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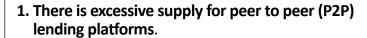
# New twist to income story

Peer to peer lending rates could fall as supply exceeds demand

an you hear the bells ringing? No, not the ones from your local carol concert; I'm talking about the noise from the market that implies the public still can't quench its thirst for income.

In the past week I've seen three signs that suggest income remains a priority for investors.

One event shows investors' ravenous hunger for yield. The other two are responses by industry participants as they try to capitalise on this hunt for income.



British P2P lending platform Zopa has told savers they can't invest any new money as there aren't enough borrowers to take this cash.

P2P platforms have been inundated by investors seeking to lend money to other people as potential interest rates, often as high as 7%, are better than you could get from bank cash deposit accounts - or indeed much of the stock market.

#### 2. Retail bonds are back.

Property financier Places for People has launched a retail bond offering 4.25% annual interest until 2023. We estimate this is the first retail bond

launch in the UK for eight months, and only the fourth of its kind this year. The launch offer is expected to close on 12 December.

3. Yet another high-yield fund is floating on the stock market.

RM Secured Direct Lending is hoping to pay 6.5% dividend yield once it has fully invested the money raised at its stock market flotation. Its shares to start

trading on 15 December.

#### **TURNING POINT**

Zopa's temporary halt on new deposits could be a major turning point in the P2P sector.

Theoretically this action could force down rates across the industry as borrowers effectively have the upper hand. They can just shop around for loans which could push down rates. For investors, that could mean P2P becomes less attractive.

In contrast, we are more enthused by RM's fund launch, although you should note the 6.5% yield level isn't expected until 2018 and isn't a guaranteed rate of return.

Next week's issue of *Shares* will take a broader look at the world of income. We've set ourselves the challenge of finding ways to exceed 4% yield from the market. We will reveal the good, the bad and the ugly.

#### WHO WE ARE EDITOR: DEPUTY NEWS COMPANIES FDITOR-FDITOR-FDITOR: Daniel William Cain Tom Sieber Steven Frazer Coatsworth @SharesMagWill @SharesMagTom @SharesMagSteve @SharesMagDan FUNDS AND INVESTMENT JUNIOR REPORTER: CONTRIBUTERS TRUSTS EDITOR: Lisa-Marie Janes **Emily Perryman** James Crux @SharesMagLisaMJ Tom Selby @SharesMagJames PRODUCTION **ADVERTISING** MANAGING DIRECTOR Mike Boydell **Head of Production** Sales Executive Michael Duncan Nick Frankland 020 7378 4592 Designer nick.frankland@sharesmagazine.co.uk Rebecca Bodi Shares magazine is published weekly every Thursday (50 times per year) by AJ Bell Media Limited,

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We use traffic light symbols in the magazine to illustrate broker views on stocks.

Green means buy, Orange means hold, Red means sell.

The numbers refer to how many different brokers have that ratina.

Eq: 4 2 1 means four brokers have buy ratings, two brokers have hold ratings and one broker has a sell rating.

The traffic light system gives an illustration of market views but isn't always a fully comprehensive list of ratings as some banks/stockbrokers don't publicly release this information.

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# Three reasons to like SSE

Big six energy supplier has fallen too far, argue analysts

here are three compelling reasons to buy shares in FTSE 100 energy supply business **SSE (SSE)**: yield, renewable growth and power generation upside, plus its inflation-busting properties.

The utilities team at UBS believe there is scope for the stock to rally more than 10% on their base case investment scenario. If sector dividend yields return to their average levels before the recent bond market correction then the investment bank sees upside of 21%.

# **BULLISH STANCE**

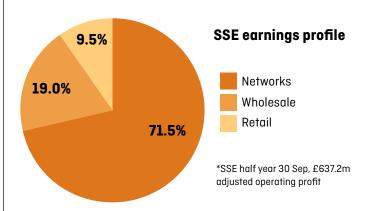
The UBS analysts are not alone in their positive assessment of SSE. While 10 of the 19 analysts that follow the stock retain a neutral stance, eight of the remaining analysts currently rank the shares as a 'buy', with just a single City number cruncher recommending the stock as a 'sell', according to Reuters data.

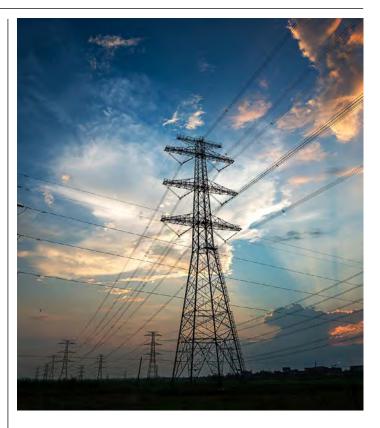
As we explained on 2 December, European utilities stocks are substantially down since September as rising bond yields have taken the shine off a strong run for the sector in recent years.

SSE is among the wider utility industry to experience a drag on its share price. The stock has declined around 5% since the end of September but almost 8.5% since recording 2016 highs of £16.28 in late July.

### **INCOME COMMITMENT**

Income is an unsurprising feature of UBS's analysis. SSE 'has a track record of delivering dividend





increases at least in line with RPI, and in our view, commitment to this policy is likely to remain strong,' it notes. RPI is the retail price index, a representative basket of goods used as one of the Bank of England's key measures of inflation.

Around 80% of SSE's net income has some level of inflation defence built in, making its RPI-beating payout policy appear sustainable in the medium-term.

According to consensus data from Reuters, SSE is forecast to pay a 91.2p per share dividend this year to 31 March 2017. This implies a dividend yield of 6.1% based on the current £14.91 share price, versus the sector average 5.8% yield, or a 4.35% average for the FTSE All-Share index.

New clean electricity generation is also coming on stream that points to the group's largest ever renewable pipeline. This includes circa 1GW of wind projects in construction and another 2GW to 3GW further pipeline options, says UBS.

BROKER SAYS 8 10 1

# Cambian's dividend cheer

Transformational deal enables social care provider to reinstate payouts

BEHAVIOURAL HEALTH SERVICE provider Cambian (CMBN) is selling its adult business for £377m to American hospital management company Universal Health Services (UHS:NYSE)

This deal should return the business to rude health. Significantly, the proceeds will repay Cambian's £293m of debt in full and still leave it with £40m to fund a 22p special payout and put it in a position to resume ordinary dividends.

The social care provider has agreed (5 Dec) to sell its adult services unit to Cygnet Health Care, part of Universal Health Services, for what looks like a good price.

Reflecting high levels of interest in the business, the proceeds represent an earnings multiple of 15.6 times. Crucially, the deal leaves Cambian, which previously ran into difficulties following some overly ambitious expansion, in ruder financial health and free to focus on rolling out its Children's Services Business.

This offers significant opportunities for growth, development and the creation of shareholder value against a backdrop of growing demand for the critical services Cambian provides.

In addition to the special dividend, one implying a 16.1% yield at 136.75p, Cambian plans to resume its progressive dividend policy, with a payout likely to be declared around the time of the half year results in 2017.

Canaccord Genuity has upgraded its rating from 'speculative buy' to 'buy' and price target from 118p to 150p following the sale.

# SHARES SAYS: 7

With operational issues behind it and this deal transforming the balance sheet, Cambian looks interesting again at 136.75p. (JC)

**BROKER SAYS** 







# **Data dumping boon for Blancco**

Digital erasing specialist is carving a profitable cyber security niche

Data erasing business Blancco Technology (BLTG:AIM) is on track to grow profit by 35% to 40% this year as organisations come to terms with the need to effectively manage confidential digital data.

With a new mobile diagnostics revenue line coming on stream through its full ownership of the Xcalibar business, analysts suggest the shares could trade substantially higher through 2017 than the current 224p level.

Paraag Amin, technology analyst at broker Peel Hunt, slapped a

340p share price target on the stock when he published a detailed initiation of coverage note on the company in September. More recently, on 29 November, Panmure Gordon's Adrian Kearsey reiterated his own 326p stock valuation in response to Blancco's positive first quarter trading update. Blancco's financial full year runs through until 30 June 2017.

Blancco is fast carving itself a valuable niche in the modern digital environment providing clients with a regulation and

compliance-friendly way to dispose of data. These might be live environment information only needed temporarily, or data that has served its useful purpose and is no longer required. Blancco has 18 certifications, approvals and recommendations from national governing bodies.

#### SHARES SAYS: 7

A current year price to earnings (PE) multiple of 25.4 should fall sharply presuming it meets its 20% to 30% earnings growth expectations. A 325p share price would imply a PE of 24 on a 12 to 18 month view.

BROKER SAYS 3 0 0





# Why Telford is our pick of the housebuilders

Focus on less pricey parts of London should pay off for AIM-quoted firm

espite a growing debt pile we prefer AIMquoted housebuilder Telford Homes (TEF:AIM) to its larger peer Berkeley (BKG) as it is better positioned for the dynamics of the London property market.

Both stocks have been hit by the sector-wide sell-off sparked by the Brexit vote, yet they are very different animals. Berkeley specialises in higher end developments in the capital. Telford is focused on 'non-prime London' and has increasing exposure to the build-to-rent market.

#### **BUMPER SALES**

Foreign investors had helped to prop up prices in prime London locations. They've been put off by the Brexit vote, as evident by Berkeley which revealed underlying demand down 20% in its half year results (1 Dec).

The concentration of jobs in London makes it easier to predict demand for Telford's more affordable properties.

Strong demand is reflected in its City North development in Finsbury Park where in November alone it sold 72 homes with a combined value of more than £43m.

Telford's pre-tax profit fell 57% in the six months to 30 September to £9m but this reflected the timing of completions. The company is on track to hit full year profit guidance of £33m. Its confidence is underpinned by a 10% hike in the first half dividend.

The company's target to exceed £50m pre-tax profit by 31 March 2019 looks plausible, in our view.

#### WATCH THE DEBT

Its forward order book has exceeded £700m worth of revenue. The strong levels of visibility provided by these sales means the company is set to dial up its debt to fund future site acquisitions and meet construction costs.

Canaccord Genuity forecasts £115m net debt by the financial year end in March 2017, rising to £162m a year later.



Build-to-rent or private rented sector developments see all the properties built for rent rather than sale. Increasing exposure to this space could limit borrowings in the future as the deals are typically forward funded by institutional investors.

Telford is close to exchanging contracts on a third transaction in this space having recently sold its Carmen Street site in Poplar to M&G Real Estate.

#### **BUY SIGNAL?**

Berkeley thinks its shares are cheap and has replaced some of its pledged dividend payments with a share buyback alongside first half results (2 Dec).

Chairman Tony Pidgley has an excellent record of calling property cycles but we still think Telford is the more attractive investment.

Based on Peel Hunt's forecasts, Berkeley trades at 1.1 times net asset value, a discount to the sector average of 1.5 times, and yields more than 5%.

SHARES SAYS: 7

Buy Telford at 319p.

BROKER SAYS 2 2 0





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**TEDDY SAGI, FOUNDER of** gaming technology outfit Playtech (PTEC), banked £330m after selling a 12% stake in the gaming technology specialist.

