ISSUE 60 – MARCH 2020

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MAGAZINE

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THE GREAT AUTOMOTIVE TRANSITION

WHO WILL BE THE WINNERS AND LOSERS?

PLUS...

FEVERTREE DRINKS
CAN IT REGAIN ITS FIZZ?

TECHNOLOGY FUNDS
THE BEST WAYS TO ACCESS THE HOTTEST SECTOR

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WILL IT EVER MAKE A COMEBACK?

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WELCOME

Dear Reader,

When there's blood on the streets...

Well, the markets have finally succumbed to the coronavirus outbreak, which now seems to be spreading globally at an alarming rate. Although its mortality rate is much lower than it was for SARS, COVID-19, as the virus is now known, is proving to be a highly contagious pathogen. While this is perhaps reassuring for patients, it is actually very bad news for the global economy, as it means that the outbreak could potentially last longer – with all the disruption to supply chains and economic activity that entails.

The European economies, already weakened by the US-China trade war, appear to be particularly vulnerable, with Italy now facing wholesale factory shutdowns. In China – which, lest we forget, is now the world's second-largest economy – the authorities' robust response to the outbreak has been generally praised and seems to have done a pretty good job at mitigating the spread; but this comes at a cost, and is now forecast to shave a couple of percentage points off Chinese growth this year. And when China sneezes, the world catches a cold...

The big question now is how severe and prolonged the impact will be to global economic activity, which to a large extent depends on how effective global health authorities are at containing the spread of the virus. So much is unknowable at this stage, but history tells us that pandemics of this kind are a threat to markets in the short term but don't make all that much difference in the long term. As such, investors should remain vigilant, as there could be some very interesting buying opportunities available once the outbreak subsides.

Master Investor Show 2020

It's that time of the year again. On 28 March, up to 5,000 investors will converge on the Design Centre in Islington for the biggest one-day investor event in the UK. Come and meet the people behind Master Investor Magazine at the show, where I'll be chairing a writers' panel discussion and talking to readers throughout the day.

I can't wait to see you all there for what promises to be an investing extravaganza. Don't forget to claim your complimentary tickets HERE using the discount code JAMESF.

Best regards,

J Faulkner
Editor

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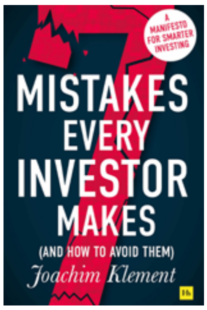

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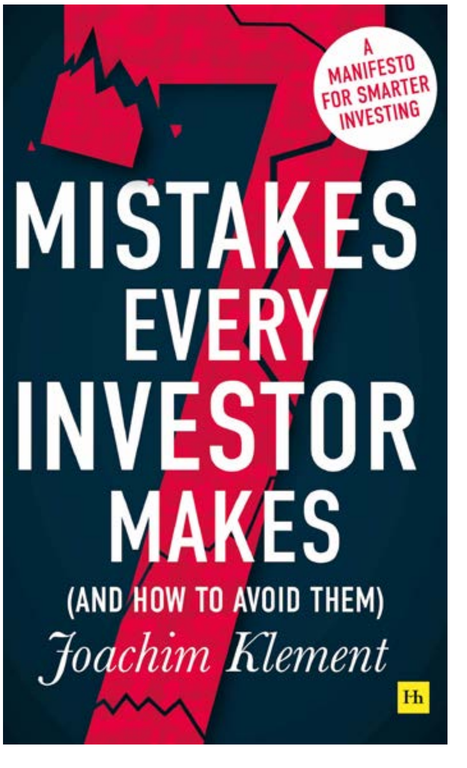

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BY JIM MELLON

MELLON ON THE MARKETS

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

This month's submission was almost sabotaged by an exploding banana. If there is one good piece of advice I have for you this month, it is to *never ever* put a banana in your rucksack, especially if it is in close proximity to a laptop and/or an iPad.

In my case, it was both devices, and the last week has seen me trudge around various branches of Curry's PC World, plaintively asking for help. I now have a new PC and iPad, both of which require hours of time and patience to set up. Luckily, I had backed up the long-in-the making second edition of my book on longevity, and that is now progressing slowly towards publication.

I have also managed to retrieve the hoard of interesting stuff I have been accumulating for my talk at this year's Master Investor show, which is fast coming up on the rails. Please join us on 28 March, in London. It's going to be great and comes at an interesting time for us investors.

Firstly, I am sure you have all loaded up on gold and silver and the like, and if you have taken this advice over the last year or so, then you should be happy – possibly, very happy indeed. My current thinking is that investors should maybe top slice one third of their physical gold and move that into silver, which will surely catch up. My year-end target for gold is over $2,000 per ounce, and around $25 per ounce for silver. There is therefore huge continuing upside, and in a way, you could almost forget all other investment opportunities.

Everything is aligned with the precious metals: the debasement

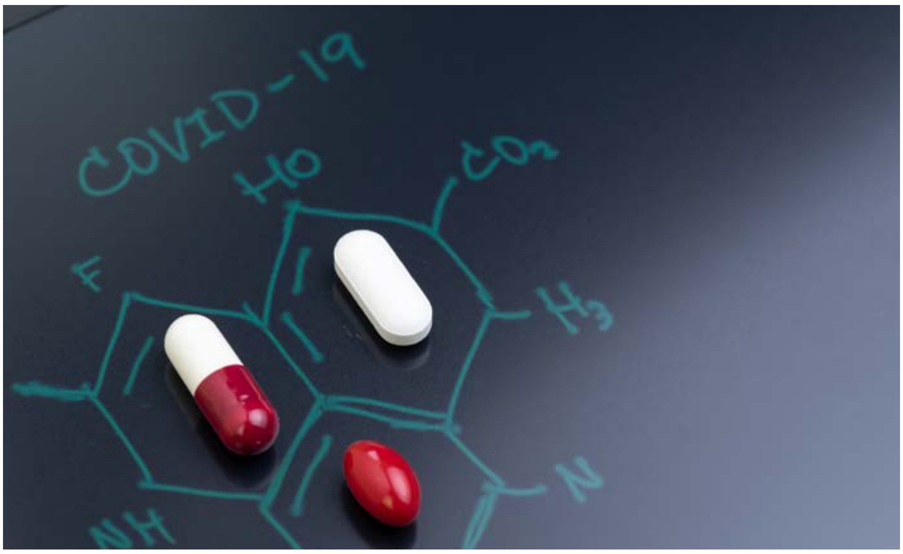
"EVERYTHING IS ALIGNED WITH THE PRECIOUS METALS."

of money by central banks almost everywhere; coronavirus (as advised, much worse than most commentators thought just a month ago, and destined to be much, much worse in my opinion); negative interest rates, which makes the holding cost of gold irrelevant compared to historical costs; and to add a marron glacé to the top of it all, political uncertainty in most places.

But I do think that there are other opportunities, both in the short and longer term. In the not so distant certainty are the twin metathemes that I have been banging on about for so long: Juvenescence and a world where we will be living much longer; and agronomics, the new clean-meat agricultures and auxiliary industries around new ways of replicating animal products without animals being involved. This nexus of two fast-changing industries which will revolutionise the world are a must for all investors, and I urge you all to investigate them for your own portfolios as soon as you are able. There will plenty of discussion of them at the upcoming Master Investor show.

One area I will be looking at is energy. Although I would never buy coal stocks, I think some oil majors are worth looking at. The relative price of energy in the US stock market is lower than at any time since the 1930s, and although oil surely will be of less import in the future, I think the disinvestment mania for anything related to oil and gas may be providing investors with an opportunity to pick up representation of a still vital part of the world economy fairly cheaply. I will be discussing this, and other matters related to the new world of energy in my speech. In fact, I have just been in the Gulf region for a few weeks, which I have to say is very impressive in terms of economic development as well as the sophistication of the finance industry, and oil is obviously one of the key talking points there. Just throwing out a couple of names, **Shell (LON:RDSB)** and **BP (LON:BP.)** look particularly cheap to me and both have excellent dividends which I don't think are imperilled.

The dollar has been strong of late, possibly because the US is relatively unaffected by Asian worries over coronavirus, and indeed, US-made goods may be selling better because of disruptions to the Far East supply chain. The euro has been badly hit by continuing poor continental economic performances (Brexit anyone?) and it's interesting that the European "partners" are currently fighting like ferrets in a sack over their diminishing budget and differing ideological objectives. Meantime, the UK is by all accounts doing well, though that comment has to be tempered by the fact that European economic weakness isn't good for us either.



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"IN THE SHORT TERM, THE VIRUS IS GOING TO GET MUCH, MUCH WORSE, AND CURRENT OUTBREAKS MIGHT JUST BE THE HERALD OF SOMETHING REALLY BAD."

I met the chief executive of a large City institution last week and he told me that money is flooding into London from Europeans worried about the state of the EU. I expect more of these sorts of stories and I think that the UK remains very undervalued, and that investors should load up on sterling assets. I also think that the Japanese yen has been beaten up too much and that buying it against the US dollar at around the 112 level is a good move. My target on the yen is 108 before year end and on cable (GBP/USD) is 1.40 from about 1.30 now. I also think that the Australian dollar is a bit undervalued and should be about AUD 70c to the US dollar.

I watched a programme recently on UK migrants to Australia, and I found it fascinating. This was made before the recent 'biblical' fires and floods, which underline the vulnerability of the previously 'lucky' country to climate change. Half of all people who emigrate from the UK to Australia return to the rainy mother country, and although property prices are lower in Australia and salaries somewhat higher, the cost of everyday living is noticeably much higher, eroding any economic gains made by upping sticks. I love Australia but I always feel terribly remote when there. My recent acquisition of permanent residency in the UAE suits me better. Oh, and by the way, there is no finer airline than Emirates!

On that subject, air travel is being devastated by coronavirus (I am afraid I can't bring myself to describe it by its new fancy name) and similarly, cruises are being given a bad name also. These will bounce back, and it's worth keeping an eye on **Delta Airlines (NYSE:DAL)** in the US, BA owner **IAG (LON:IAG)** in the UK and **Carnival Cruise Lines (LON:CCL)**, also listed in London. They are very good companies.

In the short term, the virus is going to get much, much worse, and current outbreaks might just be the herald of something really bad. If you want to get panicked, Google the pandemic of 1918.

I continue to load up on **Gilead (NASDAQ:GILD)** shares in the US (they have a potential drug) and to bang the big gong again: it's gold and silver.

Happy hunting!

Jim Mellon

About Jim

Jim is an entrepreneur with a flair for identifying emerging global trends enabling him to build a worldwide business empire. He is amongst the top 10% in the "Sunday Times Rich List" (Britain's equivalent to the Forbes list). He is often described as the British Warren Buffett and he predicted the Credit Crunch of 2007-08 in a book entitled *Wake Up! Survive and Prosper in the Coming Economic Turmoil*. Jim followed this with *The Top 10 Investments for the Next 10 Years* (2008) and subsequently *Cracking the Code* (2012), *Fast Forward* (2014) and, most recently, *Juvenescence* (2017). His monthly "Mellon on the Markets" column in Master Investor Magazine has gained him cult status among investors. He holds a master's degree in Politics, Philosophy and Economics from Oxford University. He is on the Board of Trustees of the Buck Institute in California, a trustee of the Biogerontology Institute, and a Fellow of Oriel College, Oxford.

BY VICTOR HILL

FEATURE

THE GREAT AUTOMOTIVE TRANSITION

Who will be the winners and losers in the 'great automotive transition' to electric cars - that will most likely take place in the UK by 2032 – just 12 years from now?

"WE HAVE KNOWN THIS WAS GOING TO HAPPEN FOR YEARS. THE QUESTION WAS – HOW QUICKLY WOULD IT HAPPEN AND HOW MUCH DISRUPTION WOULD THERE BE."

The UK government has brought the cut-off date for the sale of new petrol and diesel-powered, as well as hybrid cars forward from 2040 to 2035. It now looks likely that this will be brought forward further to 2032. This means that in just 12 years' time, the major automotive manufacturers will only be able to make and sell electric cars – though they may well still be making diesel or petrol-powered commercial vehicles.

This new policy has raised a number of fundamental issues. Will sufficient charging points be in place? How many legacy, internal-combustion engine (ICE) vehicles will be left on the roads (quite a few, I reckon) and what will happen to them? How will this impact on the oil majors' downstream operations (will they shut down their networks of filling stations?). Will there need to be a scrappage scheme to wean petrolheads off their ICE vehicles and how would it work? Does this really secure the target of getting to net carbon neutral by 2050?

Most fundamentally, which automobile manufacturers will be best positioned to offer a full product range of electric cars by then? And which look vulnerable? To be sure, there will be winners and losers.

The electric future

We have known this was going to happen for years. The question was – how quickly would it happen and how much disruption would there be?

I'm talking of course about the *'great transition'* from ICE-powered private cars and taxis to electric ones. This is driven by the need – now endorsed by all progressive governments – to reduce our greenhouse-gas emissions, of which carbon dioxide is the most abundant. Since motor transport is the source of about one third of all CO2 emissions in an advanced country like the UK, it is the first sector that will be largely de-carbonised. The UK is one of several countries, including France, but not the US, which has a target of reducing all carbon emissions to net zero by 2050.

When UK Transport Secretary Grant Shapps proposed on 12 February that the ban on ICE-powered and hybrid cars could be advanced to 2032 ("if feasible"), the RAC accused the government of "constantly moving the goalposts". The Society of Motor Manufacturers and Traders (SMMT) called it "a date without a plan". Mr Shapps, who drives a Tesla Model 3, said that his department would be investing around £1.5bn in new car-charging infrastructure.

"MANUFACTURERS, WHOSE R&D CYCLES SPAN DECADES, ARE NOW LIKELY TO CURTAIL INVESTMENT IN HYBRIDS AND MOVE STRAIGHT TO THE ROLL-OUT OF A RANGE OF BATTERY, ELECTRIC AND/OR HYDROGEN-POWERED VEHICLES."

Car journeys account for 78 percent of passenger kilometres travelled in the UK, vastly exceeding rail (11 percent) and buses (4 percent). The average UK household spends £81 per week on transport, of which over three quarters goes towards running and maintaining a car.

Manufacturers, whose R&D cycles span decades, are now likely to curtail investment in hybrids and move straight to the roll-out of a range of battery, electric and/or hydrogen-powered vehicles. While they will have a captive market for e-cars come 2035, they now have a shorter period to generate the cash flow from their ICE vehicles to finance new R&D.

Sales of battery-powered e-cars in the UK soared by 20 percent in January this year, compared with January 2019 – to 4,054 vehicles. But that was still only 1.6 percent of total new car sales according to the SMMT – compared with about 50 percent in Norway. Overall, new car sales in the UK last year were well down on the previous year at 2.311 million – down by 2 percent on 2018.

There are so many issues which arise from the great transition, many of which have been unforeseen. On 13 February, Baroness Vere, a junior UK transport minister, told the House of Lords that she was astonished to learn that electric vehicles stop very suddenly when they break down instead of coasting along like ICE-powered vehicles. Apparently, e-cars cannot be towed. (I wonder how many people know that). As a result, they could take longer to be removed from motorways. Add to that the prospect that in all likelihood many electric-car drivers will miscalculate the available range and run out of juice on the motorway, in some cases causing serious accidents, even pile-ups.

Remember that the range of e-cars declines as the batteries get older and is a function of the speed at which cars are driven. Plus, if you tow a caravan or put the heater on in winter that will drain the battery much more quickly. So, the range figures issued by manufacturers are only approximate.

The UK Department for Transport is thus considering how best to remove e-cars from the roads quickly when they break down. There is already a heated debate in the UK about the safety of so-called smart motorways (where the hard shoulder or emergency lane is opened up to traffic in certain circumstances). Many people claim that these have been responsible for fatal accidents. In January, the AA warned that the rise of e-cars would make smart motorways unworkable as there would always have to be an emergency lane.

One of the last things that Mr Javid did as Chancellor before he left the government last month was to retain the £3,500 taxpayer contribution towards the cost of buying an e-car in the UK, which was due to be scrapped at the end of this month. The Treasury announced on 5 February that "consumer incentives will continue to play a role beyond 2020".

The problem is that e-cars are still significantly more expensive to purchase than their ICE analogues. Some of the most popular all-electric cars are the **Renault (EPA:RNO)** Zoe, the **Hyundai (KRX:005380)** Kona Electric and the Vauxhall (owned by **Peugeot SA (EPA:UG)**) Corsa-e. All offer a range of over 200 miles and can be fully recharged overnight.

"THERE ARE LIKELY TO BE MANY PEOPLE WHO WILL BE PRICED OUT OF CAR OWNERSHIP ALTOGETHER."

While a petrol-powered Corsa Elite is currently available from most UK dealers at around £19,250, the Corsa-e Elite comes in at around £31,750[i] (less the government's £3,500 subsidy) – so still nearly 50 percent more expensive. True, the latter price includes a free charging device and a free six-month subscription to **BP**'s **(LON:BP)** *Polar Network* (which has over 7,000 charge points across the UK), and then £7.85 a month thereafter. Vauxhall reckons that the electricity cost for the vehicle will come in at about £3.90 per 100 miles – obviously much less than the cost of petrol. Servicing costs are also much lower given that these cars have no clutch or exhaust to maintain.

If the differential cost of e-cars could be brought down, as it surely will with increasing economies of scale and declining battery costs, then the great transition will become more popular than it is now. But there are likely to be many people who will be priced out of car ownership altogether.

Powering up

Currently in the UK there are about 30,000 charging connectors across nearly 11,000 different locations. That means there are more e-car charging points than there are old-fashioned petrol stations in the UK, of which there are 8,000. But critics say that they are largely concentrated in the big cities. For most people who use their e-cars for a middle-distance commute of say 20 miles in each direction, it should be possible to re-charge at home overnight or at work. (The average commute is 11 miles, according to the RAC). But drivers of e-cars will need to be confident that when they undertake long journeys – say, from London to Edinburgh – they will be able to find charging points along the way, given that few electric cars currently have a range of more than 300 miles.

It was reported in mid-February that French energy giant **EDF (ETR:EDF)** has bought into one of Britain's largest electric-vehicle charging companies. It is thought to have paid more than £100 million for a majority stake in Pod Point, a British charging firm. Legal & General Capital, the investment arm of the giant insurer **L&G (LON:LGEN)**, took a 23 percent stake. EDF announced that it planned to become the leading energy company for electric cars in France, the UK, Italy and Belgium. In 2018, BP bought Chargemaster, the UK's largest electric-vehicle charging company.

What's wrong with 'make do and mend'?

The UK government's policy means that all the cars on the road in 2032/2035 will have to be manufactured between now and then. But it is in the manufacture of cars that most carbon emissions are generated. Moreover, all the existing petrol and diesel-powered cars will have to be scrapped at some point, at great environmental cost. Some environmentalists have therefore suggested that a better policy would be to retrofit older vehicles with more modern, cleaner engines. In some developing countries like Cuba, which was subject to sanctions for many years, local mechanics have become past masters at keeping ageing vehicles on the road indefinitely – thus avoiding the emissions associated with replacing them.

Tesla: under investigation? No worries!

In mid-February the Securities and Exchange Commission (SEC) in the US issued **Tesla (NASDAQ:TSLA)** with a subpoena for "information concerning certain financial data". This occurred as Tesla announced a surprise $2bn stock offering to take advantage of its surging (though volatile) share price. Tesla's shares rose by 5 percent on the news: for Tesla's 'true believers', all news is good news.

On 21 February an environmental challenge to the construction of Tesla's new gigafactory in Germany was thrown out of court, giving the firm the go-ahead to continue the clearing of forest land outside the town of Grünheide, just east of Berlin. Tesla stated that it intends to offset the environmental impact of the construction by planting trees that cover three times the area of the factory plot. Tesla's new factory is expected to employ up to 12,000 people and to manufacture 500,000 cars per year. The firm already has factories in New York, Nevada and Shanghai. The markets have decided – for now at least – that Tesla will be one of the big winners of the great transition.

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Daimler AG: the emissions scandal drags on

Daimler (ETR:DAI) has issued four profit warnings since May last year. The world's largest luxury-car maker, which owns the Mercedes Benz brand, has faced huge charges and legal costs associated with the emissions scandal which first surfaced in the US in 2016. Daimler was shown to have systematically falsified emissions data. Now, the company is said to be investing massively in e-car technology. In mid-February the car giant announced that its dividend would be cut this year from €3.25 a share to just €0.90. Last year the company sold over three million passenger cars and commercial vehicles. Annual sales rose by three percent to €172.7bn, though profits fell from €2.7bn. Daimler plans to lay off more than 10,000 workers this year out of a total workforce of nearly 300,000. China, where Daimler sold around 700,000 cars last year is a vital market.

JLR: poorly positioned?

Jaguar Land Rover (JLR), owned by India's **Tata Motors (NSE:TATAMOTORS)** is thought to be seriously exposed to the ban on ICE cars because of its reliance on large sport utility vehicles (SUVs) produced by its Land Rover arm. These large off-roaders are harder to convert to electric vehicles while retaining the features that their loyal customers expect of them. JLR, which employs around 40,000 people in the UK, has invested billions of pounds in hybrid systems which allow the cars to be driven on their batteries for shorter journeys – typically up to 26 miles. About one fifth of the 578,000 cars JLR sold last year were into the UK market. The rest were exported.

JLR is already under pressure. It is investing nearly £1bn in its Castle Bromwich plant, to build powertrains for its e-car models. Last year it posted a £3.6bn loss as sales slowed. The company laid off 4,400 workers last year, and in January it announced that a further 500 UK jobs would go at its Halewood plant. In mid-February the company revealed that the impact of the coronavirus epidemic in China was twofold. Firstly, it was running seriously short of components supplied by Chinese factories which are currently closed. Secondly, sales of new cars into China, a hugely important market, had collapsed. Sales on new cars overall fell by an estimated 70 percent in China in February.

Other prestige British car brands such as Bentley (owned by **Volkswagen AG (ETR:VOW)**) which produces about 7,000 cars a year, and Rolls-Royce (owned by **BMW AG (ETR:BMW)**) which made 4,100 cars in 2018, will struggle to make the transition. Essentially, the bigger the car, the bigger the battery must be and the more expensive it becomes. Even if it were possible, it would strain brand loyalty.

> **“JAGUAR LAND ROVER (JLR), OWNED BY INDIA’S TATA MOTORS (NSE:TATAMOTORS) IS THOUGHT TO BE SERIOUSLY EXPOSED TO THE BAN ON ICE CARS BECAUSE OF ITS RELIANCE ON LARGE SPORT UTILITY VEHICLES (SUVs).”**

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How environmentally friendly are e-car batteries?

E-cars are not as green as they are portrayed. Their production consumes vast amounts of cobalt, nickel, manganese and rare earth metals that are mined in the rainforests of Africa, Southeast Asia and South America. Rainforest Rescue claims that a huge amount of these metals are used in a mid-range electric car such as the Chevrolet Bolt (which was briefly marketed in Europe as the Opel Ampera-e)[ii]. The European automotive industry imports almost 100 percent of these materials – with much of this coming from mines in tropical countries and rainforest areas.

The Chevrolet Bolt battery packs weigh 440 kilograms. Besides lithium, manganese and graphite, they contain about 10 kilos of cobalt and 30 kilograms of nickel. Indonesia and the Philippines are at the forefront of global nickel production. Two-thirds of the world's cobalt comes from the Democratic Republic of Congo (DRC). Cobalt, copper and nickel are mined along an 800-kilometre belt of rainforest in the south of the country. Numerous campaigning organisations have claimed that the working conditions in these open-cast mines are deplorable, with tens of thousands of child workers paid near-starvation wages.

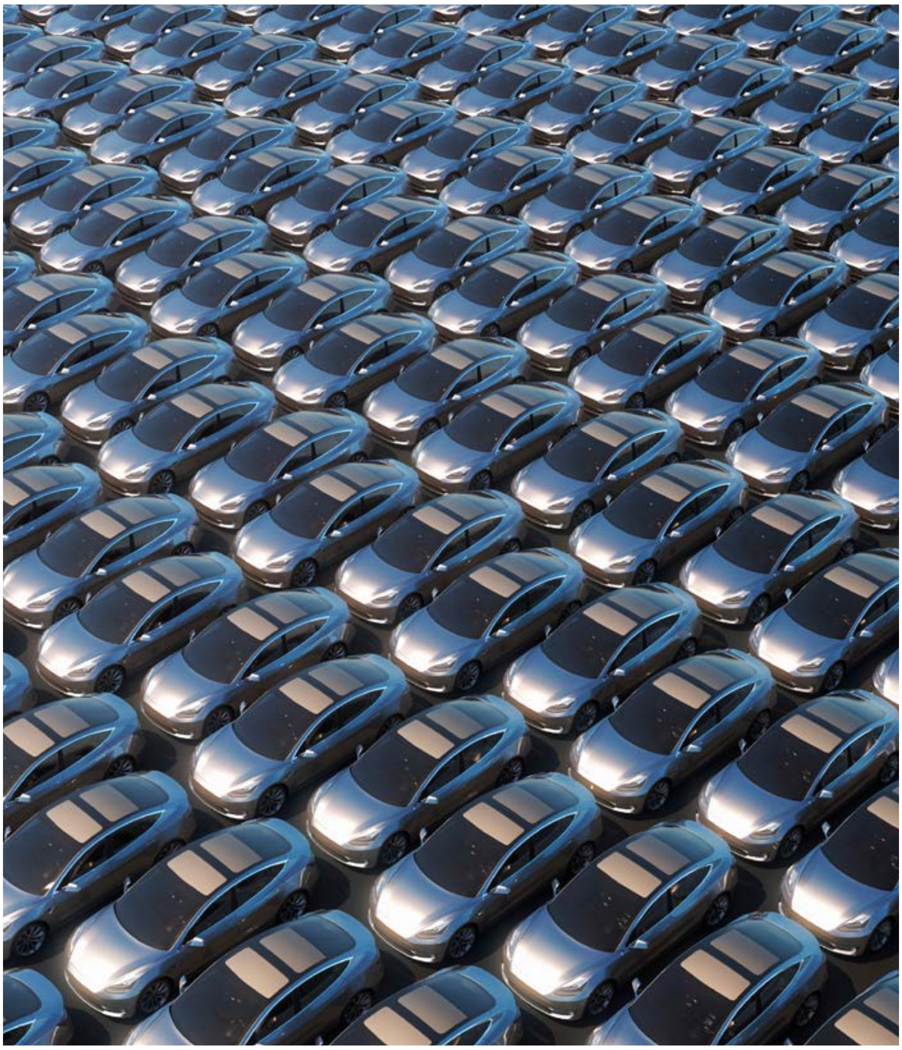
Then there is the issue of how to recycle e-car batteries once they have come to the end of their useful life. That is another reason why, in the long run, hydrogen-powered vehicles may win out over battery-powered vehicles. **Toyota (LON:TYT), Honda (TYO:7257)** and **Hyundai (KRX: 005380)** already make hydrogen-powered cars.

The impact on government finances

If all cars are electric, then the UK government will lose excise and VAT revenues on fuel sales of about £34.4bn a year (of which just £10bn is spent on roads). That money will have to be made up from somewhere else. Some commentators have suggested that the government will have to move to road charging.

