FTSE All-Share index has seen profits accumulate at the much softer rate of 4.3% per year. Most European markets have lagged behind, as have emerging and frontier markets. But now that we're in a late-cycle phase, the picture may change in favour of Europe and emerging economies, as investors reassess the highly valued US market. Declining interest rates, higher currency values and low valuations are attractive factors, justifying an exposure to emerging markets at this juncture.

## Unbalanced performance

It's a fact that markets are rising. But it's also a fact that such rises have been distributed unequally across the globe and across equities. The performance of US markets has been stunning since the global financial crisis. Over the last decade, the S&P 500 nearly tripled its value and the Dow Jones Industrials trailed this performance closely. But if we look at Europe, we see a less rosy picture, as the FTSE All-Share rose 53% and the FTSE 100 just 41%. Technology stocks




**Unbalanced Equities Performance**

| Name | %chg 2019 | %chg 3y | %chg 5y | %chg 10y |
|---|---|---|---|---|
| NASDAQ 100 | 38.0 | 81.2 | 120.0 | 391.0 |
| S&P 500 | 28.9 | 46.6 | 64.6 | 193.0 |
| FTSE All-Share | 14.2 | 8.7 | 19.2 | 53.1 |
| FTSE 100 | 12.1 | 6.2 | 15.5 | 41.0 |
| Vanguard Emerging Markets ETF | 16.5 | 23.9 | 14.0 | 10.9 |

*Source Data: Sharescope*

seemed unstoppable. The Nasdaq 100 index almost quintupled in value. At the other extreme, emerging markets rose just 10%. To some extent, this unbalanced performance reflects different circumstances around the globe. The uncertainties surrounding Brexit and sluggish growth across the EU certainly weighed unfavourably for British and European stocks. But the Schiller CAPE index is currently hovering around 31.8x, a value only surpassed during the skyrocketing valuations of technology companies during the formation of the Nasdaq bubble. Thus, to some extent, the rally may have gone too far in the US. Valuations in Europe and emerging markets are a lot more conservative, which opens up good opportunities for investors.

## Why invest in emerging markets?

While interest rates seem to have reached a low for most of the developed world, they are still declining for most of the emerging-market world. The official rate in Brazil just reached a historical low after being cut several times over the last three years. From a level of 14% in 2016, the central bank was able to cut the country's key rate to its current 4.5% without incurring an acceleration in inflation. In Russia, the key interest rate has also been cut several times, to its current level of 6.25% after peaking at 17% by the end of 2014. In India, the central bank also managed to drive its key rate from 8% in 2015 to a current level of 5.15%. Even Mexico, a country that struggled to keep its currency tight and inflation under control with the advent of Donald Trump as US president, has been able to recently cut rates four successive times to a level of 7.25%.

The US Federal Reserve made a late-cycle adjustment, cutting key rates three times in 2019. But that has not been the norm across the developed world. Sweden, Norway and the UK's central banks have hiked rates a few times. The very low rates helped to push equity prices all the way up, in particular in the US, just as they helped businesses finance their operations and pushed investors from fixed income towards equities.

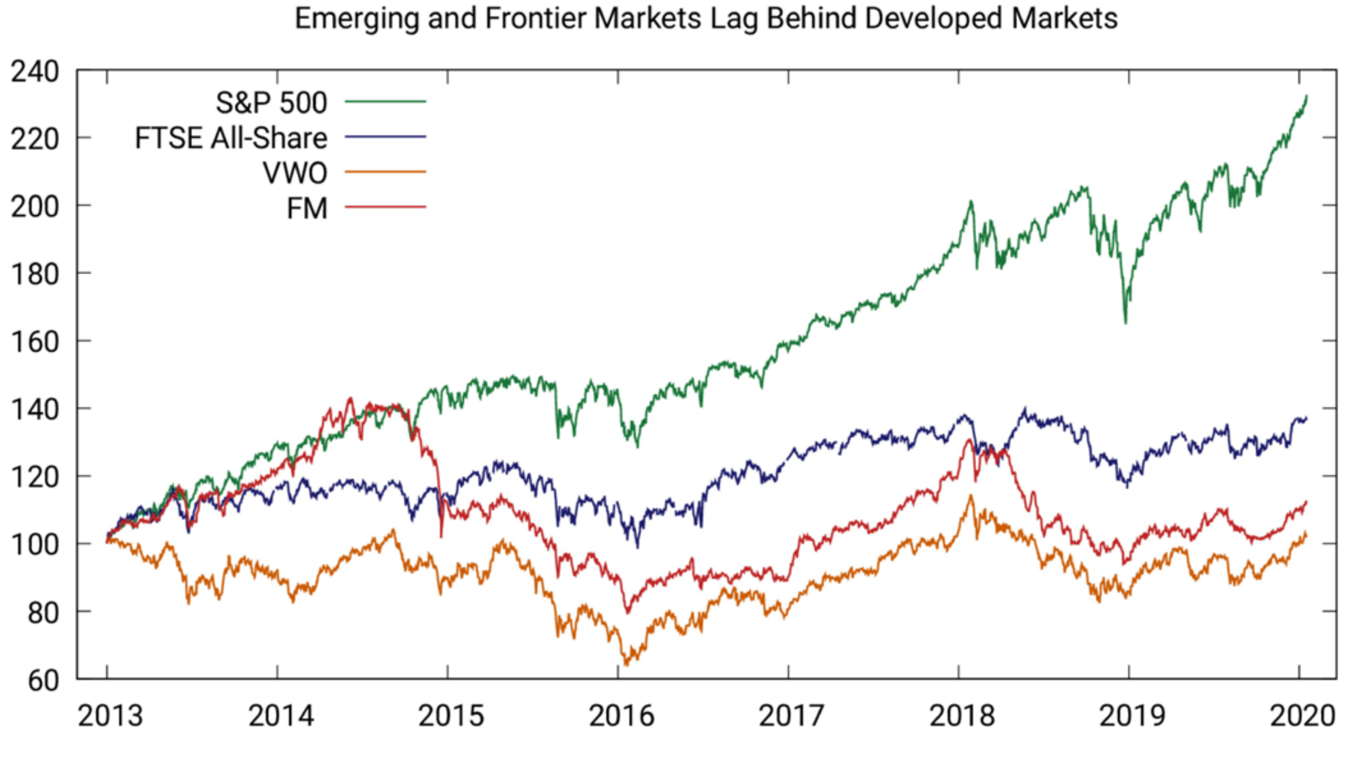
Central banks from developed economies have no firepower left, while the margin for further interest-rate cuts in emerging economies is still wide. The two-digit rates of the recent past along with a rising dollar prevented equities in emerging markets from experiencing the same kind of returns experienced in the US. While the S&P 500 is up 65% and 193% over the last five and 10 years respectively, the Vanguard Emerging Markets ETF is up 14%

**"I'M NOT FORESEEING A HARD LANDING FOR THE US, JUST A LATE-CYCLE ECONOMY GROWING AT A LIMITED PACE, WHICH IS POSITIVE FOR EMERGING ECONOMIES."**

and 11% in the same period. In general, emerging-market equities underperformed US equities since the global financial crisis. But declining interest rates are helping governments and corporations to service their debts, which should help equity values. While interest rates are already low in emerging economies, there's still plenty of room for them to go even lower, as they are still much higher than in the developed world. The lower rates should also lend support to improving economic conditions. With valuations in the US too stretched, I expect a growing number of investors to seek out value elsewhere, with the UK, Europe and, in particular, emerging markets being on the receiving end.

Other factors also provide support for a bull market in emerging economies. After significant international turbulence, with Trump pressing trading partners into conceding more favourable trade deals for the US side, it seems there is a truce between the US and China. As 2020 is an election year, I expect Trump to ease a little on that front, in particular to avoid the US economy being hurt, which would prove fatal to his re-election ambitions. This paves the way for stronger emerging-market currencies to support further interest-rate cuts.

On the US-dollar front, a few factors point to weakness for the dollar. The US runs a twin deficit that will hardly be solved in a year of elections. If Trump is going to put a brake on expenses, that won't happen in the short term. Besides, in trade-weighted terms the US dollar is also seen as being overvalued. This sentiment is even corroborated by Trump, who has often complained to European and other countries about their role in dollar strength, which hurts US trade. Over time, the pressure is on the downside for the dollar. Only a full-blown crisis and/or an increase in volatility would temporarily reverse that trend. But I'm not foreseeing a hard landing for the US, just a late-cycle economy growing at a limited pace, which is positive for emerging economies.



## Where to put your money

While there is a huge ETF offer to play the emerging-markets theme, I'm looking at seven ETFs that I believe cover different angles, and that are well managed and from established providers. I will start with two broad-based options: the **Vanguard FTSE Emerging Markets ETF (NYSEARCA:VWO)**, which is the largest ETF by assets under management, and the **iShares MSCI Emerging Markets ETF (NYSEARCA:EEM)**, which is the most traded. For investors looking for the smaller, but fast-changing frontier markets, the **iShares MSCI Frontier 100 ETF (NYSEARCA:FM)** may be a more tailored option. Or, following in Jim Mellon's footsteps (Master Investor, Issue 58, January 2020, p. 6-8), investors may like to consider an even more targeted investment through the **VanEck Vectors Vietnam ETF (BATS:VNM)**. For a different kind of bet, the **Direxion MSCI Emerging Over Developed Markets ETF (NYSEARCA:RWED)** offers the option to explore differences between developed and emerging markets. Lastly, the **VanEck Vectors J.P. Morgan EM Local Currency Bond ETF (NYSEARCA:EMLC)** and the **iShares J.P. Morgan USD Emerging Markets Bond ETF (NASDAQ:EMB)** are good options for those who want to add a fixed income layer to their portfolios.

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**Vanguard FTSE Emerging Markets ETF**

The Vanguard Emerging Markets ETF is the largest ETF dedicated to emerging markets. Its largest investments are made in China, Taiwan, India, Brazil and South Africa (73% of the fund's assets), but it invests in hundreds of stocks across several countries. This ETF is a preferred option for long-term investors seeking the growth prospects offered by rapidly evolving emerging markets. Apart from the diversification offered, one very good reason for this ETF to be considered is its low annual charge of 0.12%. This is, in my view, the best broad and diversified option for investing in emerging markets.

**iShares MSCI Emerging Markets ETF**

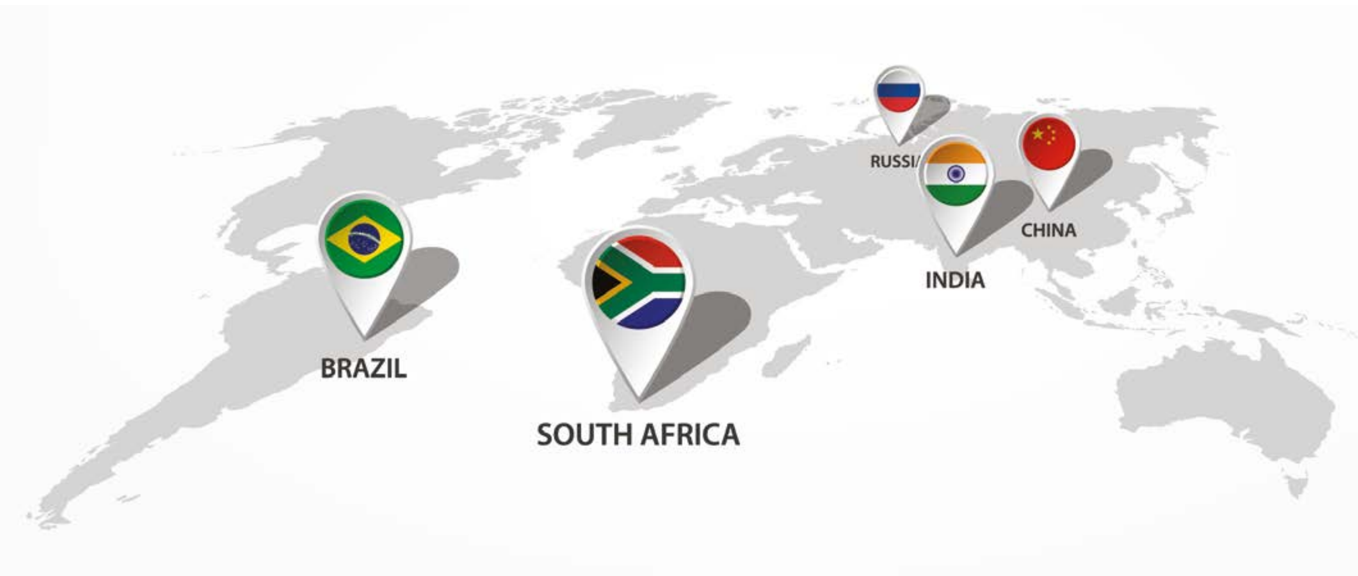
This ETF is similar to the Vanguard offer, as it targets the same emerging-markets index. But EEM is the most traded of the lot because there is an options market targeting this fund, which allows investors to use more refined strategies in the short term. Unfortunately, EEM comes with a very high expense ratio of 0.68%. For a long-term investor or someone looking to get plain 'vanilla' short-term exposure to emerging markets, VWO is the best option. For someone looking for more complex strategies, EEM could be a better option.