**Investment bank UBS** conducted the sale which initially aimed to find buyers for 10% of the company's shares. UBS said 'strong demand' from institutional investors helped Sagi secure his 12% disposal though it's worth noting the deal completed at 850p a share, an 8% discount to the previous day's closing price. Sagi still owns 22% of the business. (WC)

# 100,000

THIS IS THE number of customers satellite broadband and airtime reseller Satellite Solutions Worldwide (SAT:AIM) had been targeting by end-2017. But the company reckons it will beat that figure thanks to a period of rapid expansion. A trio of acquisitions during 2016 have transformed the scale of the business and demand for its services is soaring – the company has been adding 1,000 new subscribers a month in Australia alone of late. Management are now confident of exceeding its original target. The shares trade at 7.5p. (SF)



economic downturn. Cost-cutting and conversion of loss absorbing capital into equity, diluting existing shareholders, would reduce the capital deficit to between £1bn to £1.8bn, according to analysts at UBS.

Failing the test means RBS must submit new capital plans to the central bank. No other banks were required to do this, though Barclays (BARC) and Standard Chartered (STAN) reported capital ratios below targets in the downturn scenario. (WC)



WE ALL KNOW the NHS has been slashing budgets left, right and centre to meet the Government's austerity spending targets and this is hitting the IT supplier world. According to Brendan Mooney, CEO of digital transformation specialist Kainos (KNOS), this is unlikely to change any time soon. He anticipates only one NHS Trust IT system procurement in 2017, matching the 2016 number. For context, there were 11 in 2014 and seven in 2015. It looks like NHS managers haven't grasped the cost saving benefits of IT yet. (SF)

THERE'S LOTS of chatter about self-driving cars hitting our roads but regulations and safety measures are not the only thing putting the brakes on mass adoption.

New technology takes roughly a decade to become fully embraced by automotive manufacturers, according to broker Peel Hunt. (SF)

A WARM SUMMER helped **Britvic (BVIC)** sell 1.3bn litres of fizzy drinks in the UK during the year to 25 September 2016.

Sales of *Pepsi*, which Britvic distributes in the UK, *7UP* and *Tango's* best year in more than a decade helped volumes gain around 4.8%.

Worldwide, and including sales of still drinks including *Robinsons* cordial, Britvic sold 2.3bn litres in the year, up 12.3% year-over-year.

Robinsons struggled because political pressure around higher sugar content drinks meant a popular 'added sugar' line of the brand was removed. (WC)

# **Price-to-earnings ratios on key UK indices** (2017 estimates)

# FTSE 100 14 FTSE 250 14.2 FTSE Small cap 12.1 FTSE All-Share 14 FTSE AIM 100 20.6

# BEST & WORST - OIL & GAS STOCKS (YEAR-TO-DATE)

1030
819
377
347
305
-75.3
-88.2
-88.3
-91.9
-92.3

Source: Sharepad, data to 5 Dec 2016

# FTSE 350 OVER PAST 3 MONTHS

# **BEST PERFORMERS**

	COMPANY	(%)
1	<b>KAZ Minerals</b>	110
2	Evraz 79	
3	Vedanta Resources	77
4	Glencore	60
5	Anglo American	53
6	Petra Diamonds 48	
7	Electrocomponents 45	
8	Antofagasta	43
9	Tullow Oil	43
10	JRP Group	40

# **WORST PERFORMERS**

	COMPANY	(%)
1	SIG	-28
2	Polymetal International	-31
3	Fresnillo	-31
4	Berendsen	-32
5	Mediclinic International -33	
6	Countrywide	-35
7	CMC Markets	-35
8	NCC Group	-42
9	Capita	-49
10	Laird	-51

\* Excluding Equity Investment Instruments, Nonequity Investment Instruments Date to 5 December

Source: Thomson Reuters Datastream

# Jimmy Choo's on the front foot

Luxury shoemaker to profit as weak pound stimulates tourist spend

igh-end shoemaker Jimmy Choo (CHOO) remains on the front foot despite difficult luxury market conditions and enters the Christmas selling period with momentum at its heels. A positive January trading update could renew interest in this quality retail growth stock.

#### **WELL-HEELED WINNER**

Co-founded in 1996 by one-time Voque accessories editor Tamara Mellon and its eponymous couture shoemaker, the company offers a compelling combination of brand strength, pricing power, high cash conversion and global growth potential.

The £500m cap has an expanding store footprint, highend footwear selling through prestigious department and specialty stores worldwide and is stretching its iconic brand into handbags, fragrance, eyewear and men's shoes.

We are excited by Jimmy Choo's global growth potential. Brand awareness is rising in Asia, where well-heeled shoppers have great affection for all things British. More established luxury players with wide store footprints are seeing falling sales and margin compression but Jimmy Choo leads in luxury shoes, one of the best performing areas of luxury, and the brand remains under-penetrated in China's Tier 1 cities.

# JIMMY CHOO 7 BUY

(CHOO) 133p Stop loss: 106.4p

Market value: £500m

# **WALKING TALL**

Confounding gloomy expectations, Jimmy Choo's latest trading update (18 Nov) indicated a return to like-forlike sales growth in the second half, despite disruption from store conversions. Management reported improved retail trading across all regions with continuing strength in China and bumper appetite for its 20th anniversary collections.

Jimmy Choo is on course for



another record year. Sterling depreciation is supporting strong sales to luxury tourists from a London-centric store base.

With sterling remaining weak and the capital seeing strong growth in shoppers, investors could expect an excellent Christmas performance supported by festive gifting by Chinese, Middle Eastern and US visitors.

For the year to December 2016, Liberum forecasts improved pre-tax profit of £31.4m (2015: £24.5m) for earnings per share of 6.4p, rising to £36m and 7.3p of earnings in 2017.

The potential for earnings upgrades is significant. Generating the bulk of revenues away from UK shores, the red carpet favourite is geared into weak sterling. Overseas sales and earnings are more valuable on translation back into pounds. Strong cash generation is also helping Jimmy Choo to deleverage, with falling borrowings offering another share price catalyst.

# **BROKER SAYS:** JIMMY CHOO FTSE ALL SHARE



# IMImobile to emerge a digital winner

Mobile commerce enabler to beat off FX doubts

s global commerce increasingly goes digital and multi-channel we expect mobile customer engagement, marketing and commerce specialist IMImobile (IMO:AIM) to emerge as a digital winner.

What really sets the company out from other mobile hopefuls is its consistency, racking up growth in revenue, earnings before interest, tax, depreciation and amortisation (EBITDA) and pre-tax profit, all while throwing off impressive amounts of cash.

#### **CASHED UP**

'IMImobile remains easily the standout performer in the mobile-focused peer group, generating solid growth, margins and cash flow,' spelled out Megabuyte analyst John McCaul following first half results on 15 November.

Those figures showed substantial progress, revenue up 29% to £36m, of which 16% was organic. It delivered 14% organic improvement in gross profit. Monthly recurring and repeating revenue accounts for 94% of this amount.

EBITDA increased 17% to £5.3m and adjusted pre-tax profit was £3.3m. There is now £17.9m in the bank to fund future growth, likely through a combination of platform investment and acquisitions.



#### **NAIRA NAG**

The only fly in the ointment was FX, particularly the Nigerian naira as the currency de-coupled from the dollar. Management reassure that just 6% of its business is in Nigeria and IMImobile works with clients in 60 nations worldwide.

It's also worth noting that much of the company's focus for the rest of the year to 31 March 2017 will be on accelerating

# IMIMOBILE #BUY

(IM0:AIM) 158.5p Stop loss: 127p

Market value: £95.8m

Prospective PE Mar 2017: 15.0

Analyst price target: 210p

(Investec)

opportunities in the US, where dollar strength tailwind could help offset currency headwinds elsewhere, and in South East Asia.

The company has a great customer base that 'does business year in and year out,' says Cantor Fitzgerald analyst Kevin Ashton, including Vodafone (VOD) and IBM (IBM:NYSE).

IMImobile also provides enterprise software solutions that address a real need, such as connecting telco back office functions and banking apps to customers across a sea of network operators, devices and geographies.

# **SCOPE FOR UPGRADES**

This suggests that the company is capable of doing better than the unchanged earnings per share (EPS) performance Investec anticipates in the current financial year. Its 10.5p estimate factors in the impact of the weaker naira. It forecasts 11.1p the year after, which looks too conservative in our view. (SF)



# **PURPLEBRICKS**

(PURP:AIM) 146.4p

Gain to date: 9% **Original entry point:** 

Buy at 134.31p, 22 September 2016

OUR POSITIVE CALL on online hybrid estate agent Purplebricks (PURP:AIM) is back in the money.

A very strong set of first half results (5 Dec) helped to repair the share price damage caused by a Government ban on upfront letting fees in the Autumn Statement (23 Nov).

Purplebricks posted revenue up 159% to £18.7m in the six months to 31 October. First half instructions are up 108% year-on-year.

The group as a whole, including a recently launched operation in Australia, posted a £2.2m loss at the adjusted earnings before interest, tax, depreciation and amortisation (EBITDA) level but a modest £300,000 profit on the same measure in the UK.

Purplebricks operates a hybrid model with a website backed by a growing number of local property experts who earn a commission for each new instruction they win.

For the company to be successful in the longterm it needs to demonstrate it can actually sell houses. Otherwise homeowners will grow disillusioned with the product and stop using it.

The company is increasing marketing spend to capture market share at a time when its traditional bricks and mortar rivals like Countrywide (CWD) and Foxtons (FOXT) are struggling. It says this will have some impact on profitability in the near-term.

# SHARES SAYS: 7

We still rate the shares as a 'buy'. Investec has a price target of 185p.

BROKER SAYS: 4 0 2









# NORTHGATE

(NTG) 465p

**Gain to date: 13.1%** 

Original entry point:

Buy at 411p, 24 November 2016

A MANAGEMENT SHAKE-UP at Northgate (NTG) has been well received by the market. Investors are clearly hoping new leadership will reinvigorate the van hire business.

Chief executive Bob Contreras is set to step down in January 2017 after more than six years in charge. His replacement is the former UK managing director of car rental firm Avis Europe, Kevin Bradshaw.

We recently flagged Northgate as a potential takeover target, citing the involvement of activist investor Crystal Amber on the shareholder register as someone which could push for a sale of the business.

The change of CEO was announced alongside half year results on 6 December. Underlying pretax profit was down 12% year-on-year at £40.4m and net debt was higher at £355m. Spain is doing well but the UK is struggling.

A 12% increase in the first half dividend to 5.7p per share would suggest the company is confident it can improve earnings.

It needs to have a strong second half period to hit earnings forecasts. We remain buyers.