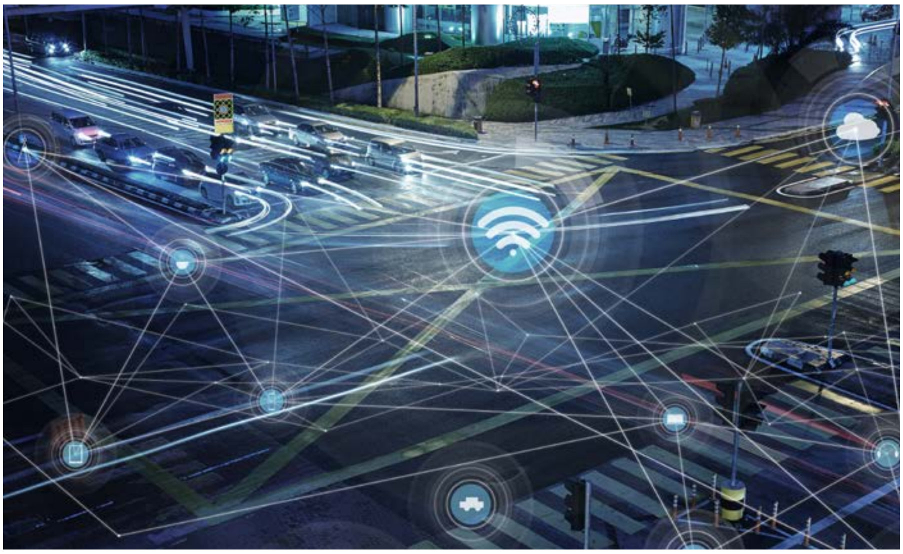
One example of a UK toll road is the M6-Toll, a 27-mile bypass around Birmingham which was opened in 2003. A consortium originally backed by **Macquarie Bank (ASX:MQG)** of Australia and Autostrade of Italy (owned by **Atlantia Spa (BIT:ATL)**) was given the concession to run the road until 2054; but they sold out and the road is now managed by IFM Investors. Designed to take 75,000 vehicles every day, only about 50,000 cars use the road, paying an average of £6.70 each. Spain's Abertis Infraestructuras runs the toll at the Mersey Gateway Bridge.

Public transport – especially rail and buses – seems to have been prioritised over roads by governments in recent years for environmental reasons. The UK government has another target that all buses will be fully electric by 2025. But traffic congestion, which makes people late for work, is a real drag on productivity. London has the distinction of being the most congested region of the UK; but it is followed by the North West, the West Midlands and the Humber – precisely the regions which turned Tory in December 2019. One solution



Where will all the electricity come from?

If everybody who currently drives an ICE vehicle drives an e-car after 2032 for the same number of miles travelled, then there will be a huge surge in the demand for electricity. One estimate suggests that we shall need to build another seven nuclear power stations equal in output to Hinkley Point C over the next 15 years.



could be dynamic road pricing – that is, charging drivers nothing if the traffic is flowing but penalising them for driving in the rush hour. With driverless cars which could automatically readjust their routing in response to traffic data, the potential efficiency gains could be huge.

"IN EARLY FEBRUARY, IT WAS REPORTED THAT A DRIVERLESS CAR HAD COMPLETED THE LONGEST AUTONOMOUS JOURNEY EVER ON BRITAIN'S ROADS."

Driverless cars: the UK in the lead?

In early February, it was reported that a driverless car had completed the longest autonomous journey ever on Britain's roads. A modified electric *Nissan Leaf* set out from the firm's HQ in Cranfield, Bedfordshire, driving to Nissan's giant factory in Sunderland, Tyne & Wear through country lanes, A-roads and motorways. The 'passenger at the wheel' took control only to recharge the car at a motorway service centre. The government-funded HumanDrive project authorised the experiment. Nadhim Zahawi MP, Minister for Business and Industry pronounced: "This is an incredible achievement for Nissan and HumanDrive".

For all that, the Oxford-based autonomy experts, StreetDrone, announced in a report last month that in this space "ambition might be outstripping capability". It seems that Waymo (owned by **Alphabet/ Google (NASDAQ:GOOG)**) has further delayed its launch programme and even **Uber (NYSE:UBER)** has gone

Were hybrids a good idea?

The key engineering weakness of plug-in hybrids is that, when they are running on their ICE, the car has to carry the significant additional weight of the battery without using it. As a result, the actual fuel consumption of hybrids is substantially greater than that advertised by manufacturers[iii]. There is also concern that plug-in hybrids are not being used principally for shorter journeys, as intended.

uncharacteristically silent on its roll-out of autonomous cabs. The challenge of producing autonomous vehicles which are absolutely safe has proven more difficult than anticipated.

Mercedes (**Daimler AG (ETR:DAI)**) is likely to launch a new S-Class flagship later this year with limited autonomy, whereby the robot requires the driver to take over when it is flummoxed – so falling asleep at the wheel is not an option!

Legacy issues

Given the prospect of a sales embargo, volume automobile manufacturers will probably cease production of ICE cars for the European market long before the deadline – and they will attempt to sell off old stock as far as possible, possibly at deep discounts. But come 1 January 2032 (or whenever) there will still be a huge number of petrol-powered vehicles on the roads of the UK. (I assume that diesel cars will be banned outright some time before then). That means that the oil majors will still have to maintain their downstream operations (ie networks of petrol stations).

There will surely be a lot of people – call them petrolheads, if you will – who prefer petrol power to e-cars and who will hang onto their ICE vehicles for as long as possible. There may well be a flourishing trade in the renovation and maintenance of ICE vehicles, even though getting spare parts for them will become increasingly difficult. Just as vintage cars have become collectable – with a number of serious investors active in this niche – so petrol-powered cars might continue to change hands indefinitely as collectors' items.

Presumably, at some point before 2032, the government will introduce a national scrappage scheme to induce drivers to give up their petrol cars and buy e-cars. London already provides such a scheme for vans and minibuses. The key question is whether the government might choose to ban petrol-powered vehicles altogether at some point. Unless there is a fundamental shift in public opinion that would prove very unpopular – just as the Johnson government's decision to ban coal fires in the home is proving unpopular, especially in the (Tory-dominated) shires. Of course, if the oil majors decide that their downstream operations are no longer economically viable then all the legacy ICE vehicles on the road will literally splutter to a halt.

What about the tractors?

A farmer wrote to the *Daily Telegraph* on 19 February to say that there are no electric-powered heavy agricultural vehicles available now – and none in prospect. Mr Lemkey of Ross-on-Wye, Herefordshire, feared that as the number of diesel-powered cars dwindles to nil, so the price of diesel will soar, leading to much higher production costs for farmers. Even if electric tractors were to become available at some point, recharging them might prove challenging as they are often in constant use miles away from a power supply. This is all further evidence that the great transition has not been fully thought through. Mr Lemkey wondered (I think sarcastically) if the government isn't surreptitiously planning the return of shire horses and oxen. Maybe that will become Labour-party policy in due course.

Personally, I don't think that will happen until towards the end of the century because so many commercial, industrial and agricultural vehicles will continue to run on fossil fuels. Then there is the issue of whether maturing millennials will want to buy new cars at all – electric or otherwise. They might prefer to get around in vertical take-off flying taxis (which I wrote about last year). But this kind of thing is notoriously difficult to predict: we are entering unknown territory.

Action

The great transition offers many opportunities for canny investors.

Firstly, there are a number of small companies that are innovating with niche technology and infrastructure so as to make that transition possible. One such is **ITM Power (LON:ITM)**. It supplies hydrogen to refuelling stations for hydrogen-powered cars and trains. Its share price has risen threefold in two years. Another is **SSE (LON:SSE)** which uses hydrogen to generate electricity. This is up by 40 percent over the last 12 months. The power generators are also worth a play. Note that **EDF** has a dividend yield of 3.62 percent at time of writing.

Secondly, the two automotive manufacturers which seem best positioned to ramp up sales of e-cars in the UK market are **Nissan (TYO:7021)** and **Tesla (NASDAQ:TSLA)**. It is too early to say if the great transition will restore the fortunes of the German automotive giants Volkswagen and Daimler.

There are numerous investment funds and trusts allocating towards companies engaged in the great transition. One is the Allianz Technology Trust and another is Impax Environmental Markets which favours companies which will be beneficial for the environment. This fund has achieved a return of 146 percent over five years, in comparison with 78 percent for the global market average. Most 'ethical' funds have a significant allocation to green energy of one kind or another.

Companies cited in this article

Company	Status/ ticker
Renault	EPA:RNO
Hyundai	KRX:005380
Peugeot SA	EPA:UG
Infosys Consulting	NYSE:INFY
BP	LON:BP
EDF	EPA:EDF
Legal & General	LON:LGEN
Tesla	NASDAQ:TSLA
Daimler AG	ETR:DAI
Tata Motors	NSE:TATAMOTORS
Volkswagen AG	ETR:VOW
BMW AG	ETR:BMW
Toyota	LON:TYT
Honda	TYO:7257
Atlantia Spa	KRX:005380
Nissan	TYO:7201
Waymo	Owned by Alphabet (NASDAQ:GOOG)
Uber	NASDAQ:UBER
ITM Power	LON:ITM
SSE	LON:SSE
Allianz Technology Trust	LON:ATT
Impax Environmental Markets	LON:IEM

About Victor

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

i Finance offer: see: www.vauxhall.co.uk/cars/new-corsa/offers-finance/electric/flexible-pcp.html
ii See: www.rainforest-rescue.org/petitions/1182/electric-vehicles-are-stealth-rainforest-killers
iii Based on the analysis of 515 plug-in hybrid cars in 2019 by The Miles Consultancy.

BY MARK WATSON-MITCHELL

PORTFOLIO INTELLIGENCE

THE 'ART' OF INVESTING

Investing can be described as an art, although there are many who believe that it is a science. Mark Watson-Mitchell explains the importance of finding your own investment style.

What is your style?

Stick your fingers into a naked flame and you will get burned. You soon start to learn what is right and what is wrong – so too in your investing style. And yes – you can have styles in investing – seeking safety, going for risk, following the herd, looking for value, searching for income, lucky dip or even 'my friend told me'.

In life you build up your confidence in anything only after you have tried it once, twice, three times or even several more times and learned from your mistakes. That goes for riding a horse, playing football or anything else.

Persevere despite your mistakes

As John D Rockefeller stated: "I don't think there is any other quality so essential to success of any kind as the quality of perseverance. It overcomes almost everything, even nature." Your personal history helps you to define what works for you – it is just the same in investments. Are you an outright gambler, is it all or bust for you or do you prefer to take the safe route?

As Ingvar Kamprad is quoted as saying: "Only those who are asleep make no mistakes." So, sometimes you have to fail if you want to progress. But as with learning to ride a horse, it is imperative that you get back in the saddle again soon, or your lesson will have gone to waste.

Stand back and listen

The process, of course, can be helped by taking guidance from others who have already made all the mistakes and who are prepared to advise you. They will tell you what works for them and what does not – and they will do so from personal experience – it really is invaluable. But as with everything else in life, the ultimate choice is yours, as to what method of investing you will follow.

"YOUR PERSONAL HISTORY HELPS YOU TO DEFINE WHAT WORKS FOR YOU – IT IS JUST THE SAME IN INVESTMENTS."

I know that there are probably hundreds of books on investment, as well as manuals, encyclopedia and reams and reams of other information on what to do. There are also evening classes, I am sure, but just do it your own way and don't be in a rush. Ultimately, only you and your wallet will be the decision makers.

Always take it slowly and do not go for broke in any one situation. So often it can go wrong.

In my time I have made some absolute howlers – but I have also been lucky enough to be in the right stock at the right time, and when that happens your errors soon fade into the background.

Tips from "arguably the greatest global stock picker of the last century"

Two decades ago, I was lucky enough to meet a top fund manager, one whose speciality was investing in emerging markets across the globe. Mark Mobius, now 83, may not be a household name to UK investors but on the international investment stage his name was and still is one that is respected.

Mobius flew across the world in private jets as he chased investment situations that made his Templeton Emerging Markets Fund one of the world's best such funds. At the time that I met him he had just published his book *Passport to Profits* and was doing some publicity for it. His real strength was his global knowledge, no doubt helped by all that he gleaned and learned while he was working at Templeton, the fund management house built up by Sir John Templeton.

While with Templeton, Mobius was involved in managing over $50bn of open-ended and closed-end funds, as well as establishing and directing its research team, which had some 18 offices overseas. Having joined the company from brokers Vickers da Costa in 1987, he eventually retired from the Franklin Templeton group in 2018. Three months later he set up Mobius Capital Partners, with a couple of former colleagues.

Sir John Marks Templeton

However, this part of the article is not about Mark Mobius, although if you read any of his books you will realise what an investment expert he is.

The Templeton maxims
Ten principles for investment success

Maxim number one

Invest for real returns

The true objective for any long-term investor is maximum total real return after taxes.

Maxim number two

Keep an open mind

Never adopt permanently any type of asset or any selection method.

Try to stay flexible, open-minded and sceptical.

Long-term top results are achieved only by changing from popular to unpopular the types of securities you favour and your methods of selection.

Maxim number three

Never follow the crowd

If you buy the same securities as other people, you will have the same results as other people.

It is impossible to produce a superior performance unless you do something different from the majority.

To buy when others are despondently selling and to sell when others are greedily buying requires the greatest fortitude and pays the greatest reward.

Maxim number four

Everything changes

Bear markets have always been temporary. And so too have bull markets. Share prices usually turn upward from one to 12 months before the bottom of the business cycle and vice versa.

If a particular industry or type of security becomes popular with investors, that popularity will always prove temporary and, when lost, may not return for many years.

Maxim number five

Avoid the popular

When any method for selecting stocks becomes popular, then switch to unpopular methods.

Too many investors can spoil any share selection method or any market timing formula.

Maxim number six

Learn from your mistakes

'This time is different' are among the most costly four words in market history.

Maxim number seven

Buy during times of pessimism

Bull markets are born on pessimism, grow on scepticism, mature on optimism and die on euphoria.

The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell.

Maxim number eight

Hunt for value and bargains

Too many investors focus on outlook and trend. Therefore, more profit is made by focusing on value.

In the stock market the only way to get a bargain is to buy what most investors are selling.

Maxim number nine

Search worldwide

To avoid having all your eggs in the wrong basket at the wrong time, every investor should diversify.

If you search worldwide, you will find more bargains and better bargains than by studying only one nation. You also gain the safety of diversification.

Maxim number ten

No-one knows everything

An investor who has all the answers doesn't even understand the questions.

Instead, this is all about the great Sir John Marks Templeton, the American-born British investor, banker and fund manager who was named 20 years ago by Money Magazine as "arguably the greatest global stock picker of the century."

Templeton, who was educated at Yale and then became a Rhodes scholar at Balliol College, Oxford, where he gained a law degree, died at the age of 95 in 2008. It was not until 1954 that he entered the fund-management market, setting up his own Templeton Growth Fund. He went public five years later by which time he had over $66m of funds under management.

In October 1992, Templeton sold out for $913m to Charlie Johnson's Franklin, with the enlarged group taking the Franklin Templeton Investments name. It was, at that time, the largest merger to date, of an independent, mutual fund company. The joining of the two houses gave Franklin an international spread of its investment activities, as well as taking on board the talents of Templeton and Mobius. Today, Franklin Templeton is one of the largest independent global asset management firms in the world, with employees in 35 countries and clients in more than 170.

The dean of global investing

Sir John was regarded as one of the world's wisest and most respected investors. The US magazine *Forbes* described him as one of the most successful money managers in history. It is said that his success was largely attributed to maintaining a positive attitude, avoiding anxiety and by staying disciplined.

He was well known for his investment philosophies of 'avoiding the herd' and for also buying when there was 'blood on the streets'. On the day that World War II broke out, he gave his broker an order to go out and purchase 100 shares in every New York stock exchange-listed company whose shares were then selling for under $1 each. Those were mainly shares in companies that had been affected by the Depression of the 1930s. When the US industry started to pick up as a result of the war, he then sold out and banked some very large profits.

Quotes from some famous investors

Warren Buffett

"Wide diversification is only required when investors do not understand what they are doing."

"We don't have to be smarter than the rest, we have to be more disciplined than the rest."

"The stock market is a device for transferring money from the impatient to the patient."

"Look at market fluctuation as your friend rather than your enemy. Profit from folly rather than participate in it."

"I will tell you how to become rich. Close the doors. Be fearful when others are greedy. Be greedy when others are fearful."

John D Rockefeller

"The way to make money is to buy when blood is running in the streets."

John Paul Getty

"Buy when everyone else is selling and hold when everyone else is buying. This is not merely a catchy slogan. It is the very essence of successful investments."

"Seek advice on risk from the wealthy who still take risks, not friends who dare nothing more than a football bet."

"Men of means look at making money as a game which they love to play."

Aristotle Onassis

"At a certain point, money is meaningless. It ceases to be the goal. The game is what counts."

George Soros

"If investing is entertaining, if you are having fun, you are probably not making any money. Good investing is boring."

"The markets generally are unpredictable, so that one has to have different scenarios. The idea that you can actually predict what's going to happen contradicts my way of looking at the market."

"Stock market bubbles don't grow out of thin air. They have a solid basis in reality, but reality as distorted by a misconception."

Benjamin Franklin

"An investment in knowledge pays the best interest."

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Everett Historical / Shutterstock.com

Henry Ford

"When everything seems to be going against you, remember that these airplane takes off against the wind, not with it."

"Even a mistake may turn out to be the one thing necessary to a worthwhile achievement."

Christopher Browne

"Value stocks are about as exciting as watching grass grow, but have you ever noticed how much your grass grows in a week?"

Woody Allen

"A stockbroker is one who invests other people's money until it is all gone."

John Maynard Keynes

"Successful investing is anticipating the anticipations of others."

Crispin Odey

"Investment styles need to adapt as opportunities change. Living in investment denial must be avoided – if an investment is not working, we won't wait until it does.

Hugh Hendry

"If the market is running towards you then you make money; if you are running after the market, you lose money. You have to get ahead of the market."

Tony Robbins

"I love quotes ... but in the end, knowledge has to be converted to action or it's worthless."

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

SMALL CAPS, BIG DEALS

THREE SMALL CAPS GROWING BY ACQUISITION

Richard Gill looks at three small-cap companies which have recently announced big acquisitions and look like they could be a good bet for the medium to long term.

There are two broad ways in which companies can grow their operations. The first, and most common, is organic growth. Here, a company expands its existing operations by increasing sales, breaking into new markets or launching new products. In contrast, inorganic, or acquisitive growth, sees a company expanding via the purchase of another business and integrating it with its own.

While often considered to be one of the more exciting and potentially lucrative sides of equity investing, acquisitions don't always go as planned. In fact, finance academics have long been critical of the M&A arena, with many studies finding that the majority of deals fail to deliver as expected. For example, a recent study by Global PMI Partners analysed 11,000 transactions executed between 2010 and 2017 involving publicly listed companies. It found that only 34% of cases saw value increases, suggesting that around two thirds of deals fail to achieve their intended goal.

"AROUND TWO THIRDS OF DEALS FAIL TO ACHIEVE THEIR INTENDED GOAL."

Why do deals fail?

Deals can fail for a number of reasons. One of the most common is overpayment, with acquirers often spending too much on a company which then goes on to perform below its pre-takeover expectations. One example is News Corporation's $580m purchase of then-popular social-networking site Myspace in 2005. Following a collapse in user numbers, due to increased competition, it was sold six years later for just $35m.

Another reason for deal failure is 'empire building', with high-powered chief executives looking to expand their 'kingdom' (and salary) without regard to whether the companies being bought are a good strategic fit. Sometimes, the merging of two companies can look like a good idea on paper, but the practicalities of integrating them often turn out to be more difficult than thought, especially in people-driven businesses with clashing corporate cultures.

Despite many disasters, acquisitions, if done correctly, can offer the opportunity for growth and value creation. Here follow three small-cap companies which have recently announced acquisitions and look like they could be a good bet for the medium to long term.

CENTRALNIC GROUP

The danger with some highly acquisitive companies is that they can take on high levels of debt to finance their deals. If acquisitions don't deliver on financial expectations, then they can get into trouble. The doomed drinks retailer, Conviviality, which massively increased borrowings to finance a takeover, is one example.

"THIS IS A HIGHLY CASH-GENERATIVE AND PREDICTABLE BUSINESS."

While this next business has just increased borrowings to finance a deal, its strong track record and predictable income streams suggest it's on a solid footing.

AIM-listed **CentralNic (LON:CNIC)** was established in 2004 as a specialist domain registry. Today it is a developer and operator of software platforms which provide web-presence services to customers worldwide. It provides the tools required to create websites, use email and secure business online. This is a highly cash-generative and predictable business, with the company earning recurring revenue from the sale of internet domain names and hosting on an annual subscription basis, with cash paid upfront.

In the 2018 financial year, CentralNic distributed more than 1,000 different top-level domain names (such as .com, .info etc) and its platforms supported around 18.6m domain names. Clients include; domain name resellers such as Godaddy; corporate customers who have large portfolios of domain names; and small businesses, which typically hold a few domains and use email and hosting services.

Top-level growth

Since listing on AIM in September 2013, CentralNic has grown from a market cap of £32.5m to one of £157m today, with revenues up from around $4m to $109m over the last seven years. Adjusted EBITDA has grown almost fourteenfold over the same period. While steady organic expansion has been seen across the group, the majority of growth has been driven by the company's deal making, with four acquisitions completed over the course of 2019 alone. The core growth strategy is to identify and acquire cash-generative businesses with annuity-like revenue streams and exposure to growth markets, and then migrate them onto the CentralNic operating platforms.

The largest deal of 2019 was completed at the end of December, with the company buying up domain-name monetisation-services provider Team Internet for a total of $48m. Based in Germany, the business has approximately 35,000 customers signed up to rolling contracts, to monetise a total of more than 20m domain names, using Team Internet's proprietary technology for matching domain names with the highest paying advertisers. The deal, which was mostly financed by a €40m bond issue, was expected to enhance earnings immediately and to be significantly accretive in the 2020 financial year, even before any expected synergies are realised.

More recently, the markets were cheered by a trading statement from CentralNic in early February, with the firm announcing that it finished 2019 with adjusted EBITDA ahead of the market consensus. Revenues for the financial year were up by 95% at $109m, with revenues for Q4 coming in at $32m. Adjusted EBITDA, meanwhile, also increased by 95%, to $18m, $1m ahead of market expectations. Team Internet contributed a modest $1.9m in revenue and $0.4m of EBITDA to the figures. At the end of period, CentralNic had net debt of $76m following the issue of the €40m bond just before Christmas, in line with previous guidance.

Host with the most

Following the recent trading update, analysts at Zeus Capital updated their forecasts for CentralNic. On the back of the acquisitions completed in 2019 further significant growth is expected in 2020, with the broker looking for adjusted EBITDA this year of $31.5m. I note that adjusted EBITDA here is a more valid measurement of the cash being generated as the company has high annual non-cash charges associated with amortisation. For example, in 2018 the cash inflow from operations was £8.9m, compared to a statutory pre-tax loss of £3.8m.

Crucially, net debt is expected by Zeus to fall to $68.6m by the end of this year, falling to $55m in 2021. The company's own guidance is that the net debt to EBITDA ratio is expected to be 2 times after the first full year of owning Team Internet, which looks like a comfortable level. That said, I would like to see the company concentrate on bedding down its recent acquisitions rather than stretch itself by making any more deals in the nearterm.

On the figures above, CentralNic is currently trading on an EV/EBITDA multiple of 8.7 times for the current financial year. That looks good value in my opinion, given the excellent track record of growth and further opportunities for expansion in the long term – the market for online-presence services remains highly fragmented and has an estimated value of around $30 billion per annum. I would describe this as a **speculative buy.**


PhotoMavenStock / Shutterstock.com

VOLVERE

This next company takes a slightly different approach to acquisitions, specifically looking for opportunities to invest capital in companies and then exit with a (hopefully large) return after a few years.

Founded by the Lander brothers, Jonathan and Nicholas, almost 20 years ago, AIM-listed **Volvere (LON:VLE)** is a growth and turnaround investment company, having a remit to invest in or acquire businesses which require growth capital.

Over the past two decades, Volvere has bought and sold many businesses but the current portfolio is a little lighter than it was in the past, if not cash-heavy. One of the company's most successful transactions of recent times was that of consultancy business Impetus Automotive. Volvere acquired Impetus in March 2015 for a consideration of around £1.25m, along with follow-on working capital loans. Not only did Impetus repay the loans and interest, in October 2018 the business was sold for £31m. With Volvere having an effective economic interest of 83% through its shareholding, and after transactional and other costs, the company retained around £23.1m from the sale. That's a highly impressive return of over 18 times the initial investment.

Volvere plc

More dough

In May last year, following the disposal of digital CCTV viewing software business, Sira Defence and Security, Volvere was left with just one trading division – food manufacturing. The main trading business here is frozen pies, pasties and sausage-roll manufacturer, Shire Foods. Acquired by Volvere in 2011, the company is based in Leamington Spa and counts major retailers, food-service companies and independent wholesalers as its clients. In the last financial year the business made revenues of £18.34m and a pre-tax profit of £0.85m.

In early February, Volvere beefed up its presence in food after announcing its first acquisition for almost five years. For the modest sum of £1.25m, the company bought Essex-based, premium dessert manufacturer Indulgence Patisserie out of administration. The business was bought with a view to carrying on trading as a going concern. With a number of clients in common with Shire Foods it is expected there will be expansion opportunities for both businesses from the deal. In the eight months to December 2019, Indulgence made revenues of £3.3m and a modest pre-tax loss of £0.23m, proving clear potential for a turnaround.

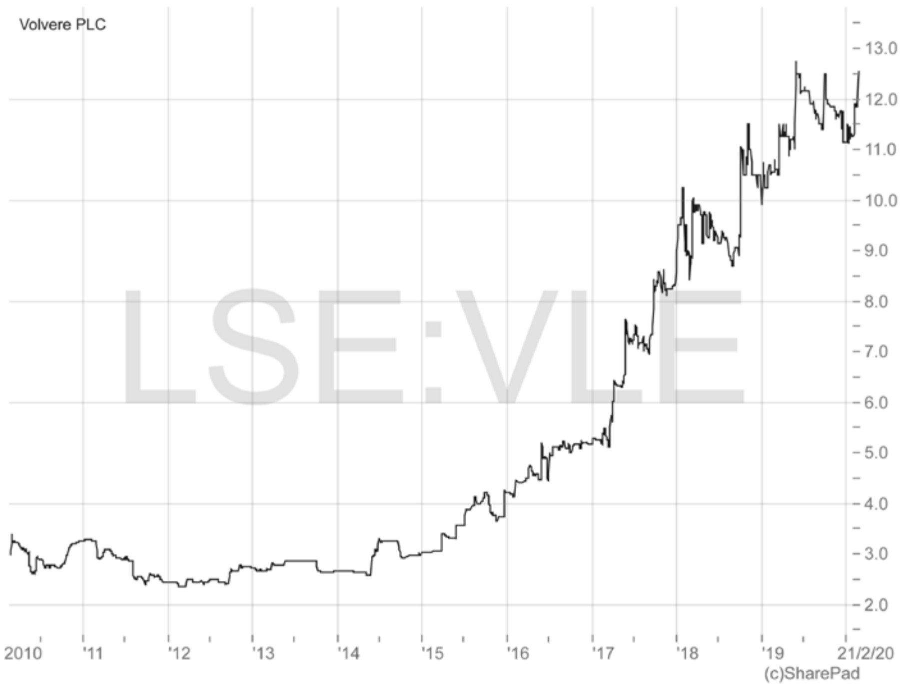
Volvere's numbers for the six months to June 2019, restated to remove the disposed operations, showed a good performance from Shire Foods in the face of margin pressure caused by raw-material and wage inflation. Revenues at the business grew to a record level, up 39% to £10.1m, with pre-tax profits at £0.24m, compared to a loss of £0.17m in H1 2018. The business traditionally has a stronger second half and is hopeful that new brand, Naughty Vegan, will be well received by the food-service market.