**iShares MSCI Frontier 100 ETF**

If the growth prospects for emerging economies are good, they are even greater for frontier economies. Some of these frontier economies will eventually replace emerging economies like China in their manufacturing role, for example. The iShares MSCI Frontier 100 ETF targets economies like Kuwait, Vietnam, Morocco, Nigeria and Romania, among many others. It invests in the 100 largest companies from those economies, giving investors great growth potential over time. However, FM invests in countries that have higher geopolitical and economic risks, which makes it more volatile. At the same time, while it invests in the largest companies from frontier markets, it is not as diversified as VWO or EEM, which invest in several hundred different assets. Its expense ratio is also not favourable, at 0.79%.

**VanEck Vectors Vietnam ETF**

Vietnam is capturing foreign investment at a fast pace, as companies are looking for alternatives to China to manufacture their products. Investors looking for direct exposure to the country's fortunes may opt for the VanEck Vectors Vietnam ETF instead of investing in broader funds. It invests in securities of publicly traded companies that are incorporated in Vietnam or that are



## Emerging Markets ETFs Performance

| Ticker | Name | %chg 6m | %chg 2019 | %chg 3y | %chg 5y | %chg 10y |
|---|---|---|---|---|---|---|
| RWED | Direxion MSCI Emerging Over Developed Markets ETF | 7.4 | --- | --- | --- | --- |
| EMB | iShares JPMorgan USD Emg Mkts Bond | 1.7 | 10.2 | 3.1 | 4.0 | 12.4 |
| EEM | iShares MSCI Emerging Markets Index Fund | 7.8 | 14.7 | 26.9 | 17.2 | 10.6 |
| FM | iShares MSCI Frontier 100 Index Fund | 3.0 | 16.0 | 15.9 | 3.8 | --- |
| EMLC | VanEck Vectors JP Morgan EM Local Currency Bond ETF | -3.3 | 3.0 | -5.0 | -20.3 | |
| VNM | VanEck Vectors ETF Trust Vietnam ETF | -2.1 | 8.1 | 20.6 | -13.8 | -37.6 |
| VWO | Vanguard Emerging Markets ETF | 7.4 | 16.5 | 23.9 | 14.0 | 10.9 |

*Source Data: Sharescope*

incorporated outside Vietnam but have at least 50% of their revenues/related assets in Vietnam.

**Direxion MSCI Emerging Over Developed Markets ETF**

For those looking for a long-short product, the Direxion MSCI Emerging Over Developed Markets ETF may be the solution. Instead of investing directly into emerging markets, the fund gives investors a relative exposure. It targets the EAFE IMI 150/50 Return Spread Index, which measures the performance of a portfolio that has a 150% long exposure to the MSCI Emerging Markets IMI Index and 50% short exposure to the MSCI EAFE IMI Index. In summary, this fund is long emerging markets and short developed markets. This has the advantage of being more market-neutral than other funds. However, its expense ratio is a bit high at 0.58% and trading volumes are low.

**VanEck Vectors J.P. Morgan EM Local Currency Bond ETF**

My last two options feature a different asset class − fixed income. All other ETFs reviewed target equities. Some investors may feel more comfortable with fixed income. With interest rates being so low throughout the developed world, investors are unable to get a decent yield unless extending the duration of their portfolios or jumping into high yield. A good alternative is to invest in investment-grade bonds − but from emerging markets.

As interest rates are declining in emerging economies, bond values should increase (as yields and prices are inversely related). The VanEck Vectors J.P. Morgan EM Local Currency Bond ETF mainly targets government bonds denominated in local currency, which means investors are also betting against the dollar. Brazil, Mexico, Indonesia, Thailand and South Africa are the largest exposures, but the fund is well balanced, as it invests in many other countries.

**iShares J.P. Morgan USD Emerging Markets Bond ETF**

For those looking for a US-dollar exposure to bonds of emerging economies, the iShares J.P. Morgan USD Emerging Markets Bond ETF is a good alternative. In this case, the ETF only invests in bonds that are issued in US dollars. From the perspective of an investor from a developed country, currency risk is much lower. Still, if the dollar rises by much, it may degrade the ability of issuers to service debt and contribute towards eroding the returns of the ETF.

## Final thoughts

While the uptrend in equities seems exhausted, investors need to look for value where it still exists. US markets look 'frothy' when compared to Europe and emerging economies, and valuations are stretched with the CAPE ratio now at levels only seen during the technology bubble. But, at a time when a trade deal between the US and China is regaining life and global volatility is declining, emerging markets offer good value to investors. The declining interest rates are helping economic growth and there's still room for further cuts.

**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

# PRICE ACTION OR INDICATORS – WHICH IS BEST?

**Charts guru David Jones investigates which tools in the chartist's toolbox are best – price action or indicators?**

Chartists are, on the whole, a mild-mannered bunch. But one divisive topic is often guaranteed to raise their hackles. And that is the question of the best approach to technical analysis – is it to focus on the price or look at some mathematical derivation? This month, we will address the question of what is best – price action or indicators. Trust me, it is much more exciting than it sounds.

## The different ways of analysing a market

I have been a technical analyst for almost 25 years and in that time, I have seen a shift in the way technical analysis and charting is viewed. Back then, it was seen as a niche and somewhat nerdy approach to looking at markets, with an element of crystal-ball gazing and voodoo thrown in. Today I think it is fair to say that, while it is still not a mainstream approach, it has gained a wider acceptance. I think this is mainly due to the greater number of private investors involved in financial markets – particularly when it comes to shorter-term trading of assets such as foreign exchange, commodities and even cryptocurrencies.

Thanks to the proliferation of higher-speed internet and smartphones over the last decade or so, financial markets have been opened up to a whole new market. This is a good thing. But some people seem to believe that there is a Holy Grail to be found. They view markets like some sort of video game, where if you can just access the 'cheat' codes, then you are going to win. I may be over-egging it slightly, but based on the conversations I have had with probably thousands of newer entrants over the past 10 years, plenty of them seem to see it that way.

Which brings us back to the argument of analysis using price action (old-fashioned), versus indicators (new-fangled). Let's examine these two approaches in more detail.

## Price-action analysis

The assumption behind this approach is very simple – price is everything. For example, if XYZ market or share is trading at 500, then 500 is the fair market price, taking into account all factors that are in the public domain. If the market or share has been trending higher over the past few days/ weeks/months, then the price-action trader or investor is looking to go with this momentum and the broader market view. The person relying on price action is not trying to guess major turning points


**"THE PERSON RELYING ON PRICE ACTION IS NOT TRYING TO GUESS MAJOR TURNING POINTS WHERE A MARKET MAY BE OVERBOUGHT OR OVERSOLD."**

where a market may be overbought or oversold (whatever those terms actually mean) but is instead looking for price to lead the way.

Here is an extreme example, but one I have traded/invested in personally over the past few months – the price of the precious metal, palladium.

I think the extreme nature of this example highlights a couple of important points. First of all, good trends in markets should be easy to spot. It is pretty clear what the trend in palladium has been since the summer of 2018, and that carried on into December 2019. On the extreme right edge of the chart, the price is again moving out to fresh all-time highs, looking like the trend is about to start its next swing higher.

But from a psychological point of view, how hard is it to buy right now? The price has doubled in the last 18 months, but the price-action trader is meant to just grit their teeth and push the 'buy' button. This is the very essence of using price – we let the market lead the way. For whatever reason, the price moving to fresh highs shows us that palladium traders and investors are happy to continue to pay higher prices for the metal. As a price-action trader, following the trend is the obvious option here. Let's jump forwards.

I did say that palladium was an extreme example – and those eye-watering moves have continued into January 2020. It is the same highlighted area on the next chart as in the previous chart. The break upwards in December was the buy signal from a price-action point of view and came in around $1,850 an ounce. So far in January, the price has traded as high as $2,300 an ounce – a rise in

## Palladium price – August 2018 to December 2019


## Palladium price October 2019 to present


## S&P 500 Index, December 2018 to present


## FTSE 100 Index – April 2018 to present


excess of 20% in under two months. The price-action trader has been well rewarded in going with the trend.

Bringing it back to markets that may have more of a mass-market appeal, here is the broad US stock-market index, the S&P 500. Let's take a look at the simple approach of buying new highs. For the novice market observer, the knee-jerk reaction of a price moving to new highs may be that it is too expensive now and cannot go any higher. But from a price-action point of view, it shows that investors and traders are happy to pay higher prices than before – otherwise it would not be going up – it can therefore be a suggestion that a new norm is being set for this market. So, following price action, the simple approach is to be a buyer of new highs.

At the time of writing, with the S&P 500 having set yet another new all-time high in the past few days, this approach obviously would have been profitable. As ever, it is where you get out that dictates the final profit or loss. But as a starting point, using the very simple approach of buying new highs, the investor or trader is at least putting momentum on their side.

## Indicators/oscillator analysis

It easy to see the appeal of using indicators and oscillators for market analysis – and one that particularly appeals to shorter-term traders. Just to show what I mean when talking about oscillators, we have a chart of the FTSE100 index with a 10-day relative strength index (RSI) at the bottom.

The RSI is a classic overbought/oversold indicator. In a nutshell, this 10-day version looks at the momentum of the FTSE over the previous 10 trading days. It measures the magnitude of daily price swings and, applying a mathematical formula, represents whether this could be an overbought or oversold move in the market. Traditionally, if the RSI has a reading above 70%, the market is thought to be overbought and is due a slide. There are three overbought areas on the FTSE100 chart, where the RSI is shaded at the peaks. An RSI reading below 30% suggests the market is oversold and is due a bounce. There is only one oversold signal on the FTSE100 chart, on the left-hand side at the lower extreme.

# "NEVER UNDERESTIMATE THE POWER OF JUST LISTENING TO WHAT THE MARKET IN QUESTION – WHATEVER THAT IS – IS TRYING TO TELL YOU."

It is easy to see the appeal of having a magic formula to figure out the market for you. And in fairness, the 10-day RSI on the FTSE100 chart has not done a bad job of calling short-term turning points for the index. Indicators such as the RSI do perform better in sideways trending markets – which is what the FTSE was doing for most of the period shown above. Where they fall over is when a market starts trending – let's return to the palladium chart.

Back to our extreme example – but it is a great illustration of the problems with the many overbought/oversold indicators that can be applied to charts. With palladium, there was only one RSI buy signal in an 11-month period, just before April. The rest of the time, the RSI was positively discouraging an investor to buy into strength. As palladium pushed higher the RSI went overbought – but the price did not care, and the trend pushed on.

In my opinion, this is the major drawback of ignoring price. Indicators such as the RSI, MACD (moving average convergence-divergence) indicator, stochastics and so on, definitely have their place as part of the toolkit in figuring out where a market may move next. But it is far too much of a temptation for those new to charting and technical analysis to place excessive emphasis on the predictive abilities of these tools. This means that they can end up not looking at what the price is actually doing – and as a result miss out on major moves such as those in markets such as the S&P 500. Never underestimate the power of just listening to what the market in question – whatever that is – is trying to tell you.

**Palladium – February 2019 to present**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**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 NICK SUDBURY

## FUNDS AND TRUSTS IN FOCUS

# THE BEST FUNDS FOR INVESTING IN JAPAN

**With Japan being a top pick for 2020 among the professionals, Nick Sudbury unearths some of the best funds and trusts for investing in the Land of the Rising Sun.**

## "IF THERE IS A POSITIVE CONCLUSION TO THE US-CHINA TRADE WAR, THEN JAPAN WOULD BE ONE OF THE MAJOR BENEFICIARIES."

Japan is one of the most favoured markets for 2020, with many advisors including the country in their top picks for the year. Despite long-established concerns over the high national debt and low rate of inflation, there are good reasons to believe that the local stock market will continue to deliver decent returns for investors.

Shinzō Abe has recently become Japan's longest-serving prime minister and during his tenure has implemented a radical series of economic policies that have become known as Abenomics. The 'three arrows' of monetary easing, fiscal stimulus and structural reforms were designed to inject some life into the moribund economy, and they have made a considerable difference, although it is still a work in progress.

Commenting on the Japanese economy's state of transition, as implementation of the prime minister's long-running reform programme continues, Ryan Hughes, head of active portfolios at AJ Bell, says:

"The recent rise in consumption tax has the ability to dent progress in 2020, but with the Olympic Games likely to bring a big summer boost, the tax rise could well pass off relatively uneventfully."

The key to the country's prospects over the next 12 months will be the health of China, which is an important trading partner. If there is a positive conclusion to the US-China trade war, then Japan would be one of the major beneficiaries.

## Attractive valuations

According to Ben Yearsley, a director at Shore Financial Planning: "Investors should ignore the demographic problem of the ageing population as there is still money to be made in some excellent companies."

Darius McDermott, managing director of Chelsea Financial Services, is also positive on Japan, commenting that: "Corporate governance is improving and dividends are growing, which is great news for income investors. It's also a market that is less well covered than most and that means active managers can really add value, especially if they are willing to do their research in the small and mid-cap space."

Valuations are towards the bottom end of the range and the region should benefit as the global economy recovers from its slump of 2019 and exports grow again, although the country faces some long-term challenges, as Adrian Lowcock, head of personal investing at Willis Owen observes:

"Japan has long suffered from deflation and anaemic growth and its companies have struggled with an ageing population.

"This has left it unpopular with investors; however the country has been undergoing a lot of reform and it has also done much to address its labour system, making it easier for women and foreign workers to enter the workforce, which should help support the economy."