BROKER SAYS: 4 1 0









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John Bennett, Fund Manager Henderson European Focus Trust

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Tim Rogers, MD of AB Dynamics (ABDP)



Clive Dix, CEO of C4X Discovery (C4XD)



Michael Hunt, CFO of ReNeuron Group (RENE)

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FRIDAY 9 DECEMBER	
INTERIMS	
PHOTO-ME INTERNATIONAL	PHTM
AGMS	
PETRO MATAD	MATD
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ECONOMICS	
UK	
GOODS TRADE BALANCE	
CONSTRUCTION OUTPUT	
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ENSOR	ESR
AGMS	
CONCHA	CHA
TUESDAY 13 DECEMBER	
FINALS	
HOLLYWOOD BOWL	BOWL
ZYTRONIC	ZYT
TRADING STATEMENTS	
BELLWAY	BWY
AGMS	
EDISTONE PROPERTY	
INVESTMENT COMPANY	EPIC
ECONOMICS	
UK	
CPI	
HPI	
PPI	
RPI	



**DIXONS CARPHONE** 

Half year results (14 Dec) from retail star turn Dixons Carphone (DC.) should be strong and contain some commentary on an extended Black Friday, where TVs, smartphones and white goods are likely to have flown off the shelves. Shares sees a bumper Christmas period in store for the Carphone Warehouse-to-Currys PC World brand-owner, though we are mindful of last year's demanding comparatives; it saw 5% growth in like-for-like sales delivered over the 10 weeks to 9

<b>WEDNESDAY 14 DE</b>	СЕМВ	ER
INTERIMS		
DIXONS CARPHONE		DC.
MICRO FOCUS INTERNAT	TIONAL	MCRO
TRADING STATEMENTS		
JOHN WOOD		WG.
AGMS		
MOBILE STREAMS		MOS
ORCHARD FUNDING		ORCH
ECONOMICS		
UK		
UNEMPLOYMENT RATE		
EU		
INDUSTRIAL PRODUCTIO	N	
US		
PPI		
RETAIL SALES		
INDUSTRIAL PRODUCTIO	N	
THURSDAY 15 DEC	EMBE	R
FINALS		
FALANX		FLX
TRADING STATEMENTS		
CENTRICA		CAN
GO-AHEAD GROUP		GOG
PETROFAC		PFC
PZ CUSSONS		PZC
AGMS		
GCM RESOURCES		GCM
GUNSYND		GUN
INNOVADERMA		IDP
LEAF CLEAN ENERGY CO	MPANY	LEAF
SAREUM		SAR
TISO BLACKSTAR GROUP	)	TBGR
EX-DIVIDEND		
ASSOCIATED		
BRITISH FOODS	ABF	26.45P
ASSURA	AGR	0.6P



### **HOLLYWOOD BOWL**

Maiden full year results as a public company from ten-pin bowling operator Hollywood Bowl (BOWL) will see the focus on an anticipated dividend and levels of footfall across its 54 UK sites. The market may also look for signs the company is able to lift spend per visit. Results are published on 13 December.



Investors are likely to be keeping a close eye on guidance for cost inflation when Newcastleheadquartered housebuilder Bellway (BWY) updates on trading (13 Dec) alongside its AGM. In an otherwise strong set of full year numbers (18 Oct), the company warned of price increases linked to the weak pound.

BCA	2.2P
	2.2P
	5.67P
	1.9P
•,	1.5P
• • • • • • • • • • • • • • • • • • • •	7.5P
•••••	2.5P
	5.7P
	8.8P
HFD	5.83P
нні	2.32P
JEMI	1P
MARS	4.7P
MKLW	6.88P
MRC	10.25P
MTO	4P
NXR	2.4P
SDY	0.33P
SFR	0.7P
UU.	12.95P
XPP	16P
ZPLA	3.7P
1S	
	HHI  JEMI MARS MKLW  MRC MTO NXR SDY SFR UU. XPP

For complete diary go to www.moneyam.com/forward-diary

January 2016.

# Six directors sell shares worth more than £1m

Seven figure sum deals hit the headlines

umerous directors of companies on the stock market have made investments worth more than £1m each over the past few weeks using their own money.

Only three of the nine deals over the past fortnight have been directors buying shares; the rest have been sales.

The purchases include **TalkTalk Telecom (TALK)** non-executive director Roger Taylor and **Mitie (MTO)** chief executive Phil Bentley. We don't rate either company as a good

investment, despite these votes of confidence.

Among the 'sells', we don't read anything negative in **GB Group's (GBG:AIM)** Richard Law selling £2.4m worth of stock in the tech group as he is retiring. The same applies to David Froker from audio products group **Focusrite (TUNE:AIM)**.

Auto Trader's (AUTO) finance director Sean Glithero sold just shy of £2.4m worth of stock. That's his second big sale this year, having sold £574,000 worth of shares in April when

restrictions were lifted as to when he could trade following the company's IPO (initial public offering) in March 2015.

Other £1m+ sellers include Simon Henry, chief financial officer at oil producer **Royal Dutch Shell (RDSB)**.

Glynn Burger, group risk and finance director at investment bank Investec (INVP), and Richard Cousins, CEO of catering giant Compass (CPG), both sold £1.1m worth of shares each to pay tax liabilities associated with receiving stock under a bonus scheme. (DC)



# We explain why the oil price is racing ahead

The commodity price has surged on an industry production agreement but question marks remain over how long the trend will last

il prices have hit their highest level in a year following the decision last week by production cartel OPEC to cut output.

We now explain five key issues concerning oil.

# 1. EXPECTATIONS WERE LOW

The oil price reaction suggests there was considerable scepticism over production cartel OPEC's ability to conclude a deal - so the end result was treated as somewhat of a surprise.

The 1.2m barrels of oil per day (bopd) cut agreed by OPEC's 14 members has clearly been received well by the market.

Deutsche Bank comments: 'The agreement is more bullish than market expectations in that first, the 33m bopd upper limit of the range has been omitted, leaving 32.5m bopd as the sole target level.'

The agreement is contingent on 600,000 bopd of production being cut by non-OPEC members with Russia and Oman expected to be the main contributors. Russia has already pledged to cut its output by 300,000 bopd.

# 2. OPEC STILL MATTERS -**JUST NOT AS MUCH AS IT DID**

The meeting on 30 November reminded the world that OPEC still has a major influence on the price of oil. The value of Brent



crude oil surged more than 10% on the day.

Perhaps what most impressed the market was the ability of Saudi Arabia and Iran to put aside their enmity to secure a deal.

Cantor Fitzgerald analyst Sam Wahab says: 'This agreement has truly changed the landscape for oil over the coming years, putting a floor of \$50 a barrel under oil prices.'

However, investments banks such as Deutsche and Goldman Sachs have left their 2017 oil price forecasts unchanged, partly due to scepticism over the cartel's ability to implement the cuts. Several members have a patchy track record when it comes to compliance with quotas.

OPEC may have lost the ability to quadruple the oil price as it did during the 1973/1974

embargo but it can probably provide a backstop to prices.

It should not be forgotten that oil's descent from \$100 per barrel was substantially accelerated by OPEC's failure to act at a pivotal meeting in November 2014.

#### 3. THE SAUDIS HAVE LOST

The decision to keep pumping the black stuff despite a growing oil glut was driven by Saudi Arabia in what was widely perceived as an attempt to protect market share by driving US shale producers out of business. This production freeze is effectively an admission of failure.

The oil price collapse had three key effects on the US shale industry. At the margin companies did go bankrupt and larger firms initially scaled back production. Perhaps most importantly, production costs roughly halved thanks to improved efficiency.

According to consultancy Rystad Energy the breakeven cost per barrel to produce from the Bakken shale in North Dakota has fallen from \$59.03 in 2014 to \$29.44 in 2016.

These streamlined shale operators are now further boosted by the election of an energy-friendly administration to the White House.

President elect Donald Trump is on record as wanting to boost domestic production. To achieve his aim could require a reduction in red tape and the fast track development of key infrastructure.

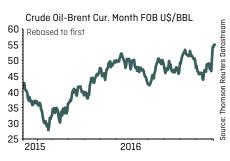
# 4. INDEBTED COMPANIES AND OIL MAJORS MOST EXPOSED TO OIL PRICE MOVEMENTS

The reaction of UK-listed oil companies to the surge in oil prices was relatively easy to predict.

Oil majors need higher oil prices if they are to fund their prized dividends from organic cash flow.

Indebted oil companies need higher prices to avoid bumping up against their lending covenants.

Shares in the sector understandably raced ahead on the OPEC news.





# 5. OIL PRICE REMAINS HARD TO PREDICT

Oil and gas producers could be winning investments if you think the oil price will stay strong well into 2017.

Sadly predicting the oil price is always tricky. So many moving parts, of which OPEC is just one, influence its direction.

Among the factors you need to grasp are the direction of the US dollar, demand in emerging markets, geopolitical instability and production outages.

Companies exposed to the oil price are therefore likely to be extremely volatile.

For example, **Tullow Oil** (**TLW**) is up 87% year to date but has traded all the way down to 116p in late January and all the way up to 309.7p at the time of writing. (TS)

REACTING TO OPEC OIL CUT DECISION				
Company	EPIC	% change since 29 November 2016		
EnQuest	ENQ	27.7		
Premier Oil	PM0	25.6		
Tullow Oil	TLW	18.1		
Cairn Energy	CNE	17.7		
Ithaca Energy	IAE	13.9		
SEPLAT	SEPL	13.5		
Ophir Energy	OPHR	12.1		
Faroe Petroleum	FPM	11.8		
Amerisur Resources	AMER	9.7		
SOCO International	SIA	7.4		
Lekoil	LEK	6.8		
Royal Dutch Shell	RDSB	5.5		
Genel Energy	GENL	5.4		
BP	BP.	5.4		
Nostrum Oil & Gas	NOG	5.3		
Sound Energy	SOU	3.1		
Gulf Keystone Petroleum	GKP	2.5		
Hurricane Energy	HUR	1.3		
Roxi Petroleum	RXP	1.2		

Source: SharePad; data to 2 Dec 2016

# THE HOUSESTICKS

n balance we believe global stock markets will have a good year in 2017 despite plenty of big political events which could cause bouts of volatility.

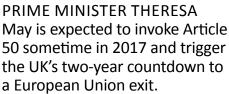
Economic data is positive in the US, Eurozone and China in particular and corporate earnings are forecast to improve over the coming year. Investment bank Morgan Stanley believes the latter point should drive outperformance from value stocks and large caps.

The biggest unknown for UK investors is how the triggering of Article 50 (officially starting the Brexit process) will impact the London stock market. We have a feeling it could set off another bout of weakness in

UK domestic companies and benefit the overseas earners on the FTSE 100.

To help you stay abreast of events, we now discuss the big issues facing the market in 2017 including Trump's first 100 days in power, where next for commodity prices and whether the European elections really matter to UK investors.

# WHAT HAPPENS WHEN THE BREXIT PROCESS BEGINS?



A pledge to declare the UK's intention to leave the trading bloc by 31 March 2017 looks ambitious given legal challenges against parliament's authority to use centuries-old executive powers originally granted to the monarchy to deliver on the promise.

Parliament may be needed to approve the move. Members of the House of Lords have also suggested progress through the upper chamber will not be straightforward.

A general election remains a possibility if the Conservative Government is hamstrung by opponents and feels the best way to gain a mandate is via the ballot box.