Cash to splash

Volvere's excellent long-term track record is demonstrated in its share price, which since bottoming out at 98p in March 2009 has risen twelvefold to currently stand at 1,185p. Nevertheless, that price is still a 13% discount to net assets per share of 1,356p as at 30 June last year. I note that figure is also equivalent to net tangible assets as Volvere retains no goodwill on its balance sheet. What's more, net cash of around £17.7m as at the end of last June covers around 82% of the current market cap and provides plenty of firepower for further deals.

With the company well-funded, and the Lander brothers having a very keen eye for a deal, Volvere looks attractive to me at current levels. Some excellent returns have been delivered in the past by investing in underperforming businesses and then selling them for many multiples of the initial amount paid.

However, it does seem that the directors are cautious, only putting the company's money into the best deals that they can find. This is demonstrated by Indulgence being the first business bought since March 2015. As such, investors should have patience with Volvere. But it is encouraging that in the interims management commented that the level of deal opportunities has increased since 2018 and that they are optimistic they will identify new businesses in which to invest. Overall, as a play on a cash-rich company with a highly able management team, the shares are worth considering as a **speculative buy.**



NORTHERN BEAR

This next company I have covered previously, but following a recent return to the acquisition trail I believe it's worthy of another look. Based in Newcastle and a few other places in the north-east of England, **Northern Bear (LON:NTBR)** owns a group of companies which provide a range of specialist building and related support services. These include roofing, solar-panel installations, asbestos management and drone surveys. Clients include local authorities, housing associations, NHS trusts, universities, construction companies and national house builders.

Prior to the financial crisis of 2008/9 Northern Bear was a highly acquisitive business. For instance, it bought 12 companies within 16 months of joining AIM in December 2006. This came to a swift end after the building sector experienced trading conditions which the then chief executive described as "the worst experienced in recent memory".

With profits falling and net debt having risen to over £10m, the company began to focus on repairing the balance sheet by disposing of underperforming businesses, paying off debt and cancelling the dividend. There has been a significant recovery since then, with the business eliminating its debt, returning to the dividend list, and now making a record level of profits and looking for new assets to acquire.

Several events have occurred over the past few months which suggest to

“THE SHARES ARE YIELDING A CHUNKY 4.36%.”

me that investors should take another look at Northern Bear.

Firstly, in mid-January the company announced the acquisition of J Lister, an electrical contracting business based in York. Key services include electrical repairs; installation; maintenance and testing; fire alarms, emergency lighting; and door-access systems. The deal is expected to be earnings enhancing in the current financial year, with significant growth potential envisaged through both organic expansion and cross selling. A maximum £1.25m will be paid for the business, which looks good value, given that Lister made pre-tax profits of £0.28m in the year to March 2019.

The company's financial results are also continuing to look healthy, with Northern Bear reporting operating profits up from £2.8m to £3.3m in the year to March 2019. More recent interims to September 2019 were a little more downbeat, with profits down by £0.3m at £1.4m. However, following contract delays earlier in the year, the second half was said to be "much stronger". Supported by a "significant order book", another strong result is expected for the full year.

Finally, in September last year the company received a tender offer for up to 29.6% of its shares, from private investment holding company Cedarvale Holdings. The offer was made at 72p per share, a 17% premium to the previous day's closing price. Cedarvale is owned by Canadian real-estate tycoon Jeff Baryshnik, president of the private asset management firm Republic Funds USA Inc. He and his company ended up with a 25.6% holding in Northern Bear following the results of the offer.

Why buy man?

Northern Bear isn't covered by any brokers at present so the historic figures will have to do for looking at the valuation. On last year's numbers the shares trade on an earnings multiple of just 5.5 times. This looks like an absolute bargain given the company's recent performance and considering the modest net debt of £0.7m as at 30 September last year. What's more, on last year's numbers the shares are yielding a chunky 4.36%, based on a dividend of 3.25p.

I continue to believe a valuation of eight times earnings would look like a reasonable valuation for Northern Bear – arguably higher, although this is a cyclical stock. That equates to a share price of 108p, implying upside of 45% from the current 74.5p. While Cedarvale stated at the time of the tender offer that it doesn't intend to make an offer for the company, I do note that Jeff Baryshnik has significant access to capital, with his corporate profile on the Republic Funds USA website suggesting he has participated in more than $15bn of acquisitions.

For value, income and a possible takeover, Northern Bear is a **buy.**

About Richard

Richard Gill is an investment analyst with over a decade's experience of analysing small/mid cap equities. He is the Head of Research at Align Research. Richard qualified with the Chartered Financial Analyst (CFA) designation in 2012 and was awarded PLUS Markets Financial Writer of the Year at the 2008 PLUS Awards. He has been a judge at the Small Cap Awards from 2013 to 2018.

BY JAMES ANDERSON, JOINT MANAGER OF SCOTTISH MORTGAGE INVESTMENT TRUST

THE IMPERATIVES OF GROWTH INVESTING

James Anderson, joint manager of Scottish Mortgage Investment Trust, talks about why we need to embrace risk and volatility to achieve long-term rewards.

The value of your investment and any income from it can go down as well as up and as a result your capital may be at risk.

This is not an easy article to write. It comes with an apology to any readers who think it is too dogmatic. But the investment industry has turned in on itself in a fateful way for our economies and societies. We need to rediscover a sense of purpose beyond competing with each other for assets, immediate returns and via Byzantine metrics that rarely make any sense other than to consummate insiders. If this sounds arrogant then so be it. It's too important an issue to be ignored.

What's the point of capital markets? There are surely two fundamental components behind any satisfactory answer. The core objective, even the genius, of equity capital is to use the savings of society to provide the necessary risk capital in order to both drive economic progress and deliver returns to savers. This is in one sense the canonical description of stock exchanges as the enablers of industrial achievement best remembered in railway and railroad epics of the 19th century in Britain and the Americas. It's also not too far away in substance, if not form, from the Chinese economic transformation of the last decades. The remarkable savings of the population were transmuted into world-leading industries, if without adequate reward.

But the ideal of productive investment is long gone in most equity markets of today. This is especially true of developed markets and above all in Britain. Companies pay out far more money in dividends and share buybacks than they receive for new issues or to provide new risk capital. Indeed, it's worse than that. In aggregate, companies invest less of their cash flow than they spend on dividends. When new capital is urgently required it rarely appears from British institutional investors. When banks desperately needed more money it was taxpayers who found the necessary billions. When ARM required heavy investment it was taken over by Japan's SoftBank.

Why is this so? Is it what retail investors want or require? For sure, income has its uses and certainly companies can be tempted to over-invest in a declining future. But the critical problem is far less misjudged capital expenditure by individual companies than the risk and loss aversion of those who determine the overall framework for capital allocation, ie fund managers. The intermediation of the savings system by trained professionals is a recent phenomenon. At earliest it dates from after 1945 and its dominance from only the 1980s. But inserting the industry between savers and companies changes far more than we are accustomed to think or commentators are willing to examine. The only acknowledged impact is that of fees. There was once a famous book entitled *Where are the Customers' Yachts?* These days yachts are but minor trinkets to billionaire hedge fund managers.

The hidden issues are more warping. They are both practical and theoretical. They combine to deadly effect. The reality is that to stay rewarded and regarded in the profession a fund manager cannot afford to underperform

"THE IDEAL OF PRODUCTIVE INVESTMENT IS LONG GONE IN MOST EQUITY MARKETS OF TODAY. THIS IS ESPECIALLY TRUE OF DEVELOPED MARKETS AND ABOVE ALL IN BRITAIN."

indices for long. So the principal task for the individual and the fund management company is to preserve their job and the firm's assets by not underperforming the index. Big, safe cash-rich companies are built for this task. The ideologues of academic portfolio theory and their avid followers in the strange trade union that is the Chartered Financial Analyst (CFA) qualification then turn this into intellectual conformity by defining risk as volatility around an index measured over short-time historic horizons.

But it's clear that if a company is trying to build a great business for the future in a complex and uncertain world then it almost always needs to take large risks and endure extreme volatility of results and share price. The possibility of failure is inevitable, necessary and far from shameful. This is not just what economic progress requires but what produces stock-market returns. I apologise for sounding like a broken record to some of you but the record is that stock-market returns are dominated by the identification and compounding of a very small number of great companies. In the US since 1926 half the added return from equities has come from just 90 companies.

So what must we do? We have to pursue everything we can to help companies that we believe have even a slight chance of attaining a rarefied level of success. That's true at each stage of their evolution. We should only give up once this chance dissolves. We must ask ourselves if our presence makes or has made any difference.

There are some companies in our portfolio that might not have existed without our backing. Two examples are the digital advertising platform You & Mr Jones, which now seems to be finding its path, and Recursion, a candidate to eventually revolutionise drug discovery, which because of its youth has struggled to gain initial financing.

In other instances support at moments of difficulty is vital. This can translate into relationships and insights that are transformational. We've experienced this with companies that are now giants far beyond our imagining but are still happy to communicate with us. This applies to Alibaba, to Tencent and to Amazon. It applies to Illumina, which we defended from takeover and angst in difficult moments, and through which we have gained access to a world of genomic innovation. It applies to Zipline, which prefers us as a partner to SoftBank. It applies to Spotify in its attempts to demonstrate that a European company can dominate an online industry.

I'd like to make a few comments about such relationships. The objective is to be involved with people who are far more perceptive, far more knowledgeable and far better at seeing the future and building a business than us. We want to be learning not preaching. We have absolutely no belief that we could run any of our companies. At times we can help in communicating with capital markets and governance matters. Tesla provides an example of this on both sides – we may be able to assist but the notion that we can, or should, tell Mr Musk how to reinvent the world is laughable.

What we do provide is patient support in search of extraordinary opportunity, the understanding that bad times will always happen and empathy in dealing with fate. This often involves accepting that there will be years of struggle before instant success. That's bad for our monthly volatility relative to indices but we believe it's powerful for long-term shareholders and might even assist in reviving economic progress.

About James

James has been the Manager and then Joint Manager of Scottish Mortgage Investment Trust since 2000. James has served as a member of the Advisory Board of the government sponsored Kay Review and as Chair of the subsequent industry working group that set up the UK Investor Forum. He joined Baillie Gifford in 1983 and became a Partner in 1987. James graduated BA in History from the University of Oxford and after postgraduate study in Italy and Canada he gained an MA in International Affairs in 1982. He is a Trustee of the Johns Hopkins University.

BY FILIPE R. COSTA

THE MACRO INVESTOR

PROTECT AND ENHANCE YOUR PORTFOLIO WITH PRECIOUS METALS

At a time when global equities are looking overvalued, it may be sensible to increase your allocation to precious metals, writes Filipe R. Costa.

"There can be no other criterion, no other standard than gold, gold which never changes, which can be shaped into ingots, bars, coins, which has no nationality and which is eternally and universally accepted as the unalterable fiduciary value par excellence."

— Charles De Gaulle

More than 10 years after central banks started cutting interest rates, monetary policy is yet to be normalised. Low-to-negative interest rates are seen everywhere around the developed world despite economic growth. While consumer price levels are still on the weak side, thereby encouraging policy makers to keep printing massive amounts of money, asset prices are rising fast, making fiat currency ever less attractive. While this dynamic unfolds, there is a new form of virus in China which threatens lives and may arrest global economic growth. The coronavirus may shorten the late-cycle phase of the world economy and trigger a recession. At the same time and due to a decline in factory activity in China, it may lead to a global shortage of products and higher consumer prices.

While there is no known vaccine for the coronavirus as yet, there is a financial antidote to the mix of slowing growth, higher asset prices, supply shortages and a global public-health threat – and that's precious metals, in particular gold.

Reasons to be afraid

With the quick spread of the Wuhan coronavirus so far, it's not hard to view 2020 with a sense of foreboding. The virus has spread to more than 75,000 people across 25 countries and has been responsible for the death of 1,750. At the time of publication, these figures may very well look outdated, as the virus shows no signs of respite. Still, I believe that the containment measures taken along with the advances in public health and prevention systems will put an end to the virus in a matter of a few months.

However, there are other reasons for investors to be afraid in 2020. As I revealed in my January article (Master Investor, issue 58, January 2020, p. 30-35), equity valuations are too stretched, in particular in the US.

"AN ETF IS A SAFE, CONVENIENT AND EFFICIENT WAY OF HOLDING GOLD."

Profit growth has been mild to non-existent, but the S&P 500 and the Nasdaq 100 rose 29% and 38% respectively in 2019, which are gigantic upswings. If we add these figures to the accumulated gains since 2009, we end up with annualised returns of 11.8% and 18.1% for a period of 10 years.

There's no need to dig much into financial statements to see that these trends are unsustainable. No matter how beneficial President Trump may be for financial markets, it's ever more difficult to justify a continuing uptrend at such a pace. After all, we're in a late-cycle phase of the business cycle. Unemployment is at historically low levels, economic growth is still around 2% and confidence in the economy is high. But some indicators are already pointing to milder future conditions, as reflected in the decline in industrial production and manufacturing activity. There are still opportunities to invest in equities, but these are mainly outside the US.

The case for precious metals

While most of the effects related to the coronavirus are temporary, we cannot ignore them. To contain the virus, the Chinese authorities closed down entire cities' communications with the outside world, affecting millions of people. Many airlines suspended flights to China, while those who didn't scaled back operations. The EU, as well as the US, UK and other countries, evacuated their citizens from the Wuhan province, including businesspeople and diplomats. Some Chinese frontiers are closed and passengers are being scanned for the virus at connecting airports worldwide. While the financial and economic impact of the virus may be just temporary, it has already been significant for travel, gambling, restaurants, hotels and airline companies. Commodities that are often positively correlated with economic activity are also suffering this year. This includes brent crude (-14%), heating oil (-16%), natural gas (-15%), copper (-7%) and iron ore (-7%). The expected drop in economic activity due to the coronavirus provides a rationale for the decline, but explains just part of the story. There is a broader cooling of economic activity worldwide due to the late phase of the business cycle.

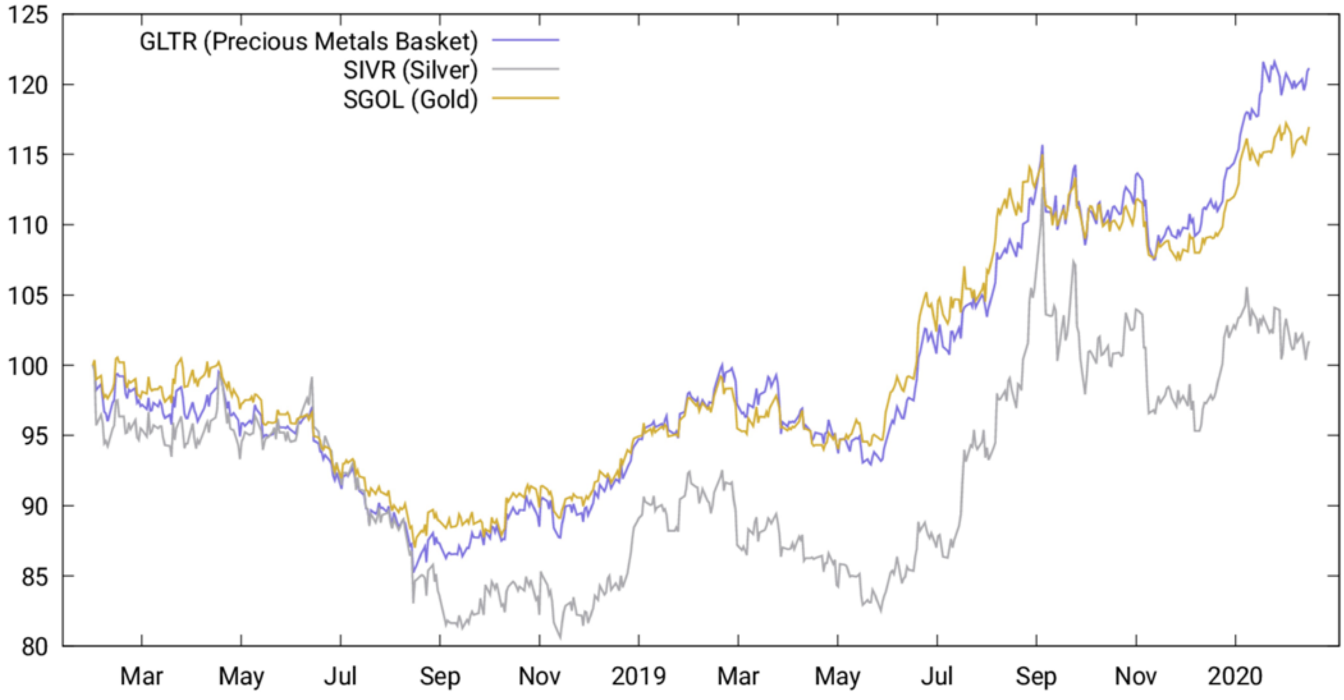
At this point, with equity valuations looking stretched, interest rates at record lows, economic growth declining and inflation about to make an entrance, there's an investment worth considering – precious metals. Gold and silver have traditionally worked well under these kinds of conditions, offering investors protection against international turmoil, economic slowdown and accelerating inflation.

"GOLD AND SILVER HAVE TRADITIONALLY WORKED WELL UNDER THESE KINDS OF CONDITIONS."

Unlike bonds and stocks, which earn interest and dividends, gold doesn't earn anything for its holder. At times when interest rates are high, the opportunity cost of holding gold is very high. But, when inflation is positive and nominal interest rates are near zero, the real interest rate investors earn on the safest interest-paying bonds is negative, and holding gold is then costless. If inflation sets in, the case for gold would become even better.

Investors concerned with high stock-market valuations have been reducing exposure to stocks and increasing exposure to bonds. But, with real interest rates on the safest bonds being negative, the only way to get a decent yield is by increasing the duration of the bond holdings, which at a time of low nominal interest rates represents a huge price risk. The alternative is to use this opportunity to allocate some portfolio funds to precious metals.

Gold, Silver and a Basket of Precious Metals



What are the options?

There are several alternative ways of getting exposure to precious metals. In my view, and from the perspective of an individual investor, no other alternative is as flexible and safe as using an ETF. You can always buy physical gold, in the form of coins, ingots or jewellery, but you would incur mark-ups in price, very high buy-sell spreads and the cost and hassle of keeping the gold safe. Using futures for the purpose of hedging against fiat money is a contradiction in itself. A future is a paper claim on gold and there are more outstanding claims on gold than the physical metal to fill them. In other words, gold futures are a form of fiat gold. ETFs are also a paper claim on gold but, unlike futures, most gold ETFs are physically backed in full, which means the holders of the paper claim do own the physical gold. For this reason, an ETF is a safe, convenient and efficient way of holding gold, which costs investors a very small fee per year. With the fierce competition among ETFs, holding $10,000 in gold may cost as little as $17 per year.

While gold is usually at the top of the precious metals list, it isn't the only precious metal worth considering for investment purposes. Silver, platinum and palladium are other rare metals with limited availability that may provide benefits to investors. None of them has the same shiny appeal of gold as a medium of exchange, but all of them may work well as a store of value.

During troubled times, precious metals are a much better store of value than fiat money. Additionally, there is one important feature provided by precious metals that is beneficial to investors, which is diversification. All these metals have a low (and often negative) correlation with the broad equity market, thus providing diversification benefits to a portfolio.

14 ETFs to choose from

This month, I'm looking at 14 different ETFs that cover the precious-metal spectrum. The first five options cover the gold market. All those five ETFs are about the same, as they're all fully invested in physical gold. But they have different features that are tailored to different investors and strategies. The next three ETFs invest in miners instead of gold. Miners are a leveraged bet on gold and one that can be backed by the fundamentals of the companies. The last six ETFs provide alternative exposure to silver, platinum and palladium, as well as a broad exposure to all four.

PRECIOUS METALS ETFS - KEY CHARACTERISTICS

Ticker	Issuer	Index Tracked	AUM ($M)	Volume ($M)	Expense Ratio (%)
		GOLD			
GLD	State Street SPDR	Gold Bullion	46,971.70	7.02	0.40
IAU	iShares	Gold Bullion	18,981.90	16.19	0.25
SGOL	Aberdeen Standard	Gold Bullion	1,370.00	0.64	0.17
GLDM	State Street SPDR	LBMA Gold PM	1,297.70	1.22	0.18
BAR	GraniteShares	Gold Bullion	652.50	0.15	0.17
		GOLD MINERS			
GDX	VanEck	NYSE Arca Gold Miners	12,763.30	45.85	0.53
GDXJ	VanEck	MVIS Global Junior Gold Miners	4,828.10	13.44	0.54
GOAU	US Global Investors	US Global Go Gold and Precious Metal Miners	57.50	0.07	0.60
		OTHER			
SLV	iShares	Silver Bullion	6,435.10	11.92	0.50
PPLT	Aberdeen Standard	Platinum Bullion	727.20	0.10	0.60
GLTR	Aberdeen Standard	Precious Metals Basket	537.90	0.03	0.60
SIVR	Aberdeen Standard	Silver Bullion	403.90	0.14	0.30
PALL	Aberdeen Standard	Palladium Bullion	393.20	0.05	0.60
REMX	VanEck	MVIS Global Rare Earth/Strategic Metals	190.10	0.16	0.59

Source: etfdb.com

SPDR Gold Trust (NYSEARCA:GLD)
The State Street SPDR gold trust is the largest physically backed gold ETF, currently holding $47 billion in assets. It was originally listed on the New York Stock Exchange in November 2004. Each share was originally issued to correspond to one tenth of a gold ounce, a conversion that is slightly eroding over time because of the annual expense fees charged to investors of 0.4%. The SPDR Gold Trust is not cheap, in particular because the competition among fund providers brought down the fees charged and led to the creation of new cheaper ETFs, but it didn't prevent GLD from being at the top of institutional investors' preferences. One share on the SPDR Gold Trust currently trades around $150, which is 10 times more than one share on the other four ETFs reviewed below. From the perspective of someone with a larger wallet, or looking to trade options on the fund (at some point), the higher price is an advantage. For individual investors looking to optimise their portfolio holdings, lower prices give them more flexibility. The expense fee is also a bit high. While $40 per year is certainly much less than what it would cost to buy and keep safe $10,000 of gold at home, it is more than double the cost involved with other ETFs reviewed. But the positive thing about GLD is its high liquidity, which gives rise to very tight bid-ask spreads, thus minimising the transaction costs for active investors. For buy-and-hold investors though, the higher expense ratio may be a deal breaker.

iShares COMEX Gold Trust (NYSEARCA:IAU)
BlackRock is one of the largest ETF providers, and is present in the gold market with IAU. Carrying an expense ratio of 0.25%, it has been stealing clients from State Street. While IAU holds just a fraction of the assets GLD holds, it is the most traded gold ETF. As each share entitles the holder to approximately one-hundredth of a gold ounce, the fund trades around $15, which is more appealing to retail investors willing to buy small amounts over time.

Aberdeen Standard Physical Swiss Gold Shares ETF (NYSEARCA:SGOL)
Created in 2009, the Aberdeen Standard Gold ETF is a perfect match for retail investors looking for an established fund that offers liquidity, trades at a low price (around $15) and comes with the smallest fees. To gain market share, Aberdeen Standard cut the expense ratio of SGOL from 0.39% to 0.17% by the end of 2018. Since then, the ETF has been gaining market share and it currently positions itself as the third-largest gold ETF. SGOL is a good option for investors adopting a buy-and-hold strategy.

SPDR Gold MiniShares Trust (NYSEARCA:GLDM)
While the State Street GLD is the oldest and most popular gold ETF, it has been losing business to the cheapest alternatives. Smaller investors cannot deal well with price fractions of $150 and are sensitive to the charged fees. In order to fight losing market share, State Street decided to create a new gold trust, with a gold-per-share ratio of one hundredth instead of one tenth and reduced fees of just 0.18%. This is another good option for small investors.

GraniteShares Gold Trust (NYSEARCA:BAR)
The newest fund in the gold ETF list is the GraniteShares Gold Trust. Compared with the other four alternatives, this is the smallest and least traded fund, but it still offers the same 0.17% fee as SGOL.

VanEck Vectors ETF Trust Gold Miners ETF (NYSEARCA:GDX)
Some investors prefer to concentrate their holdings in stocks instead of precious metals. In that case, as an alternative to investing in physical gold, investors may wish to invest in the companies that extract gold. GDX invests in miners, in an attempt to replicate the overall performance of the companies involved in the gold-mining industry. The fund invests globally, with Canada topping the list with a 52% share. Top stock holdings include Newmont Corp, Barrick Gold Corp and Franco-Nevada Corp. Through investing in miners instead of gold, GDX is a leveraged bet on the metal, which means it usually results in amplified volatility. The standard

deviation of returns is roughly double that found in the previous five gold ETFs referred to. However, investors should be aware that, because this ETF tracks companies and not gold directly, there may be times when the performance of the ETF and that of gold go in opposite directions. While the correlation between the fund and gold is high, there are many variables besides gold prices influencing the activity of miners. The expense ratio is 0.53%.

VanEck Vectors ETF Trust Junior Gold Miners ETF (NYSEARCA:GDXJ)
The Junior Gold Miners ETF is similar to the Gold Miners ETF but invests in smaller companies. Junior miners generally operate small-scale mines and are involved in defining gold or silver ore bodies through drilling. While the potential for future profits is higher for junior gold miners, their revenues have yet to gain traction and consistency, which make this ETF riskier than GDX. The expense ratio is 0.53%.

US Global GO Gold & Precious Metal Miners ETF (NYSEARCA:GOAU)
GOAU is a very different proposition for playing the gold market. The ETF invests not only in companies actively engaged in the extraction of precious metals but also in companies owning royalties or production streams. These latest companies rent out mines to earn royalties over time.

"YOU CAN ALWAYS BUY PHYSICAL GOLD, IN THE FORM OF COINS, INGOTS OR JEWELLERY, BUT YOU WOULD INCUR MARK-UPS IN PRICE, VERY HIGH BUY-SELL SPREADS, AND THE COST AND HASSLE OF KEEPING THE GOLD SAFES."