**"CORPORATE GOVERNANCE IS IMPROVING AND DIVIDENDS ARE GROWING."**

## Currency risk

Before investing, it is important to decide whether or not to hedge the currency risk. This is quite easy to do as many of the open-ended Japanese funds are available in both hedged and unhedged share classes. Commenting on hedging decisions, McDermott says:

"The pound is cheap relative to its long-term history and we can see a scenario for it appreciating strongly, but also a scenario where it dips again or stays lower for longer. In our managed funds we have decided to opt for a 50:50 split between hedged and unhedged share classes."

The problem is that the currency markets are a potentially volatile and dangerous place to try to make predications, especially given that the trade discussions between the UK and the EU are likely to cause volatility in sterling throughout the year:

"As it stands, I see no compelling case to hedge Japanese exposure and a look at last year shows just how costly getting it wrong can be with a 13% swing both down and up in the GBP/yen exchange rate over the past 12 months," notes Hughes.

## The best open-ended funds

According to data from FE Trustnet, there are 70 open-ended funds operating in the Japan sector and over the last five years they have generated an average gain of 74.4%. The best of the lot with an impressive cumulative return of 190% was **Legg Mason IF Japan Equity X**. Commenting on the fund, Yearsley says: "It tends to invest in much smaller companies and is higher risk, so if you feel comfortable with this sort of profile you need to treat it as a long-term buy and hold."

He also likes **Man GLG Japan Core Alpha**, which is run by Stephen Harker, a contrarian investor who looks for companies that are out of favour. The fund buys into the cheapest companies listed in Japan, often using the price-to-book metric, with the manager happy to move around the different sectors depending on where the value is. Lowcock also likes it, pointing out that: "Harker uses a rigorous, repeatable process that draws on the team's extensive knowledge of the Japanese market. With the clear focus on value, long-term investment horizon and no consideration for the benchmark, the portfolio will differ from the index."

> **"BAILLIE GIFFORD JAPANESE SMALLER COMPANIES IS THE TOP-PERFORMING FUND IN THE SMALLER JAPANESE COMPANIES SECTOR, WITH A FIVE-YEAR RETURN OF 142.8%."**

## Baillie Gifford

One of the most highly regarded investment groups operating in the region is Baillie Gifford, which runs a number of successful open-ended funds and investment trusts.

Yearsley's favourite is **Baillie Gifford Japanese**, which like most of the firm's other funds buys into long-term growth companies. It has a good track record and is ranked eighth in the sector over the last five years, with a return of 101.2%.

McDermott prefers Baillie Gifford Japanese Income Growth, which aims to take advantage of the growth in dividends in the country. It has returned 27.7% over three years and is yielding a higher than average 2.2%.

The fund is co-managed by Karen See and Matt Brett, who are supported by nine other Japan specialists, each with sector-research responsibilities. Lowcock is also a fan, commenting: "Baillie Gifford has a collegiate approach and all ideas are debated by the team. Careful stock selection is paramount and the managers also consider industry trends and themes such as technology and demographics. The focus is on companies with strong balance sheets and a commitment to growing dividends."

**Baillie Gifford Japanese Smaller Companies** is the top-performing fund in the Smaller Japanese Companies sector, with a five-year return of 142.8%. The seven constituents have produced an average gain of 102.5% over the same period.

## Other options

Other decent options include **Comgest Growth Japan**, which McDermott says has a long-term focus, with the manager picking a few really good quality companies and investing in them for many years. The fund is the third-best performer in the sector over five years, with a gain of 135.1%.

Lowcock prefers **Lindsell Train Japanese Equity**, which is managed by Michael Lindsell, who has specialised in Japanese equities since he first started covering them in 1985. Lowcock says:

"Lindsell's investment philosophy lies in the belief that a highly concentrated portfolio of high-quality, cash-generative, strong, and easily understood business franchises will outperform the market and reduce volatility over the long term."

Lindsell uses strict criteria aligned to this belief to significantly filter down the universe to 80 or 90 qualifying stocks that are then subject to in-depth fundamental analysis. The fund will typically underperform in strongly rising markets, yet his unwavering adherence to the investment philosophy has resulted in considerable long-term success.



**"MANY JAPANESE COMPANIES ARE AVAILABLE AT ATTRACTIVE VALUATIONS AND THE STRUCTURAL REFORMS SHOULD HELP TO IMPROVE SHAREHOLDER RETURNS."**

For smaller-company exposure McDermott suggests **AXA Framlington Japan**. "It invests in companies of all sizes, but has about a 60% allocation to the mid and small caps and is investing in the automation and robotics themes, which are important to the country to help it cope with the ageing population."

## The best investment trusts

Data from Winterflood shows that there are six investment trusts operating in this area and over the last five years, they have generated a weighted average share-price return of 104%, which is well ahead of the 76% gain from the large-cap TSE First Section benchmark.

The best performer over this period was the £295m **Fidelity Japan Trust (LON:FJV)** with an increase of 151%. Despite the strong returns, the sector as a whole is trading at an average discount to NAV of five percent.



**JPMorgan Japanese (LON:JFJ)** is the largest investment trust in the sector with total assets of £974m. It has been managed out of Tokyo since 2007 with lead manager Nicholas Weindling, supported by a well-resourced team that enables him to follow a bottom-up, stock-picking strategy.

They have developed a thematic approach that underlies much of their stock selection with the key areas of interest including internet, Japanese brands, automation and improving corporate governance. It is a growth-oriented portfolio that has delivered strong long-term returns, yet the shares are available on a nine percent discount, which is one of the widest in the sector.

There are also four smaller-companies investment trusts that have generated an average five-year gain of 151%. Leading the way is the £555m **Baillie Gifford Shin Nippon (LON:BGS)** with an impressive return of 198%.

BGS was launched in July 1985 and has been managed by Praveen Kumar and a nine-strong support team since December 2015. Kumar aims to identify small Japanese stocks with above-average prospects for capital growth and looks to hold them for at least three to five years. The fund has an excellent long-term track record and normally trades at a small premium.

## Funds targeting the corporate governance reforms

One of the newest and most unusual investment trusts in the sector is the £134m **AVI Japan Opportunity Trust (LON:AJOT)**, which aims to exploit improvements in corporate governance by investing in a concentrated portfolio of small and mid-cap Japanese stocks.

Japan is unusual in that there are some large cross-shareholdings between certain companies that can result in bloated balance sheets with

## FUND OF THE MONTH

One of the big themes in Japan is the move towards companies becoming more shareholder friendly. This is having an impact on a number of different areas, including the payment of dividends:

"Dividends are becoming a bigger part of the market and dividend-growth prospects look attractive, especially as companies are sitting on large cash piles with 2019 dividends hitting record levels," says Hughes:

"The pay-out ratio remains at a low base, giving significant scope for year-on-year increases, which could make this market very interesting for income seekers."

He therefore recommends the £257m **Coupland Cardiff Japan Income & Growth Trust (LON:CCJI)**. Like all investment trusts it has flexibility on its income policy, being able to add to its revenue reserves in good years and draw on them in bad years, thereby delivering consistent dividend growth over time.

CCJI has a concentrated portfolio of 42 different holdings with 35 held for their dividend growth, five for their stable yield and two special situations. The fund is yielding 2.5% and over the last three years has returned 37%, which is almost double the MSCI Japan index. The shares are trading close to NAV.


### Fund Facts

| | |
|---|---|
| Name: | Coupland Cardiff Japan Income & Growth Trust |
| Type: | Investment trust |
| Sector: | Japan |
| Total assets: | £257m |
| Launch date: | December 2015 |
| Historic yield: | 2.5% |
| Ongoing charges: | 0.94% |
| Website: | www.ccjapanincomeandgrowthtrust.com |

lots of cash and minimal investor scrutiny. Under President Abe's policy of structural reforms, this poor corporate governance is starting to change, with businesses having to focus more on shareholder returns.

AJOT aims to profit from this trend by adopting a 'friendly activism' approach, by giving companies an extra nudge in the right direction. This now seems to be paying off with 11 of its 28 holdings announcing share buybacks in the last year and two of its positions moving from being part-owned by Toshiba to fully owned at a large premium to their previous share prices.

A second investment trust is also planning to follow a similar approach. At time of writing, the **Nippon Active Value Fund** was hoping to raise £200m to take minority stakes in a concentrated portfolio of up to 20 holdings in undervalued Japanese equities. The manager intends to focus on stocks where cash constitutes a significant proportion of the market cap and where the company has no controlling or majority shareholders.

Many Japanese companies are available at attractive valuations and the structural reforms should help to improve shareholder returns. In the past, the country has mainly been of interest to those looking for capital growth, but the increased focus on dividends could make it a decent option for income investors.

### 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

# HUNTING FOR SUSTAINABLE DIVIDEND GROWTH

**John Kingham of UK Value Investor reveals his secrets for building a portfolio of sustainable dividend-growth stocks.**

In almost all cases, long-term dividend growth is unsustainable without earnings growth, earnings growth is unsustainable without revenue growth and revenue growth is unsustainable without capital employed growth.

In practice, this means companies can only produce long-term sustainable growth if they employ more capital to fund more factories, warehouses, vehicles, machines, robots, offices, computers and an endless array of other capital assets. Or to put it another way, if you're looking for sustainable dividend growth, you should start by looking for sustainable capital employed growth.

## What is sustainable capital employed growth?

Capital employed consists mostly of equity capital, debt capital and leased capital, and these differ in terms of their risk profile and sustainability.

The easiest way for a company to employ more capital is to take on more debt or leases. You just sign up for a new bank loan or rental agreement and you have access to another retail store or factory. Anyone can do that.

However, growing capital employed primarily through increased debt and lease obligations can be risky. Those funding sources come with relatively inflexible interest and rent costs, and if earnings growth doesn't keep pace with interest and rent increases then eventually some sort of crisis is inevitable.

The alternative is equity capital growth. This is typically the most sustainable form of capital growth because equity funding doesn't come with fixed-expense obligations. Of course, shareholders expect a return on their equity, but unlike debt interest or rent, those returns don't have to be paid out in cash on a regular basis (management can choose to cut or suspend the dividend, although it may cost them their jobs).

We can break equity growth down into two types; equity growth from rights issues and equity growth from retained earnings.

Rights issues occur when management asks shareholders for more money, in exchange for newly issued shares. Rights issues are often used to fund long-term investments (such as a new factory or an acquisition) when the returns on those investments are highly uncertain. This can be sensible, because it matches uncertain returns from the investment with a funding source that has extremely flexible repayment terms (dividends

**"IF YOU'RE LOOKING FOR SUSTAINABLE DIVIDEND GROWTH, YOU SHOULD START BY LOOKING FOR SUSTAINABLE CAPITAL EMPLOYED GROWTH."**

are optional and equity funding is perpetual, ie it never has to be repaid).

Although using rights issues to fuel growth isn't necessarily a problem, it can be if the amounts raised are very large. If a rights issue is used to fund a very large acquisition, for example, the time and effort required to integrate the acquired company can be seriously disruptive to the acquirer's existing business.

The most common way for management to raise additional equity funding from shareholders is to simply retain earnings instead of paying them out as a dividend.

This is also the most sustainable way to grow capital employed, for two reasons.

First, as I've already mentioned, equity capital doesn't come with fixed costs. Second, retained earnings are usually relatively small compared to existing capital employed (typically in the range of 5% to 20%). This is an amount of additional capital that most companies can absorb and deploy while maintaining the structural integrity of the business.

Since retained earnings are usually the most sustainable driver of long-term growth, we can use the rate of retained earnings to calculate a company's sustainable growth rate.

## Calculating a sustainable growth rate

Imagine we have a company with £100 million of equity capital, £50 million of debt capital and £50 million of leased capital. Total capital employed is therefore £200 million.

Over the next year, the company produces £20 million of earnings and pays a £10 million dividend, so £10 million of earnings are retained.

That £10 million is added to the company's existing £100 million of equity, leaving year-end equity at £110 million, an increase of 10%.

With a 10% increase in equity capital, the company has the funds to invest in more assets which should drive earnings growth. Management decides that with the increased earnings potential, taking on a proportional amount of additional debt and lease obligations is prudent.

A proportional increase means that management will increase debt and lease obligations by 10%, in line with the increase in equity. And since equity capital, debt capital and leased capital are all growing at the same rate, total capital employed will grow at the same rate as equity.

This gives us the sustainable growth rate, which equals retained earnings/ equity * 100%.

In other words, if a company produces a return on equity of 10%, then 10% is its maximum sustainable growth rate. Also, the more it pays out as a dividend, the lower its sustainable growth rate will be. To grow faster than its sustainable growth rate, a company must either raise additional equity through rights issues or increase debts and leases faster than equity, both of which increase risk.

This gives us a simple rule of thumb; growth which is consistently higher than average returns on equity is unlikely to be sustainable over the long term.

This is a good starting point, but there's a problem with the sustainable growth rate. It's based on the assumption that existing debts and leases are sustainable, and that proportional increases in those financial obligations will also be sustainable.

That is quite a large assumption, so I prefer to use a more cautious version of the sustainable growth rate, which I call the self-funded growth rate.

> **"THE MORE IT PAYS OUT AS A DIVIDEND, THE LOWER ITS SUSTAINABLE GROWTH RATE WILL BE."**

## Calculating a self-funded growth rate

The self-funded growth rate is basically the same as the sustainable growth rate. The only difference is that instead of assuming debt and lease obligations can grow sustainably in proportion with equity, we assume that truly sustainable growth is funded purely by retained earnings.