# WHAT DOES THIS MEAN TO INVESTORS?

Investors should take nothing for granted. It is worth remembering that while there were a lot of political and economic surprises in 2016, the UK stock market gained for nine months in a row from February through October and looks likely to end the year higher than a year earlier.

Analysts are grudgingly starting to nudge up UK GDP forecasts following savage cuts after the 23 June referendum.

Retail spending has propped up the economy, the jobs market, while weaker, is not as chronic as feared and third quarter GDP at 0.5% was well above consensus.



But business investment intentions are softening, say analysts at Bank of America-Merrill Lynch. 'Firms' decisions seem to have been affected by uncertainty,' writes BAML UK economist Robert Wood.

'Job gains have slowed, jobless claims have risen and investment intentions dropped. The official employment rate fell again in September but for bad reasons (because people left the labour force rather than strong job gains). The news has not been all good since June.'

# **CONSUMER CONFIDENCE TO FADE?**

Wood believes retail spending strength will fade next year as inflation squeezes spending power.

'Consumer confidence has been supported by groups that

favoured Brexit. Inflation will likely squeeze most of those people on fixed incomes.

'If productivity continues to flatline and immigration slows then UK trend growth will be weak. It may just be a blip but we think it is worth noting that the total workforce fell in October. We need to keep a close eye on immigration flows.'

The economist says a 'hard Brexit' in which UK and EU governments engage in titfor-tat disputes around key bargaining points remains his central scenario.

Since the publication of his research note on 23 November, the Government's chief Brexit negotiator David Davis said payments into the EU budget might continue after the UK's departure from the EU.

That prompted a rally in sterling as markets factored in a smoother and more amicable settlement between trading partners either side of the Channel.

Such a situation still looks a long way off at present and investors should probably avoid making investment calls based purely on winners and losers from the EU negotiations given the uncertainty. (WC)





# **SHOULD UK INVESTORS CARE ABOUT EUROPEAN ELECTIONS?**



THE LAST 12 months have seen considerable political upheaval and 2017 could offer more of the same as voters in the two remaining big European Union (EU) powers go to the polls.

# **POPULIST WAVE**

The failure of many pollsters to predict a vote for Brexit in June and Donald Trump in the US presidential elections in November make it very difficult for markets to price in these events ahead of time and, as such, there is scope for considerable volatility.

The French presidential election is up first in the spring, followed by a federal election in Germany in the autumn. Of the two respective incumbents, president François Hollande and chancellor Angela Merkel, the former says he won't stand for a second term. Merkel remains popular despite the impact of the refugee crisis.

# FRANCE DECIDES

The nature of the German

GERMAN
FEDERAL ELECTION 27 AUG-17 -22 OCT-17 (PROBABLY LATE SEPTEMBER'

system means it is unlikely any party will command an outright majority. Merkel and her Christian Democrats should therefore be able to form a coalition to hold off any challenge from the right wing populist Alternative for Germany party led by Frauke Petry and Jörg Meuthen.

The France election looks set to be a fight between the expected centre right candidate François Fillon and the leader of the far right National Front Marine Le Pen. The ultimate risk of a Le Pen presidency is that she would successfully lead France

out of the EU, leaving the whole European project in tatters.

# STOCK IMPLICATIONS

Viktor Nossek, director of research at ETF provider WisdomTree Europe, says such a situation would have all kinds of ramifications for all asset classes, starting with the euro and reverberating negatively into the banks.

If banks are most exposed to the systemic risks associated with any political shocks in 2017, which sectors could do well? Nossek thinks large technology and consumer discretionary stocks could continue to prosper thanks to their strong balance sheets and international horizons.

Matt Siddle, fund manager of Fidelity European Growth (LU0346388373), sees opportunities in the energy sector. 'Many large cap energy stocks are trading at close to 60-year lows, while fundamentals continue to improve,' he says. (TS)



# WHAT CAN TRUMP DELIVER IN HIS FIRST 100 DAYS?



closely watched by global stock

markets.

Priorities may include pulling out of the Trans-Pacific Partnership, promoting production and innovation and loosening environmental restrictions to boost shale and clean coal industries.

Significantly, Trump's victory has landed the Republican Party ongoing control of Congress, paving the way for major fiscal, monetary and regulatory changes with profound implications for sectors, the economy and the environment.

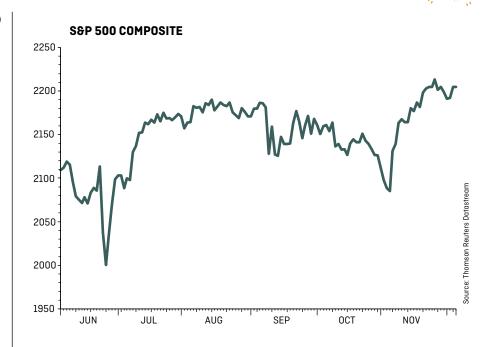
A 'fiscal bazooka' would boost growth and lead to higher inflation and faster rate rises, with Trump expected to prioritise tax cuts and spending increases, mainly for infrastructure.

# WHAT SHOULD WE EXPECT FIRST?

One quick win in the first 100 days would be to rip up trade agreements with China in order to appease rust belt voters.

Marc Pullen, senior equity analyst at Canaccord Genuity Wealth Management, comments: 'Which if any of his campaign promises Trump will implement is anybody's guess, however presumably putting tariffs on Chinese imports and starting a tit for tat trade war will be far easier and a quicker win than building a wall across the Mexican border and deporting thousands of immigrants.'

Pullen says losers would be US companies with sales exposure



to the Asia Pacific region (a proxy for China), while winners would be UK and European companies with sales exposure to Asia Pacific (filling the void left by the US). Potential winners might include Unilever (ULVR) over Procter & Gamble (PG:NYSE).

# SHIFTING EXPOSURE

Michael Stanes, investment director at Heartwood Investment Management, says his focus is tilting portfolios towards a value bias.

He expects a Trump presidency will have a meaningful impact on sectors where he has stated ambitions: infrastructure, industrials, defensives and energy.

'We therefore expect to shift exposure into these areas within our US equity allocation. With the support of a Republican Congress, Trump has a clear mandate to target growth through tax cuts and infrastructure spending.

'Our portfolios have been focused on highly liquid US large caps, but we expect a Trump presidency to take on a more domestically-focused agenda and this could benefit US smaller companies. Over the mediumterm, therefore, we have been recalibrating some of our US equity market-cap bias towards smaller companies.'

Geir Lode, head of global equities at Hermes Investment Management, sees Trumponomics as a further positive catalyst for banks, hurting since the financial crisis as ultra-low rates have eaten away at their top line.

Hermes believes higher rates will improve margins in a number of core banking services and lead to stronger earnings. 'Furthermore, the recent rally of US banks also reflects the hope that the Republicans will cut red tape around regulations allowing banks to release greater amounts of capital or increase levels of lending.' (JC)

# **WILL COMMODITY PRICES HAVE ANOTHER STRONG YEAR?**



OIL, COPPER, ZINC, nickel and palladium stand out as the best placed commodities for 2017, based on our analysis of various research notes.

We're making the bold call that commodities - and therefore stocks in mining, oil and gas companies - will next year be a good place in which to invest. That is as long as China doesn't destabilise the world economy by seeing its debt bubble burst.

There have been growing concerns in 2016 that China's economy is on the brink of a large debt crisis. Even the Bank of England has publicly commented on the matter. In September, it said: 'Credit growth in China continues to materially outpace GDP growth, and the level and growth of credit relative to GDP in China are very high by international standards.'

# **POSITIVE SIGNS**

Mining stocks soared in 2016 on the back of good commodity prices gains. They've reaped the benefits of leaner business models, sterling weakness and hopes for resurgent demand.

Inflation is expected to rise next year in many parts of the world. Such economic conditions have traditionally pushed up commodity prices.

A recent acceleration in global PMI data also suggests demand is strengthening for commodities. PMI is an index that represents activity by purchasing managers across a range of businesses. PMI data is a reliable lead indicator of economic activity.

China and Euro Area

manufacturing PMI data has been getting stronger every month since August, according to Markit Economics. Manufacturing activity in the US has displayed the same upwards trend since September, according to Markit PMI figures.

Goldman Sachs says commodity returns don't depend so much on the rate of economic growth as they do on the level of demand relative to supply.

'So while property-related demand growth in China is slowing, the level of demand is still very high requiring a high level of supply even if growth slows,' it comments.

# **BRIGHT SPOTS**

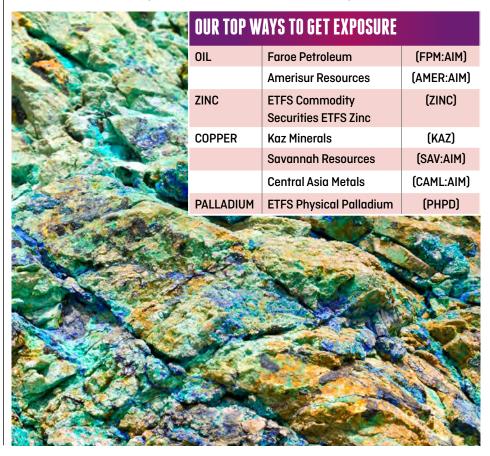
The oil price should benefit from production cutbacks as well as global economic growth.

Zinc is in a deficit position;

however we would be more cautious on the metal pricing if the big producers like **Glencore** (GLEN) start to reopen mines previously suspended amid lower commodity prices. Copper is also forecast to be in deficit.

A pickup in industrial activity should support palladium. Demand is expected to outweigh supply in 2017 in what would be the sixth year of deficit in a row, according to industry expert Johnson Matthey (JMAT). It says tighter legislation should boost auto consumption, even if Chinese car sales slow.

'Demand for palladium in auto catalysts, which turn noxious gasses into less harmful substances, is growing - due to rising sales of light and heavyduty vehicle sales in China and Europe, and tighter emissions standards,' says UBS. (DC)





# **HOT THEMES FOR 2017**



# MONETARY POLICY VS FISCAL SPEND

IN 2017 THE pendulum looks set to swing from the central bankers to politicians as monetary stimulus gives way to fiscal spending. Since the financial crisis, developed countries have adopted austerity policies and relied on interest rate cuts and so-called quantitative easing, aimed at boosting the supply of money, to boost ailing economies.

MONETARY

**POLICY** 

Setting of interest

rates and influencing

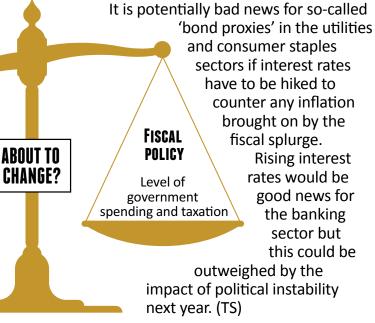
money supply

Now the focus has switched to tax cuts and increased expenditure on large scale projects, partly as a corollary of the populist revolt witnessed on both sides of the Atlantic.

# SPENDING SPLURGE

President-elect Donald Trump has pledged to spend at least \$500bn on US infrastructure and lower corporation taxes. In the Autumn Statement UK Chancellor Philip Hammond announced a £23bn innovation and infrastructure fund.