This ETF only holds 29 companies, but it is actively managed in the sense that it chooses carefully which companies to own across the potential universe. This ETF comes with the highest expense ratio of the gold ETFs, at 0.60%, as well as the highest volatility and lowest volume. For these reasons, retail investors should be careful.

iShares Silver Trust (NYSEARCA:SLV)
As an alternative to gold, silver may be the most attractive precious metal. Unlike gold, which has limited industry uses, silver is not only a precious metal but also an industrial commodity. However, while silver certainly provides portfolios with diversification benefits, during bearish times it is not as strong as gold. Investors looking for exposure to silver may opt for the iShares Silver Trust. With $6.4 billion in assets under management, this ETF is by far the largest silver fund. Unfortunately, expense ratios for silver come a bit higher than for gold. Fees are 0.50% per year. For a cheaper option, there is the Aberdeen Standard ETF reviewed next.

Aberdeen Standard Physical Silver Shares ETF (NYSEARCA:SIVR)
In order to gain market share from its competitors, Aberdeen Standard has been slashing its fees. Buy-and-hold investors may be better going with SIVR instead of SLV because of the lower expense ratio set at 0.30%. However, for those wishing to trade often, this ETF is thinly traded when compared with SLV.

Aberdeen Standard Physical Platinum Shares ETF (NYSEARCA:PPLT)
PPLT is a pure bet in platinum. Unlike gold, platinum has several industrial uses and has a much more limited supply. While investors shouldn't see platinum as an alternative to money, it still offers good diversification to a portfolio.

Aberdeen Standard Physical Palladium Shares ETF (NYSEARCA:PALL)
Palladium is another precious metal with several industrial uses, in particular in the manufacturing of automotive catalytic converters. More than 85% of global palladium production is used for industrial purposes. Palladium has of late been on a huge bull run driven mainly on speculation about catalytic-converter demand from the automobile industry. This year, PALL has been by far the best ETF performer in the list, rising more than 25%. Despite this strong performance, investors looking for the usual hedging characteristics of precious metals should understand that for a significant part, the price of palladium is determined by demand from its industrial uses. Still, palladium provides good diversification benefits because it shows a weak correlation with the broad equity market.

"ALL THESE METALS HAVE A LOW (AND OFTEN NEGATIVE) CORRELATION WITH THE BROAD EQUITY MARKET, THUS PROVIDING DIVERSIFICATION BENEFITS TO A PORTFOLIO."

VanEck Vectors ETF Trust Rare Earth/Strategic Metals (NYSEARCA:REMX)
For investors wishing to target less explored alternatives, the VanEck Vectors ETF Trust Rare Earth/Strategic Metals ETF offers the opportunity to explore rare metals with industrial uses. These rare metals are typically mined as by-products in operations focused on precious metals and base metals and include cerium, manganese, titanium and tungsten. They're used in myriad technologies such as jet engines, hybrid cars, steel alloys, wind turbines, flat-screen televisions and cellular phones. Among the universe of ETFs reviewed in this article, REMX is the most correlated with the broad market and less correlated with all other ETFs.

Aberdeen Standard Physical Precious Metals Basket Shares ETF (:GLTR)
Sometimes the best way of getting exposure to a market is by targeting a fund that invests in a portfolio of different assets. GLTR offers exposure to the four most important precious metals in a single fund: gold (55.6%), silver (22.8%), palladium (17.1%) and platinum (4.5%). A disadvantage is the high expense ratio of 0.60%. A more adventurous investor with the time and patience, can buy the four ETFs from Aberdeen Standard targeting each of the markets individually: SGOL, SIVR, PALL and PPLT. All it takes is to buy each in the desired proportions. If the proportions taken are equal to those of the GLTR, the expense ratio would come in at 0.29% − half the value charged here. Still, rebalancing is costly, which may make an outright investment in GLTR cheaper and simpler.

Which ETFs to choose?

One of the key reasons to invest in precious metals is diversification.

We expect all these ETFs to share low-to-negative correlations with the broad market. To check for this, I selected the **Vanguard Total Stock Market ETF (NYSEARCA:VIT)**, which is a very broad selection of equities representing the whole US equity market. If we look at the correlation matrix provided with this article, in particular at the column for VTI (or row, which is the same), we see that most values are low, negative and coloured in blue. This is very good news for our diversification goal. Most of the 14 ETFs reviewed share low and negative correlations with

PRECIOUS METALS ETFS - PERFORMANCE

Ticker	Name	%chg YTD	%chg 6m	%chg 2019	%chg 3y	%chg 5y	%chg 10y
	GOLD						
GLD	SPDR Gold Trust	4.2	4.3	17.9	26.6	28.4	36.4
IAU	iShares COMEX Gold Trust	4.2	4.4	18.1	27.2	29.3	38.3
SGOL	Aberdeen Standard Physical Swiss Gold Shares ETF	4.2	4.5	18.2	26.7	28.8	36.8
GLDM	SPDR Gold MiniShares Trust	4.3	4.4	18.2	---	...	---
BAR	GraniteShares Gold Trust	4.2	4.6	18.3	---	---	---
	GOLD MINERS						
GDX	VanEck Vectors ETF Trust Gold Miners ETF	-3.5	0.0	38.7	14.0	37.4	-36.8
GDXJ	VanEck Vectors ETF Trust Junior Gold Miners ETF	-3.1	4.5	40.0	-0.7	56.6	-59.1
GOAU	US Global GO Gold & Precious Metal Miners ETF	-6.0	2.5	55.5	---	---	---
	OTHER						
SLV	iShares Silver Trust	-0.9	3.3	14.9	-3.1	4.5	5.1
PPLT	Aberdeen Standard Physical Platinum Shares ETF	0.0	13.3	20.8	-5.5	-20.4	-40.6
GLTR	Aberdeen Standard Physical Precious Metals Basket Shares ETF	5.6	11.5	21.1	27.8	29.9	---
SIVR	Aberdeen Standard Physical Silver Shares ETF	-0.9	3.4	15.2	-2.5	5.5	7.2
PALL	Aberdeen Standard Physical Palladium Shares ETF	25.2	67.8	53.9	207.0	202.0	423.0
REMX	VanEck Vectors ETF Trust Rare Earth/Strategic Metals ETF	1.5	7.0	-1.1	-31.8	-48.0	---

Source: Sharescope

Correlation matrix

	PALL	PPLT	GLTR	SIVR	SGOL	BAR	IAU	SLV	GLDM	GLD	GOAU	GDX	GDXJ	REMX	VTI
PALL	1.0	0.4	0.5	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.2	0.3	0.2
PPLT	0.4	1.0	0.6	0.6	0.5	0.5	0.5	0.6	0.4	0.5	0.4	0.4	0.5	0.2	0.2
GLTR	0.5	0.6	1.0	0.9	0.8	0.8	0.8	0.9	0.8	0.8	0.6	0.7	0.7	0.1	-0.1
SIVR	0.2	0.6	0.9	1.0	0.8	0.8	0.8	1.0	0.8	0.8	0.6	0.7	0.7	0.1	-0.1
SGOL	0.2	0.5	0.8	0.8	1.0	1.0	1.0	0.8	1.0	1.0	0.7	0.8	0.8	-0.1	-0.2
BAR	0.2	0.5	0.8	0.8	1.0	1.0	1.0	0.8	1.0	1.0	0.7	0.8	0.8	-0.1	-0.2
IAU	0.2	0.5	0.8	0.8	1.0	1.0	1.0	0.8	1.0	1.0	0.7	0.8	0.8	-0.1	-0.2
SLV	0.2	0.6	0.9	1.0	0.8	0.8	0.8	1.0	0.8	0.8	0.6	0.7	0.7	0.1	-0.1
GLDM	0.2	0.4	0.8	0.8	1.0	1.0	1.0	0.8	1.0	1.0	0.7	0.8	0.8	-0.1	-0.2
GLD	0.2	0.5	0.8	0.8	1.0	1.0	1.0	0.8	1.0	1.0	0.7	0.8	0.8	-0.1	-0.2
GOAU	0.1	0.4	0.6	0.6	0.7	0.7	0.7	0.6	0.7	0.7	1.0	0.8	0.8	0.0	-0.1
GDX	0.1	0.4	0.7	0.7	0.8	0.8	0.8	0.7	0.8	0.8	0.8	1.0	1.0	-0.0	-0.2
GDXJ	0.2	0.5	0.7	0.7	0.8	0.8	0.8	0.7	0.8	0.8	0.8	1.0	1.0	-0.0	-0.2
REMX	0.3	0.2	0.1	0.1	-0.1	-0.1	-0.1	0.1	-0.1	-0.1	0.0	-0.0	-0.0	1.0	0.5
VTI	0.2	0.2	-0.1	-0.1	-0.2	-0.2	-0.2	-0.1	-0.2	-0.2	-0.1	-0.2	-0.2	0.5	1.0

the broad market, thus providing a hedge to a portfolio filled with equities. The correlation of GLTR, SIVR, SLV and GOAU with VTI is below 0.1.

Overall, the correlation with VTI doesn't surpass 0.2 (or -0.2), with the exception of REMX, for which the correlation is around 0.5. This finding further enhances the thesis that investing in precious metals helps diversify a portfolio away from the equity market. On that front, GLTR provides all that is needed for most investors in a single package.

While the blue colour and low numbers dominate the VTI column, we can see the dominance of red and of numbers higher than 0.8 in several instances of the table. This is because many of the reviewed ETFs essentially invest in the same assets. Take for example the case for gold. GLD, IAU, SGOL, GLDM and BAR all invest the totality of their assets in physical gold. The same reasoning applies for SIVR and SLV, as both invest all of their assets in silver. The correlation among these ETFs is near one, as expected. That means that, if you want to invest in gold ETFs, you should opt for just one. The same goes for silver. Even in the case of GDX and GDXJ, which invest in miners instead of gold, the diversification benefits of adding them to a portfolio where one of the above gold ETFs has been selected is limited. The best option is to choose just one gold ETF and one silver ETF.

Another question that may arise is related to the correlation between gold, silver, palladium and platinum. Is it worth investing in all of them? Or, are they highly correlated? A look at the table gives us a clear idea. The first and second columns, for PALL (palladium) and PPLT (platinum) show very light colours, which depict low correlations with other assets. This means that both palladium and platinum provide good diversification benefits, not only from the broad equity market but also from the most common precious metals – gold and silver. If we analyse the correlations between gold, silver, palladium and platinum in pairs, we come to the conclusion that correlations are low, except for the gold-silver pair.

One last reference goes to REMX. The rare earths ETF is uncorrelated with gold and silver and shares low correlations with both palladium and platinum, making it deserving of a place in a portfolio.

Final words

In summary, I believe investors may benefit from investing in precious metals, in particular at a time when equities look overvalued, the coronavirus is disrupting the international supply chain and real interest rates are negative.

The simplest option involves buying GLTR, which is a basket of four different precious metals, and adding REMX, as it provides an additional exposure to a different part of the market. For other investors looking for individual exposures, the option may be to choose one from the five gold ETFs, another from the two silver ETFs, the palladium ETF, the platinum ETF and finally REMX.

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

THE INVESTING 'HOLY GRAIL' MIGHT BE EASIER TO FIND THAN YOU THINK

Every investor dreams of a foolproof system that gives clear buy signals and is never wrong. David Jones believes he may have found it.

It is every investor's dream to find a simple system that gives clear buy signals and is never wrong. All you have to do is follow the rules and wait for the profits to clock up. After extensive research – and with the benefit of hindsight – I have found this system and what is more, I am going to share it in this month's article.

That is a slightly tongue-in-cheek opening, but I am going to start this month by outlining a strategy that, if it had been followed, would have resulted in no losses for as far back as you want to go. I have written extensively about trend following in the magazine in the past and this approach is the most basic. If you had bought the S&P500 US stock-market index (which you can do through various exchange-traded funds for example), each time it set fresh all-time highs, all of your decisions would currently be profitable. Actually, that is not 100 percent true – you would be around breakeven on your latest purchase.

S&P500 Index 2006 to present

"A PROFITABLE STRATEGY DOES NOT HAVE TO BE COMPLICATED, BUT AS HUMANS WE HAVE A TENDENCY TO MESS IT UP."

I can only make the claim for this approach never having lost any money because at the time of writing the S&P500 is at all-time highs. In October last year it moved above the latest all-time high which was set in July and has continued to set fresh all-time highs on a regular and somewhat uncanny basis since then.

This is an extreme example, but I think it does frame the point for the rest of this article – a profitable strategy does not have to be complicated, but as humans we have a tendency to mess it up.

Why we are not very good at timing the market

I will admit that saying that we are not very good at timing the market is something of a broadbrush statement, but I do think it holds true. My background for the past 20 years has been in trading and I have worked for some of the leading spread bet and CFD brokers. Due to a change by the regulator 18 months ago, all companies now need to state what proportion of their clients lose money. If you read any broker's marketing material or look at their website, this information will be displayed and it is typically around 70% of clients who lose. Markets change, technologies change – but I don't think this number ever will. The weak link in any trading strategy is the person carrying it out and I think many of us are not wired particularly well for financial speculation.

This brings us back to the S&P system outlined previously. There are a few reasons why most people lose money when it comes to shorter-term trading – but an inability to go with the trend is one of the major ones. I think it is part of our nature to see a market that has risen strongly and think that it can't go any higher. And I am sure plenty of us have the experience of buying into a share that is in freefall, thinking that it must hit the bottom soon – only to see it plunge further. We need to turn that attitude on its head if we are going to start buying all-time highs.

Putting the odds in your favour – the psychology behind fresh all-time highs

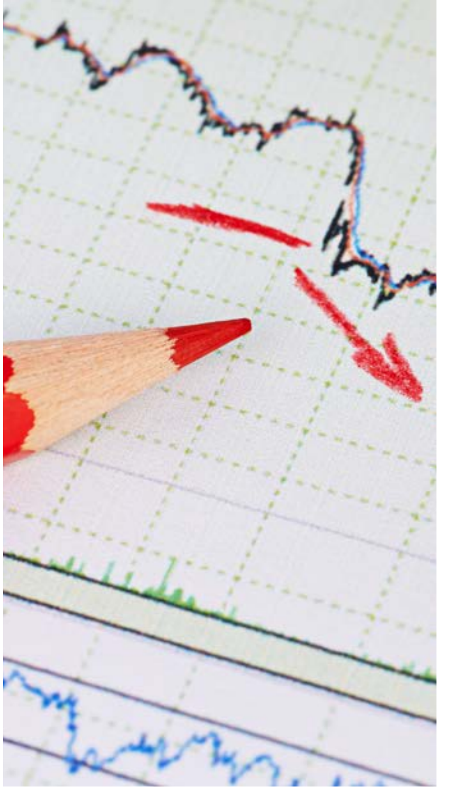
Here is a market that I think most people will not be familiar with – the price of palladium (the metal, not the London theatre). By October 2019, the metal's price had already more than trebled since the 2016 low. Surely it could not go any higher? But then as October went on, the price pushed out to fresh all-time highs once more, breaking through the old $1,600 highs. Well done to anyone who was in that move – but surely buying here would just be throwing caution to the wind?

Let's assume someone was crazy enough to buy into that break and bought palladium at $1,700 in October. By the end of January, the price had moved as high as $2,400 – a

Palladium price 2016 to October 2019

Palladium price 2016 to present

Bitcoin May 2017 to December 2018



gain in excess of 40%. At the time of writing, palladium was once again having a push to break those previous all-time highs.

The market psychology here is very clear. The previous high occurred because investors or traders earlier in 2019 had decided that $1,600 was too expensive. And we know it was too expensive because the price stopped going up and left a peak. At its most basic level, this is why highs are formed. But the subsequent breakthrough also tells a story. This suggests that sentiment and perception of a fair price has now changed. A level ($1,600) that had previously been viewed as too expensive, now had buyers pushing the price higher. The market view of a fair price for palladium has shifted.

Don't forget risk management

Before we all go off and buy everything currently setting fresh all-time highs, consideration needs to be given to risk management. Buying at all-time highs works very well – until it doesn't. Here is a market that more of us may be familiar with.

In the great cryptocurrency boom of 2017, the strategy of buying at all-time highs would have worked very well indeed – with one exception. Pity the poor soul who finally decided to get into bitcoin on 18 December 2017, paying $19,000. If this person had no risk-control strategy (a method for getting out), then a year later they would have been nursing an 80% loss on their investment.

So just blindly buying in is not the 'Holy Grail'. Give some thought to the all-important stop-loss – in my book, equally important for investors and not just traders. If the market is setting fresh all-time highs then it does suggest there is a new surge of momentum – but if it sets a new all-time high and then promptly drops back heavily, it can be a warning something is not quite right. Tech giant Apple can help illustrate the point.

The Apple share price had been consistently setting fresh all-time highs through 2018. The move right on the edge of the chart highlighted above was another push to a new high. If we were a buyer at $230 a share, we should have had a stop loss

Apple share price June 2017 to October 2018

Apple share price June 2017 to January 2019

Apple share price June 2017 to present

in mind. I would have been tempted to put it below the $200 per share level. Whatever level is chosen, it is always important to have a Plan B in place if things do not go as expected – as they didn't with Apple.

The share price dropped by more than a third over the next few months, so that stop loss would have saved the investor from a lot of financial damage. To completely square the circle, let's bring things up to date with Apple.

Once again Apple has been back to its winning ways. That old October 2018 high at $230 per share was surpassed in October of last year and the strategy of buying fresh all-time highs delivers another winner.

It's not actually a Holy Grail

I am sure I do not need to spell out the above fact to readers of this publication. I always run a mile when I hear of a Holy Grail strategy that is never wrong. The S&P approach outlined at the start only works because the market is currently at all-time highs and I assumed never using a stop loss on any of the buys over the years. There have been some major slides in US indices just in the past two years and they are clearly not going to keep going up for ever.

But it is important to bear in mind that plenty of people have been calling the top in the likes of US stocks for many years. Following their advice would have meant investors missed out on so many profitable opportunities. Ultimately no one knows when a market will set its major peak – or major bottom. I think the best indicator for the market is what the price is doing, because that is typically being moved by the actions of investors and traders. This is why the simplistic approach of looking for opportunities in markets hitting fresh all-time highs is as near to a Holy Grail as we are likely to get. For a flawed system, it is still a pretty effective one.

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 TECH FUNDS

As the technology sector continues to lead the way for global equities, Nick Sudbury unveils his favourite picks within the technology fund and trust universe.

Last year was another good one for tech; many of the funds that specialise in this area were amongst the top performers of the decade. The fast-changing nature of the sector gives the managers the chance to really add value, especially in up-and-coming areas like fintech, AI and robotics.

US technology stocks have continued to outperform the wider market and their success has drawn comparisons with the dotcom bubble in 1999/2000. However, the nature of the companies driving the sector is very different from what it was then. The internet, data and social media are changing the way in which many traditional industries operate and delivering strong earnings growth in the process.

The global tech giants have had a phenomenal run as their products and services have grown in importance and some of the valuations of these stocks have become stretched. However, as the recent Apple results have shown, there is still huge scope for these companies to expand their operations, as services such as TV streaming still have very low market penetration.

Commenting on the potential expansion of these companies, Ryan Hughes, head of active portfolios at AJ Bell, says:

"As they move to influence more and more of our lives, the ability for the good ones to grow remains huge. That said, given how they are valued, they will need to achieve this to justify their premium ratings and any miss on market expectations is likely to see share prices punished."

Not all tech stocks are trading on excessive valuations and the valuation bubble is nowhere near as widespread as it was in the dotcom boom. It is also important to bear in mind that many of the highly rated companies are profitable or have strong cash-flow generation.

Adrian Lowcock, head of personal investing at Willis Owen, says:

"Technology is playing a very different and significant role, enabling new companies to not only disrupt old businesses, but to create new barriers to entry which make it increasingly harder to compete against. This has justified the high valuations."

Added value

The 10 top performing open-ended funds from across the whole market over the last decade include four tech mandates, with a passively managed tech tracker in tenth place behind three of its actively managed counterparts from the same sector.

Ben Yearsley, a director at Shore Financial Planning, says that this shows how hard it has been to beat broad-based tech. "The performance has been driven by the biggest tech companies, but that's not to say it will be, going forwards. When the largest drive a sector, it

"NOT ALL TECH STOCKS ARE TRADING ON EXCESSIVE VALUATIONS AND THE VALUATION BUBBLE IS NOWHERE NEAR AS WIDESPREAD AS IT WAS IN THE DOTCOM BOOM."

is very hard for active managers to outperform as they typically can't go overweight in those stocks."

The problem is that a number of these companies now represent much more than 10 percent of the tech index, which is the maximum holding in an open-ended fund. This means that even if a manager likes Apple, they are always structurally underweight, although the growing influence of tech gives them the scope to look elsewhere.

"Tech is a broad sector that touches almost everything in life these days, so there are plenty of opportunities all over the market," explains Darius McDermott, managing director of Chelsea Financial Services: "Artificial intelligence is coming through and robotics is another new theme that should grow over the coming years."

Tech is essentially separating into two distinct areas, with the first consisting of the established behemoths like Google, Amazon and Netflix. These are no longer really tech companies at all, but are better thought of as advertisers, retailers and TV production operations respectively.

The second category contains the more recently formed tech companies that are looking to develop new and innovative solutions for our lives. It's this group from which tomorrow's 'winners' will emerge and where the real opportunity lies.

Fintech

One of the emerging areas is fintech and there is a handful of funds that target this particular subsector including **AXA Framlington Fintech**. It is a small vehicle with assets under management of just £64m, which probably also accounts for the high ongoing charges figure of 1.62%.

Manager Vincent Vinatier believes that the fintech structural growth drivers, such as the move towards a cashless society or the rise in cyber threats, remain firmly in place, with areas such as digital banking and digital payments having the potential to generate exponential growth in 2020.

The only investment trust to specifically target this area is the £131m **Augmentum Fintech (LON:AUGM)**, which has put together an interesting, but highly concentrated portfolio of unlisted businesses. Unfortunately, the recent performance has been undermined by a write-down in the value of its largest holding, Zopa, that was triggered by problems in the peer-to-peer sector. As a result, the shares are currently trading at a 14% discount to NAV.

Fintech offers exposure to some exciting companies with the potential for growth. However, like all tech subsectors, it is niche and risky, as Lowcock explains:

"These companies could end up staying small if the barriers to entry are not enough to prevent new competitors or to stop the incumbent businesses from responding. The best approach in these situations is to take a more diversified stance than look for a pure fintech fund."

He suggests the £382m **Merian Chrysalis Investment Trust (LON:MERI)**. This is managed by Merian's UK equities team, which has a lot of experience in smaller companies investing in the UK and has developed the network to access businesses that are near to listing on the stock exchange.

Lowcock says: "It has a concentrated portfolio of up to 15 companies and there is a significant financial technology bias with holdings such as Starling Bank, Embark Group and Transferwise to name but a few."

The best open-ended global tech funds

Tech funds form part of the Investment Association's Specialist sector so it is not easy to isolate the full performance data; yet there is no doubt that these vehicles have dominated the market over the last decade. In fact, there are four of them in the top 10 performers: **Polar Capital Global Technology** 548%, **Fidelity Global Technology** 504%, **AXA Framlington Global Technology** 471% and the passively managed **L&G Global Technology Index Trust** 463%.

McDermott's preferred pick is **AXA Framlington Global Technology**. He says: "Manager Jeremy Gleeson is very experienced and focuses on 'new technology', which are companies that have a significant competitive advantage and that are making money today, not just promising things tomorrow. It has a mid and small-cap bia.,"

The £779m fund has a 65-stock portfolio and although the top 10 holdings include familiar names like Apple, Alphabet, Facebook and Amazon, there are also less well-known alternatives such as Salesforce.com and Servicenow.

He also likes **Smith & Williamson Artificial Intelligence**, which he says

"FINTECH OFFERS EXPOSURE TO SOME EXCITING COMPANIES WITH THE POTENTIAL FOR GROWTH."

is a slightly different play on tech, but an evolving area. McDermott says: "This fund 'eats its own cooking' using an artificial intelligence system to help find companies whose business models are aligned to benefit from this growing theme."

It is a smaller fund with just over £200m in assets under management and has less of a track record, as you would expect, having only been launched in June 2017. It is interesting that only 39% of the portfolio is invested in the information-technology sector, with the 10 largest holdings including stocks like TransUnion and Ocado.

Lowcock recommends the £2.3bn **Blackrock World Technology**, which is run by Tony Kim, a seasoned analyst and manager with 23 years' experience of looking at tech companies:

"Kim has built a lean three-person team with a flat structure, with each team member responsible for understanding the investment landscape and every name in the portfolio. His distinct skill set and process are the strategy's main competitive advantages, leading to key-person risk, but in a sector that rapidly produces new, dominant players, few investors can match his skill and experience in identifying the ongoing shifts."

Tech investment trusts

There are only four investment trusts operating in the tech sector and these are dominated by fund of the month **Polar Capital Technology (LON: PCT)** and **Allianz Technology (LON: ATT)**, which has been recommended by the analysts at Winterflood.

They say that Allianz benefits from an experienced management team that is based near Silicon Valley and this proximity to the major global tech companies gives them a competitive advantage. Manager Walter Price has an unconstrained approach to compiling a portfolio and has an overweight position in the innovative mid caps that leaves it well-placed to outperform the benchmark over the longer term.

Hughes is also a fan: "He (Price) has seen the sector develop throughout its lifecycle giving him almost unique experience in the sector. The trust is widely liked and the board is active in issuing new shares to ensure the premium to NAV doesn't get too high."

Allianz Technology has assets under management of £646m that have been invested in a 68-stock portfolio, with the largest holdings including the likes of Microsoft, Apple and Facebook, alongside less familiar names such as Teradyne and Fortinet. Over the last 10 years it has generated an impressive share price total return of 681%, which is 230% more than the comparative benchmark.

The other main option here is the £1.1bn **Herald Investment Trust (LON:HRI)**. It invests in smaller quoted companies in the areas of communications, multimedia and technology. The fund has a global mandate, although half of the portfolio is currently allocated to stocks listed in the UK.

It offers a different kind of exposure to the rest of the sector, but the long-term returns have not been as good, with a 10-year gain of 352%, which along with the relative lack of liquidity explains why the shares are available at a 14% discount to NAV.

Tech investors have had a fantastic time of it over the last 10 years and the changing nature of the sector could mean that there are further excellent returns to come. A well-managed specialist fund is the easiest way to keep up with all the latest developments and benefit from the new trends.

FUND OF THE MONTH

Polar Capital Technology (LON:PCT) is the largest and most liquid investment trust operating in the tech sector, with a market cap of just under £2.3bn. It has been recommended by the analysts at Numis who like the fact that it has a diversified portfolio that is focused on the themes that are driving future growth, rather than on the industry incumbents.

The trust is built around eight core secular themes that highlight the massive potential that this broad area has to offer. They are: e-commerce and digital payments; digital marketing and advertising; cyber and physical security; cloud computing and artificial intelligence; software as a service; digital content and gaming; robotics and automation; and rising semiconductor complexity.

Hughes says that the Polar Capital team, which is led by Nick Evans and Ben Rogoff, is the standout technology team in the market: "They are hugely experienced having invested in this space for over 20 years and have built up their team to be a very well-resourced group of analysts that are at the cutting edge of the tech market."

They also run an open-ended fund, **Polar Capital Global Technology**, which has £2.8bn in assets under management. These vehicles are very similar and their returns have been highly correlated, but the trust has the advantage that it can hold smaller, incubator-style stocks alongside the more mainstream options, without running into any liquidity concerns.