This isn't necessarily true, but it does give us a very conservative view of how a company should fund its growth.

If retained earnings are the sole driver of capital employed growth, then capital employed growth will be limited to the net return on capital employed. In other words, the calculation for the


**"GROWTH WHICH IS CONSISTENTLY AND SIGNIFICANTLY HIGHER THAN NET RETURNS ON CAPITAL EMPLOYED IS A RED FLAG THAT NEEDS INVESTIGATING."**

self-funded growth rate is: self-funded growth rate = retained earnings/capital employed * 100%.

For example, if a company produces a net return on capital employed of 10% and retains all of those earnings, then its maximum self-funded growth rate would be 10%. As before, if some earnings are paid out as a dividend then retained earnings and the self-funded growth rate will be lower.

If you see a company where capital employed growth consistently exceeds the self-funded growth rate, then that growth has been at least partly driven by some combination of rights issues and increasing debts and leases.

In many cases that will be quite reasonable. Most growing companies will be growing their earnings and so will be capable of increasing their debt and lease burdens, at least to some extent. However, if there is a very large gap between a company's actual capital employed growth over several years and its self-funded growth rate, then that could be storing up problems for the future.

Here's another simple rule of thumb; growth which is consistently and significantly higher than net returns on capital employed is a red flag that needs investigating.

We can see how these ideas play out in the real world by taking a look at Ted Baker, the global fashion retailer.

## Ted Baker's sustainable and self-funded growth rates

Ted Baker produced impressively rapid and consistent growth over the period from 2009 to 2018, including annualised revenue and dividend growth of 17% per year and capital employed growth of 18% per year, all on a per share basis.

Using the sustainable and self-funded growth rates, we can check to see whether that growth is likely to be sustainable over the longer term.

Over that 10-year period, Ted Baker produced average earnings of 66.4p and paid an average dividend of 34.0p, leaving the company with average retained earnings of 32.4p. It also had average equity per share of 285.1p.

We can use this information to calculate the company's sustainable growth rate as follows:

sustainable growth rate = retained earnings / equity * 100%, therefore sustainable growth rate = 32.4p/285.1p * 100% = 11.4%.

With an annualised capital employed growth rate of 18% and a sustainable growth rate of 11.4%, it's clear that Ted Baker's growth over the last decade was fuelled to a considerable extent by increasing debt and lease obligations faster than equity (there were no rights issues during that period).

The implication is that the company's historic capital employed growth rate of 18% will not be sustainable in the longer term, because eventually its debt and/or lease burden will become intolerable. And with such a large gap between actual and sustainable growth rates, there is a real risk that Ted Baker's rapid growth has sown the seeds of future problems.

Let's see how Ted Baker's actual growth compares to the more conservative self-funded growth rate.

To calculate that we'll need to sum up average per share debts (97.6p), leases (406.4p) and equity (285.1p), giving average capital employed per share of 789.1p. As the self-funded growth rate = retained earnings/ capital employed * 100%, the self-funded growth rate in this case is 32.4p/789.1p * 100% = 4.1%.

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As you can see, the company's self-funded growth rate is just 4.1%, compared to a sustainable growth rate of 11.4%. There is a significant difference because its capital employed is much larger than just its equity, mostly due to extensive use of leased capital, primarily in the form of rented stores.

The self-funded growth rate says that if Ted Baker were to fund its growth purely from retained earnings and without increasing its debt or lease liabilities (perhaps by leasing stores for five years or so with a single cash payment up front, paid for out of retained earnings), then it would be able to sustain a growth rate of no more than 4.1%.

That's a very long way short of the company's actual 18% capital employed growth rate, and it highlights just how much the company has depended on higher-risk external funding to fuel its rapid growth.

But as I've said before, not all external funding is bad, and some use of external debt, lease or equity funding is quite sensible for most companies. So, while fully self-funded growth may be the ideal, what I'm really interested in is the degree to which external funding has been used to drive growth.

We can measure this with the growth funding ratio.

### Calculating the growth funding ratio

One way to measure the degree of external growth funding is to compare the amount of additional external funding taken on (ie debts, leases or equity from rights issues) to the total amount of earnings produced over a period of time.

The higher the ratio of external growth funding to earnings, the less sustainable the company's growth has been.

Here's the calculation:

Growth funding ratio = additional external funding/total earnings * 100%

A negative growth funding ratio means that all of the company's growth either was or could have been funded by retained earnings. A positive growth funding ratio means that retained earnings alone were not enough to drive the company's growth, so additional external funds were required.

As with most financial ratios, the growth funding ratio provides a more meaningful result when measured over a five or 10-year period. Let's see how it works out for Ted Baker.

### Calculating Ted Baker's growth funding ratio for 2009-2018

To calculate the amount of external growth funding, we can subtract the total amount of retained earnings from the total amount of capital employed growth per share (external growth funding = capital employed growth – retained earnings).

In 2009, Ted Baker had capital employed of 381.1p and in 2018 that had grown to 1409.6p, an increase of 1028.5p. Between those two years, the company earned a total of 633.9p and paid out dividends totalling 323.3p, so

total retained earnings were 310.7p. The total amount of external growth funding was therefore 1028.5p – 310.7p = 717.8p.

We can now work out the growth funding ratio, ie 717.8p / 633.9p = 113.2%.

Ted Baker's growth funding ratio is over 100%. That means it raised more external funds to drive growth than it made in profit over the nine years between 2009 and 2018.

That's a lot of additional funding and it shows up in the company's financial statements. They show that debts went from zero to £129 million between 2009 and 2018 while lease liabilities went from £100 million to £276 million.

In late 2019 and early 2020, Ted Baker surprised shareholders (of which I am one) with a string of profit warnings, a dividend cut and then a full dividend suspension.

Tough trading conditions were blamed, but I now think the company's aggressive use of external funds to drive growth far above its self-fundable and sustainable growth rates was the underlying root cause.

Rapid growth requires lots of new stores, new staff, new supply-chain partners, new customers, new processes, new management and so on, and all of these have to go through a long and expensive experience curve before they can operate anywhere near optimally. Combine all this newness with the relatively fixed costs of rapidly increasing debt and lease obligations and it's no wonder Ted Baker eventually ran into serious problems.

To use a driving analogy, growing too fast is like driving too fast. It doesn't matter how safe the car is. Even the sturdiest Volvo will crash and burn if it's being driven too fast down

**"IN MY EXPERIENCE THEN, A GROWTH FUNDING RATIO OF 100% OR MORE IS VERY LIKELY TO CAUSE OPERATIONAL PROBLEMS AT SOME POINT."**

a bumpy, twisty road late at night. Or to use a building analogy, if you build your house as quickly as possible, don't be surprised if it falls down during the first storm.

Over the last 10 years, I have invested in two high-growth companies which subsequently collapsed and then required major repair work. In both cases they had a growth funding ratio of more than 100% (one fuelled growth through multiple rights issues and acquisitions, the other – Ted Baker– used rapidly increasing debt and lease liabilities to fund aggressive store, inventory and infrastructure expansion).

In my experience then, a growth funding ratio of 100% or more is very likely to cause operational problems at some point. The truth is that most companies simply cannot absorb and deploy that amount of capital without producing cracks that eventually cause the company to crumble.

Thanks to Ted Baker, I will no longer invest in a company if its growth funding ratio is anywhere near 100%. I'll just look for a more sustainable growth rate elsewhere.

Here's my rule of thumb for the growth funding ratio: only invest in a company if its growth funding ratio is below 50%.

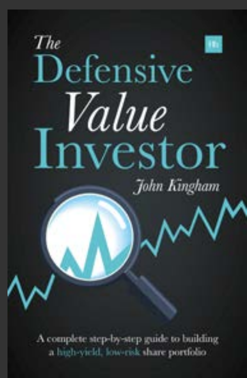
To wrap things up, here are two examples of more sustainable growth from my portfolio. Next and Burberry have both produced high, single-digit capital employed growth over the last 10 years – funded almost entirely from retained earnings. And yes, that capital employed growth has, so far, consistently fed through into revenue, earnings and dividend growth.

**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

# A NEW BULL RUN FOR GOLD?

**Gold started 2020 with a surge, hitting its best levels in almost seven years, with a brief trip above $1,600 an ounce. Is this just a flash in the pan – or a sign that this may be another stellar year for the precious metal?**

## US/Iran tension boosts safe havens

Anyone expecting a gradual easing into the new year by financial markets had a rude awakening in the very first week of January 2020. The airstrike that the US carried out on Baghdad airport, which resulted in the killing of Iran's most powerful general sent investors scurrying for so-called safe-haven investments – the best known of which is, of course, gold. It's no secret that uncertainty – whether political or economic – is a 'friend' to gold. This action by the US and the subsequent ratcheting up of tensions between the two countries over the next few days caused the price of gold to soar, hitting its best levels since March 2013.

### Gold – November 2019 to present


The chart shows an impressive move by gold, which meant that at the peak, where it briefly traded above $1,600, it had gained 10% in little over a month. Experienced investors and traders are used to markets overreacting in both directions to shock news – but it does not necessarily mean that the market in question is going to continue that momentum over the medium term. However, I think with gold, 2020 could be another year of good gains for some of the reasons discussed below.

## Gold is in a recovery

The first of these reasons is a chart-based technical assumption – which has served me well over the past 12 months as an investor in gold. Since the August 2018 lows ahead of $1,160 per ounce, the trend for gold has been up.

## Gold price – August 2018 to present


One of the simplest ways of spotting a trend (which I can't claim to have invented) is to pin the chart on a wall and walk to the other side of the room. If there is a trend there, you should be able to see it. Of course, not many of us may print our charts off anymore, but obvious trends should still jump off the screen at you. I think the chart of gold has fitted that description since at least May of last year.

Since then the trend has accelerated – gold and silver both enjoyed a strong boost into the summer of 2019 before cooling off. But it hasn't changed that broader picture of recovery. From a technical point of view, the price of gold would need to fall to approximately $1,350 to change that trend. At the moment, any weakness in the gold price still looks to be a buying opportunity.

### The dollar may be due a slide

In theory, gold can be priced in any currency of course, but traditionally the main market convention is to quote it in US dollars. If the dollar weakens then gold usually rises – and vice versa.

The US dollar has had a good couple of years, as we can see from the chart, which shows the dollar against a basket of other currencies.

After a dire performance in 2017, the last couple of years have seen a solid bounce back for the dollar – but it has struggled in recent months. Concerns about growth in the US economy for 2020 have prompted some analysts to forecast a slide for the currency. The US economy has certainly outpaced the eurozone, but perhaps it is time for these to converge again. The euro has been recovering against the dollar in recent months and further pressure should help the price of gold. This year of course also sees the US presidential election; while, at the moment, markets are expecting Donald Trump to win again, any uncertainty in the long run up to the vote could also put pressure on the US dollar.

**"AT THE MOMENT, ANY WEAKNESS IN THE GOLD PRICE STILL LOOKS TO BE A BUYING OPPORTUNITY."**

### Gold holds onto its crisis gains

I also think we could expect more gains for gold this year as a result of the wider political backdrop and market psychology. You do not have to be a genius to expect the price of a safe haven like gold to rise on the back of military action between the US and Iran. That really should come as no surprise and is a widely expected knee-jerk reaction by investors and traders.

But given that the threat of further action was ruled out fairly quickly, markets returning to normality would

## US dollar index – January 2018 to present

**"A MEDIUM-TERM TARGET OF $1,700 AT SOME POINT THIS YEAR IS NOT TOO OVER-OPTIMISTIC."**

be expected. Of course, gold did drop back from that early January high at $1,611 – but not all the way back to where it was at the beginning of the year.

In addition to this, the middle of January saw the US and China agree a trade deal. The trade war between the two economic behemoths has concerned investors for some time and contributed in part at least to gold having such a good performance last summer. China appears to be less enthusiastic about this agreement than the US – but at the very least it does take away some uncertainty. However, looking at the reaction by the gold price, you would not necessarily see it that way. There was some slight volatility on the announcement, but gold held steady and did not suffer a sharp sell-off. Given its stability in the light of these two major events, it suggests that investors still have a healthy appetite for gold at the current levels.

## $2,000 an ounce next?

Let's not get too carried away! The most recent high for the gold price was briefly above $1,900 in the summer of 2011. I think a medium-term target of $1,700 at some point this year is not too over-optimistic and while that recovery continues to hold, investors are still expected to be buyers of dips.

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## Gold price – June 2011 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

# TECHNOLOGY TRUMPS CONSUMER STAPLES

**In a period of change, the franchise/growth framework can help to identify attractive investments. They are increasingly found in the IT sector, writes Andrew Latto.**

Quality investing is in vogue. The main focus of quality investors is on financial-return ratios and sector performance. But we have recently seen a reversal of fortune for both the IT and consumer-staples sectors.

The consumer-staples sector was the strongest US market performer from 1968 to 2009, with a 13.57% annualised return. The consumer-staple giants are now challenged by new competition, changing tastes and online distribution.

The IT sector was the weakest US market performer from 1968 to 2009, with a 7.29% annualised return. The technology giants of today, though, benefit from strong and resilient business franchises.

Evaluating the past is generally a prudent and diligent approach. But the forty-two-year period to 2009 has proven to be a poor guide. This article sets out an alternative approach; the franchise power/growth framework.