At a stock market level this could be good news for stocks with exposure to government spending, specifically infrastructure specialists like **Ashtead** (AHT), CRH (CRH) and Hill & Smith (HILS).



# **CAN EMERGING MARKETS REGAIN STRENGTH?**

EMERGING MARKETS WERE enjoying a major resurgence in 2016 until Trump's election. That's soured sentiment thanks to his trade protectionism and anti-immigration measures and uncertainty in terms of foreign policy.

Yet not all countries are dependent on trade with the US, such as India and Brazil.

A lot of people think emerging markets are very reliant on exports. That's a common misconception, says investment bank Credit Suisse. It claims large domestic populations across Asia and Latin America, plus fast-growing middle classes, allows for substantial growth from within.



This is all macroeconomic stuff and not necessarily meaningful to smart stock pickers, such as Nitin Bajaj, who runs **Fidelity Asian Values (FAS)** fund. For him it's all about keeping investment simple and buying good businesses with good management in the Warren Buffett vein. (SF)



# **MORE HOT THEMES FOR 2017**



# **CHINA DEBT BUBBLE**

CHINA'S DEBT SHOT up from 154% of GDP in 2008 to nearly 250% of GDP in 2015. 'The worry now is that this debt load is unsustainable, and will lead to a collapse in China's FX reserves, massive defaults, capital flight and a financial meltdown,' says Lombard Odier chief investment strategist Salman Ahmed.

'Considering the size of China's economy and its integration with the rest of the global economy, such a "hard landing" would be felt around the world.'

It's easy to see why many investors are worried about China. Ahmed isn't one of them. He believes China is rare in that its authorities have 'enormous influence' over the way markets function and plenty of tools to maintain stability.

We expect China's debt situation to move higher up the news agenda in 2017 and wouldn't be surprised to see a few bouts of negative stock market performance around the world as investors speculate over the country's next move. (DC)

# **INFLATION IS BACK**

RISING INFLATION PRECIPITATED by sterling weakness will be among the key themes in 2017 and could come down on average households like a ton of bricks.

Rising inflation could trigger interest rates hikes. It would also threaten retailers since consumers may feel less confident to spend money.

Investments suitable for an inflationary

environment may include gold, commodity producers and real estate.

We'd also look for businesses with pricing power. Such companies can pass on extra input costs to customers by raising prices without denting demand and will be able to generate the profits and cash to fund progressive dividends that can not only match, but outpace the so-called 'cruellest tax'. (JC)

# FINANCIAL RESULTS TO SHOW MORE BENEFITS OF CURRENCY TAILWINDS

EXPECT SOME FAIRLY punchy double digit revenue and profit growth numbers to be posted in early 2017 by a range of companies which earn most of their sales overseas.

Benefits to earnings from weaker sterling will be more apparent after the turn of the year when companies report year-over-year growth rates in the first quarter and first six months of the year.

Companies still need to be delivering decent underlying growth to enjoy decent share price performance around results, however, so investors should careful not to overpay for companies delivering growth which is mainly a result of currency moves. (WC)

# **EXPECT A FURTHER SHIFT FROM DEFENSIVES TO CYCLICALS**

THERE IS A definite shift in investor appetite from high quality companies with pedestrian but semi-reliable growth, to stocks which could see rapid earnings growth if there is an improvement in economic conditions.

We noted this trend in 24 November issue of Shares – and it has become even more apparent going into December. On one hand this is bringing new life to some of the lower quality companies on the market; it is also making the high quality businesses a lot cheaper.

The challenge is whether to start snapping up the defensive companies now – or wait until they get even cheaper. Their downwards trends look strong at present, so we'd hold off in favour of finding better 'bargains' in the quality space later on. (DC)

# **SECTOR WINNERS AND LOSERS IN 2017**



IT WILL BE another exciting year for technological breakthroughs and advancement in 2017.

In 2016 we saw Elon Musk's SpaceX launch and land the world's first reuseable rocket. Cars started to park themselves; and Amazon (AMZN:NDQ) gave us Alexa, an in-home talking, music-playing, encyclopaedic assistant.

The next 12 months will see increasingly smarter stuff plus the acceleration of trends already disrupting consumers, businesses and governments.

# CYBER SECURITY WILL BE EVEN HOTTER

Peel Hunt technology analyst Paraag Amin says data is a major theme for next year. He believes data is the 'primary driver of business models, and the key to higher returns on investment,' both inside and out of the technology sector.

Cyber security will be even more in demand in order to keep that data safe. Ali Unwin, manager of Neptune Global Technology Fund (GB00BYXZ5N79), says threats are changing every day.

'One thing that Hillary Clinton and Donald Trump agreed on during the US election was more cyber security spending,' Unwin points out.

New regulations during the next 12 months in the US and across the EU should force corporates and public organisations to address the multiple weaknesses in their operations, bolstering the opportunity for cyber security suppliers.

Unwin says to look at companies with high gross margins as one good measure of a quality business. We note **GB Group (GBG:AIM)** and **Sophos (SOPH)**, both current top stock picks in *Shares*, run on attractive gross margins in the region of 77%.

# MORE TRIPS TO THE CLOUD

The Neptune fund manager believes more companies will move software services to the cloud. Suppliers should enjoy predictable cash flows and improved quality of earnings.

This chimes with the outsourcing theme flagged by Peel Hunt technology analyst Paraag Amin. 'Where companies used to run things

themselves (IT projects and system implementations, for example), now they are looking for specialist partners,' Amin says.

That's the sort of niche that **Iomart (IOM:AIM)** has been filling for several years. We would also expect 2017 to spark a recovery at network services group **Redcentric (RCN:AIM)** after its recent accounting issues.

# **GET READY FOR MORE TAKEOVERS**

Mergers and acquisitions should be big news next year. Unwin says he has been told by industry contacts there is more private equity 'dry powder' on the sidelines than there's ever been, referring to available cash that needs to find a home.

Hot targets are tech firms with solid overseas earnings from quality products or intellectual property (IP), strong cash generation and limited debt. Could this be the year someone buys ticketing technology specialist **Accesso** (ACSO:AIM)? (SF)



# **SECTOR WINNERS AND LOSERS IN 2017**



THE IMPACT OF underinvestment over several years could lead to a gradual rebalancing of the oil market in 2017. This would be beneficial to oil services stocks as prices recover and spending begins to ramp up.

The likes of **Hunting (HTG)**, Weir (WEIR) and Wood Group (WG.) could also benefit from their exposure to a US shale sector bolstered by a newly supportive administration in the White House. True to form, the market has already started to price this in, reflected in a sector price to earnings ratio of 17.9 times. However, these estimates are likely to be pitched at conservative levels after a long spell of disappointing operational performance. (TS)



WEAKER STERLING SHOULD provide a rare boost to the UK manufacturing and engineering sectors in 2017.

After decades of struggles with higher costs at home, many have developed offshore production centres which would tend to reduce the benefit received from the currency drop.

Renold (RNO) is one such company; while it generates much of its sales abroad, production is now based all around the world. It will still benefit from the weaker currency though less so than if it produced products in the UK.

**Hayward Tyler (HAYT:AIM)** is another; a new manufacturing facility in Luton might provide it more flexibility to take advantage of a more cost competitive UK export market in 2017. We'd also flag Castings (CGS).

Longer term, there are risks to manufacturing and export sectors more generally in the UK if it goes down a free trade post-Brexit route as EU protectionist tariffs versus the rest of the world are scaled back. (WC)



JUNE'S VOTE FOR Brexit only compounds the problems facing the retail sector, which Shares expects will have a tough time in 2017. Weak sterling and the prospect of a return to falling real incomes are set to sap UK demand.

Over-capacity on the high street is endemic and the need to embrace omni-channel retailing only adds to the costs of shopkeepers whose margins are being squeezed by business rates, higher wage bills and a further expected decline in the pound.

Higher inflation on the horizon will be a challenge for retailers in 2017, since the spending power of consumers will change.

On the positive side, weak sterling could attract more tourists so retailers may get some relief from increased spending by overseas visitors.

Lower consumer confidence or financial distress may drive people towards domestic holidaying which could be another boost for many UK retailers. (JC)



# Sage confident ahead of new test

Accounting software supplier must prove it can deliver higher pace of growth

TSE 100 software supplier Sage (SGE) remains convinced it can accelerate its pace of growth in the face of stiff competition.

The past 12 months were largely about transitioning many of the company's thousands of small and medium-sized enterprise clients into the cloud. The next 12 months will see Sage invest in sales and marketing to boost customer numbers.

Sage has become one of the UK's leading software and enterprise tools suppliers. Although best known for accounting services like payroll and tax processing, it also offers extra services for areas such as human resources and customer relationship management.

Chief executive Stephen Kelly has been trying to move clients to a software-as-a-service (SaaS) model without cannibalising its large installed licence buying base.

## **SLOW AND STEADY**

Full year results to 30 September 2016 demonstrate the skill with which this task has been handled. Organic revenue growth marginally beat the 6% target (6.1% reported) to £1.57bn.

It also achieved a modest uptick in operating profit margins from 26.5% to 27.2%.

Sage reported a 10.4% increase in recurring revenues, its best in a decade, to £1.09bn largely driven by 32% growth in subscription income.

This was managed in the face of an expected but well-managed decline in perpetual licence revenues, down around 15%. This latter revenue stream now accounts for less than 9% of overall group sales.

# **IMPROVING QUALITY**

'Two things jump out from Sage's results,' says Angela Eager, analyst at the TechMarketView website. 'The control and visibility it has regarding its business model transition, and that in terms of revenue, the quality is improving,' she explains.

Kelly is steering the market towards another year



of 6% organic revenue growth and for operating profit margins of 'at least 27%'.

Numis analyst David Toms has trimmed back operating margin forecasts for this year and next to 27.5% and 28% respectively. The previous figures were 28% and 29%. 'We see little to make us expect earnings outperformance on a 12-month view,' comments Toms.

There is also intensifying competition in this space. Intuit's Quickbooks has been spending heavily in a bid to take market share, while newer entrants such as Kashflow and New Zealand-based Xero are also active on the marketing front. (SF)

# **SHARES SAYS:**

These latest figures were very solid but, as we cautioned in Shares on 3 November, there is not yet firm evidence of accelerating growth at Sage. The shares at 639p are trading on just below 20 times forecast earnings. That's high enough for current events. We want to see Sage step up a gear before getting excited about the shares.

BROKER SAYS: 9 4 7







# **Proof that EasyHotel** has fixed its problems

Profit soars as new CEO completes first year in the job

uy Parsons' first full year as chief executive of EasyHotel (EZH:AIM) has seen the low-cost operator outperform the broader UK hotel market, raise money at a premium to its market value and accelerate growth opportunities.

A 38.4% rise in pre-tax profit to £1.09m in the 12 months to 30 September 2016 is proof that the business model is working.

# **INITIAL SETBACKS**

EasyHotel got off to a bad start when it floated on the stock market in 2014, raising only half the desired amount of money.

The company lost its finance director within six months of its IPO (initial public offering), and the CEO was replaced six months later.