"The Polar Capital Technology trust is my favoured broad-based tech fund," says Yearsley: "It is a benchmark-aware fund, so they will probably always own the big four in the index, namely: Microsoft, Apple, Facebook and Alphabet. These currently account for almost 30% of the portfolio."

Over the last 10 years, the trust has delivered a total share-price return of 613%, which is 160% more than the Dow Jones Global Technology benchmark. If you are only going to own one tech fund, this should probably be it.

"IT'S THIS GROUP FROM WHICH TOMORROW'S 'WINNERS' WILL EMERGE AND WHERE THE REAL OPPORTUNITY LIES."

Fund Facts

Name:	Polar Capital Technology Trust (LON: PCT)
Type:	Investment trust
Sector:	Technology
Total assets:	£2,395m
Launch date:	December 1996
Historic yield:	0%
Ongoing charges:	0.95%
Website:	www.polarcapitaltechnologytrust.co.uk

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.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Investing in the age
of longevity

BY ED MARTEN, CEO QUOTEDDATA

WOODFORD INVESTMENT MANAGEMENT'S DEMISE HIGHLIGHTS INVESTMENT-COMPANY ATTRACTIONS

QuotedData is delighted to be a main sponsor of MasterInvestor once again in 2020. This year, our village grows. We are bringing along more of our favourite managers of investment companies, from BlackRock, JPMorgan, Baillie Gifford, Polar Capital, Allianz, AberdeenStandard, Oakley Capital and HarbourVest so far. They will be talking about how they choose their investments and some of them will have their own stands in the QuotedData village – come along and find out more about them and please come and say hi at our stand too!

For the asset-management industry, the big scandal of 2019 was the collapse of Woodford Investment Management. As readers of QuotedData's research knew well beforehand, we were not fans of his work, but our commiserations go out to you if you had money invested in any of its funds.

Towards the end of the year, a related problem popped up with the M&G Property Fund. In both cases, poor returns were the trigger for outflows of cash, but the managers were investing in illiquid assets and couldn't raise money fast enough to meet outflows. Woodford's open-ended funds and the open-ended M&G Property Fund were forced to suspend redemptions.

The administrators of the Woodford funds have been selling off their portfolios, often at knock-down prices. Investors in Mark Barnett's funds at Invesco (some of which Neil used to manage) have also been asking for their money back; this is compounding the problem. However, funds with cash, and in particular, investment companies with borrowing facilities, have been able to pick up some great bargains.

Managers of open-ended funds have to worry about being able to hand cash back to investors on demand, a point I raised at last year's Master Investor Show. By contrast, the money in an investment company (or REIT) is there for the long term; consequently, they make ideal vehicles for accessing illiquid investments that are hard to turn into cash, such as property, infrastructure, renewable energy, some debt, unquoted companies (private equity) and even many smaller quoted companies.

Because they have a fixed pool of assets, investment companies can also choose to borrow money and this flexibility can magnify returns (but remember this can work both ways, so be more cautious about backing a fund with a high level of borrowing/ gearing).

The debate about whether open-ended funds should be allowed to hold any illiquid assets has been going on for some time and the FCA deserves some of the criticism that has been aimed at it for not addressing this problem earlier. Many open-ended property funds were forced to prevent investors from withdrawing their money in 2016. This seemed to just compound investors' fears and make the problem worse. The FCA could have sorted the problem once and for all by mandating that open-ended property funds convert into real estate investment trusts (REITs), but it didn't. The message didn't get through to investors and the fund-management industry that open-ended funds and illiquid assets shouldn't mix.

"IF YOU WANT EXPOSURE TO ILLIQUID ASSETS, IT MAKES SENSE TO DO IT THROUGH AN INVESTMENT COMPANY."

Woodford Patient Capital Trust suffered alongside the open-ended funds, but as an investment company, it didn't have to sell off its investments at 'fire-sale' prices. Now with a new manager and renamed Schroder UK Public Private Trust, it is picking through its portfolio to sort the diamonds from the rough. We would suggest caution though. Early-stage companies, such as the ones this trust holds, can be quite risky and the trust does not have cash on hand to support these companies if they need it, which means its stakes may get diluted.

When investors turn negative on a particular investment theme, the safety valve for investment companies is the discount. In contrast with investors in suspended open-ended funds, investors can always sell their shares in investment companies. However, if sellers overwhelm buyers, the shares of the investment company may trade at a discount to their true worth (the net asset value). You, as an investor, can choose between instant liquidity at a lower price or holding on for better times. We would say, always double-check your thinking and try to avoid panicking for the exit at the bottom as well as piling in at the top.

The ability to buy assets at a discount is often cited as a big attraction for investors in investment companies, but bear this in mind (from our guide): *"Investment companies trading on wide discounts may look like bargains but this can be misleading. There is often a good reason for the discount. Big premiums can be problematic too. If investors lose faith in a popular investment company, the premium can quickly turn into a discount."*

If you want exposure to illiquid assets, it makes sense to do it through an investment company; if markets are panicky, you will be able to sell if you absolutely have to but you can also take a long-term view. Then you might benefit if your manager is able to take advantage of the situation by buying when everyone else is selling.

The QuotedData.com website has discount data on all London-listed investment companies and REITs as well as a wealth of other information.

Some good examples of trusts that we think just wouldn't work as well if they were open-ended include:

- Herald Investment Trust, a small-cap technology trust with a very diverse portfolio that has made investors more than 16% a year over the last 10 years. It is one of the most important investors in early-stage technology companies in the UK.
- Private equity trusts, such as Oakley Capital, Standard Life Private Equity and HarbourVest, that can access a much wider range of companies than is available on the stock market.
- Property companies and REITs, such as Aberdeen Standard European Logistics (which is investing in the infrastructure that supports the growth of online shopping in Europe) or Standard Life Investments Property Income (which invests in a spread of different types of property in the UK).
- Funds investing in infrastructure and renewable energy, such as GCP Infrastructure and JLEN Environmental Assets, which try to generate relatively predictable, high and growing income.

These aren't recommendations (we do not give investment advice) but you will find research notes that we have written on almost all of these and many others besides, plus our investment companies guide (which should help with most of your technical questions) at our stand at Master Investor or in soft copy from our website. Do sign up for free if you haven't already and come and say hi to our analysts, and hear our presentation at the Master Investor show's property panel on the main stage at 10am.

About Ed

Prior to founding QuotedData in 2013, Edward spent 10 years in investment banking with Cazenove (now JP Morgan Cazenove) and before that, Collins Stewart (now Canaccord Genuity). At Cazenove Edward focused on Investment Trusts, working with the number-one Extel-rated team, and broadened his focus to Pan European equities, servicing a global investor base and raising over €1 billion for companies. After this, Edward set up a new equity agency broker in 2010 that was subsequently sold to SpareBank1Markets, part of the second biggest savings alliance in Norway.

BY JOHN KINGHAM

DIVIDEND HUNTER

HUNTING FOR DIVIDENDS IN THE 'GOLDILOCKS' ZONE

John Kingham examines a couple of FTSE All-Share companies, both of which have more than 10 consecutive years of dividend payments and a starting dividend yield of more than of 4%.

It goes without saying that dividend investors want a reasonable yield, but what is reasonable?

Some investors are happy with yields of 2% or less because they believe that high growth tomorrow will more than compensate for a low yield today. But for investors who want a decent income today, 2% is unlikely to be enough for all but the wealthiest.

At the other end of the scale, some investors will only invest in high-yield opportunities, aiming for something close to and preferably above a double-digit yield. At first glance this seems like a no-brainer, but don't forget that dividends are not guaranteed and promises of double-digit yields are often followed by the reality of dividend cuts and suspensions.

For most dividend investors then, looking for shares where the dividend yield is in the 'Goldilocks' zone (just the right amount) is sensible. Of course, what is neither too high nor too low an amount is subjective, but I think something in the range of 4% to 8% is a good starting point.

So, this month I have decided to focus on a couple of FTSE All-Share companies, both of which have more than 10 unbroken years of dividend payments and a starting dividend yield above 4%.

Elementis PLC

- **Index: FTSE 250**
- **Share price: 129p**
- **Dividend yield: 4.9%**

Elementis develops and manufactures chemical additives which improve the performance of its customers' products.

These additives are applied in a range of industries, including personal care; coatings; energy; chromium (Elementis is the world's largest producer of chromic acid, used for chrome plating) and talc (for use in plastics, ceramics, paper and even food).

The company can trace its roots as a chemical manufacturer back to 1947 and is a global business, with only 4% of revenues generated in the UK.

Dividend growth but shrinking dividend cover

The first thing I do when analysing a company is to find its financial data for the last 10 years, on SharePad and enter it into my spreadsheet. This gives me an overview of the company's performance over the last few years.

For Elementis, this highlights a couple of concerns straightaway. First, the company made a loss in 2009, although that's not exactly shocking as it was the year of the financial crisis, so perhaps a small loss is forgivable. Second, over the last two years, Elementis has spent around $850 million on acquisitions, which is a lot for a company earning around $100 million per year (I'm quoting US-dollar figures as that's the reporting currency).

Turning to the headline results, revenues per share have failed to grow at all over the last 10 years, while earnings have been volatile and also show no underlying growth trend. Dividends have grown consistently, and the annualised dividend growth rate is just over 6% per year over 10 years.

The company also paid a string of special dividends during the 2012-2015 period, when earnings were at their peak and the company was largely debt free. However, following those large acquisitions the company is no longer debt free and so the special dividends have come to an end.

As I said in last month's Dividend Hunter article, sustainable dividend growth requires earnings growth, and the lack of earnings growth at Elementis, combined with consistent dividend growth, has seen its dividend cover shrink from around three times in the early 2010s to about two times today. If earnings continue to lack growth in the years ahead, then at some point dividend growth will have to grind to a halt as well.

Capital employed (equity capital, debt capital and leased capital), which is the engine of corporate results, grew by about 30% during the early part of the last decade. In the last two years it leapt upwards by another 30%, driven by an additional $590 million of debt which was used to fund the recent acquisitions (with the remainder funded by shareholders through a rights issue).

Profitability is high but also declining

My preference is for companies to self-fund their capital employed

"THE LACK OF EARNINGS GROWTH AT ELEMENTIS, COMBINED WITH CONSISTENT DIVIDEND GROWTH, HAS SEEN ITS DIVIDEND COVER SHRINK FROM AROUND THREE TIMES IN THE EARLY 2010s TO ABOUT TWO TIMES TODAY."

growth (which should increase their earnings potential) with retained earnings. This forces management to focus on producing high rates of return on capital, because measly returns on capital will produce measly retained earnings which will produce measly growth and measly management bonuses.

In the years leading up to the recent acquisitions, Elementis produced net returns on lease-adjusted capital employed (net ROLACE) of 18%. That's very good and far above the average return which is in the region of 7% to 10%. This may suggest that Elementis has some kind of competitive advantage, such as low cost of production or the ability to develop better additives.

After dividends, the company retained earnings equivalent to about 13% of its capital base each year, so that represents the company's self-fundable growth rate. However, we know that Elementis didn't grow its revenues or earnings at all during this period, so although those retained earnings did lead to capital employed growth, that bigger corporate engine didn't produce any better results. This shows up in the net ROLACE figures, which declined from around 20% a few years ago to little more than 11% today.

Without knowing all the details, this looks like a company that has been reinvesting earnings into capital assets, but those assets have not been able to generate returns that are comparable to the company's existing assets. This is not a good sign and perhaps Elementis has lost its competitive edge.

Reigniting growth but uncertainty is high

To fix this zero-growth situation, a new chief executive was brought in with the inevitable business review and subsequent new strategy, code-named Reignite Growth. The findings of this review were that the company had many leading positions in a variety of additives and markets, but that it was underperforming relative to its potential.

One area of focus was additives for personal-care products, which is both a defensive and high-growth market. This led to the acquisition of SummitReheis, the global leader in active ingredients for anti-perspirants, for around $360 million in 2017. In 2018 Elementis purchased Advent Mondo, a leading global supplier of talc-based additives, for around $500 million.

In summary then, Elementis is a company with historically high levels of profitability which has produced progressively weaker returns for much of the last decade. To fix this, the new chief executive is carrying out a turnaround strategy involving very large acquisitions.

As a potential investment, I quite like the look of Elementis, especially its global reach and leading positions in multiple markets. However, I'm not keen on investing in turnarounds and I don't like investing in highly acquisitive companies, as large acquisitions have a nasty habit of not working out very well. The company also has a substantial post-acquisition debt pile, which will probably take a few years to pay down.

At the moment Elementis isn't quite what I'm looking for, but it isn't a 'basket case' either, so I'm going to reserve judgement for the moment.

Chesnara PLC

- **Index: FTSE Small-Cap**
- **Share price: 325p**
- **Dividend yield: 6.2%**

Chesnara is a life insurance and pensions closed-book consolidator. In plain English that means it buys 'books' of existing insurance policies (sometimes tens-of thousands of policies) from companies that no longer want to manage those policies.

This typically happens when a company has sold life insurance or pensions as an add-on to some other service, such as estate agency or funeral services. The management of these insurance policies then becomes a distracting burden, so the company looks for some way to offload them, preferably onto a company where managing closed books of insurance is the core business.

Chesnara's whole existence has revolved around acquiring closed books of business. In fact, the company was born following the spin-out of Countrywide PLC's life-insurance book (Countrywide is a leading UK estate agency). The newly spun-out company, Countrywide Assurance, became Chesnara's first subsidiary and since then Chesnara has followed a path to growth driven primarily by the prudent acquisition of unwanted closed books of business.

The basic idea is simple. For each acquisition to work out, Chesnara has to be able to run the policies efficiently, manage the investment assets successfully and pay out any claim expenses promptly in order to satisfy the demands of customers and regulators.

Of course, Chesnara has to be able to buy these policies at a price which makes sense, where the discounted value of the book's future cash flows are likely to provide an attractive rate of return and sufficient cash to grow the dividend.

Chesnara is an interesting company because management describes it as “a reliable income stock”. This is unusual, but the description is backed up by 14 years of consistent dividend growth, which is every year since the company was formed in 2004.

One final point I'll make before diving into the numbers is that Chesnara has acquired some 'open books' over the years, and

does write new policies in Sweden through its Movestic business and in the Netherlands through Scildon, which it acquired from Legal & General. Both of these 'new business' operations provide additional cash for acquisitions or dividends.

So, having entered 10 years of data into my spreadsheet, I can see a couple of things right away.

Volatile earnings but steady growth of book value and dividends

First, Chesnara's earnings are volatile and don't show any sort of upward growth trend. On the other hand, its assets (mostly insurance-premium reserves and pension assets held in collective investment funds) have increased reasonably steadily at about 5% per year, and its capital employed (equity capital, debt capital and leased capital) has grown by about 7% per year. The dividend has increased every year, by an average of 3% per year.

The lack of earnings growth is a concern, but at least the company's assets and capital employed are increasing. This is good, as an insurer's dividend can only grow sustainably if

"IF YOU'RE LOOKING FOR A DECENT YIELD TODAY AND THE POTENTIAL FOR STEADY DIVIDEND GROWTH TOMORROW, CHESNARA COULD BE WORTH A CLOSER LOOK."

the company is also increasing its pool of premium assets, as they are the fundamental source of dividends.

So why are earnings volatile with no underlying growth trend? The main reason is that earnings for life insurers can be significantly impacted by investment market returns. In Chesnara's case, it has more than £7 billion of financial assets, at least £5 billion of which are equities or collective-investment schemes. When markets went up in 2017, Chesnara's investment return was recorded as an income of £532 million, and when markets went down in 2018 the decline was recorded as an expense of £335 million. Most of those investment gains and losses are negated by related changes in insurance and pension liabilities, but these are still huge swings for a company earning an average of about £40 million a year.

In my opinion, what matters here is not so much that earnings are going up smoothly and steadily, but that they cover the dividend consistently over time. And that has been the case almost every year over the last decade, with dividend cover averaging 1.7. The only uncovered dividend came in 2018, largely thanks to terrible market returns that year which depressed earnings. Last year was a much better year for markets, so I would expect the dividend to be re-covered sooner rather than later.

Profitability is okay but growth is only partially self-funded

Turning back to growth, the most sustainable form of growth is self-funded growth driven by retained earnings. This requires both sufficient profits to be generated from capital employed and for a dividend policy that allows some earnings to be retained to support and drive growth.

In Chesnara's case, it has produced average net returns on lease-adjusted capital employed of just over 10% over the last decade. This is reasonably good and just exceeds my preferred hurdle rate of return of 10%. About six percentage points of those earnings have been paid out as dividends, leaving average retained earnings equivalent to about 4% of capital employed.

So, 4% is approximately the company's self-fundable growth rate, ie growth funded purely from retained earnings. However, Chesnara's capital employed has grown by about 7% per year, so additional capital must have come from rights issues, debts or leases.

In fact, most of this additional capital has come from rights issues, which have increased the number of shares from about 100 million a decade ago to 150 million today. I'm not a massive fan of using rights issues to fund acquisitions, but in this case, acquisitions are central to Chesnara's DNA and their size and frequency has not been excessive. In other words, Chesnara spent the equivalent of 50% of earnings on acquisitions over the last decade, and my definition of excessive acquisitions is anything over 100% of earnings over 10 years.

A medium to high yield dividend plodder

What are the results of this initial analysis? We have an insurance consolidator which has a reasonably long history of successfully acquiring and squeezing value and cash out of closed insurance and pension books. We have a dividend which has grown every year since the company floated 14 years ago, at an annual rate of about 3% over the last decade. We also have a self-fundable growth rate of 4%, total asset growth of about 5% per year and capital employed growth of about 7%, fuelled partly by additional funds from rights issues.

Chesnara's dividend yield is currently just over 6%. If the company can continue to find attractive acquisitions and continue to write profitable new insurance and pension business, it may be able to sustain its historic levels of profitability and its mid-single digit growth rate. If it can do that, then a dividend yield of 6% plus dividend growth of 4% means that expected returns could be in the region of 10% per year, using the yield plus growth method of estimating potential returns.

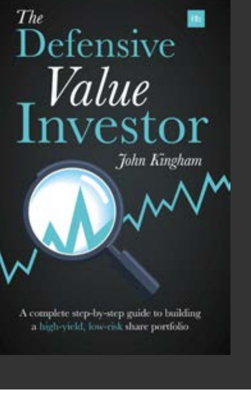
Of course, there are no guarantees and the future is a very uncertain place, but I like Chesnara, and I like its valuation and yield. That's why I'm a shareholder. This certainly isn't a very exciting investment, but if you're looking for a decent yield today and the potential for steady dividend growth tomorrow, Chesnara could be worth a closer look.

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

WILL 2020 FINALLY BE THE EURO'S YEAR?

After a period of persistent underperformance, veteran trader David Jones thinks the euro's fortunes might finally be changing.

As February got underway, the UK started its first few days of being outside the EU. But there was also something significant happening for Europe's common currency – it slipped to its lowest level in more than two and a half years. Are financial markets being too pessimistic about the euro's fortunes – and could it actually be the surprise 'winner' in 2020?

The euro has not had the best of times in recent years. Typically, when talking about the euro in broader terms, it is the euro US-dollar exchange rate (EUR/USD) that is used in financial markets. After a strong performance in 2017, the years since have seen a steady decline in EUR/USD.

Even against the pound – which has of course had its own challenges in recent years – the euro to pound exchange rate (EUR/GBP) is back to its lowest values since immediately after the June 2016 referendum vote.

EUR/USD September 2016 to present

"A BIT OF PATIENCE WOULD NOT GO AMISS HERE."

EUR/GBP April 2016 to present

What's gone wrong for the euro?

If you take a look at some of the recent economic numbers for the eurozone it can be seen that not much is going right at the moment – and a weaker economy normally has an immediate impact on that area's currency.

In the final quarter of 2019, the eurozone economy just about achieved growth – but at a mere 0.1%. The figure was not that much different for the UK, but it is the ongoing sluggishness of that traditional powerhouse, the German economy, that is weighing on sentiment. In 2020 as a whole, the German economy grew by 0.6%. This was its lowest rate of growth since 2013 and last year Germany narrowly avoided slipping into an official recession by the smallest of margins. Now this hardly means that the German economy is on its knees – it still has one of the lowest percentage unemployment rates in the world – but if industry is weak in Germany, it seldom bodes well for the rest of the EU.

Is the European economy past the worst?

There was plenty weighing on the European economy last year. Of course, we are all well aware of the impact that the lack of progress on Brexit had in the UK – but the threat of a potential "hard Brexit" was doing the EU no favours either. There was a virtual sigh of relief in foreign-exchange markets following the December general election, where it looked like finally things would move forward. A sharp rally in the pound against the US dollar saw a similar move by EUR/USD. But for the euro, all those gains and more have been given up in 2020 on the back of the latest weak economic data.

In addition to Brexit, the trade wars and threats of increased tariffs from the US weighed heavily on economic sentiment in the second half of last year. Agreement was reached between the US and China – but this seems more of a short-term fix, so those concerns of a global slowdown have not fully receded.

And just when economists may have thought that there was finally some light at the end of the tunnel, 2020 has brought the coronavirus crisis. At the time of writing, it is still not clear just how large the economic impact will be – we are already aware of the devastating human impact this has had so far, in under two months. More uncertainty for the world economy does not bode well for sentiment towards the euro changing any time soon.

The contrarian trade – buy the euro

I think plenty of people love the idea of being a contrarian in financial markets; rushing in to buy as all the misguided 'sheep' are selling – and then being rewarded with an immediate rise in price! If this were Hollywood, this is how it would work all the time. But the reality is that those who cannot resist trying to 'catch a falling knife' often have plenty of time after to regret it – and the

EUR/USD April 2008 to present

> **"THERE IS A VERY IMPORTANT LEVEL TO WATCH IN THE COMING WEEKS AND MONTHS – AND IT IS NOT A MILLION MILES AWAY FROM WHERE THE MARKET IS NOW."**

opportunity to buy in even cheaper as the slide continues. I think a good dose of common sense is needed when we are tempted to go against a major trend, so let's take a look at the facts.

While there has been the occasional – and impressive – rally along the way, the euro has been losing ground against the US dollar since 2008. In that time, one euro has gone from buying almost $1.60 to now struggling to get more than $1.08. Given that major economic shifts tend to happen with the speed of an oil tanker turning rather than the nimbleness of a speedboat, it does not look like we are set to see a V-shaped recovery in the euro any time soon. A bit of patience would not go amiss here.

But there is a very important level to watch in the coming weeks and months – and it is not a million miles away from where the market is now.

Over the last five years, EUR/USD has gone hurtling towards these lows on three previous occasions. And that is normally whesn the negative market commentary gets stepped up, with plenty forecasting the euro to hit parity with the US dollar – where one euro is worth one dollar. So far, this parity has not happened – the last time the rate was that low was 2002. As can be seen from the chart, historically EUR/USD has bottomed out in the $1.03 to $1.05 area.

Of course, history does not have to repeat this time around. But, as we edge closer to those old lows, I think we may finally see the fortunes of the euro changing, and it may offer up a potentially great entry point, if you think the euro will recover for the rest of 2020.

EUR/USD November 2014 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

FEVERTREE DRINKS IN MIXED SPIRITS

Once the darling of quality growth investors, Fevertree Drinks has seen its share price come under pressure of late, writes Andrew Latto.

Fevertree Drinks (LON:FEVR) was founded in 2004 and rapidly established the market for premium spirit mixers. UK revenue grew rapidly until 2019 when it fell by 1%. The group is now increasingly dependent on international expansion.

Fevertree Drinks has delivered rapid and profitable growth. Revenue increased from £4.2m in 2009 to £260.5m in 2019. The operating profit margin in 2018 was impressive, at 31.7%.

The group has taken market share from the incumbent Schweppes, which failed to spot the premiumisation trend. Fevertree has become "the world's leading supplier of premium carbonated mixers for alcoholic spirits, by retail sales value."

The company has benefited from growing demand for spirits and in particular premium spirit brands. A recent tailwind has been the UK gin boom and the related demand for premium tonic water.

Fevertree Drinks in 2019

	Revenue	% Total	Growth
United Kingdom	£132.6m	51%	-1%
Europe	£64.4m	24.7%	16%
United States	£47.6m	18.8%	33%
Rest of World	£15.8m	6%	32%
Total revenue	£260.5m	100%	9.7%

Source: SharePad

Fevertree Drinks has been in vogue in recent years but fashions can rapidly change. The crux for investors is whether the group can keep rivals at bay and continue to grow. Full-year results will be announced on 24 March.

Quality investors: Smithson Investment Trust

Smithson Investment Trust (LON:SSON) listed in October 2018 and added Fevertree Drinks to its portfolio in July 2019. Shares in the AIM-listed firm accounted for 3.9% of Smithson's asset value at the end of 2019.

In July 2019 the investment manager stated: "The position was initiated after the share price fell 47% from its peak in 2018, resulting in an attractive valuation given our estimation of the business quality and growth prospects."

Fevertree Drinks: a brief history

Fevertree Drinks was founded with the aim of "developing premium natural mixers using the highest quality ingredients." The brand

"FEVERTREE DRINKS MAY HAVE LIMITED SCOPE TO TAKE FURTHER UK MARKET SHARE."

Source: Fevertree Drinks

launched in 2005 when it listed its first product, Indian tonic water, in Selfridges and Waitrose.

By the first half of 2014, Indian tonic water accounted for 45% of revenue and its other tonic waters accounted for 20% of revenue. Ginger beer delivered 15% of revenue and in the US was the top seller, due to the popularity of the 'Moscow Mule' cocktail.

The company launched in Spain in 2006, in the US in 2007 and introduced partnerships with local importers from 2007. In July 2014, the group started to distribute the product in India.

Fevertree's mixers are designed to accompany alcoholic spirits or to be used in cocktails. Co-founders Charles Rolls and Tim Warrillow are non-executive deputy chairman and chief executive respectively.

Production innovation

In the first half of 2014, the group's product line-up included Indian tonic water, elderflower tonic water, naturally light tonic and Mediterranean tonic. The non-tonic waters on offer were ginger beer, ginger ale and soda water.

By 2018, Fevertree had added five more tonic flavours; aromatic, cucumber, clementine, citrus and lemon. Other drinks added included smoky ginger ale, spiced orange ale, Madagascan cola, Sicilian lemonade and lemonade.

The market leader in premium cola, Coca-Cola, recently launched a premium mixer of its own which is available in the UK.

The company launched its latest product, a ready-to-drink gin and tonic combination, in 2019. There are currently three varieties; premium Indian gin & tonic, refreshingly light gin & tonic and elderflower gin & tonic.

Growth backdrop

Fevertree Drinks has seen UK growth explode in recent years on the back of the gin boom. Revenue increased from £4.4m in 2012 to £134.1m in 2018 – a compound annual growth rate of 76%.

International revenue increased from £11.8m in 2012 to £103.3m in 2018 – a compound annual growth rate of 43%. UK revenue weakened in 2019 but international revenue increased by 24%.