### Sector performance 1968-2009 (annualised)

| Sector | Return | Standard deviation |
|---|---|---|
| **Consumer staples** | **13.57%** | **15.76%** |
| Financials | 12.37% | 17.74% |
| Telecom | 11.86% | 21.44% |
| Materials | 11.59% | 20.83% |
| Energy | 11.57% | 25.48% |
| Utilities | 11.25% | 13.69% |
| Healthcare | 10.55% | 23.16% |
| Industrials | 9.82% | 20.55% |
| Consumer discretionary | 9.6% | 21.97% |
| **Information technology** | **7.29%** | **31.14%** |

*Source: What Works on Wall Street (2012), J.P. O'Shaughnessy, (P545).*

## Technology-sector turnaround

"For the loser now, will be later to win. For the times they are a-changin'" – Bob Dylan, 1963.

In 2011, Andreessen Horowitz wrote the article "Why Software Is Eating the World." He stated that: "We believe that many of the prominent new Internet companies are building real, high-growth, high-margin, highly defensible businesses."

Technology has traditionally been viewed as a volatile area, with winners hard to predict

**"THE NATURE OF THE IT SECTOR APPEARS TO HAVE FUNDAMENTALLY CHANGED FOR THE BETTER. POWERFUL GROWTH DRIVERS HAVE ENABLED TECHNOLOGY STOCKS TO DELIVER SIGNIFICANT SHAREHOLDER VALUE."**

### S&P 500 IT sector and S&P 500 (£ ETFs)


*Source: SharePad*

### S&P 500 consumer-staples sector underperforms (£ ETFs)


*Source: SharePad*

and long-term success stories few and far between. But the leading US technology stocks have held onto their market positions since 2010.

The nature of the IT sector appears to have fundamentally changed for the better. Powerful growth drivers have enabled technology stocks to deliver significant shareholder value.

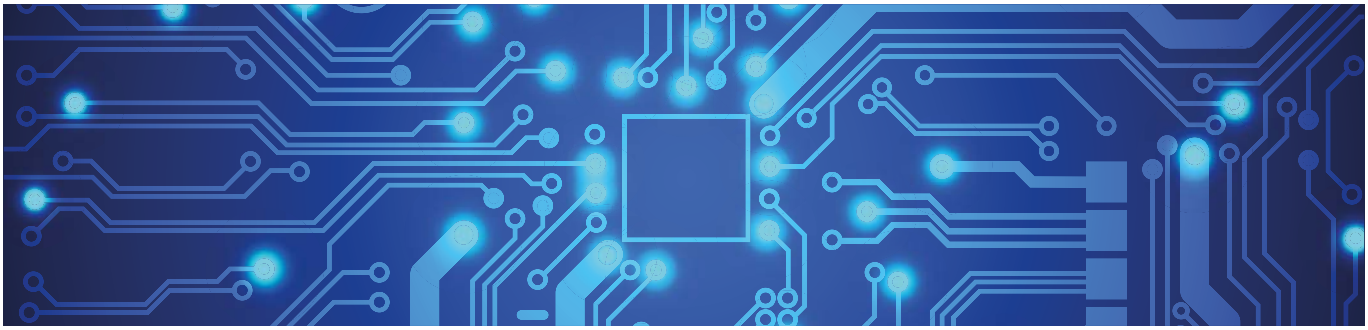
The IT sector is now the largest in the S&P 500 index with a 23.6% weighting. The two largest S&P 500 companies, **Apple (NASDAQ:AAPL)** and **Microsoft (NASDAQ:MSFT)**, are both technology stocks.

## Consumer staples under pressure

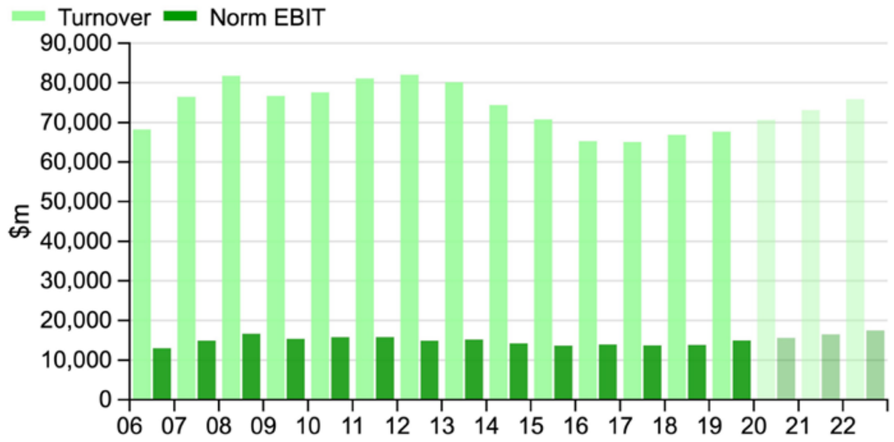
The consumer-staples sector is generally viewed as a safe and steady performer. It generated the second-lowest sector standard deviation from 1968 to 2009 – a measure that some investors use as a proxy for risk.

But the largest US consumer-staples group, **Procter & Gamble (NYSE:PG)**, has trailed the S&P 500 since 2009. P&G's market-leading shaving brand, Gillette, has lost market share to the online subscription start-ups Dollar Shave and Harry's.

P&G has found it hard to keep up with changing consumer trends. The net result has been stalling sales in the West. Procter & Gamble appears to have become a classic case of quality without growth.

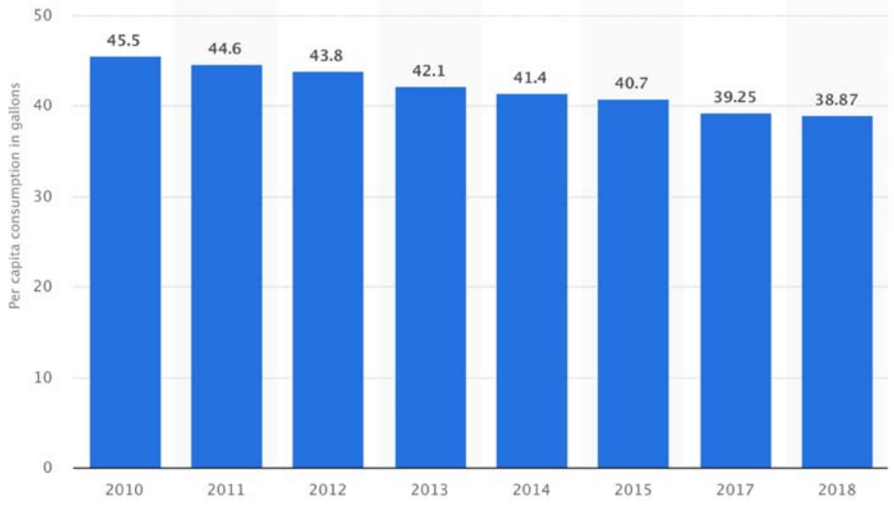


### Procter & Gamble: a lack of growth




*Source: SharePad*

### US per capita soft-drink consumption (gallons): 2010 to 2018




*Source:* [https://www.statista.com/statistics/306836/us-per-capita-consumption-of-soft-drinks](https://www.statista.com/statistics/306836/us-per-capita-consumption-of-soft-drinks)

**Coca-Cola (NYSE:KO)** and **PepsiCo (NYSE:PEP)** are the second and third-largest US-listed consumer staple stocks. But per capita soft-drink consumption in the US fell for the thirteenth consecutive year in 2018.

The tobacco giants **Philip Morris International (NYSE:PM)** and **Altria (NYSE:MO)** make up 12% of the S&P 500 consumer-staples sector. Declining tobacco use, increased regulation and a shift towards vaping products have become significant headwinds.

Growth at **Colgate-Palmolive (NYSE:CL), Kimberly Clark (NYSE:KMB)** and **Campbell Soup (NYSE:CPB)** has been uninspiring in recent years. Kraft Heinz has been particularly badly hit by a shift away from processed foods like Kraft macaroni and cheese.

All is not lost. Consumer-staple companies with strong brands and long-term growth drivers will continue to do well. Examples include the spirits group **Diageo (LON:DGE)** and the cosmetics groups **L'Oreal (EPA:OR)** and **Estee Lauder (NYSE:EL)**.

## If not the past, then what?

"The past is a foreign country; they do things differently there". – L.P. Hartley

If the past is a poor guide to the future, what else should we use? The alternative is to adopt a qualitative and forward-looking approach. Our objective is to find companies that are able to generate and grow free cash flow.

We invest in order to get something back. This company valuation dependent on the free cash flow it generates. Free cash-flow generation is determined by the capital intensity of a business and its profit margins.

Free cash-flow growth is driven by the ability to attract more customers to an existing business franchise. The development of a new franchise can also work wonders, with the launch of the iPhone in 2007 transforming Apple's fortunes.

## Franchise power

I define franchise power as the ability to generate a high return in cash on invested capital. Capital intensity is in large part industry-dependent, with airlines inevitably capital intensive.

Profit margins are driven by cost advantages and the scope to charge premium prices. If the prices can be increased without a significant impact on demand, a product is said to have pricing power.

### Largest listed consumer-staple stocks

| United States | Sector % | Europe | Sector % |
|---|---|---|---|
| Procter & Gamble Co | 16% | Nestlé | 24.6% |
| Coca-Cola Co | 11.1% | Diageo | 7.7% |
| PepsiCo Inc | 9.8% | British American Tobacco | 7.5% |
| Walmart Inc | 8.5% | Unilever NV | 6.5% |
| Philip Morris Int. | 7% | L'Oréal | 5.7% |
| Costco Wholesale | 6.8% | Unilever Plc | 4.9% |
| Altria Group | 4.9% | Anheuser-Busch | 4.8% |
| Mondelez International | 4% | Reckitt Benckiser | 4.4% |
| Colgate-Palmolive | 3.1% | Danone | 3.9% |
| Kimberly-Clark | 2.5% | Pernod Ricard | 2.9% |

*Source: SharePad*

**"CUSTOMERS REMAIN LOYAL IF THERE ISN'T A STRONG ALTERNATIVE. THIS MAKES COMPETITIVE 'MOATS' CRUCIAL TO LONG-TERM SUCCESS. IT STOCKS INCREASINGLY BENEFIT FROM THE MOST POWERFUL MOAT OF ALL: NETWORK EFFECTS."**

## Loyal customers drive margins

The franchise power of a product is for the most part driven by the strength of the customer relationship. This is dependent on product differentiation; product superiority; and the time customers invest in a product.

If we cannot imagine living without something, we will remain loyal users, and this generally results in high profit margins. Microsoft Windows and Microsoft Office are two must-have products for the corporate world.

Businesses benefit from using the same operating system, with key software products designed to work on Windows. The financial world is tied into Microsoft Excel, with accountants trained on it and banks using it for financial analysis.

Apple's profit driver is the iPhone and the related high-margin services revenue, ie the App Store and licensing income. It can be hard to switch platform after becoming familiar with the iPhone's operating system.

## IT 'moats'

Customers remain loyal if there isn't a strong alternative. This makes competitive 'moats' crucial to long-term success. IT stocks increasingly benefit from the most powerful moat of all: network effects.

The more banks and merchants on the **Visa (NYSE:V)** and **Mastercard (NYSE:MA)** payment networks the more valuable they are. This makes it hard for competitors to get a look in – **American Express**'s **(AXP)** payment network is struggling in third place.

The IT sector increasingly involves significant customer switching costs, because software products take time to master. The high cost and risky nature of product development also gives incumbents an advantage.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## Consumer-staples sector moats

The main competitive advantage for consumer-staple companies has been the appeal of their brands. But this is only an enduring moat if a product has a timeless brand, as appears to be the case for Coca-Cola.

At the same time, there are now alternatives to Coca-Cola, such as Fritz Cola, Karma Cola and Fever-Tree Cola. It is hard to think of a new competitor emerging for Microsoft Windows or the Visa/Mastercard duopoly.

Consumer-staple giants have enjoyed a distribution moat due to limited supermarket shelf space. But online distribution disrupts this advantage and supermarkets are increasingly offering high-quality, non-brand alternatives.

## Consumer staples franchise/growth

The franchise/growth framework helps explain the diverging fortunes of the IT and consumer-staples sectors. Consumer-staples companies have benefited from the dominance of TV advertising in the past.


Tetiana Shumbasova / Shutterstock.com

## IT sector

| United States | Sector % | Europe | Sector % |
|---|---|---|---|
| Apple | 20.2% | SAP | 26% |
| Microsoft | 19.2% | ASML | 15% |
| Visa | 5.2% | Amadeus IT | 6.4% |
| Mastercard | 4.3% | Prosus | 5.8% |
| Intel | 4% | Infineon | 5.2% |
| Cisco | 3.1% | Ericsson | 4.8% |
| Adobe | 2.6% | Dassault | 4.2% |
| Salesforce.com | 2.5% | Nokia | 4.1% |
| NVIDIA | 2.3% | CapGemini | 3.7% |
| PayPal Holdings | 2.1% | STMicro | 3.2% |

*Source: SharePad, iShares*

But online and viral marketing strategies have allowed new competitors to rapidly emerge. Dollar Shave's first online advert went viral while the Halo Top ice-cream brand benefited from social media word-of-mouth.

The growth of the middle class in the West was a growth tailwind for the consumer-staples sector from 1968 to 2009. Increased knowledge has changed consumer preferences and has led to a shift away from established brands.