Former Travelodge boss Parsons walked into a business that he described as lacking a decent growth pipeline and staff with the wrong experience. 'There was only one other person who had worked in the hotel industry when I joined EasyHotel. It does help having people who've done it before.'

## A BETTER EXPERIENCE

He reset the strategy, brought in people who'd worked in budget hotels and quickly found investment opportunities for new hotels. The franchise side of the business was also strengthened.

More dynamic pricing systems have been introduced, charging progressively more as the accommodation date draws closer. It has also decided to make some rooms available through a select number of online travel agencies such as Booking.com. Those initiatives have helped to drive extra business, says Parsons.

EasyHotel raised £38m in September to fund new hotels. Five potential sites have been identified; three in England, one in Wales and one in Europe. It hopes to reveal the first location by the end of 2016.



Market sentiment has weakened towards the hotels sector as a result of rapid expansion by the large operators and the growing popularity of Airbnb which helps homeowners rent out rooms or whole properties on a short-term basis.

We believe EasyHotel can continue to outperform the market because of its low pricing point. Parsons says no-one really wants to stay in a budget hotel, yet they provide an ideal solution if you need somewhere cheap to stay because of a work trip, football match, wedding and so on.

He is confident EasyHotel has significant scope to grow in the UK despite a proliferation of budget rooms already earmarked for development across the industry. (DC)

#### SHARES SAYS: 7

The latest set of financial results are very impressive. We believe this company could be very successful over the long term and view it as one of the most attractive small cap stocks on the UK market. Buy at 92p.

BROKER SAYS: 2 0 0







# Jersey milking North Sea opportunity

Partner has committed to drill in 2017

lay momentum in £12.4m small cap oil explorer Jersey Oil & Gas (JOG:AIM) at 147.2p ahead of drilling at the Verbier well on its P2170 licence in the North Sea.

The drilling effort is backed by Norway's **Statoil (STLO:STO)** after a farm-out (Jersey retains an 18% working interest). The licence operator has formally communicated to the UK Oil & Gas Authority its intention to drill in 2017. A £1.6m



placing (30 Nov) means Jersey's share of the costs are now fully covered.

Asset manager Toscafund, known for its activist investing, has a position through Toscafund Micro Cap (IE00B68Z1V62) and noted in October that Verbier has a unrisked value to Jersey of £10 per share. The fact Statoil is choosing to drill this prospect in the near-term, despite restrictions on capital spending, implies confidence in its potential.

Jersey is also sitting on tax losses of £24m. It plans to take advantage of the majors scaling back their portfolios and financially distressed peers being forced to sell to pick up producing assets against which it can offset these losses.

# SHARES SAYS: 7

There could be further upside to come as we move towards the drilling of this key well. Buy at 147.2p.

BROKER SAYS: 🕕







# Crawshaw ready to meat the challenge

LOCAL BUTCHER CRAWSHAW (CRAW:AIM) is on the comeback trail following a profit warning blamed on subdued high street footfall and aggressive supermarket meat promotions. **Boss Noel Collett reports (29** Nov) a pick-up in sales over recent weeks, customer numbers growing amid sharper prices and a return to localised ranging. Ex-Lidl man Collett is now 'confident sales will continue to improve through the important winter and festive period'. (JC)

# Sanderson eyes retail plan

**ENTERPRISE IT SOLUTIONS** supplier Sanderson (SND:AIM) is hoping an investment push on its digital retail side will pay-off in the same way as earlier investment in its enterprise division.

Enterprise profit jumped nearly 40% year-on-year to £2.8m in the 12 months to 30 September after expansion spend over the past couple of years. Retail profit declined from £0.9m to £0.4m as the extra costs dragged on performance. The shares trade at 70.5p. (SF)

# **Road remains lumpy for Filtronic**

COMMUNICATIONS KIT DESIGNER Filtronic (FTC:AIM) admits it still has only limited visibility for wireless infrastructure project demand. This leaves the company exposed to lumpy orders and possibly delays. The company is hoping its new range of ultra-wide band integrated antennas will help relieve operational pressure points once they have gained meaningful traction. The shares trade at 9.62p. (SF)



# IPOs, closures and mergers in the funds space

New opportunities arise amid trust arrivals and departures

ew product launches, market departures and management changes are throwing up opportunities for fund investors to consider.

Fresh opportunities need to be scrutinised with care and altered mandates assessed to see whether they suit your financial needs and risk appetites.

#### **SAY HELLO**

BB Healthcare Trust (BBH) has joined the stock market (2 Dec) after raising £150m. It should interest investors wanting to play the theme of rising healthcare demand amid an ageing population having to deal with more diseases.

It will use the money to invest in a concentrated portfolio of no more than 35 companies. Dividends are expected from mid-2017.

The product has been launched by Swiss healthcare specialist Bellevue Asset Management which runs the top-performing BB Biotech fund in Zurich.

It will focus on firms with a market cap of less than \$10bn and will cover a broader range of sub-sectors and stocks outside the biotech sector.

It won't invest in companies whose current profits are dependent on very high drug pricing. Furthermore, it says the fund will focus on investment

# The People's **Trust**

Its staff won't get bonuses and part of their salaries will be paid in shares that can't be sold for at least seven years

ideas that it believes will deliver superior total returns over a three year-plus period – and not be distracted by shorterterm volatility.

# **ANOTHER FAMILIAR NAME**

Waiting in the wings is **The** People's Trust. Daniel Godfrey, the former chief executive of the Investment Association, has raised £110,853 at the time of writing through crowdfunding to launch the new, low-cost investment trust ahead of a listing in the first half of 2017.

The trust will be 100% owned by its customers. Retail investors have the opportunity to invest £20 to become a 'founder', or £10 if you're under-35, and qualify for a discount on the share price when the fund launches.

### **WAVE GOODBYE**

Investment trust BH Macro (BHMG), a hedge fund which makes investments on the back of global economic analysis, could be leaving the stock market.

The fund is offering to buy



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# **INVESTMENT TRUSTS**



back shares from its investors for 96% of the value of its net assets, a discount which reflects the costs of selling investments and winding up the fund.

If more than two thirds of investors accept the offer the fund will sell all its investments and return the money to shareholders.

Shares in the macro hedge fund have rallied by 9.4% since the start of November because it previously traded at a wider discount to its net assets than the level at which it is offering to buy back shares.

Trusts which have announced plans to wind themselves up sometimes provide decent returns.

Private equity investment trust Northern Investors (NRI) said in 2011 it would stop making new investments and return money to shareholders.

It has delivered the strongest return of any trust in the private equity sector over the past decade. Not far behind is fellow private equity trust Electra (ELTA) which was itself in winddown between 1999 and 2006 before reversing course.

Private equity trusts take a long time to wind down because they own entire businesses which can sometimes be difficult to sell at a good price.

#### **HEADING FOR THE DOOR**

Another shutting down is litigation finance provider Juridica (JIL:AIM) after a short and ill-fated spell on the stock market. Usually when an investment trust is set up investors have an opportunity to call for the winding up of



the vehicle after a certain period of time if performance disappoints.

Elsewhere, M&G has announced it will wind up its M&G High Income Trust (MGHU) in March 2017. The default options for investors will be a switch into the openended M&G Extra Income (GB0031107021) fund run by the same manager, Richard Hughes. Those who prefer the closed-ended structure have JP Morgan Elect Trust (JPE) as their rollover option.

#### THIRD TIME LUCKY?

**BlackRock Income Strategies** Trust (BIST) is set to merge with Aberdeen UK Tracker Trust (AUKT) to form Aberdeen **Diversified Income and Growth Trust.** 

The trust's management deal with BlackRock will be terminated in January following 19 months of dire performance. And it is important to note that BlackRock was originally hired to revive the trust when it was a flop under the previous name of British Assets Trust run by F&C. Therefore Aberdeen's plans will be the third version of the product.

Aberdeen will pursue a diversified multi-asset strategy with a change in investment objective to target returns of LIBOR+5.5% per annum (net of fees) over rolling fiveyear periods.

Dividends will be reduced, in recognition of a low yield environment, while the zero discount policy will be replaced with a more flexible approach. (JC/WC/DC/LMJ)





**IT IS TIME TO VOTE** in the seventh annual UK Stock Market Awards, the event that showcases the best of UK PLC.

We want your views on those companies which have truly delivered value to shareholders over the past 12 months, as well as the advisers which have contributed to corporate plc success.

In making your decision it is worth considering the quality of management, the transparency of

communication with investors and the market, the level of shareholder returns and how the company has tackled any challenges.

Once your submissions have been collected, a list of six nominees per category with the most amount of votes will be discussed at length by an expert judging panel chaired by *Shares* editor Daniel Coatsworth.

The winners will be announced at the 2017 Awards Ceremony on 30 March.

# **Award Categories**

AIM COMPANY OF THE YEAR

AIM COMPANT OF THE TEAM

MAIN MARKET COMPANY OF THE YEAR

M&A TRANSACTION OF THE YEAR

FUNDRAISING OF THE YEAR

**IPO OF THE YEAR** 

**BEST PERFORMING SHARE** 

**GROWTH COMPANY OF THE YEAR** 

BEST CUSTOMER FOCUS

**INNOVATION OF THE YEAR** 

**INVESTOR RELATIONS TEAM OF THE YEAR** 

**BEST SOCIAL IMPACT** 

**CEO OF THE YEAR** 

**FD OF THE YEAR** 

**ENTREPRENEUR OF THE YEAR** 

FINANCIAL PR TEAM OF THE YEAR

**CORPORATE SPONSOR OF THE YEAR** 

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# **Surgical Innovations** in turnaround mode

Why the medical tool manufacturer's recent acquisition will help its recovery



eeds-based Surgical Innovations (SUN:AIM) is in an interesting phase of its development as it continues to move forward from a series of profit warnings last year.

## **KEYHOLE SOLUTIONS**

The company designs and manufactures solutions for minimally invasive surgery, also known as keyhole surgery. These procedures can reduce scarring and decrease recovery times in hospital. The instrumentation manufactured by Surgical Innovations makes it easier for surgeons to view and access parts of the body precisely during operations.

Surgical Innovations has historically specialised in 'resposable' technology, which comprises a mixture of parts that are designed for single

use and for reuse. Parts of the instrumentation that are liable to contamination are single use only, while other elements can be reused for up to 200 procedures.

All of its products are sold through distributors with 75% exported overseas and the remainder sold in the UK. One of its core selling points is that it manufactures in the UK, which is seen as appealing to distributors resistant to low-cost medical instruments from China.

#### **PARTNERSHIP PLAN**

**Surgical Innovations wants** to form new partnerships with original equipment manufacturers (OEMs) in product development and sourcing to accelerate the development of its solutions. One of its key partners is wound

care dressing tech developer **Advanced Medical Solutions** (AMS:AIM) which markets the LiquiBand Fix8 after it was manufactured by Surgical Innovations.

LiquiBand Fix8 offers a controlled and specific delivery of a tissue adhesive to reduce the risk of post-operative complications.