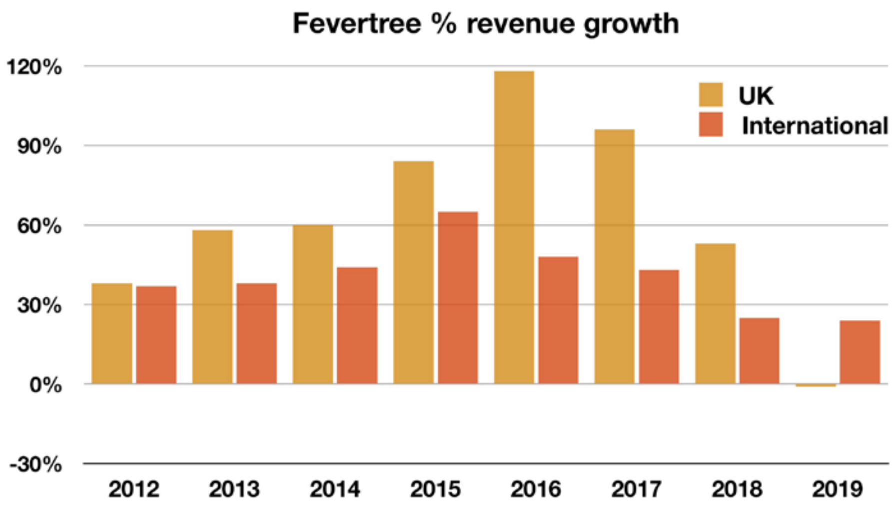
The UK market, as a percentage of Fevertree's total revenue, increased from 27.1% in 2012 to a peak of 56.5% in 2018. This reflects the faster pace of revenue growth in the UK compared to international markets.

Fevertree Drinks' mixers

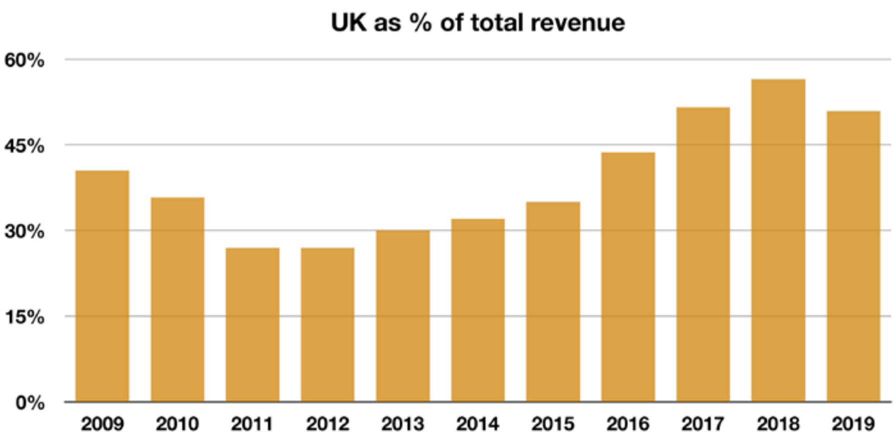
Source: Fevertree Drinks

Fevertree Drinks' ready-to-drink gin & tonics

Kelly Simone Photography / Shutterstock.com



Source: Fevertree Drinks



Source: Fevertree Drinks

Fevertree Drinks: revenue in 2019

	First half	Second half	2019
United Kingdom	4.7%	-5.5%	-1%
Europe	13%	19%	16%
United States	31%	34%	33%
Rest of World	49%	19%	32%
Group total	13%	7.4%	9.7%

Source: Fevertree Drinks

The Fevertree brand has had an international focus from an early stage, having sold well in Europe and in the US since 2009. If the gin boom takes hold overseas, the company could repeat the success it has had in the UK.

Trading in 2019

The second half of the calendar year generates around 55% of Fevertree Drinks' annual revenue. This reflects the importance of the late summer months and the Christmas trading period.

UK revenue increased by 4.7% in the first half of 2019 but fell by 5.5% in the second half of the year. Revenue growth in both the US and Europe remained strong in the second half of 2019.

Fevertree Drinks' changing UK outlook

In March 2019 Fevertree Drinks stated:

> "Looking ahead to 2019, we are now clear market leader in the Off-Trade and would naturally expect a moderation in growth rates compared to those of 2018 but remain excited about the opportunity ahead in the UK."
> With UK revenue declining in H2 2020, the company blamed "...a challenging Christmas with the mixer category not immune from the weak consumer confidence and corresponding slowdown in spending."

Fevertree expects the UK mixer category to remain challenging in H1 2020 due to "the current level of consumer confidence." But the group is confident that the UK market will return to growth during 2020.

Fevertree Drinks share price since IPO

Source: SharePad

Alcohol market drivers

The market backdrop for Fevertree is positive. Beer consumption is declining in the West while spirit consumption is increasing. Younger drinkers don't want the calories and carbohydrates associated with beer.

At **Diageo**'s **(LON:DGE)** May 2019 investor day, the group stated: "Consumers are continuing to switch into spirits from beer in markets like the US, UK and Australia, from wine in Europe as well as from illicit [spirits] across Africa."

Premium spirits are seeing much faster growth than mid-market spirits as consumers trade up. Buyers of premium spirits are more likely to opt for a premium mixer from the likes of Fevertree.

In the space of 10 months, Fevertree Drinks has shifted from being excited about the UK to hoping that it can return to growth – that is quite a turnaround. It is unlikely that UK consumer confidence is the only explanation.

Brexit uncertainty in the UK hit consumer confidence in the second half of 2019. But the UK GfK consumer confidence index improved in December and January. IHS Markit's February survey saw UK confidence hit an 11-year high.

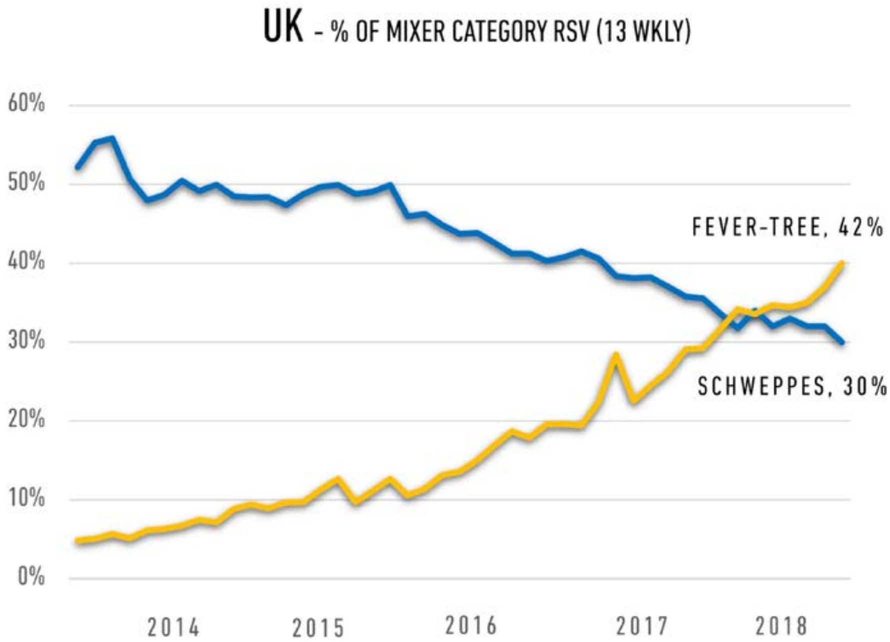
Reading between the lines

Fevertree Drinks may have limited scope to take further UK market share. The company overtook Schweppes by retail sales value at 42% of the market at the end of 2018. Schweppes had 30%.

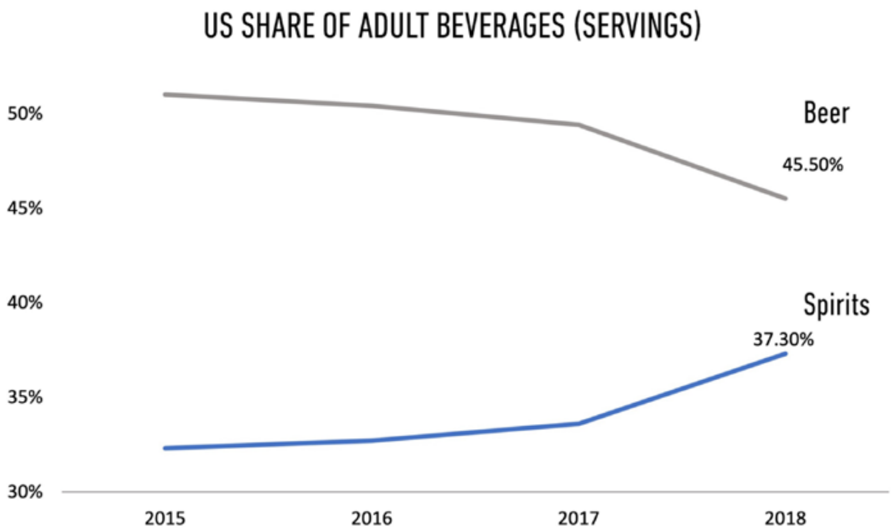
Some have also called time on the UK gin boom. Gin has taken market share from other spirits such as whisky in recent years. But with gin bars two a penny, the scope for further growth may be limited.

One UK drinks distributor I contacted blamed Fevertree's recent weakness on a larger choice of premium brands. They flagged Lamb & Watt, Fentimans and Schweppes as brands that have taken market share.

The distributor stated that 'posh pubs' no longer view Fevertree as special and are looking for the new and unique brands. This suggests that there may not be meaningful brand loyalty when it comes to mixers.



Source: Fevertree Drinks



Source: Fevertree Drinks

Sipsmith pioneered craft gin

Source: Sipsmith

Gin is in vogue

No mention of Fevetree Drinks is complete without discussing the 'gin boom' or the 'ginaissance'. Gin consumption by volume was up 8.3% globally in 2018 and by 32.5% in the UK.

Chief executive of beverage market researcher IWSR, Mark Meek, expects the ginaissance to continue. IWSR forecasts that the gin category will deliver compound annual growth rate of 4.2% to 2023.

UK gin consumption was 24.3 million litres in 2010, 61.7 million litres in 2019 and is forecast to hit 92.4 million litres in 2023. Non-traditional gin markets that are expected to do well include Japan and a number of developing countries.

The gin boom has been underpinned by craft production and the resulting increase in gin quality and variety. Sipsmith pioneered the trend when it opened the first copper pot distillery in London in over 200 years, in 2009.

UK laws surrounding gin production had been draconian on account of The Gin Act of 1751. It forbade small-batch distilling and required distillers to use massive-sized stills. Sipsmith got the rules relaxed after 18 months of lobbying.

European and ROW expansion

Fevertree Drinks will be hoping that its playbook in the UK works out in the rest of the world. The group's market share (retail sales value) in Denmark hit 35% towards the end of 2018 compared with 20% for its key competitor.

Fevertree's market share was 15% in Scandinavia, 27% in Ireland, 13% in Switzerland and 17% in Austria towards the end of 2018. The company has also taken market share from the main competitor in each of these countries.

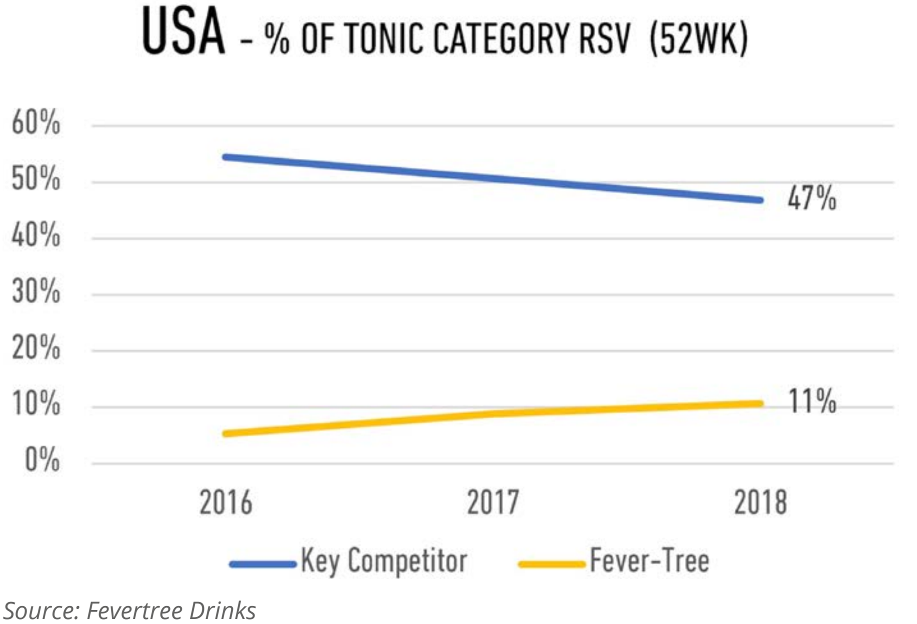
The rest of world category was only 6% of revenue in 2019 but includes Australia and Canada. In both of these countries the group is outperforming incumbents and is exploring opportunities to invest in growth.

"FEVERTREE DRINKS WILL BE HOPING THAT ITS PLAYBOOK IN THE UK WORKS OUT IN THE REST OF THE WORLD."

US expansion

While the US contributed only 18.3% of the group's revenue in 2019, it generated the fastest growth, with a 33% increase. At the end of 2018, Fevertree had a market share of 11% in the US tonic category by retail sales value (RSV).

However, the group revised down its expectations for US revenue growth in 2020 to "low double digit." This is due to initiatives being undertaken to invest in its brand that should deliver "significant long-term volume and profit growth."



Source: Fevertree Drinks

Schweppes' 1783 premium mixer brand

Source: Schweppes

Fevertree Drinks forecasts

	2020	2021
Price to Earnings ratio	26X	23.8X
Free cash flow yield	3.7%	4%
Net cash to market cap (year end)	10.2%	13%
Revenue growth	10.1%	9.8%

Source: SharePad (share price £14 on 17 Feb)

IWSR expects the gin market in the US to remain static over the next five years. It believes that Fevertree's success in the US will depend on whether it can revitalise the gin category in the world's largest economy. This is far from certain.

Hard (alcoholic) seltzer is the latest trend in the US with the White Claw brand expected to generate $1.5 billion revenue in 2019. Seltzer is the US term for carbonated water, sparkling water or soda water.

Moats and mixers

Fevertree Drinks' marketing tagline is: "If ¾ of your drink is the mixer, make sure you use the best." The brand has been the mixer of choice for consumers of the premium gin brands that have been launched since 2009.

Mixers are a high-volume product and pubs and bars therefore tend to go with only one or two brands. In supermarkets there is room for more than one brand, but Fevertree appears to be holding its own.

The crux is whether the group can hold off new competitors that include Double Dutch, Belvoir, Fentimans and Buzbees. IWSR states: "Fever-Tree is facing an increasingly competitive market landscape within the mixer category."

Schweppes launched its own range of naturally flavoured premium mixers under the 1783 label in late 2017. It has had some success in persuading pubs and bars to adopt Schweppes branded premium mixers.

Brand loyalty for mixers

Key to Fevertree's prospects is how loyal consumers prove to be to a particular premium mixer brand. This is hard to say for certain because the premium-mixer category is relatively new.

The mixer had previously been seen as a secondary ingredient with the spirit brand all-important. It is unclear if consumers will remain loyal to Fevertree Drinks if competing premium mixers are of a similar quality.

The on-trade (pubs, bars and restaurants) may be willing to switch brands if better terms are offered. The off-trade (supermarkets etc) has increasingly launched rival own-brand tonic waters.

Valuation

Fevertree Drinks listed at £1.60 and saw its share price hit a record high of £39.56 in September 2018. It closed at £14 on 17 February 2020, giving the group a market value of £1.6 billion.

The forecast price/earnings ratio for 2020 is 26 times and the forecast free cash-flow yield is 3.7%. Net cash is forecast to be 10% of the market value by the end of 2020. The group is forecast to deliver 10% revenue growth in 2020 and 2021.

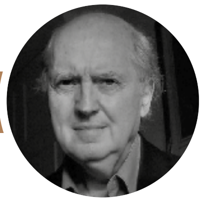
Summary

Stein's Law states: "If something cannot go on forever, it will stop." The pace of Fevertree Drinks' UK revenue growth is a case in point. The issue is whether the UK slowdown is due to competition and/or weak gin demand.

International markets remain promising but competitors like Schweppes are upping their game. Fevertree Drinks' investment case depends on it having a competitive moat that rivals are unable to breach.

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 JOHN CORNFORD

CONDOR GOLD: MUCH CLOSER TO PRODUCTION

A rise in the price of gold and a revised plan means this junior miner has cash flow in its sights much sooner than investors expected, writes John Cornford.

Like most junior miners, **Condor Gold** (listed on AIM **(LON:CNR)** and in Toronto **(TSX:COG)**) has taken a long time developing its La India mine in Nicaragua, so most of the market has probably lost sight of its potential. Condor's 2.32M oz of 'in-ground' gold mineral resource is valued at only $11/oz. For a miner as far along its development path, with government permits already in place to construct a large mine, this is at the very bottom end of valuations, compared with other Canadian-listed gold miners.

One reason for this is that most potential investors are probably still going by the results of the economic study for La India published in 2014, which has not been publicly updated since. At a gold price of $1,250/oz then, the 22% IRR (internal rate of return) didn't look that compelling, and even now investors won't be expecting a return until the mine starts production in at least two-three years' time.

Even a preliminary note by new broker SP Angel still refers to that 2014 study and plan, and will probably not be updated until the broker gets around to researching its new client and its updated prospects over the next few months.

Importantly, what has been somewhat lost sight of has been a significant 'reworking' in 2015 of the 2014 economic study through a 'Whittle Consulting' optimisation study of the mine plan. It looks at the whole process from mining to processing and gold sale in greater detail to identify measures to improve profitability.

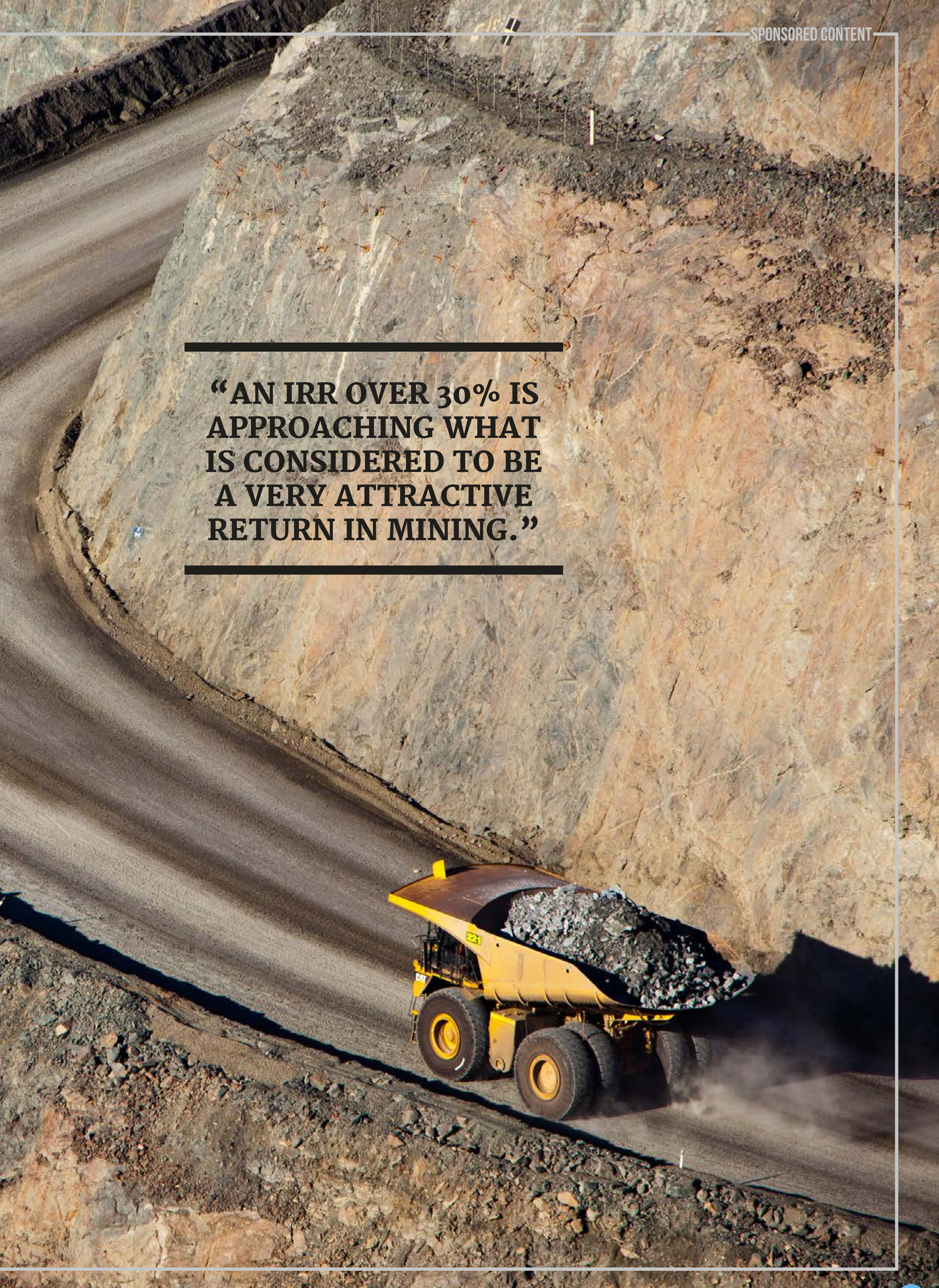
WCL is the recognised world leader in maximising the economics of a mine, and its optimisation studies are used by major mining companies such as Rio Tinto and Anglo. For La India, the study showed that the vital rate of return, and the NPV substantially improved even without any increase in the gold price. But such a study is not 'compliant' with the Canadian NI43-101 requirements for calculating a mining project's economics and cannot be published in any reporting documents for a listed company. So, Condor has not so far been able to emphasise this to investors.

> "CONDOR'S 2.32M OZ OF 'IN-GROUND' GOLD MINERAL RESOURCE IS VALUED AT ONLY $11/OZ."

Substantial improvements

However, the results showed (for instance in the 'base' case) an increase in IRR from 22.0% to 30.4%, and a 77% increase in NPV – even at the now out-of-date $1,250/oz gold price. Similar improvements are seen in the other scenarios (described later) which all saw cash flow brought forward by two-three years and a consequent reduction in payback time.

These are substantial improvements, and an IRR over 30% is approaching what is considered to be a very attractive return in mining (giving comfort to financing providers). With the gold price more than $250/oz higher now than



"AN IRR OVER 30% IS APPROACHING WHAT IS CONSIDERED TO BE A VERY ATTRACTIVE RETURN IN MINING."

assumed in both studies, even that can be expected to have improved considerably more. Practically all its de-risking development milestones have been under its belt since 2015 – including government permits granted more recently for La India with its economically mineable reserve of 675,000 oz gold at 3.1g/t. Other permits are expected soon for smaller satellite pits that will enable much cheaper and earlier exploitation than envisaged for the main La India pit in 2014. The new broker can therefore be expected to publish a considerably higher valuation.

Even more importantly for investors, any review will almost certainly point the way to Condor generating income much earlier than the market expects.

Recovery

All of this means we can expect the shares to start a well-deserved recovery during the coming months, from an exceptionally depressed level plumbed throughout 2019. At that time the costs of gaining its permits and a need for new funds from investors coincided with a change in investment policy towards all its mining investments by the IFC arm of the World Bank, resulting in it selling its stake.

Political unrest (now subsided) in Nicaragua didn't help; Condor had to issue more new shares than existing shareholders would have liked.

But from now on, investors will be compensated by that updated and considerably enhanced value. Gold now looks fairly set for a steady price well over $1,500/oz compared with the $1,250/oz assumed in the 2014 and 2015 studies. Even a crude calculation would show that this will increase La India's average bottom line cash flow for the 80,000 oz per annum base-case production in the 2014 study by more than $13m a year (after tax) in only the first year of an eight-year mine life, over and above the average $34m arrived at there.

Compare that with Condor's current market value of under $25m, and the Whittle optimisation study finding that the vital cash flow (at only a $1,250 gold price) in the base case could be more than doubled during the first three-four years after mining start.

Furthermore, Condor now also has options to considerably reduce the mine's start-up costs assumed there, and to start mining much earlier from its satellite pits, which centre on collaboration with existing nearby producing miners – one of whom took a 10% stake in Condor in last July's placing. Another, Canada's Calibre Mining, has a currently under-utilised plant (acquired in October from another Canadian miner B2Gold). It could process selective higher-grade ore from the permitted La India open pit and, once they are also permitted soon, also from two smaller, but even higher-grade, satellite pits (Mestiza and America).

These have mineral resources which if added – as in one of its options considered in the 2014 study – to those from the main La India pit, would add 50% to its annual gold output. This would improve the economics even further, at relatively low additional cost.

Options

However, the options which will please investors more, are those which will enable Condor to get into much earlier production even if at an initially lower rate, but at considerably less initial cost.

One is to build a smaller processing plant at La India (perhaps with cheaper, second-hand equipment – for which we understand Condor has already received tenders) by which to

process ore from the satellite pits first and generate early cash flow before, later on, spending more to get the main La India pit into fuller production on the older, longer-term, production plan.

This longer-term plan, depending on extension drilling, aims to exploit the much wider scale potential which Condor's airborne and other surveys lead it to believe exists on the extensive concessions it has been acquiring (now 588 sq km) around La India, and which it thinks could deliver a 'gold district' containing up to 5M oz. That would take it closer to having a major gold resource and a much longer life, as opposed to the 'junior' resource lasting up to 10 years that Condor is perceived to own at present.

In the shorter term, however, the two largest La India satellite pits, for which Condor expects permits in the next few months, will be easier and cheaper to extract, and have a

230,000 oz gold resource at a higher grade (5.5g/t compared with 900,000 oz gold at 3.1g/t) than La India. While the company has not yet announced a definite plan, we understand that engineering studies for this option are almost complete and envisage production of about 40,000 oz per year (for six years – ie at half the rate envisaged initially for La India) which would either be processed in the smaller plant, or, even more cheaply and, if it can be agreed, trucked to a nearby existing miner for toll processing, or both.

Condor had been discussing such an option with nearby Canadian miner B2Gold (who successfully tested its ores' suitability) before Calibre Mining (also listed on TSX) took over the latter's two mines at El Limon and La Libertad, respectively 80 and 230km from La India. With their acquisition only completing in October, Calibre has naturally been getting its feet under the table before resuming any talks with Condor, but has published its aim to fill spare capacity at La Libertad currently amounting to 600,000 tpa of ore, which would easily cope with Condor's satellite pits' output. (La India's milling capacity to produce 80,000 gold oz pa was to be 2,300 tpd.)

This option, however, is not yet agreed, and Calibre might have others, among which is the development of its own new resource at Pavon, but which seemingly will take at least two and probably more years before producing any ore to utilise its spare capacity.

Another option might stem from the relationship Condor has built recently with the Nicaragua Milling Co, which took a 10.3% stake in last July's £4m placing. It has its own relatively small milling plant in the country (producing about 12,000 gold ounces in 2019) but is 80% owned by TSX-listed Para Resources which specialises in toll milling ore on behalf of producers like Condor and obtaining for them (and itself) income much earlier than if waiting to build a full-scale plant. It seems unlikely that NMC would have taken a stake in Condor without some plan to progress such a toll milling idea for either La India and/or the satellite pits, especially since Randy Martin, the owner of NMC, and chief executive of Para Resources, has built five mines in Nicaragua and Central America in recent years.