## IT sector: from hardware to software subscriptions

The 10 largest global companies in 1999 included Microsoft, **Cisco (NASDAQ:CSCO), Intel (NASDAQ:INTC)**, Lucent Technology and **Nokia (HEL:NOKIA)**. Hardware companies are at risk of technological obsolescence and cyclical demand.

Software companies like Microsoft, the largest US stock in 1999, were dependent on volatile corporate spending. The IT sector has shifted from hardware stocks to software and payment companies.

The software sector itself has moved from one-off payments to a subscription model with products hosted in the 'cloud'. This is known as software as a service (Saas) and has improved the quality of software groups.

SaaS means no big product launches, lower marketing requirements and products maintained centrally at a lower cost. The SaaS business model ensures that customers pay their dues – if they fail to do so, they are cut off.

## IT sector growth

Global IT spending is forecast to grow 3.4% in 2020, according to Gartner. Key drivers include the shift towards cloud computing, increasing digital payment volumes and the growing use of software products.

Microsoft's fastest growth division is the cloud-computing business Azure, which is second only to Amazon. The company has moved its Microsoft Office products towards a subscription payment model.

Apple's main growth driver in recent years, the iPhone, has seen volumes plateau. But the group's high-margin services segment is delivering rapid growth and the wearables segment is also performing well.

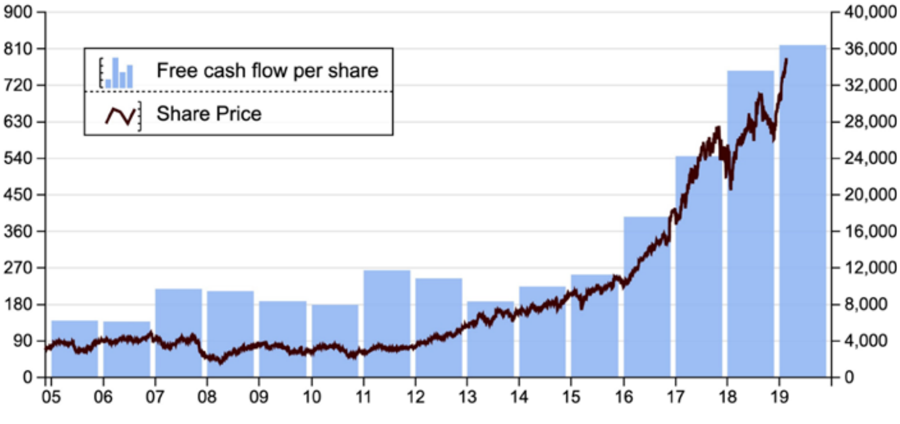
Visa and Mastercard are benefiting from the shift away from cash and towards digital payments. **PayPal (NASDAQ:PYPL)** is benefiting from the growth of online spending with the group having a long-established and trusted brand.

## Adobe case study

**Adobe (NASDAQ:ADBE)** makes a range of software products for graphic designers, creative professionals and website developers. The company has moved from one-off sales to software subscriptions, which has improved the quality of earnings.

The growth of internet use from 2009 has spurred demand and the net result has been rapid growth in free cash flow per share. Adobe highlights the change in fortune for some of the established IT companies.

## Adobe's transformation




*Source: SharePad*


*FOXARTBOX / Shutterstock.com*


## Sector exposure at the end of 2019

| | Fundsmith Equity Fund | Smithson IT | Blue Whale Growth Fund | Lindsell Train Global Equity |
|---|---|---|---|---|
| % IT sector | 30.4% | 40.2% | 46.7% | 9.9% |
| % Consumer staples | 31.8% | 3.9% | 6.4% | 44.1% |
| Consumer-staple stocks | Philip Morris, Estee Lauder, McCormick | Fever-Tree Drinks | Unilever in 2019 | Unilever, Diageo, Heineken, Kao |
| 2019 Return | 25.6% | 33.2%* | 27.6% | 19.4% |

*Source: Factsheets, *Net asset value*

## Quality investors

Against this backdrop, we can consider how the leading quality investors were positioned at the end of 2019. The Lindsell Train Global Equity Fund has a 44.1% weighting in consumer staples and a 9.9% weighting in technology.

The Blue Whale Growth Fund has a 46.7% weighting in technology and a 6.4% weighting in consumer staples. The Blue Whale Growth Fund returned 27.6% in 2019 while the Lindsell Train Global Equity Fund returned 19.4%.

The Fundsmith Equity Fund had a 62% weighting in consumer goods and no technology exposure at the end of November 2010. The fund currently has a 31.8% weighting in consumer staples and a 30.4% weighting in technology.

The largest holding in the Lindsell Train Global Equity Fund, Unilever, recently warned on growth. The third-largest holding in the Fundsmith Equity Fund, Philip Morris International, has one of the fund's weakest performers.

The newer quality funds – **Smithson (LON:SSON)** and Blue Whale Growth – have a relatively high weighting in IT and a low weighting in consumer staples. This may reflect fresh thinking on where it is best to invest.

## Summary

"The difficulty lies, not in the new ideas, but in escaping the old ones" – John Maynard Keynes

"When the facts change, I change my mind.  What do you do, sir?" – John Maynard Keynes

The past is a guide to the future to the extent that the future mirrors the past. But much has changed since 2009. The past has been a poor guide to the IT and consumer-staples sectors.

In a period of change, the franchise/growth framework can help to identify attractive investments. Strong business franchises with long-term growth prospects will perform well. They are increasingly found in the IT sector.




**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 modsel 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

# JD SPORTS FASHION

## BUCKING THE RETAIL TREND

**The retail sector may not be the most popular industry in which to invest at the moment. But JD Sports Fashion could offer long-term investment appeal, writes Robert Stephens, CFA.**

Investing in UK retail stocks may not be in fashion at the moment, but **JD Sports Fashion**'s **(LON:JD)** financial performance shows that the right business strategy can lead to high returns. The sports, fashion and outdoor brands retailer has increased its earnings per share at an annualised rate of 32% over the past three years.

It has benefited from a multi-channel strategy which has expanded the business into new territories, thereby reducing its reliance on the UK. It has ambitious plans to further grow its international presence, which could act as a catalyst on its financial performance. Alongside this, it has growth opportunities in adjacent market segments such as gyms, while its efficiency is likely to be boosted by an increasing use of automation.

Risks such as weak consumer confidence in the UK and difficult trading conditions in its outdoor segment are likely to remain in 2020. However, wage growth is substantially ahead of inflation and could lead to an improving outlook for UK consumers. Therefore, even though the stock trades on a high valuation compared to many of its retail peers, it appears to deserve a premium valuation owing to its attractive growth prospects.

### International expansion

The positive contribution of the company's international presence was evident in its Christmas 2019 trading update, which reported strong growth across its international stores. Since they contribute around 55% of its total revenue, their ability to deliver strong like-for-like sales growth suggests that JD's international-expansion strategy is paying off.

It expects to maintain its pace of growth in regions such as continental Europe, Asia Pacific and the US. For instance, in the first half of the 2020 financial year it opened 23 new stores in Europe. This increases its presence in mainland Europe to 11 countries, and the company expects to open a similar number of stores in the second half of the current financial year.

Additionally, it opened seven new stores in the Asia Pacific region in the first half of the current year. It expects to maintain this pace of growth in the near term,

**"THE SPORTS, FASHION AND OUTDOOR BRANDS RETAILER HAS INCREASED ITS EARNINGS PER SHARE AT AN ANNUALISED RATE OF 32% OVER THE PAST THREE YEARS."**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and to further expand its presence in a region where growing wages are boosting consumer disposable incomes. The US, meanwhile, may have only six of the company's stores at the moment, but it is expected to become a significant part of its future growth plans. It is the largest market in the world for sport lifestyle footwear and apparel, and could become a major contributor to the company's sales and profit.

As well as offering growth potential, the company's international stores reduce its overall risk. Should the UK economy experience a challenging period, JD may be less affected than many of its retail-sector peers.

## UK performance

Clearly, the UK is still JD's most important market in spite of its growing international presence. It has been able to attract a loyal customer base over recent years through a strategy which has focused on offering exclusive brands in a multi-channel environment.

It has strong relationships with major sporting-goods producers such as Nike and Adidas, and sells its own high-margin brands alongside them in a vibrant store setting that appeals to its target demographic of younger, fashion-conscious consumers. Continued investment in refurbishing its stores could differentiate its offering from those of its sector peers and improve its competitive advantage.

JD has also invested heavily in its multi-channel offering. This allows its customers to shop seamlessly across its website and in its stores, which has led to 19% of its total sales being generated from its multi-channel operations. It has a strong presence on social media, and has invested large sums of capital in influencer marketing. This has proved to be a successful means of appealing to its core customer base, with this trend likely to continue due to the ongoing popularity of social-media sites such as Instagram.

Therefore, even if the UK economy experiences a difficult period, JD's performance could prove to be relatively resilient. Evidence of this can be seen in its performance in the key Christmas trading period, when it reported positive like-for-like sales from its global operations.

Viewfinder / Shutterstock.com



## UK growth prospects

The prospects for retailers with UK operations may prove to be more encouraging than has been the case in recent years. Wage growth reached an 11-year high in 2019, and is now around 1.9 percentage points ahead of inflation. This could mean that consumers adopt an increasingly relaxed attitude towards spending, with their disposable incomes likely to rise over the medium term in real terms.

Furthermore, employment levels are high and the UK's GDP growth is forecast to rise by 0.2 percentage points to 1.4% in 2020. Clearly, Brexit poses an exceptional risk over the short run. However, a trade deal seems likely to be signed between the UK and EU within the transition period. Consumer confidence could improve further, following its largest rise in three years in December, if an agreement becomes increasingly likely.

## Investment opportunities

The company has growth opportunities in niche areas. For example, it has built a network of 25 gyms in the UK that together have 120,000 members between them. JD plans to open a further four gym sites before the end of the 2020 financial year. This could provide cross-selling opportunities for its products, as well as diversify the business away from high-street retailing. It may also help it to capitalise on an ongoing shift among younger consumers towards leading healthier lifestyles, with gym membership likely to become akin to a necessity for many people in the long run.

JD is seeking to expand its presence in premium-brand fashion. For example, it has made numerous small and selective acquisitions to enhance its profile in higher price-point market segments. This could broaden its customer demographic and improve its margins. It is also aiming to acquire Footasylum, which has 69 stores in the UK and a product range which appeals to older consumers. The purchase is currently subject to an ongoing Competition and Markets Authority investigation, but if it goes ahead then it could act as a means of broadening its appeal to a wider range of consumers.

The retailer has invested in improving the efficiency of its supply chain in the last few years. For instance, it has invested in the

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installation of additional automation equipment at its primary warehouse in the UK. This could help to lower its costs and increase margins. It has also established a new operational section at its primary warehouse that will provide a bespoke packing and fulfilment service for its premium fashion businesses. This could elevate the shopping experience for its premium customers and help to further differentiate its offering from sector peers.

## Potential threats

JD's half-year results highlighted the challenges it has faced within its outdoor segment. They were caused by internal factors resulting from the company's decision to switch to a central warehousing model that aims to integrate the supply chains of its various outdoor businesses. The process of implementing that change proved to be more difficult than the business had anticipated, and led to reduced availability of stock. Further challenges could be ahead as the process is set to continue in the first quarter of the 2020 calendar year.

The company's rising profitability in the past three years has led to improving investor sentiment. The stock's price gained 146% in the 2019 calendar year, and it now trades on a price-earnings ratio of 30.9 using its 2019 financial figures. This is a significantly higher valuation than most of its retail-sector peers, and suggests there is a lack of margin of safety available for new investors. However, with JD forecast to produce a 12% rise in earnings per share in its 2021 financial year, followed by growth of 11% in 2022, its premium valuation may be justified over the long run.

> **"JD'S PROFIT GROWTH OVER THE PAST FEW YEARS IS A TREND WHICH COULD CONTINUE."**

## Investment potential

JD's profit growth over the past few years is a trend which could continue. The company is set to outperform many of its peers as a result of its international-expansion plans, as well as its differentiated, multi-channel offer. As it continues to refurbish its stores, make acquisitions and expand into fast-growing markets such as the US and Asia, its financial performance could improve yet further.

Alongside this, its prospects in the UK could be more robust than expected. Consumer confidence has improved since the general election, while real-terms wage growth may encourage consumers to relax their spending as the Brexit process nears its conclusion.

JD's near-term financial performance could be held back by ongoing issues in its outdoor segment, while its valuation is substantially higher than most of its sector peers. However, its investments in improved supply-chain efficiency and in establishing a stronger presence in adjacent categories and premium price points could pay off in the long run.

The retail sector may not be the most popular industry in which to invest at the moment. But JD's strategy, growth forecasts and increasingly international focus may mean that its stock-price growth continues to impress.