In November, Surgical Innovations announced the acquisition of laparoscopic (keyhole) instruments business Surgical Dynamics for £360,000 in cash. The acquired business develops fully disposable products using vertical moulding and currently has several products in its pipeline, including grasper heads and scissors.

Specialising in both resposable and single-use instrumentation will help Surgical Innovations

to access a wider spread of countries with different requirements. The UK and Germany are more likely to invest in resposable technology, while Italy, Greece and Spain are more inclined towards single-use products due to the cost of sterilisation in those countries. The company hopes to capture market share using Surgical Dynamics single-use pipeline.

Eric Burns, analyst at broker WH Ireland, highlights that Surgical Dynamic's precision metal injection capability will be adopted at the Leeds facility. This will help to reduce waste and speed up the manufacturing of certain components. The analyst also notes the deal will bring in some 'potentially interesting intellectual property' to Surgical Innovations' existing portfolio.

#### **INTO THE BLACK**

In 2015 the medical tool maker issued several profit warnings and racked up losses, resulting in the resignation of chairman Doug Liversidge after sales in the US didn't materialise as expected. Turnaround specialist Nigel Rogers was appointed executive chairman in October 2015 to take the company forward.

He has already helped the firm return to profitability in the first half of 2016 with adjusted EBITDA of £0.5m, up from £0.24m for the whole of 2015. Gross profit has also improved, jumping nearly four-fold from £217,000 in the six months to June 2015 to £809,000 in the same period a year later.

The company also moved from a net debt position of £1m at the end of 2015 to a net cash



position of £0.43m.

Investors have been buying into the recovery, helping the share price nearly double in a year from 1.6p to 3.12p, although there have been bouts of volatility along the way.

At a site visit attended by *Shares*, Rogers and managing director Melanie Ross acknowledge the firm's troubled past and believe it is on the road to recovery following management changes.

One of the root causes of its previous issues was unrealistic expectations as it used to stock 12 months worth of inventory. To combat this, the firm decided to mothball production and now has a healthier stock holding of two months, which also reflects stronger demand and turnover.

#### WHERE NEXT?

The Brexit vote is seen as both a challenge and an opportunity in the future. The company

has experienced export-led revenue growth after the shock result. Management expects its margins to benefit from currency fluctuations as the majority of its exports are priced in local currencies while the cost base is primarily priced in sterling.

Increasing medical device regulation and barriers to entry are concerns. They could result in higher costs and longer time to market, which can affect future pipelines and profitability. Despite these potential roadblocks, Surgical Innovations says it is up for the challenge.

#### SHARES SAYS: 7

On the surface the shares look expensive at 34.7 times 2017 earnings but this reflects the fact the business is in the early stages of profitability. We are impressed by the management and think patient investors could be rewarded at 3.12p. (LMJ)

## **Up 17% but still** not satisfied

Man Group-GLG fund manager Powe says it has been an average year

an GLG Continental **European Growth** (GB00B0119370)

fund manager Rory Powe insists he's had a pretty mediocre year in terms of stock picking, despite the fund rising nearly 17% in value.

Much of the fund's gain year-to-date is related to its investments in Europe which have increased in sterling terms but stayed relatively flat on domestic exchanges in Europe.

But Powe is still pretty close to the fund's benchmark, which has advanced around 18.6% over the same period, and long-term returns are strong. The fund is in the top 25% of funds in its category over the last five years.

#### **DOWNSIDE RISKS**

After an eight-year stock market bull run and wobbles in the market over recent months Shares is keener to hear how the fund might perform in a tough market.

Funds managed by Powe previously struggled in the dot. com bubble and another had to be closed in the crash of 2008 because of investments in illiquid stocks.

Lessons have been learned, Powe says. Investments are focused on good quality companies in two categories: Established Leaders and **Emerging Winners.** 

Powe now runs a cap on



Rory Powe, Fund manager

the riskier Emerging Winners category at 33% of assets and these stocks currently make up 20% of the portfolio. Liquidity of underlying positions is also monitored more carefully.

'My experience as a fund manager – some of it in difficult periods – has taught me to be more and more insistent on investing in stocks of the highest quality and that is about investing in these Established Leaders which have clear competitive advantages,' says Powe.

As well as a cap on Emerging Winners, Powe is also more discerning around which

#### **Fast Fund Facts**

ISIN: GB00B0119370

**Man-GLG Continental European Growth Fund Retail** 

Fund size: £526m Manager: Rory Powe Launch date: 04 Oct 2004

Fund size: £643.4 million (as at 30 Sep)

No. of holdings: 267 (as at 03 Oct)

stocks meet the criteria. 'Concept stocks', those with a great story but no earnings, are generally avoided.

'They need to be in pole position in their markets,' Powe adds.

Investors also need to remember that Powe is managing to a 'growth' mandate which means performance should only be measured against that category. In the last few months 'value' funds have started to beat 'growth' and 'momentum' styles.

Powe cannot suddenly change styles to capture this change in the wider market because of the fund's growth mandate. Investors in the fund are taking a view that growth stocks will do well and that Powe's stock-picking will mean the fund's returns are better than the average 'growth' fund manager, which it has been in the past.

With an initial 5% charge to retail investors on new money invested as well as an ongoing charge of 1.65% of assets, it is not cheap either.

#### AFFORDABLE LUXURY

Mass market designer, manufacturer and retailer of jewellery Pandora (PNDORA:CPH), listed in Denmark, is the fund's top position at 7.5% of assets. Powe's depth of knowledge on the business models of

stocks owned by the fund is exceptional. In Pandora's case, the key element of the investment thesis is affordability with average sales prices at around £40. Pandora's products are luxuries at reasonable prices and its brand is recognised the world over.

Scale is another competitive advantage in both production and sales. Pandora employs 11,000 workers in Thailand where products are manufactured and individually finished. A new facility in the north of the country will open soon. Retail outlets are increasing at around 300 per year and Pandora's sales mix is shifting from unbranded to branded sales, driving topline growth of around 20% in recent years.

#### **LOW COST CARRIER**

Airline Ryanair (RYA) is a stock Powe has held in various funds for a decade or more and represents 7.2% of the growth fund's assets. The fund manager highlights its number one market share in short-haul European air travel and industry-leading cost base at around €28 per passenger (excluding fuel) versus EasyJet (EZJ), Wizz Air (WIZZ) and the flag carriers at above €40.

Ryanair's scale also means it has bargaining power with airports which want to secure the airline because of the volume of passengers it pulls through terminals.

'In the case of Pandora and Ryanair (RYA) we can see a road map of growth,' says Powe.

'We do not want to invest in companies where it relies on the



TOD TEN HOLDINGS

(AS AT 03 OCTOBER 2016)			
Pandora	Jewelery	7.5%	
Ryanair	Airline	7.2%	
Essilor	Glasses/ contacts	5.3%	
Christian Hansen	Dairy products	5.2%	
Yoox Net-A-Porter	Online retail	5.2%	
Moncler	Fashion	4.8%	
Eurofins Scientific	Quality assurance	4.4%	
Assa Abloy	Locks and security	4.2%	
Asmi	Technology hardware	4.1%	
Glanbia	Agriculture	4.1%	



Source: Marlborough Fund Managers

general economy or the shape of the yield curve. We want companies that are driving their own destiny.'

#### **OTHER KEY PICKS**

Powe's third-largest position is Paris-listed Essilor (EI:EPA), a designer and manufacturer of glasses and contact lenses, but in our interview Powe focuses more on Christian Hansen (51C:FRA) which at the time was in the number three slot.

Christian Hansen has similar investment characteristics to Pandora and Ryanair in that it is a market leader in what it does, in this case the production of cultures, enzymes probiotics and natural colourings for the food industry. Key strengths include double digit top-line growth last year, pricing power and its ability to innovate.

'We are confident it can grow sales between 5% and 10% a year out to 2020 and we are comfortable they can grow at a decent rate beyond that as well,' says Powe.

'We like that they are selling essentials, it's repeat business and not particularly economically sensitive.'

Investments are chosen based on financial metrics and price target forecasts three years out into the future.

'Sometimes we will make mistakes if companies' financial results in the future are not what we expect them to be,' adds Powe.

'Currently our companies are very good at delivering strong growth in net profits and also converting it into free cash flow and that's pretty good compared to the rest of the market.' (WC)









he squeeze on incomeyielding assets has made the hunt difficult for income investors. Interest received on savings accounts is close to zero, translating into a negative real return when accounting for inflation.

Henderson European Focus Trust fund manager John Bennett sees the potential for a continued sector rotation as the key factor for European equity investors next year.

While he maintains an overall positive outlook, John acknowledges that currency, politics and the chance of deflation are all risks to this view.

#### WHAT LESSONS HAVE YOU **LEARNED FROM 2016?**

Markets are one long enduring learning curve. If a fund manager thinks they have nothing left to learn, then they're finished, because the market loves to humble. And I think 2016 has been a humbling year for a lot of managers.

One or two of our peer group have said exactly the same, that this has been the toughest year I have known.

One of the factors that has made it so tough has been the rotation - it's been a traders' market. The rotation has been violent because of positioning.

The big lesson I learned in 2016 is 'maybe you didn't look at positioning enough'. First we had the rally in energy, then mining; two areas that many people had found easy to avoid for a number of years. And more recently in the US we had 'the big one', and thankfully for this we did manage to be on the right side.

It's unusual for us to like the banking sector, but we managed to pre-position for that. And that was through applying the lesson we learned about positioning.

#### WHAT ARE THE KEY THEMES LIKELY TO SHAPE THE **MARKETS IN WHICH YOU INVEST IN 2017?**

I think the key influences going into 2017 will be whether we're right on equities moving from a growth to value market on a global basis.

Growth stocks are those companies whose earnings are expected to grow faster than the broader market, whereas value stocks are those the fund manager believes are trading below their intrinsic worth.

It's been a one-way growth market since the financial crisis vou haven't wanted to be in value.

I'm not a great fan of those labels (growth versus value), as these things are in the eye of the beholder. But I do think that we are running out of road on quantitative easing (QE) - central bankers know this - and that will shape markets.

I therefore believe we have touched the lows on bond yields globally, and the valuation high watermark for bond proxies (defensive, low volatility, high yielding equities that mirror bond-like characteristics) stocks that have been 'oh-socomfortable' to be in.

In October and November it became very uncomfortable to be in those stocks, and I think this is a move that has only just begun. To be right on that, I've got to be right on one thing; that





#### **MORE ON THE MANAGER AND HIS STYLE**

John Bennett is Director of **European Equities at Henderson** Global Investors and manages £9.4bn across a number of European mandates.

He constructs his portfolios utilising a blend of top-down analysis - which observes macro-economic factors and over-arching sector trends - and bottom-up stock-picking.

When it comes to selecting his investments John is a style agnostic, which means

he doesn't pin his flag to the mast and invest with any one style at any period of time; for example, growth which looks for companies with above average levels of earnings growth, or value which looks for companies that the market has intrinsically undervalued.

He also runs a focused list, meaning his portfolio will generally contain between 50 and 60 companies, and will buy all sizes of businesses but mainly focuses on mid and large caps.

deflation doesn't win, and that therefore bond yields have got further to go up (or certainly not going down).