Financial implications

Faced with these various options, and probably ongoing negotiations, it is perhaps not surprising that Condor hasn't yet informed investors about its thinking, although it has floated its various ideas in presentations. However, Mark Child, chief executive and driving force since Condor's 2008 inception, recognises the need after last year's 48% expansion in issued shares (not to mention warrants) to limit shareholder calls from now on (the directors own 20% of Condor's equity). He will therefore be concentrating on the need to re-programme development to a more affordable level, producing earlier cash generation and which could attract funding more easily.

So, in advance of details which we expect will be published some time this summer, it becomes possible to speculate about the financial implications for Condor. These should be elaborated on further by its new broker, who I believe will as a result be putting Condor's attractions to its own investor base. Helping Child might also be the results of the upgraded (bankable) feasibility study that we

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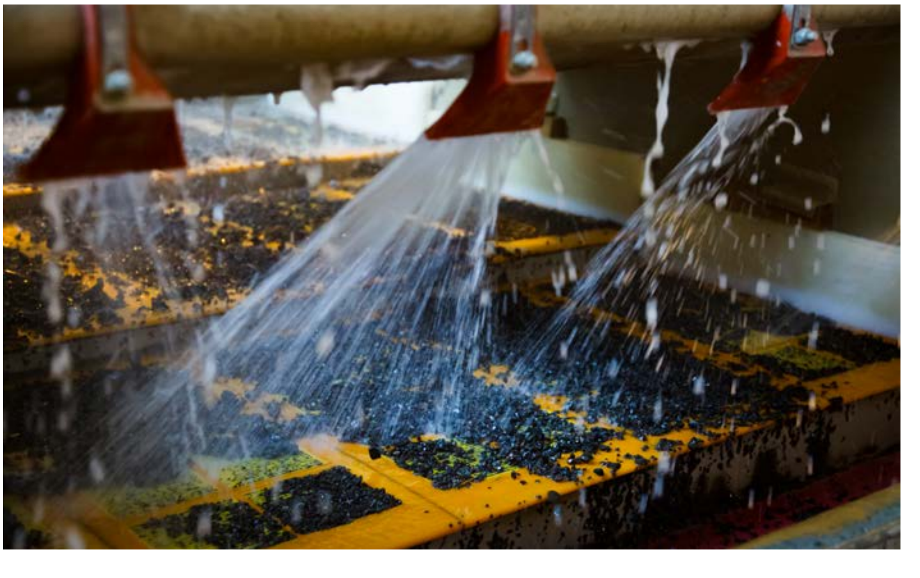

understand Condor is working on at present, and which could incorporate the Whittle study findings.

To summarise Condor's best options, they would seem to centre around postponing the $110m capital cost that the 2014 Preliminary Feasibility Study (PFS) estimated is required to get La India to a 80,000 oz/yr production – but not before two-three years' time – and instead, for well under half that initial cost, going for a combination of mining the satellite pits, selectively processing higher grades from the permitted La India open pit and either processing on site with second-hand plant or trucking to a nearby producer – all of which could possibly be put in train during the current year.

With higher gold, a lower capital cost, those Whittle study improvements and engineering studies to take the project into production nearing completion, obtaining a large proportion of the cost via a project loan, or a gold loan (which, unlike a streaming deal which is open-ended and therefore incapable of being costed, is repaid to a given schedule) or perhaps a partial earn-in by Nicaragua Milling (or even Calibre), should be much easier.

To make a stab at a revised value, my readers will know that I don't rate NPVs or share predictions based on them. That's because very different cash-flow profiles can produce the same NPV, while achieved share prices, with no exception I've ever been able to find, fall a long way short of those based on NPVs – because the owning company's shares' NPV is only indirectly related to the project NPV). Instead I will quote later the annual cash flows thrown up by the studies and various scenarios which investors find easier to interpret.

For what it's worth in NPV terms, and to show the improvement to the results from Condor's 2014 scenario just from the higher gold price alone, the 2014 PFS shows that its base case (80,000 oz/yr) scenario would increase the 8% NPV from $65m at $1,250/oz, to $131m at $1,500/oz – ie double. (Condor uses the 5% discount rate normal for Canadian quoted miners whereas I use the 8% more commonly used by UK investors which typically almost halves the stated NPV.)

On top of that, the Whittle study showed that even at $1,250/oz the 5% NPV would increase further by 77%.

Estimates

There are now too many options and resulting economics for us or anyone to reliably estimate what would be the results for any of them. But a back-of-the-envelope estimate at half production and half-capex will of course deliver a $65m NPV ($130m/2) at an 8% discount rate. Capital costs are likely to be much less than half however (with second-hand plant) and so also will be the initial stripping costs for the much smaller satellite pits. If the ore is trucked for processing elsewhere, sharing the processing costs will also be cheaper. But without details of any tolling deal we can't really speculate further. All that can be said at present is that the cash costs for the base case 80,000 oz pa gold are already at a well below average $690/oz, producing an

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$810/oz gross profit margin with gold at $1,500/oz, and any of the mooted options for an initially cheaper, smaller, operation should show even better figures.

What I believe investors find more relevant than NPVs are the cash flows, and therefore Condor's dividend paying ability. The 2014 PFS full-scale plan – adjusted for a $1,500/oz gold price – shows first full-year revenue of $85m, and a net cash inflow of $35m (after royalties and 30% tax, which won't be paid until later) – rising to $118m and $47.7m respectively in year three.

A half-scale operation, mining higher-grade ore from smaller pits, can be expected to incur well under half the full-scale mining costs, offset by the trucking costs, while processing costs at (eg) Calibre's spare capacity ought also to be less (at the margin). So, it seems reasonable to assume that each partner would earn a half share of the extra revenue generated, offset by less than half a full-scale operating cost.

Assuming Condor could start by extracting and trucking only 1,000 tonnes/day (to fill only half Calibre's spare capacity – or someone else's) allowing for 10% downtime, this would produce 36,000 gold oz, $54m annual revenue and cash profit to be shared at $1,500/oz gold amounting to over $28m (£21m) after royalties (but before tax, which would probably not be payable for some years).

That (and the possibility of double from a 2,000 tpd operation, not to mention the Whittle improvements) compares with Condor's current £20m market value. While still speculative and dependent on the necessary agreements, bearing in mind that Condor seems to be homing in on this sort of deal, and that the resulting income could loom very soon after a decision is made, perhaps during this year, it would be strange if investors didn't soon realise how cheap Condor must now be.

For perspective, Calibre Mining – with two producing, and one developing, mines surrounding La India – is valued in Toronto (TSX:CXB) at around US$220m (or £169m GBP). It has gold resources of 5.1Moz compared with Condor's 2.3Moz, and this year expects to produce 140,000-150,000 oz at a cash cost over $840. Deducting its $36m balance sheet cash, Calibre's enterprise value becomes £134m compared with Condor's equivalent of about £17m.

Comparing mining companies' market caps and enterprise values against their multitudes of characteristics is fraught with pitfalls. But, even so, that comparison shows how far below its potential Condor's shares must currently be.

Next steps

Condor still has a few more steps to complete before any of the options can start, and another cash raise before this year end can't be ruled out. Land purchases to enable the pits are not complete, with some owners possibly holding out for the best price, so Condor has recently expanded its team of negotiators. A few of the 10 conditions for the main La India permit are still to be completed, as also is a bankable feasibility study (if one is required) before a project loan can be applied for. But a deal with Calibre or Nicaragua Milling might obviate the need for the latter.

Condor's cash resources at the last reported date in November amounted to £3.37m, which will be supplemented over the next few months by the $555,000 proceeds from the recent sale of an unwanted concession separate from La India. Given a £1.04m cash outflow on operating costs in the previous nine months, and £1.3m in consulting and permitting costs, this cash can be expected to last some time into the current year, except for the commitments mentioned above and to progress La India's longer-term plan. However, we would expect Condor will be able to raise at least a majority of the funds for a half-scale operation from a gold loan or similar.

As for 2018's political unrest in Nicaragua, this stems from opposition to President Ortega who has been in power one way or another for 41 years and is regarded as a repressive dictator. Under him, however, the mining industry, whose gold exports are crucial to the economy and are its third-largest export, has been strongly supported. Also, politics does not seem to have deterred six other TSX-listed miners operating in the country, who between them have permitted three new open pits only recently.

About John

John is semi-retired after 40 years in City research of one sort or another covering most sectors, and an earlier career in the MoD and management consulting. As well as institutional research he has also long taken an interest in research for private investors, editing the long established and top performing Investors Stockmarket Weekly in the '90s, and later Small Cap Shares. In the noughties he worked for seven years with Hardman and published his own research for institutions via his FourSquare Research.

Disclaimer: Readers will know that Master Investor's Jim Mellon is a major investor in Condor. He has however had no part in our decision to feature the company. Master Investor has been paid by Condor Gold for the production of this article.

BY ROBERT STEPHENS, CFA

STOCKS IN FOCUS

BARRATT DEVELOPMENTS

ARE FURTHER GAINS ON THE WAY FOLLOWING THE 'BORIS BOUNCE'?

Robert Stephens discusses why Barratt Developments could offer an attractive investment proposition even after its recent share-price gain.

Investor sentiment towards UK housebuilders such as Barratt has improved dramatically since the general election. The company's shares have risen by over 25% since Boris Johnson won a significant majority and, in doing so, removed the threat of a major change in government housing policy from a left-leaning Labour party.

In spite of its recent rise, the stock appears to offer good value for money as it continues to experience favourable operating conditions. They include a likely continuation of the expansive monetary policy which has catalysed the wider housing market since the global financial crisis, as well as a lack of supply compared to demand for new homes.

In addition, Barratt is becoming increasingly accommodative of evolving consumer demands. As well as being the UK's only major housebuilder to score a five-star Home Builders Federation (HBF) rating over the past decade, it is investing in making its business more sustainable. This could appeal to first-time buyers who are becoming increasingly concerned about the environment.

Risks inevitably remain on the horizon for the housebuilding sector. The continued uncertainty surrounding Brexit may limit the optimism of investors in 2020. But with a high yield, a solid balance sheet and upbeat recent trading, the stock could deliver further gains, in my opinion, in the long run.

Government housing policy

As well as relief at avoiding the radical housing policies proposed by the Labour party, investors are likely to feel optimism at the prospect of a continuation of the demand-side policies used by the Conservatives over recent years.

They include the Help to Buy scheme, which is set to run until 2023. It provides buyers with a loan of up to 20% of a property's value (40% in London) which is interest-free for the first five years of property ownership. It is repaid upon the property's sale and is a means of allowing buyers to access more competitive mortgage rates, since they will require a mortgage with a lower loan-to-value. It also means buyers will need a smaller deposit to purchase a home.

Since the Help to Buy scheme is only applicable to newbuild properties, it has pushed a large amount of buyers towards homes built by Barratt and its peers. As a result, the company continues


The Waterperry

to enjoy strong demand for its properties. It reported in the first half of the current year that completions increased by 9.1% compared to the first half of the previous year.

Although there is scope for a change in government policy before the next general election, it seems unlikely that demand-side policies which have been successful in helping first-time buyers onto the property ladder will end abruptly. More likely is their continuation and eventual replacement, with watered-down policies which could continue to act as catalysts on the housebuilding sector.

Demand/supply

The UK's housing shortage has been a driver of house prices over the past few decades. This is expected to show little sign of abating, in spite of continued efforts by the government to stimulate housebuilding and increase the number of homes being built each year.

For instance, the number of new households in the UK is expected to rise by around 160,000 per annum between now and 2045. This is a similar figure to the number of new homes currently being built per year, and suggests that the imbalance between supply and demand which has existed over an extended time period could continue.

Demand for new homes is likely to be supported by an extended period of low interest rates. There seems to be little appetite from the Bank of England's Monetary Policy Committee (MPC) to adopt a tighter monetary policy due to low inflation and an uncertain economic outlook caused by Brexit. In fact, in the most recent MPC meeting, two members called for a fall in interest rates to stimulate inflation while it is below its 2% target.

Low interest rates mean that homeowners have been spending less on their mortgage payments in the past five years than they have been at any point since 2002. Last year, they spent around 29% of their incomes on mortgage payments. This compares to a figure of 48% prior to the global financial crisis, as well as a figure of 66% prior to the early 1990s housing-market crash. Those were the last two instances of major house-price falls. As a result, even though house prices are currently high compared to metrics such as their historic levels and average incomes, they could increase should interest rates remain at low levels.

A changing industry

One of the biggest changes in society over the past decade has been an increasing focus by consumers on the environmental and social impact of their lifestyles. For instance, 88% of consumers say they would have a more favourable view of a company which makes a positive contribution to the environment or to society.

Housebuilding is unlikely to be any different from the rest of the economy in terms of being required to adapt to changing consumer tastes. Therefore, Barratt has become the first UK housebuilder to set a science-based target for sustainability. It is aiming to reduce its carbon emissions by a third between 2018 and 2025, and in doing so plans to become the UK's leading, national, sustainable housebuilder.

An increasing focus on sustainability could resonate with buyers – particularly first-time buyers. Many of them will be millennials, who have been shown to consider a company's environmental and social credentials as being more important than previous generations. This approach could help Barratt to maintain its five-star HBF rating and avoid the customer complaints and redress that have affected some of its competitors over the past decade. This could reduce risk for investors and enable the stock to deliver relatively consistent returns.

Financial strength

One of the surprising aspects about the company given its recent

"BARRATT'S LOW VALUATION, HIGH YIELD AND LONG-TERM GROWTH PROSPECTS COULD EQUATE TO AN ATTRACTIVE RISK/REWARD OPPORTUNITY."

share-price rise is its dividend yield. Including the special dividends which it intends to pay in 2020 and 2021, the stock currently yields 5.6%.

As well as offering a high-income return, it could prove to be resilient. In the current year, the company's overall shareholder payment is expected to be covered 1.55 times by earnings, while Barratt's net cash position of £434m highlights its balance-sheet strength. Therefore, should there be a period of difficulty ahead for the wider sector, due, for example, to Brexit-related concerns, it seems to have sufficient financial strength to overcome it.

In addition, the value of the company's shares indicates that they offer a margin of safety. They trade on a price-earnings ratio of 11.5, which highlights how cheap they had become prior to the election and their scope for an upward rerating over the long run. A rapid rise in earnings may not be feasible in the near term, but last month's half-year results from the company highlighted a robust rise in completions due to high demand which could catalyse its financial performance in the long run.

Potential threats

As well as the potential for a change in government policy in the current parliament, the financial performances of housebuilders could be impacted by the outcome of Brexit negotiations with the EU. This, however, is the same situation for almost all companies with operations in the UK. While it could limit the optimism of investors in the short run, over the long-term, factors such as a demand/supply imbalance and demand-side government policies may create favourable operating conditions for housebuilders.

Brexit uncertainty has been present for three and a half years. Yet Barratt has consistently reported resilient demand for its properties, which suggests that the sector may be more robust than market valuations indicate. Therefore, the stock's low valuation may factor in the political and economic risks facing the UK.

Furthermore, with unemployment at its lowest level since 1974; the UK forecast to grow at a faster pace than major European economies such as France and Germany in 2020; and wage growth currently around two percentage points ahead of inflation, the outlook for the housing market could be more positive than market sentiment suggests.

Investment potential

Barratt's low valuation, high yield and long-term growth prospects could equate to an attractive risk/reward opportunity. It is likely to benefit from supportive government policies which are designed to make it easier for first-time buyers to access the property market. Likewise, low interest rates could maintain houses at what is a historically affordable level, and may even help to push house prices higher.

Risks are likely to persist at elevated levels as trade negotiations continue throughout 2020. However, the UK's economic forecasts and the margin of safety offered by Barratt's stock price could make its risk/reward ratio highly appealing. It also looks set to enjoy further strong demand growth in an era where housing supply continues to be limited.

Therefore, Barratt's strong balance sheet and innovative strategy, which aims to maintain a high rate of customer satisfaction could make it an attractive investment proposition for the long run. After a stock-price rise of more than 25 percent since the election, it could have scope to deliver further capital gains.

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 VICTOR HILL

INVESTING IN FINE WINE

Pope Benedict said that wine was a gift from God. Fine wine is also an appreciating asset, writes Victor Hill. But you will need to engage the services of a reputable vintner.

The best things in life cost money. But collecting beautiful things can also make money – whether it be fine art, vintage cars, antique furniture or even wine. All of these, if selected carefully and judiciously, can appreciate in value over time. I purchase and store bottles or cases of wine, usually through a reputable vintner, in anticipation of selling them at a higher price some time later – often more than 10 years later.

Investing in wine is something that any investor can do without specialist knowledge and with a minimum amount of funds to invest. Most people who invest in wine already have exposure to stocks, mutual funds and exchange-traded funds, and regard allocating a small part of their portfolio to fine wine as an aesthetically pleasing diversification strategy. Wine prices do not correlate with any principal financial market.

Where to start? In my case I made way down to Berry Brothers and Rudd (BBR), one of the most prestigious names in the wine world, to their offices on the corner of Pall Mall and St. James's Street in London's most exclusive neighbourhood. To enter their lobby is to be transported back into the mid-18th century (though with up-to-date technology). There I met one of their experts in wine investment, Gary Owen, who took me through the basics.

A liquid investment?

First of all, wine may be a liquid investment (excuse the pun), but if you really want to get decent returns it pays to be patient. Consider five years a minimum holding period, though eight to 10 years, or even longer, is better. Some of finest wines achieve their maximum values after 30-40 years. That said, you can normally sell on to another investor at almost any time.

You buy wine in bottles (75 centilitres) – even though it might, physically speaking, still be in a barrel. With some grandes marques (the most prestigious brands), you can, of course, buy magnums (a double bottle) or any configuration up to the Nebuchadnezzar (15 litres or equivalent to 20 bottles). Most investors buy cases of wine (12 bottles) or half cases (six bottles) – even though they never see them.

So I asked Gary what I could buy that morning for around £1,000. He suggested a case of 2000 Dom Pérignon (a classy Champagne) and a half case of 2016 Chateau Léoville Barton (one of the most distinguished Bordeaux labels). The latter would be en primeur, which means that the actual wine is still in barrels down in Bordeaux and will be bottled within about two years, then shipped to BBR's bonded warehouse in Basingstoke. But one is not buying blind: BBR's connoisseurs have been down to Bordeaux and tasted the wine last April – and it promises to be mind-blowing (in about 16 years' time).

The really important thing to remember is to buy from a reputable vintner with a track record. There are all kinds of conmen out there (especially on the web) who are desperate to sell you wine that they do not own. With BBR and others the wine is (at some point) physically imported and stored. Only when it is released for sale for consumption is the VAT and excise duty paid to HMRC. So long as the wine continues to reside in the temperature-controlled tranquillity of the bonded warehouse you, as owner and investor, can sell the wine to any third party (which could indeed be the vintner itself, a restaurant chain or another investor) without paying VAT or excise duties. BBR and others even offer investors access to a digital wine portal where they can check on the progress of their wines and their estimated market value.

So how does the vintner make his or her profit? Gary assured me that BBR doesn't charge any upfront fee or management fee. They charge a mark-up on the original purchase plus a modest storage fee of £13.20 per case per year – which includes insurance. When you come to sell the wine (usually to another investor) they will take a commission of around 10 percent.

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There is a temptation to try to cut out the middleman: but there is always a price to pay for that. If you trundle down to Chateau Léoville-Barton in the SUV and load up the goodies, first of all, they won't offer you the best price for the goods. Then you'll have to pay the costs of transportation plus the VAT and excise duty. And then you'll have to find an appropriate place to store the bottles. No respectable vintner will buy wine from an amateur because they just cannot be sure that the storage conditions have been ideal. They might have been kept in a mouldy cellar or (even worse) next to the Aga. They will not do business with you.

What's your vintage?

So, what sort of returns can wine investors expect to make? This is where wine investment, once arcane, has become a lot more transparent in the last 10 years or so. Firstly, there are quite a few websites which offer wine valuation – but you may need to tread carefully here. Second, there are a number of broker-dealers who have been tracking wine prices closely over time and who have effectively created their own indices. BBR works with Liv Ex (the London International Vintage Exchange). Liv-ex is generally only available to professional wine traders, but index values are available to BBR account holders.

According to their numbers, over the last five years, vintage Champagne laid down has increased in price by 42 percent; the 'Italian 100' is up by 38 percent; and the Fine Wine 100 (a diversified global selection) by 40.8 percent. So – very approximately – returns of 7-8 percent per year are realistic. Of course, experts like Gary can tweak your portfolio of wines so as to include some higher-risk/higher-return wine plays as well. Or you can just stick with the trusty grandes marques.

I asked Gary who his investors were. He reckons most of them are high-net-worth individuals – though there are a few not-so-wealthy wine buffs as well. About one third are purely engaged for the investment potential; about one third wish to serve the finest wines at their tables; and about one third is a mixture of the two. There are a few institutional investors as well.

Wine regions that have a reputation for consistently producing outstanding vintages have greater investment potential. Generally, wines from Bordeaux, Burgundy, Tuscany and Napa Valley are the top crops for investors. I asked Gary if he thought English wine was a candidate for long-term investment. He agreed that some English sparkling wines compare favourably with Champagne – not surprising, since the Weald of Kent and Sussex share the same calciferous geology as that of the Champagne region – and with global warming, temperatures are analogous. But Gary thinks that, although Nyetimber and others have produced some outstanding wines, they just don't yet have the longevity factor. That could change.

I can imagine that for connoisseurs, wine investment could be a lifetime passion. As newer wines are introduced to your portfolio, older wines may be approaching peak maturity. But don't hold those wines too long. While the fascination factor increases, very few wines improve in quality after about 40 years – though brandy is another matter.

It is possible for the small-scale investor to dabble in wine without using a vintner at all – just as many of us dabble in antiques (mostly for the pleasure of browsing rather than the returns). In terms of buying individual wines, a full case in its original packaging is more likely to increase in value. The exception is if you have an opportunity to buy a rare wine of which there are only a few bottles in circulation. In 2017, for example, a single, specially created bottle of California cabernet sauvignon sold at auction in the US for $350,000. (But remember that the auction house takes about 20 percent of the sale proceeds).

Take into account that, even if you go through a reputable vintner with a first-class reputation, you are buying

"IF YOUR WINE DOES NOT APPRECIATE IN VALUE AS MUCH AS YOU MIGHT HAVE HOPED, YOU CAN ALWAYS DRINK IT YOURSELF."

someone else's judgement – just as when you buy into an investment fund. Gary is confident that 2016 was a superb year for Bordeaux – on a par with 1947, 1961 and 2005. But of course that is not guaranteed.

High-end Burgundy (Bourgogne) prices have been rocketing recently. This most family-dominated of the great wine regions has been hit by a shortage of supply while demand continues to increase. The Côte d'Or, where the most famous and highly sought-after wines are made, is a fairly small place. The circle of wineries where the best wines are produced is even smaller – and the best vineyards within these estates are limited in number[i]. Burgundies are expensive because they are good, original, rare and prestigious, with strong brand recognition. They are outstanding because over the last 40 years, skills have developed and new investment has paid off, says Frédéric Mugnier, a vineyard owner in the Nuits-Saint-Georges area. The originality of these wines lies in the Burgundian approach to wine, which gives priority to terroir (an untranslatable French term denoting the specific harmony of location, climate, soil type and grape varietal).

Changing tastes

The wine business – just like the arts – is subject to changing fashions. For a while in the first decade of this century the Russians and then the Chinese couldn't get enough of French wine and for a few years prices were very buoyant. Then the Chinese "went DIY" (as a wine-investor friend put it) and the Russians stopped spending – and prices fell.

(Interesting fact: about half of the output of Calvados is shipped to Russia – Russians have a penchant for the distinguished apple brandy.) I've never understood why we can't produce an equivalent product on this side of the Channel.

The past two years have been tough for China's wine trade. In the first 11 months of 2019 alone, wine imports dropped 12 percent by volume and nearly 17 percent by value, according to the China Association of Wine and Spirits. And local production has also fallen despite some Chinese wines gaining medals and critical praise. Right now, demand from China has slumped as the Corona virus epidemic pans out, with millions of restaurants having closed their doors.

Wine can also be in the first line of fire when it comes to global trade protection. President Trump has imposed 25 percent import tariffs on all French wine and sales in the US of France's finest wines are in freefall. The result? Bordeaux prices are on the wane. And just wait until we get the now expected 'Hard Brexit'. (I'll be advocating sending supertankers of Australian Shiraz and South African Pinotage to our damp islands just to keep us going. The thought of a wine shortage is unconscionable).

If your wine does not appreciate in value as much as you might have hoped, you can always drink it yourself. But as soon as you ship the wine home, you'll be hit with the VAT and excise duty bills (plus any commissions).

There is always the lingering fear, expressed by one wine investor that I spoke to recently, that the wine cognoscenti (and their friends) get tipped off long before the rest of us as to where the stonking profits are to be had. But isn't that always the case?

Why not take a small amount of the dividend cash from your share portfolio and plonk it into wine? If it doesn't outperform then you will still have a memorable birthday or anniversary party one of these days. Cheers!

About Victor

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

i **See: www.wine-searcher.com/m/2020/02/the-perfect-storm-behind-burgundys-price-boom**

BY JAMIE ROSS OF HENDERSON EUROTRUST

THE ANATOMY OF A GOOD COMPANY: DSM

Henderson EuroTrust manager Jamie Ross looks under the bonnet of Dutch company DSM to see what makes it tick.

"WE HAVE A LONG-STANDING POSITION IN DSM AND IT HAS CONTRIBUTED STRONGLY TO PERFORMANCE."

"WE SEE DSM AS AN 'IMPROVER': A BUSINESS CAPABLE OF IMPROVING ITS ROIC PROFILE OVER A NUMBER OF YEARS."

When considering an investment for the Henderson EuroTrust portfolio, we tend not to focus on market noise or any technical factors; the main thing we are doing is trying to establish whether what we are looking at is a good company or not. This is a key part of the research process.

There tend to be many features that most good companies have in common, but there are myriad characteristics and features to analyse that will be unique to each and every business. By undertaking detailed analysis of the 50 or 60 companies we have on our radar (a portfolio of ~40 positions and a watch list of 10-20 names) we try to ascertain whether a business is a good business and if so, whether now is the right time to be invested or not. In this article we will highlight aspects of our process using one of our portfolio companies, DSM.

What does the company do?

The Dutch company DSM was founded in 1902 as a coal mining company; in fact, the name DSM comes from the English translation 'Dutch State Mines'. The company has changed dramatically since the early 20th century (the last coal mines closed in the 1970s) and over the last twenty years or so, the business has been transitioning again; this time away from chemicals and materials towards food ingredients.

As we stand today, around 1/4 of earnings comes from DSM's remaining Materials activities and around 3/4 of earnings comes from their Ingredients portfolio. Within their Materials business, DSM produce and sell sustainable thermoplastics, industrial resins & coatings and a strong fibre called Dyneema. Within their Ingredients division, DSM sells vitamins, ingredients and solutions for use in human and animal nutrition. In the company's own words, DSM is focused on 'creating science-based solutions in health, nutrition and sustainable living'.

Does this company generate strong Return on Invested Capital (ROIC)?