### 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

# RETURN OF THE ACTIVE MANAGER

## HOW TO APPLY BEHAVIORAL FINANCE TO RENEW AND IMPROVE INVESTMENT MANAGEMENT

### BY C. THOMAS HOWARD AND JASON APOLLO VOSS

**In *Return of the Active Manager*, authors C. Thomas Howard and Jason Apollo Voss seek to provide a range of prescriptions for behavioural biases, helping readers to not only overcome them, but also take advantage of them.**

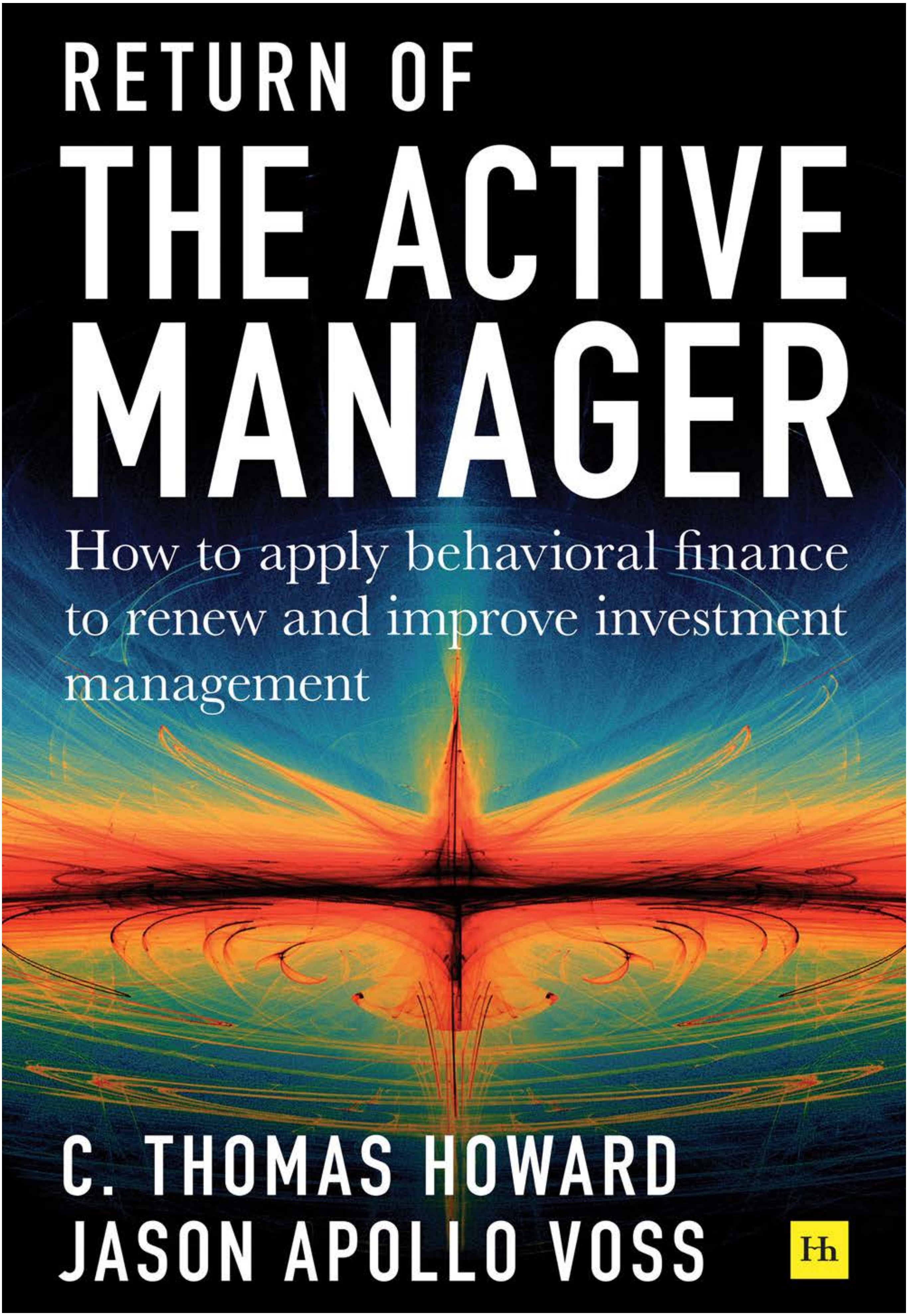
According to traditional economic theory, humans are rational thinkers, making decisions based on maximising their utility as consumers and their economic profit as producers. According to these theories, an investor would analyse a stock rationally and objectively, not letting emotions sway their investment decisions. But in the real world, a whole range of biases and feelings can affect how we look at our investments and what decisions we make. This is the domain of behavioural finance, which attempts to explain why investors decide to make irrational choices.

An estimated 117 biases have been identified by proponents of behavioural finance as being likely to sway decision-making for the worse. Some of the more common ones include confirmation bias (where investors focus on information that confirms their prior beliefs and ignore counter evidence) and overconfidence bias, which refers to excessive or false confidence in an individual's skill or ability to do things. Perhaps more common in the small-cap markets is the 'bandwagon effect', where investors are inclined to do or believe things that others do or believe.

> **"A WHOLE RANGE OF BIASES AND FEELINGS CAN AFFECT HOW WE LOOK AT OUR INVESTMENTS."**

While behavioural finance is clearly useful for describing how we make biased decisions, it is often lacking in solutions for how to fix them. However, in *Return of the Active Manager*, authors C. Thomas Howard and Jason Apollo Voss seek to provide a range of prescriptions for behavioural biases, helping readers to not only overcome them, but also take advantage of them. While the book has been written for active investment managers and investment advisors, I see no reason why private investors can't benefit from it too. After all, if you're a stock picker then by definition you're an active manager of your own portfolio.

Both authors have a lot of experience of the subject matter, with Howard having taught, researched, consulted and invested in stocks for


RETURN OF
THE ACTIVE
MANAGER
How to apply behavioral finance
to renew and improve investment
management
C. THOMAS HOWARD
JASON APOLLO VOSS
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over 40 years. Not only is he a prolific writer, he is also a professor at the University of Denver, teaching stock analysis to a range of students. Jason Apollo Voss, CFA is the chief executive of Active Investment Management Consulting. He is the retired co-portfolio manager of the Davis Appreciation and Income Fund which during his time bested the S&P 500 by a highly impressive 49.1%.

## A new way of thinking

The prologue to the book sets out the case for the return of active investment management in a world which has seen increasing amounts of money flow into passive funds over the past few decades. The environment for the success of such funds, like index trackers, has been based on the much maligned and now almost universally discredited efficient markets hypothesis and modern portfolio theory.

These approaches make unrealistic assumptions about the rationality of investors and efficiency of markets, and use rigid and unrealistic mathematical models. Howard and Voss therefore believe they are an inferior template for making investment decisions. Instead, they believe that behavioural finance is a superior tool to use, as it more accurately describes the real world and stands up to empirical testing. After all, individuals rarely change their behaviour and emotional crowds even less so.

What's more, as an increasing amount of stocks are held by passive investors, markets become more informationally inefficient. This is because trades become more driven by the volume of investor inflows and less so by new information. So, given the rise in passive funds, which now make up around half of the total fund market, this provides more opportunities for active managers to identify mispriced assets. The core of the book goes on to deliver a number of practical applications (or prescriptions) investors can use to take advantage of the insights of behavioural finance.

## Behave yourself

Chapter one provides a discussion of the authors' own behavioural financial markets notion, providing four concepts which create a framework for investment decision making. To paraphrase, these consider that prices are mainly driven by emotional crowds; investors are not rational; there are hundreds of price anomalies to exploit; and that managing emotions is key for acquiring long-term wealth.

Perhaps of most interest to private investors is chapter three, which looks at how behavioural finance can improve the equity investment process, and chapter four, covering fundamental analysis. Minimising our own behavioural biases is of course critical to success in investment so some top tips are given on how to do this. There are practical applications on how to filter out bias when reading investment news, keeping opinion diaries to assess quality of thinking over time and writing an investment thesis, ie a contract with yourself to outline your relationship with an investment. Also useful for private investors is chapter six which looks at quantitative analysis and how 'big data' can be used to reveal and exploit behavioural anomalies.

While the above methods mainly look at behaviours surrounding how people react to numbers and financial results, a good chunk of chapter four is dedicated to the human interaction in investment – namely dealings with company management. The authors argue that earnings calls, one-on-one meetings, presentations and the like can provide important insights into the behavioural tendencies of management and help to improve investment decisions. For example, it has been reported that companies whose management are perceived to have higher levels of candour (being open and honest) consistently outperform the S&P 500. Perhaps more important for small-cap investors, there is also a section on lie and truth detection.

## Conclusion

*Return of the Active Manager* is a refreshing read in the context of an industry which has increasingly moved towards delivering average returns over the past few decades. Combined with the backdrop of very few active managers actually outperforming their chosen benchmark, it also challenges readers to think differently about investing, along with providing actionable principles for identifying profitable investments. While the book has obvious benefits for the professional investment community, it also acts as a primer for those private investors who want to gain an edge in the markets. This is definitely the best investment book I have read so far this year.



**"THIS PROVIDES MORE OPPORTUNITIES FOR ACTIVE MANAGERS TO IDENTIFY MISPRICED ASSETS."**

**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

# GREENWASH AND "THE GREAT DISAPPOINTMENT"

**As the climate-change debate descends into farce, fund manager Tim Price reflects on the implications for sensible investors.**

*"Carney warns of climate change hit to corporate assets"*

**— Headline from *The Financial Times*, December 30, 2019.**

Now that the issue of Brexit has been almost completely resolved, one gets the strong impression that those people perpetually inclined to wailing and gnashing of teeth will take to displaying hysteria about climate change as some form of surrogate displacement activity.

The climate-change 'debate' already has much in common with the near civil war over Brexit, ie weapons-grade virtue-signalling by the 'in' group; emotional incontinence everywhere; the monstering of any acknowledgments of doubt by anybody; and an almost pathological sense of scientific certainty, fuelled by the selective use of heavily conflicted academic research.

As the author Ian Hall points out in his jeremiad against climate-change advocates, *Unsettled Science*, the scientific lobby was largely enabled by President Truman after America's victory in the Second World War; the winding down of the Manhattan Project that helped develop the atom bomb led to 130,000 scientists being put out of work. And so began the era of government research contracts. This is not to say that all climate scientists are hopelessly conflicted by dint of their addiction to money from the 'Big State', only to suggest that, as Ian Hall advises, a philosophy of 'follow the money' may well explain some of the professional behaviours and strong feelings linked to the topic of climate change. When you're paid to follow the party line, you follow the party line. Hall cites President Eisenhower in his parting address of 1961 (the emphasis is mine):

> "Yet in holding scientific discovery in respect, as we should, we must also be alert to the equal and opposite danger that **public policy could itself become the captive of a scientific-technological elite."**

The danger in hewing to an academic consensus with a strong political agenda can also be seen, for example, in a) how academia almost universally came out in favour of 'Remain'; and b) how most economists, being in the pay of either investment banks or lobby groups with financial


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connections to the Big State, remain unreconstructed neo-Keynesians (ie they believe in tax-and-spend policies and aggressive money printing). At *MoneyWeek*'s recent annual investor conference, for example, I was struck by the consensus among the associated panellists that modern monetary theory (MMT) – essentially, endless money printing and inflation be damned – was alive and well and heading to a central bank near you. Suffice to say, my investment recommendations for this year will be heavily focused on a mixture of global 'value' stocks – and gold. There was a helpful letter to the *Financial Times* from a Mr. George Hatjoullis in November 2014 that explains some of the dangers of MMT:

> Sir, Adair Turner suggests some version of monetary financing is the only way to break Japan's deflation and deal with the debt overhang ('Print money to fund the deficit – that is the fastest way to raise rates', Comment, November 11). This was precisely how Korekiyo Takahashi, Japanese finance minister from 1931 to 1936, broke the deflation of the 1930s. The policy was discredited because of the hyperinflation that followed.

Don't get me wrong. I am not stating that climate change is not real. I am merely confessing that I don't know enough about the science to make an informed judgment. But to have a properly informed opinion on climate change requires us all to be experts in astrophysics, astronomy, geology, meteorology, physics, chemistry, ecology, zoology and economics.

I admit to being a climate sceptic. Is our climate changing? Perhaps. Is human activity responsible for that change? I don't know. If human activity is to blame for climate change, can we reverse that change? I don't know. What I do know is that the most powerful energy source in our solar system, by some margin, is the sun. Anthropogenic climate change may well be real for all I know, but I am personally more interested in the effect of cycles in solar activity since that's where most of our energy actually comes from. And trying to prevent the developing world from materially advancing – in part through the use of polluting fossil fuels – seems a particularly imperious way of hoisting the ladder of progress up behind you, once your own country has already achieved wealthy status.

Climate-change advocates seem to me very millenarian (ie they believe in a forthcoming transformation of society). A good example of a similar 'doomsday cult' is the Millerites, who followed the teachings of William Miller.

Born in Massachusetts in 1782, William Miller predicted that the world would end in April 1843. Miller had served in the War of 1812 against the British and ultimately became a Baptist preacher. No doubt influenced by his war-time experiences, he became obsessed with death and the afterlife. After the war he devoted 15 years of his life to study of the Bible. During this period, a number of movements sprang up – influenced perhaps by economic crises (such as the recession that followed the Panic of 1837) or the growing social tensions that would in time erupt in the Civil War.

Miller based his analysis on Daniel 8:14, which states that: "Unto two thousand and three hundred days; then shall the sanctuary be cleansed."

He then used a contentious "day-year principle," by which a day in Biblical prophecy became reinterpreted as a calendar year. By this reckoning, and using the starting point as the decree to rebuild Jerusalem by Artaxerxes I of Persia in 457 BC, Miller concluded that the second coming would occur on or around 1843. In a letter to his brother, Miller predicted that Christ would come:

> "...in the glory of God, in the clouds of Heaven, with all the saints and angels, change the bodies of all that are alive on Earth that are his, and both the living and the raised saints will be caught up to meet the Lord in the air."