However if deflation does win, and bond yields go further down, I will be wrong on being in value stocks; you would've wanted growth. But growth has been the last decade: I believe value will be the next.

#### WHAT ARE YOUR HIGHEST **CONVICTION POSITIONS MOVING TOWARDS THE NEW** YEAR?

I think if you have 'high conviction' at the end of 2016 you're a strange person, or you've got a stronger constitution than I have.

I've always said, be aware of the fund manager who's got high conviction on everything at all times – that's quite a dangerous beast in my view. A dose of humility and neurosis is always welcome.

I go into 2017 shaken by some of the events of 2016. But where

ONE OF THE REASONS I DON'T DESCRIBE MY VIEW AS 'HIGH **CONVICTION' IS NOT** JUST BECAUSE OF THE **EVENTS OF 2016 AND HOW TOUGH IT HAS BEEN FOR ACTIVE** MANAGERS, BUT **BECAUSE THE MOST IMPORTANT SECTOR** AS WE MOVE INTO 2017 IS SOMETHING I HAVE NOT LIKED FOR THE PAST DECADE -FINANCIALS.

I do have conviction is in the view that we are moving from a growth to a value market.

One of the reasons I don't describe my view as 'high conviction' is not just because of the events of 2016 and how tough it has been for active managers, but because the most important sector as we move into 2017 is something I have not liked for the past decade – financials.

#### WHAT SHOULD INVESTORS **EXPECT FROM YOUR ASSET CLASS AND YOUR** PORTFOLIO(S) GOING **FORWARD?**

There's a whole interplay of things. I think currency is important. If we get a strong dollar it is usually good for European equities, and less good for emerging market equities.

If I'm right that we're moving from a growth to value market, I think this can knock on the head US equity outperformance versus other parts of the world.

The value markets of the world



are more Europe and Japan than they are the US, just by the nature of indices. So I think there might be an asset allocation shift to come.

The thing that holds me back from having 'high conviction' is that the political upheavals that we've seen - Brexit, Trump are moving now to Europe, and that will be a whole lot trickier as it's not one nation, it's a currency bloc.

I think you could easily see the wobbles come back on the periphery in the form of the euro, and that political risk holds me back from saving that relative to the US, Europe is now a 'buy'.

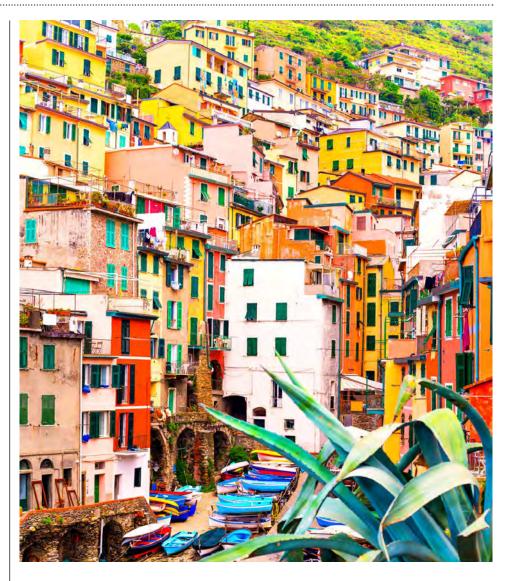
But, we will get through that political risk, and that is what might create the opportunity to buy Europe.

European equities have seen big outflows this last year, and this gives me much more optimism. I was not that positive on markets going into 2016; I'm much more so for 2017.

#### WHAT ARE THE MAIN RISKS?

In pure market direction terms, if the US raises interest rates and the market doesn't like it and falls, say 10%, then Europe isn't going up.

Beta traditionally measures the outsized reaction of a stock relative to its market, so a high beta – where it's greater than



one – would point to a stock that outperforms its market on the way up, but conversely underperforms on the way down.

Europe is effectively quite a high beta play on the US, especially on the way down. That would be the near-term risk to direction.

The other is the Chinese renminbi devaluation, which is ongoing and not getting air time. If that comes back to centre page, that could be a risk to market direction.

The risk to Europe experiencing a change in market leadership is bond yields going to new lows; i.e. the deflation argument keeps winning. That would knock on the head any renaissance of value.

Before investing in an investment trust referred to in this document, you should satisfy yourself as to its suitability and the risks involved, you may wish to consult a financial adviser.

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## **Curbing excessive** pension exit penalties

Financial regulator to impose cap on charges from next year

ensions have changed a lot in the past three decades. We no longer have virtually unregulated salesmen in shiny suits flogging expensive policies and taking a hefty commission from the provider. Charges have also (on average) plummeted, while regulatory and governance standards have ramped up as part of a wider effort to protect savers.

However, the legacy of this bygone era lives on through 'exit penalties'. Such penalties were common in policies sold in the 1980s and 1990s, with providers arguing the fees were necessary to ensure the adviser was paid and, more importantly, the provider made a tidy profit.

These old-style plans often come with eye-wateringly high annual charges compared to modern pension contracts charges that eat away at the value of your retirement pot.

#### **PENALTY PROBLEM**

The introduction of the pension freedoms in April 2015 crystallised the problem of early exit penalties.

Savers were told they could spend and invest their retirement savings as they wanted, and yet for many archaic charging structures blocked their path.

To give some context, FCA investigations revealed 670,000 people aged 55 or over faced



an early exit charge. That's a whopping £22.5bn of pension money.

Of these, 358,000 faced charges between 0-2%; 165,000 charges between 2-5%; 81,000 would pay between 5-10%; and 66,000 faced exit charges above 10%.

The severity of these charges meant many would not even countenance the prospect of switching to a modern, low-cost pension plan.

#### **NEW SYSTEM**

As a result, the FCA has decided to impose a 1% charge cap on old-style early exit fees from March 31 2017, potentially fundamentally shifting the equation for savers considering whether or not to abandon these costly policies.

According to our calculations, if someone aged 55 had a pension with a 5% exit penalty and chose to transfer to a scheme with an annual charge that is 0.5 percentage points

lower, it would take 11 years for them to recoup the negative impact of the exit fee.

However, once the cap bites and the 5% exit penalty charge falls to 1%, the maths changes dramatically.

Even with the hit of a 1% penalty on transferring, the lower annual charge means the saver is in 'profit' after just three years and would be £20,000 better off after 20 years.

This assumes a pot worth £100,000 at age 55 and annual investment returns before charges of 5%.

While this analysis is illustrative, the message to anyone with an exit fee is clear - review your policy, look at the annual charges and consider if it's worth bearing the penalty in order to benefit from lower fees, and greater flexibility, in the long-term.

**TOM SELBY** Senior analyst, AJ Bell













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# Why it can pay to take a long-term view

Riding out the waves of market volatility is critical to investment success



📆 taying focused on your long-term financial goals can be difficult when stock markets plummet and news pages are filled with images of Wall Street despair. But unless you've got the skills to be a professional trader, taking the long view is crucial to protecting your financial future.

There have been numerous examples of stock market volatility in recent times. This year the markets fell sharply after Britain voted to leave the EU and again when Donald Trump won the US presidential election. In both instances, the markets soon bounced back.

#### THE POWER OF EQUITIES

Over the past couple of decades we've experienced wars, recessions, financial crises and natural disasters, but equities have still done well. The FTSE 100, for example, has risen by 519% since April

Over the long-term it is earnings, profit and growth that drive share price performance and that is why it is better to take a long-term perspective when it comes to investing.'

1984 despite several big bumps along the way.

'The adage that time in the market beats timing the marking is one that should be heeded by retail investors,' says Ryan Hughes, head of fund selection at AJ Bell.

'In the short-term, markets can be volatile and unpredictable, with sentiment and specific events having an impact on share prices without necessarily being related directly to the underlying performance of the business.

'Ultimately, over the longterm it is earnings, profit and growth that drive share price performance and that is why it is better to take a long-term perspective when it comes to investing,' adds Ryan.

'Taking a short-term approach often turns you into a trader rather than an investor and there can be little coincidence that Warren Buffett, the most successful investor of all time, takes a very long-term view to his investments.'

#### **BAD TIMING**

Trying to time when to buy and sell shares is notoriously difficult, even for professional investors.

There is a very high chance you'll sell investments after they've performed badly and buy investments after they have already done well, thereby missing out on the gains.

'The result is that you

could end up buying at the top of the market and selling at the bottom and having a thoroughly miserable experience along the way. Unfortunately this is what too many investors do,' warns Patrick Connolly, head of communications at independent financial adviser (IFA) Chase de Vere.

#### **FILTERING THE NOISE**

Dan Brocklebank, director at asset manager Orbis Investments, says maintaining a long-term focus is hard when investors are bombarded with news and commentary about events which on the surface appear to impact the prospects for all investments.

'It is actually very difficult to filter out from all of this noise what, if anything, really matters over the long-term. Evolution has also meant that we are highly primed via stress responses to react and try to run away from perceived threats,' he explains.

Brocklebank suggests the best approach is to have a solid plan in place long before short-term falls happen. He says investors could write down their long-term goals and assess investment results against this framework, rather than looking at how they have done in any given year.

For particularly volatile periods, Peter Chadborn, a director at IFA Plan Money, recommends looking back over the previous five years in order to put short-term volatility into context.

'Viewing investment behaviours over the short-term will make volatility appear



greater than it is when looking at the bigger picture over the long-term and therefore can cause unnecessary anxiety for the investor,' he adds.

#### **STAYING FIRM**

Most experts recommend taking a 10 to 20-year view when buying investments and sticking with them through the ups and downs, unless your circumstances or objectives change significantly. Connolly points out that each time you change your investments you'll incur dealing fees.

'You shouldn't switch out of a fund just because it has performed badly. Instead you should fully understand why it has performed badly and then whether that is likely to change in the future, before you make any decisions,' he says.

Connolly reckons tracker funds are the ideal long-term holding because you don't need to worry about significant underperformance or a fund manager leaving. The funds simply track the performance of an index.

'Those who are investing for

longer periods can afford to take more risk; this usually means investing more in equities. This is especially the case if they're making regular premiums, which many who are saving long-term will be,' he says.

If you want to add some capital protection to your portfolio you could consider adding fixed interest, property and absolute return funds. They might provide more security and will diversify your portfolio, thus spreading the risk.

#### **BORING IS BEST**

Fund managers who take a long-term view of investing include Terry Smith, manager of Fundsmith Equity (GB00B41YBW71), and Nick Train, manager of CF Lindsell Train UK Equity (GB00B18B9X76). Those funds have five-year annualised returns of 21.3% and 16.7%, respectively.

'Both of these managers could be considered as useful holdings for those looking to generate long-term returns from a portfolio,' says Hughes.

Regardless of which investments you choose, it's important to be patient. Unfortunately there is no such thing as a get-rich-quick scheme and no way to become an instant millionaire outside of winning the lottery.

Hughes concludes: 'Investing is a long-term business where patience is one of the most valuable attributes and, as George Soros said, "Good investing is boring".' (EP)

DISCLAIMER: Daniel Coatsworth, who edited this article, holds shares in Fundsmith Equity.



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