At the moment, DSM's ROIC is in the low-double digit percentage range according to our estimates. This is an improvement from recent years, is well above the company's cost of capital, but is materially lower than the ROIC generated by a number of our well-established 'Compounders' within the portfolio. In fact, we see DSM as an 'Improver': a business capable of improving its ROIC profile over a number of years. There are several things that should help to drive this improvement in returns. First, there should be some natural operational leverage from volume growth (costs should grow more slowly than revenues). Second, we see the movement of the company away from the Materials business and towards the Ingredients business as something that should result in higher margins and lower capital intensity. Third, we back the current management team to improve the efficiency of the business over the medium term.

What are the risks to the business and to this ROIC profile?

Inevitably, by having some exposure to Materials, which tend to have industrial end markets, there is some cyclicality to the business and if there is an economic slowdown, that could certainly delay the improvements being made to the business. Another risk would be that the company felt compelled to make a large and expensive acquisition to speed up their transition towards Ingredients;

we rate management very highly and see this as a low probability risk. Finally, within the Ingredients portfolio, DSM has some exposure to vitamins, whose prices are notoriously volatile; vitamin pricing is therefore also a risk to the return profile of the company.

Is there scope for growth?

The Ingredients business has significant scope for structural growth over the medium-to-long term. End markets (animal and human nutrition) will see demographically-driven growth and ingredients are an increasingly important component of nutrition products. You can also make the case that large ingredients companies with global reach will gain share from smaller local competitors. DSM look very well placed. In addition, and as described above, we see earnings growth as likely to be faster than revenue growth due to margin expansion.

Investment decision?

We have a long-standing position in DSM and it has contributed strongly to performance. We remain positive on the company's prospects and can see how the business has a good chance of rerating from its current ~11 x EV/EBITDA multiple towards that of its Ingredients peer group (who trade at >15 x EV/EBITDA).

Glossary

EBITDA (Earnings before interest, taxes, depreciation, and amortization): A company's earnings before interest, taxes, depreciation, and amortization is an accounting measure calculated using a company's earnings, before interest expenses, taxes, depreciation, and amortization are subtracted, as a proxy for a company's current operating profitability

About Jamie

Jamie Ross is a Portfolio Manager of European equities at Janus Henderson Investors, a position he has held since 2016. He was appointed as a joint Portfolio Manager for a European investment trust in 2018 and became sole manager in 2019. Prior to this, he was a portfolio manager on the UK Equities Team, where he co-managed a UK equities pooled fund. Before that, he was an assistant portfolio manager on the Pan European Equities Team. He started his career with Henderson in 2007.

Jamie graduated with a BA degree (Hons) in economics from Durham University. He holds the Chartered Financial Analyst designation and has 13 years of financial industry experience.

BY RICHARD GILL, CFA

BOOK REVIEW

7 MISTAKES EVERY INVESTOR MAKES

(AND HOW TO AVOID THEM)

BY JOACHIM KLEMENT

Richard Gill reviews *7 Mistakes Every Investor Makes*, the book that aims to help investors make better decisions and more money.

Everyone makes mistakes. This is especially true when it comes to investing, with professional and private investors alike inevitably seeing some kind of bungle over the course of their career. However, I recall the story of one investor who wanted to buy £2,000 worth of shares in oil giant BP. Instead, due to either a lack of concentration or 'fat-finger' syndrome, they ended up with a holding in the small-cap investment company BP Marsh & Partners. This actually turned out to be a blessing in disguise, with BP Marsh going on to outperform its blue-chip namesake.

Most other errors however usually turn out negatively. Confirmation bias, for example, can lead to investors holding onto a stock for too long as they ignore any negative news. Blindly following a 'bandwagon' stock can lead to investing in shares at a high price as they are being pumped up by characters looking to make a quick buck.

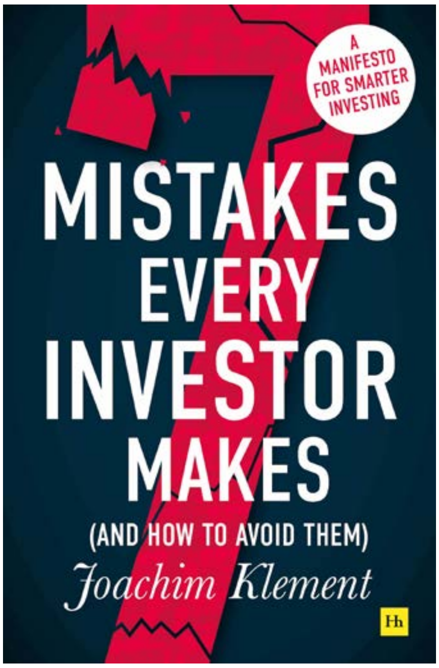
In *7 Mistakes Every Investor Makes*, author Joachim Klement uses his financial-industry experience, along with years of scientific research, to identify the most common mistakes that plague investors' decision making. He then goes on to discuss the tools and techniques which he personally uses to avoid and mitigate these errors, with the ultimate aim to help investors make better decisions and make more money.

Klement is a research analyst and former chief investment officer with 20 years' experience in the financial markets. He spent most of his career working with wealthy individuals and family offices, advising on investments and managing portfolios. He is a clever fellow, holding a master's degree in mathematics as well as a master's in economics and finance.

Stop slipping up

In the introduction to the book, Klement discusses his personal "relay of misery". As well as being an excellent name for a death-metal band, this refers to the mistakes the author has made over his investment

"GOOD DECISIONS COME FROM EXPERIENCE. BUT EXPERIENCE COMES FROM BAD DECISIONS."



career. Setting the scene for the rest of the book, he suggests that these mistakes are inevitable. But if you want to be a good investor, you should admit they happened, accept the consequences and, most importantly, go on to learn from them.

The core text of the book covers seven chapters, each looking at a specific mistake that investors frequently make, showing (with evidence) how they can lead to poor performance and then explaining techniques for how to avoid them.

One of my favourites is chapter two which looks at how our tendency to focus on the short term can lead to bad outcomes over a longer-term horizon. With companies focusing on quarterly reporting and investors wanting quick returns, the bigger picture can be often be ignored, leading to lost opportunities. One example is investors selling stocks after a short-term setback or poor share-price performance. For instance, internet 'darling' ASOS saw its shares fall from 16p to 5p in 2002 but anyone focusing on the short-term here would have missed out on the shares rising to a peak of £77 over the next 15 years. The diagnosis here is to look many years ahead when investing and work with people (directors/fund managers etc) who have a similar view.

In contrast, chapter three suggests investors can be overly focused on the long term as well, holding on to positions that will never make a profit. The key to investment success is to find the right balance between the two approaches.

Moving on, chapter six focuses on what to look for when delegating investments to professional money managers. While many private investors like to manage their own portfolios, often thinking they can do it better than the professionals, sometimes it can be a good idea to get the experts to make decisions for you – especially if you lack knowledge in a specific area. Of course, when choosing a professional investor, mistakes can occur, especially if past performance is looked at as the main deciding factor. Klement helps readers to find managers that can outperform by suggesting they look at fund fees, their degree of activity and for managers who are incentivised to deliver good returns rather than just match the benchmark and collect their salary.

Following the seven core chapters, chapter eight explains how the recommendations given in the rest of book can be adapted to personal needs – after all every investor is different. Klement advises that investors take a look at their own strategies and philosophies, whether value based, growth based or driven by technical or fundamental analysis. This will help to identify things that went well and not so well in the past. The chapter ends with a discussion of how the author's approach to forecasting has changed over time, along with his current top 10 forecasting rules.

Give up gaffes

Someone, I'm not sure who, once said: "Good decisions come from experience. But experience comes from bad decisions.... learn from mistakes and go ahead." This sums up Joachim Klement's excellent book, which should be a fixture in every investor's library. It is well written and packed with a mix of economics, psychology and finance theory, complemented by stories of the author's own career experience. Most useful of all, there is plenty of practical advice to make you a better investor. While Klement admits that the book isn't the solution to all your problems, it does act as a perfect primer to a lifelong journey of learning.

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

THE STRANGE 'DEATH' OF VALUE INVESTING

As Benjamin Graham, the 'father of value investing' rightly observed, you can invest on the basis of hope or you can invest on the basis of mathematics. In this instance, I prefer mathematics, writes fund manager Tim Price.

"An investment operation is one which, upon thorough analysis, promises safety of principal and an adequate return. Operations not meeting these requirements are speculative."

— Benjamin Graham

According to the late, great Canadian value investor, Peter Cundill: "There's always something to do". What he meant, I suspect, was that regardless of apparent overvaluations in certain markets, there are always undiscovered bargains somewhere else in this world just waiting to be discovered. (I agree.)

Right now, it seems that there is always something to worry about. A list that includes the global debt mountain; negative interest rates; the fragile state of the eurozone banking system; tariffs and trade wars; and a general mistrust of capitalism, has now been joined by concerns that the Wuhan coronavirus threatens to turn into a global pandemic, with the impact on global trade that that represents.

There is an obvious response to all of this. Given that deposit rates are derisory, the pragmatic conclusion has to be to invest defensively and in a genuinely diversified way. Inasmuch as listed equities are likely to form the lion's share of even the most defensively minded investors' portfolios – let's not dwell on the risks of bonds for the moment – how do we retain 'skin in the game' without exposing our capital to overmuch risk?

My answer, not just now but for all time, is value investing, practised according to the time-honoured principles of Benjamin Graham, author of the value investor's Bible, *The Intelligent Investor*. If the name Benjamin Graham is unfamiliar to you, bear in mind he's the person who taught Warren Buffett at Columbia Business School. Enough said, probably.

In his introduction to a reissue of Benjamin Graham's book, the *Wall Street Journal* columnist Jason Zweig writes that

..."this book will teach you three powerful lessons: how you can minimize the odds of suffering irreversible losses; how you can maximize the chances of achieving sustainable gains; how you can control the self-defeating behaviour that keeps most investors from reaching their full potential."

Benjamin Graham handled the first two objectives with his concept of the 'margin of safety'. Equity investors can secure a margin of safety when they purchase securities at a price sufficiently below the business' underlying value to allow for human error, bad luck or – something else.

Within my own investment business, we pursue Benjamin Graham's vision of investing by trying to focus solely on the shares of companies run by principled, shareholder-friendly management with an absolute mastery of capital allocation − when and only when we can buy such securities at a meaningful discount to their inherent worth. Any assessment of corporate talent is bound to be at least somewhat subjective, but happily there are some objective measures of value that can be assessed mathematically. They include, for example, the following metrics:

- at least a 10% cash flow from operations yield (the cash flow from a company's operations divided by the combined value of the company's equity and debt)
- a price/earnings ratio of less than 15 times
- a price/book ratio of less than 1.5 times and ideally less than 1
- a debt/total assets ratio of less than 30%
- cash from operations growth (we have no interest in declining or stagnating businesses)
- a return on equity of at least 8% on average per annum.

Fulfilling these criteria is no guarantee, of course, of securing a successful investment, but they're unlikely to hurt your prospects of such, especially if you can identify genuinely able management.

And then there's the market experience of the last 10 years...

Conventional wisdom has it that value stocks have been a disaster for the last decade – ever since central-bank monetary policy drifted away from any form of rationality and became the biggest experiment in world monetary history. The reality is more down-to-earth. To outperform over the last 10 years, you needed to do just two things − one: own US stocks and forget all the others or ignore almost all of the US stock market and concentrate on the shares of Facebook, Amazon, Apple, Netflix, Google and Microsoft. Those FAANGM stocks, for example, between 2015 and the end of 2019 delivered returns of 300%. The S&P 500 index itself over the same period delivered a return of 72%.

As the asset managers at the US firm Dimensional Fund Advisors point out, the recent returns from value stocks – in the US market, at least – have been broadly in line with their long-run average. As their charts below show, the annualised return of US value stocks for the last decade stands at 11.4%, just a shade below their overall annualised return since January 1979.

The real outlier is growth. US growth stocks for the last 10 years delivered to investors lucky or shrewd enough to own them 14.7% on average, annualised, versus a return of 11.3% for the period since January 1979.

(If you're interested in seeing DFA's original piece, you can find it here.)

Performance of US value stocks in past 10 years and since 1979, and performance of US growth stocks over the same periods

Source: Dimensional Fund Advisors LP.

So, at least for US investors, value has not been a recent disaster. Rather, growth has been an almost incredible triumph.

DFA's research doesn't end there. Have there been previous examples of the market suddenly flipping back from a preference for growth to one of value? Indeed, there have. It was called the first dotcom boom. Consider the charts below.

As DFA points out:

"While stock returns are unpredictable, there is precedent for the value premium turning around quickly after periods of sustained underperformance. For example, some of the weakest periods for value stocks when compared to growth stocks have been followed by some of the strongest... On March 31, 2000, growth stocks had outperformed value stocks in the US over the prior year, prior five years, prior 10 years, and prior 15 years. As of March 31, 2001 – one year and one market swing later – value stocks had regained the advantage over every one of those periods."

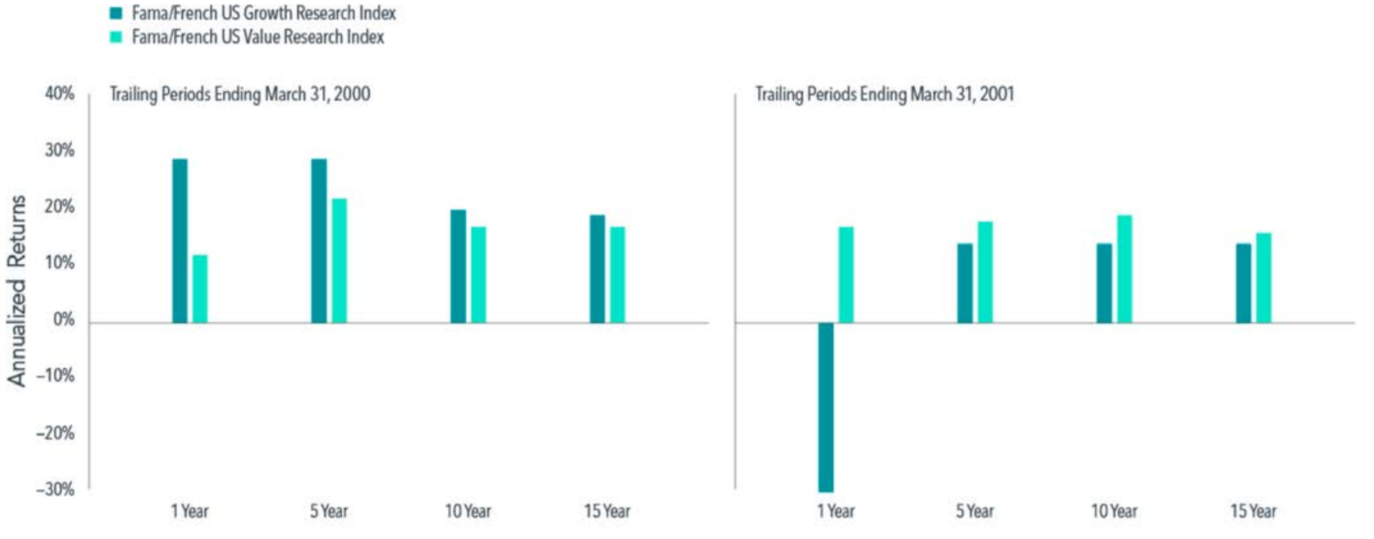
Sentiment, in other words, can change on a dime. In the process, it can swiftly reverse 10 years of accumulated outperformance.

As DFA goes on to say:

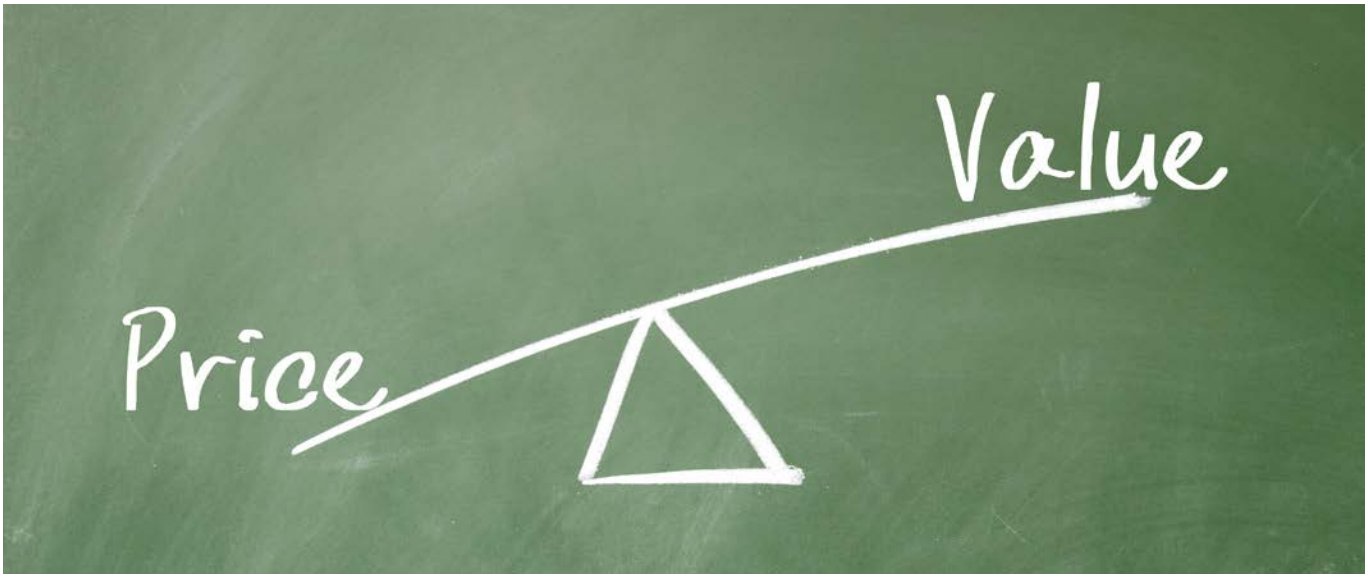
"The theoretical support for value investing is longstanding – paying a lower price means a higher expected return. However, realized returns are volatile. A 10-year negative premium, while not expected, is not unusual.

"VALUE HAS NOT BEEN A RECENT DISASTER. RATHER, GROWTH HAS BEEN AN ALMOST INCREDIBLE TRIUMPH."

Using March 31, 2000, and March 31, 2001, as ending points, performance of US value and US growth stocks over 1- to 15-year trailing periods



Source: Dimensional Fund Advisors LP.



But history also tells us that changing course after a disappointing spell for known premiums can lead to missed opportunities. When those drivers of outperformance have turned around in the past, steadfast investors have been rewarded. A key to successful long-term investing is sticking with your approach, even through difficult periods, so that you are there for the good times too."

Peter Cundill also famously wrote that:

"The most important attribute for success in value investing is patience, patience and more patience. The majority of investors do not possess this characteristic."

Readers of a certain vintage may remember Fidelity's star manager Peter Lynch, who steered its Magellan Fund between 1977 and 1990. During that period, Lynch's average annual return to investors was 29%. How much do we think the fund's average investor made over the same period? Michael Torrence of Alpha Wealth Funds suggests that the average investor in Peter Lynch's fund lost money over the same period. If this seems extraordinary – and it surely is – it is a reflection of the average individual investor's propensity to take profits too quickly and to sell out despondently too quickly, too.

Benjamin Graham had a way of describing this sort of behaviour. He even coined the phrase 'Mister Market' to define it. Sometimes, the price is not right. Sometimes, the price is very wrong indeed. Jason Zweig picks up the story:

"EQUITY INVESTORS CAN SECURE A MARGIN OF SAFETY WHEN THEY PURCHASE SECURITIES AT A PRICE SUFFICIENTLY BELOW THE BUSINESS' UNDERLYING VALUE TO ALLOW FOR HUMAN ERROR, BAD LUCK OR – SOMETHING ELSE."

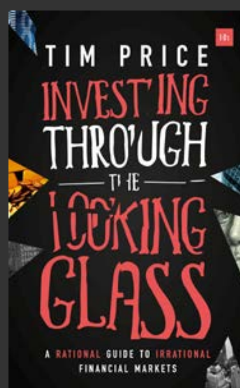
"...at such times, you need to understand Graham's image of Mr. Market, probably the most brilliant metaphor ever created for explaining how stocks can become mispriced. The manic-depressive Mr. Market does not always price stocks the way an appraiser or a private buyer would value a business. Instead, when stocks are going up, he happily pays more than their objective value; and, when they are going down, he is desperate to dump them for less than their true worth..."

There is nothing wrong with 'momentum' investing (trading, to be fair, would be a better description), but we should recognise it for what it is worth, and it is not value investing. It is not even investing by Benjamin Graham's earlier definition. Rather, it is speculation – that what has gone up will continue to go up.

I prefer a more defensive stance, not least because I fear storm clouds ahead. As Benjamin Graham rightly observed, you can invest on the basis of hope, or you can invest on the basis of mathematics. In this instance, I prefer mathematics.

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'.



MARCH 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

WEDNESDAY 4 MARCH | 13:00-14:00

Event:	Tips and tricks for your first trade. Get started with Fineco
Organiser:	FinecoBank
Place:	FINECO HUB, 19 Great Winchester Street, London EC2N 2JA
Tickets:	https://finecobank.com/uk/public/corsi-e-education/corsi

TUESDAY 10 MARCH | 08:15-10:00

Event:	2019 Award Winners Breakfast & Panel Discussion
Organiser:	Small Cap Network
Place:	Hamlins LLP, Roxburghe House, 273-287 Regent Street, London W1B 2AD
Tickets:	www.eventbrite.co.uk/e/2019-winners-breakfast-panel-discussion-tickets-93310414963 Or https://smallcapnetwork.co.uk/events

WEDNESDAY 11 MARCH | 12:30

Event:	The Netwealth investment approach
Organiser:	Netwealth
Place:	Webinar
Tickets:	https://attendee.gotowebinar.com/register/6648704337382790923

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

TUESDAY 17 MARCH | 12:30

Event:	Moving into drawdown with Netwealth
Organiser:	Netwealth
Place:	Webinar
Tickets:	https://attendee.gotowebinar.com/register/813493874194764044

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

THURSDAY 26 MARCH | 12:30

Event:	How to move from cash to being invested
Organiser:	Netwealth
Place:	Webinar
Tickets:	https://attendee.gotowebinar.com/register/8204387946359005964

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:	100% discount using code: MAG03 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

THURSDAY, 11 JUNE | 19:00-21:30

Event:	Chairman's Reception / EISA Awards
Organiser:	EISA
Place:	TBC
Tickets:	https://finecobank.com/uk/public/corsi-e-education/corsi

THURSDAY 25 JUNE | 18:30-00:00

Event:	Small Cap Awards 2020
Organiser:	Small Cap Network
Place:	The Montcalm Hotel London, 2 Wallenberg Place, Marylebone, London W1H 7TN
Tickets:	www.eventbrite.co.uk/e/small-cap-awards-2020-tickets-79392449955?aff=ebapi Or https://smallcapnetwork.co.uk/events

MARKETS IN FOCUS

FEBRUARY 2020

GLOBAL EQUITIES

Index	Last Month %	YTD%	52-Week Strength
Hang Seng	-0.7	-7.3	
CSI 300	-1.6	-3.8	
NASDAQ 100	-5.9	-3.1	
Swiss Market	-7.5	-7.4	
S&P/ASX 200	-8.2	-3.6	
FTSE All-World	-8.2	-9.3	
DAX Xetra	-8.4	-10.3	
S&P 500	-8.4	-8.6	
CAC 40	-8.6	-11.2	
Euronext 100	-8.8	-10.7	
Nikkei 225	-8.9	-10.6	
Bovespa	-9.5	-10.9	
FTSE 100	-9.7	-12.8	
Dow Jones	-10.1	-11.0	
Russian TSI	-14.3	-16.1	

COMMODITIES

Commodity	Last Month %	YTD%	52-Week Strength
Palladium	21.9	42.0	
Coffee	6.9	-15.4	
Iron Ore	6.4	-4.8	
Gold	3.4	7.8	
Copper	2.2	-8.1	
Palm Oil (Crude)	1.4	-20.5	
Cotton	0.1	-2.2	
Cocoa	-1.2	8.1	
Silver	-1.5	-1.0	
Sugar (No. 11)	-2.8	5.8	
Natural Gas	-4.8	-20.0	
Bitcoin	-5.2	24.1	
Platinum	-5.9	-7.4	
Crude oil (Brent)	-8.6	-21.6	
Crude oil (Light Sweet)	-8.7	-22.9	

FOREX

Pair/Cross	Last Month %	YTD%	52-Week Strength
EUR/GBP	2.5	1.7	
USD/CAD	1.4	3.2	
USD/CHF	0.2	-0.3	
GBP/AUD	-0.1	3.7	
USD/JPY	-0.2	-0.5	
EUR/CHF	-0.4	-2.1	
EUR/USD	-0.6	-1.7	
EUR/JPY	-0.8	-2.3	
AUD/USD	-2.5	-7.0	
GBP/USD	-2.9	-3.3	

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 (RBA)	0.75%	Mar 03	Apr 07
Swiss National Bank (SNB)	-0.75%	Mar 19	Jun 18
Banco Central do Brasil (BCB)	4.25%	Mar 18	May 06
Central Bank of Russia (CBR)	6.00%	Mar 20	Apr 24
Reserve Bank of India (RBI)	5.15%	Apr 03	

FTSE 350 TOP RISERS

Company	Last Month %	YTD%	52-Week Strength
Daejan Holdings PLC	53.5	47.8	
Syncona Ltd	14.5	11.9	
Bank of Georgia Group PLC	11.8	4.1	
Plus500 Ltd	6.6	7.2	
TBC Bank Group PLC	4.4	-0.5	

FTSE 350 FALLERS

Company	Last Month %	YTD%	52-Week Strength
Tullow Oil PLC	-33.7	-47.3	
Aston Martin Lagonda PLC	-32.2	-35.0	
SIG PLC	-31.8	-48.7	
Micro Focus Int PLC	-27.8	-30.4	
Playtech PLC	-27.6	-37.0	

FTSE 350 SECTORS RISERS

Sector	Last Month %	YTD%	52-Week Strength
Forestry & Paper	1.0	-11.9	
Electricity	1.0	4.3	
Oil Equipment, Serv & Dist	-3.4	-12.3	
Gas, Water & Multiutilities	-4.2	0.8	
Leisure Goods	-5.1	3.2	

FTSE 350 SECTORS FALLERS

Sector	Last Month %	YTD%	52-Week Strength
Automobiles & Parts	-21.0	-27.8	
Oil & Gas Producers	-15.6	-22.5	
Food Producers	-12.2	-11.1	
Mining	-11.9	-18.3	
Travel & Leisure	-11.7	-16.9	

IA SECTORS RISERS

Sector	Last Month %	YTD%	52-Week Strength
China/Greater China	4.6	0.7	
UK Index Linked Gilts	3.2	8.6	
Global Bonds	1.2	2.2	
UK Gilts	1.1	5.2	
Global Emerging Mkt Bond	0.7	1.4	

IA SECTORS FALLERS

Sector	Last Month %	YTD%	52-Week Strength
Japanese Smaller Companies	-9.1	-12.8	
UK Smaller Companies	-6.2	-5.7	
Japan	-5.7	-7.7	
UK Equity Income	-5.6	-8.1	
UK All Companies	-5.4	-7.6	