As for those left behind, the outlook was not quite so benign. Miller forecast that the Earth would be

> "...cleansed by fire, the elements will melt with fervent heat, the works of men will be destroyed, the bodies of the wicked will be burned to ashes."

**"I HAVE NO PROBLEM WITH HEALTHY DEBATE. I HAVE A BIG PROBLEM, HOWEVER, WITH BEING COMPELLED TO ACT IN A CERTAIN WAY SIMPLY BECAUSE THE CHATTERING CLASSES DEEM IT SOCIALLY RESPECTABLE TO DO SO."**


*Daniele COSSU / Shutterstock.com*

The wicked – those who rejected the Gospel – would not only die, but their spirits would be banished from the Earth, "shut up in the pit", and not allowed to return to Earth for a thousand years.

The arrival of an extremely bright comet in 1843 bolstered fears of an impending apocalypse. Although reluctant to identify a specific date for the Day of Judgment, Miller finally settled on April 23, 1843.

April 23, of course, came and went without incident.

Miller concluded that he had erred in using solar years instead of lunar years, and came up with a replacement date for the end of days, namely March 21, 1844. The Millerites, as they were now known, purchased an enormous tent capable of accommodating more than 2,000 people, and were said to have bought "ascension robes" in preparation for their heavenly journey.

When March 21 came and went without incident, the Millerites plumped for October 22, on the basis that it was also the date of Yom Kippur.

When October 22 came and went without incident, Miller and his associate Joshua Himes embraced a new cause, namely to raise money for Millerites who had given up everything including their jobs and possessions to prepare for the end. Thus began a period known as "the Great Disappointment". A more expansive list of delusional 'end of days' predictions is available here.

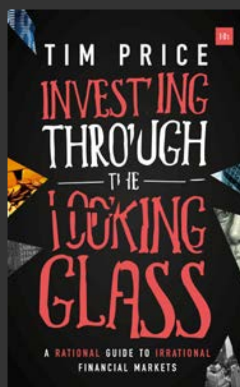
The British philosopher John Gray recently recorded an audio essay for BBC Radio 4 in which he suggested that "... the belief that an end to history is imminent never really goes away." Gray compared the antics of the likes of climate-change pressure group Extinction Rebellion to those of previous Armageddonists such as the Millerites. And then, of course, there is the cult of Greta...

I have no problem with healthy debate. I have a big problem, however, with being compelled to act in a certain way simply because the chattering classes deem it socially respectable to do so. Fund managers are already being urged to draft statements of their ESG (environmental, social and governance) policy commitments. This seems dangerously faddish and subjective to me, perhaps because I am old enough to remember the 1970s, when we were all being warned of an impending new Ice Age.

For as long as it remains legal to do so, I fully intend to take advantage of attractive valuations in the commodity and energy-extraction space – particularly since the activities of people like Greta Thunberg and her related moral panickers have driven the share prices of companies in these sectors, in many cases, to extremely desirable levels. Tobacco companies underwent a similar process of incurring pariah status during the 1980s and 1990s, and their shares have been surprisingly strong performers for as long as I can remember.

**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'.



FEBRUARY 2020

# INVESTOR EVENTS DIARY

## EVERY WEDNESDAY | 12:30

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

## EVERY THURSDAY

| | |
|---|---|
| **Event:** | FinecoBank open house |
| **Organiser:** | FinecoBank |
| **Place:** | FINECO HUB, 19 Great Winchester Street, London EC2N 2JA |
| **Tickets:** | Not needed, drop in |

## TUESDAY 11 FEBRUARY | 12:30-13:00

| | |
|---|---|
| **Event:** | Netwealth webinar series: Why you could expect better net returns with Netwealth |
| **Organiser:** | netwealth |
| **Place:** | Webinar |
| **Tickets:** | https://attendee.gotowebinar.com/register/5680976873340616461 |

## WEDNESDAY 12 FEBRUARY | 13:30-18:00

| | |
|---|---|
| **Event:** | Short Term Trading using Technical & Fundamental strategies |
| **Organiser:** | FinecoBank |
| **Place:** | FINECO HUB, 19 Great Winchester Street, London EC2N 2JA |
| **Tickets:** | https://finecobank.com/uk/public/corsi-e-education/corsi |

## WEDNESDAY 19 FEBRUARY | 13:00-14:00

| | |
|---|---|
| **Event:** | How to identify investment opportunities with Fineco |
| **Organiser:** | FinecoBank |
| **Place:** | FINECO HUB, 19 Great Winchester Street, London EC2N 2JA |
| **Tickets:** | https://finecobank.com/uk/public/corsi-e-education/corsi |

## THURSDAY 20 FEBRUARY | 18:30-20:00

| | |
|---|---|
| **Event:** | Learn how to make a predictable income from trading |
| **Organiser:** | FinecoBank |
| **Place:** | FINECO HUB, 19 Great Winchester Street, London EC2N 2JA |
| **Tickets:** | https://finecobank.com/uk/public/corsi-e-education/corsi |

## THURSDAY, 20 FEBRUARY | 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 | 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 |

## WEDNESDAY 4 MARCH | 13:00-14:00

| | |
|---|---|
| **Event:** | Short Term Trading using Technical & Fundamental strategies |
| **Organiser:** | FinecoBank |
| **Place:** | FINECO HUB, 19 Great Winchester Street, London EC2N 2JA |
| **Tickets:** | https://finecobank.com/uk/public/corsi-e-education/corsi |

## WEDNESDAY 11 MARCH | 18:30-20:00

| | |
|---|---|
| **Event:** | Fineco Investment Platform: risk management and diversification strategies |
| **Organiser:** | FinecoBank |
| **Place:** | FINECO HUB, 19 Great Winchester Street, London EC2N 2JA |
| **Tickets:** | https://finecobank.com/uk/public/corsi-e-education/corsi |

## WEDNESDAY 18 MARCH | 13:30-18:00

| | |
|---|---|
| **Event:** | Systems and Strategies for Profitable Trading |
| **Organiser:** | FinecoBank |
| **Place:** | FINECO HUB, 19 Great Winchester Street, London EC2N 2JA |
| **Tickets:** | https://finecobank.com/uk/public/corsi-e-education/corsi |

## SATURDAY, 28 MARCH | 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: MAG12 https://masterinvestorshow.eventbrite.co.uk |

## THURSDAY, 2 APRIL | 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 |

## WEDNESDAY, 22 APRIL | 13:30-18:00

| | |
|---|---|
| **Event:** | The Essentials of All Trading Success |
| **Organiser:** | FinecoBank |
| **Place:** | FINECO HUB, 19 Great Winchester Street, London EC2N 2JA |
| **Tickets:** | https://finecobank.com/uk/public/corsi-e-education/corsi |

## THURSDAY 30 APRIL | 08:30-10:30

| | |
|---|---|
| **Event:** | EISA Spring Seminar 2020 |
| **Organiser:** | EISA & hosted by PWC |
| **Place:** | More London, 7 More London Riverside, London SE1 2RT |
| **Tickets:** | https://finecobank.com/uk/public/corsi-e-education/corsi |

## MARKETS IN FOCUS

# JANUARY 2020

### GLOBAL EQUITIES

| Index | Last Month % | YTD% | 52-Week Strength |
|---|---|---|---|
| S&P/ASX 200 | 5.0 | 5.0 | |
| NASDAQ 100 | 3.0 | 3.0 | |
| Swiss Market | 0.1 | 0.1 | |
| Bovespa | -0.1 | -0.1 | |
| S&P 500 | -0.2 | -0.2 | |
| Dow Jones | -1.0 | -1.0 | |
| FTSE All-World | -1.2 | -1.2 | |
| Nikkei 225 | -1.9 | -1.9 | |
| DAX Xetra | -2.0 | -2.0 | |
| Russian TSI | -2.1 | -2.1 | |
| Euronext 100 | -2.1 | -2.1 | |
| CSI 300 | -2.3 | -2.3 | |
| CAC 40 | -2.9 | -2.9 | |
| FTSE 100 | -3.4 | -3.4 | |
| Hang Seng | -6.7 | -6.7 | |

### COMMODITIES

| Commodity | Last Month % | YTD% | 52-Week Strength |
|---|---|---|---|
| Bitcoin | 32.5 | 32.5 | |
| Palladium | 16.0 | 16.0 | |
| Cocoa | 10.3 | 10.3 | |
| Sugar (No. 11) | 8.7 | 8.7 | |
| Gold | 4.3 | 4.3 | |
| Silver | 0.4 | 0.4 | |
| Platinum | 0.3 | 0.3 | |
| Cotton | 0.0 | 0.0 | |
| Copper | -9.8 | -9.8 | |
| Iron Ore | -10.0 | -10.0 | |
| Crude oil (Brent) | -13.1 | -13.1 | |
| Crude oil (Light Sweet) | -14.6 | -14.6 | |
| Natural Gas | -16.4 | -16.4 | |
| Palm Oil (Crude) | -19.9 | -19.9 | |
| Coffee | -21.7 | -21.7 | |

### FOREX

| Pair/Cross | Last Month % | YTD% | 52-Week Strength |
|---|---|---|---|
| GBP/AUD | 4.1 | 4.2 | |
| USD/CAD | 1.8 | 1.8 | |
| USD/JPY | -0.3 | -0.3 | |
| USD/CHF | -0.4 | -0.4 | |
| GBP/USD | -0.4 | -0.4 | |
| EUR/GBP | -0.8 | -0.8 | |
| EUR/USD | -1.1 | -1.1 | |
| EUR/JPY | -1.4 | -1.5 | |
| EUR/CHF | -1.7 | -1.7 | |
| AUD/USD | -4.6 | -4.6 | |

### CENTRAL BANKS – RATES & MEETINGS

| Central Bank | Key Rate | Next | After |
|---|---|---|---|
| Bank of England (BoE) | 0.75% | Mar 26 | May 07 |
| European Central Bank (ECB) | 0.00% | Mar 12 | Apr 30 |
| Federal Reserve System (FED) | 1.75% | Mar 18 | Apr 29 |
| Bank of Japan (BoJ) | -0.10% | Mar 19 | Apr 28 |
| Bank of Canada (BoC) | 1.75% | Mar 04 | Apr 15 |
| Reserve Bank of Australia (RB | 0.75% | Feb 04 | Mar 03 |
| Swiss National Bank (SNB) | -0.75% | Mar 19 | Jun 18 |
| Banco Central do Brasil (BCB) | 4.50% | Feb 05 | Mar 18 |
| Central Bank of Russia (CBR) | 6.25% | Feb 07 | Mar 20 |
| Reserve Bank of India (RBI) | 5.15% | Feb 06 | |

## FTSE 350 TOP RISERS

| Company | Last Month % | YTD% | 52-Week Strength |
|---|---|---|---|
| Galliford Try Holdings PLC | 64.7 | 64.7 | |
| Crest Nicholson Holdings Ltd | 15.8 | 15.8 | |
| Persimmon PLC | 13.3 | 13.3 | |
| BAE Systems PLC | 11.8 | 11.8 | |
| IntegraFin Holdings PLC | 11.2 | 11.2 | |

## FTSE 350 FALLERS

| Company | Last Month % | YTD% | 52-Week Strength |
|---|---|---|---|
| Finablr PLC | -51.5 | -51.5 | |
| Elementis PLC | -28.5 | -28.5 | |
| NMC Health PLC | -26.9 | -26.9 | |
| Hunting PLC | -26.6 | -26.6 | |
| SIG PLC | -24.8 | -24.8 | |

## FTSE 350 SECTORS RISERS

| Sector | Last Month % | YTD% | 52-Week Strength |
|---|---|---|---|
| Leisure Goods | 8.7 | 8.7 | |
| House Goods & Home Const | 5.9 | 5.9 | |
| Gas, Water & Multiutilities | 5.2 | 5.2 | |
| Aerospace & Defense | 4.1 | 4.1 | |
| Tobacco | 4.0 | 4.0 | |

## FTSE 350 SECTORS FALLERS

| Sector | Last Month % | YTD% | 52-Week Strength |
|---|---|---|---|
| Fixed Line Telecom | -14.8 | -14.8 | |
| Forestry & Paper | -12.8 | -12.8 | |
| Industrial Metals | -12.2 | -12.2 | |
| Tech Hardware & Equipment | -11.9 | -11.9 | |
| Oil Equip, Services & Dist | -9.3 | -9.3 | |

## IA SECTORS RISERS

| Sector | Last Month % | YTD% | 52-Week Strength |
|---|---|---|---|
| UK Index Linked Gilts | 6.1 | 6.1 | |
| Technology and Telecom | 5.4 | 5.4 | |
| UK Gilts | 4.3 | 4.3 | |
| North America | 2.6 | 2.6 | |
| £ Corporate Bond | 2.5 | 2.5 | |

## IA SECTORS FALLERS

| Sector | Last Month % | YTD% | 52-Week Strength |
|---|---|---|---|
| Japanese Smaller Companies | -4.2 | -4.2 | |
| Japan | -1.7 | -1.7 | |
| UK Equity Income | -1.6 | -1.6 | |
| Asia Pacific Excluding Japan | -1.6 | -1.6 | |
| China/Greater China | -1.6 | -1.6 | |