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# Is it time to be brave and buy depressed UK-focused stocks?

Well-known fund manager implies many investors are being too pessimistic

**S**ome of the best valuation opportunities lie among UK domestic-focused stocks. Your challenge is to shift through the pack and find ones which stand a chance of re-rating in a market where sentiment remains poor towards companies doing business in the UK.

Weighing on sentiment is renewed political concern which this week dragged down the value of sterling once again. That in turn has weighed on the FTSE 250 index which contains a large number of UK domestic stocks.

The currency has weakened amid growing concerns about the future of Theresa May as prime minister. Last weekend, reports suggested that 40 Tory MPs had agreed to sign a letter of no confidence in May.

And on Monday business leaders told the prime minister that she needed to speed up Brexit talks with the European Union.

Talking at AJ Bell's *Investival* conference last week, Invesco Perpetual's Mark Barnett said the market believes Brexit is 'an accident waiting to happen'. That's why many UK domestic-focused stocks have been marked down in valuation terms – amid fears about what Brexit could do to the UK economy.

## WHAT'S HAPPENING WITH EARNINGS?

'The market is pricing in quite a pessimistic outcome. Investors said at the point of the referendum vote that the UK economy would go down fast. That still stands today; people are saying avoid domestic stocks,' he commented.

'However, earnings from domestic companies remained positive apart from a period after the referendum when analysts downgraded forecasts. They've been upgraded since, so overall the earnings picture remains relatively stable.'



Against that backdrop, stocks which have suffered downgrades to earnings due to sales disappointments have also seen a downgrade to their stock rating – essentially they are trading on lower earnings multiples. Good examples are outsourcing group **Capita (CPI)** and retailer **Next (NXT)**, said Barnett.

On the flip side, investors are happy to pay high prices for stocks that have already done well. Barnett is convinced this trend will change. He believes there are three reasons why this might happen.

US monetary tightening might start to affect some ratings versus the rest of the market. A resolution around some of the Brexit uncertainty might get overseas investors to look at the UK again. Or valuations could get too stretched as people have paid high multiples for companies where the rating isn't justified. Over time you would expect the market to reprice those stocks back towards fair valuations.

So if you're brave, now might be a good time to start looking at the multitude of UK-focused stocks on depressed valuations.

## REAL ESTATE BARGAINS

One of Barnett's top picks among sectors with depressed valuations is UK real estate where the market has taken a gloomy view of near-term prospects. He highlights office specialist **Derwent London (DLN)**.

'There are companies in the sector trading at a 25% discount to book value and selling assets at book value or at a premium. Or they are selling assets at a premium and retiring equity at a 25% discount,' commented the fund manager.

'There is significant overseas interest in this sector. I imagine we'll see some deals.' (DC)

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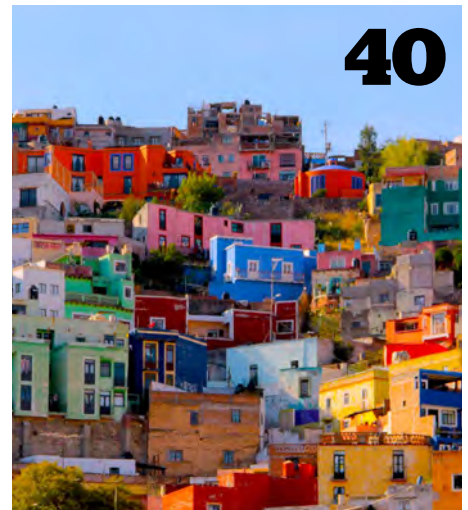
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## BROKER RATINGS EXPLAINED:

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 rating.

Eg: **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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# Worrying number of profit warnings in 2017

The FTSE 100 is losing momentum and bad news is piling up from London-listed stocks

**L**ondon-listed companies issued 75 profit warnings in the three months to 30 September and there have been plenty more in recent weeks.

Among the latest offenders is **Ultra Electronics (ULE)** whose profit warning on 13 November was blamed on Ministry of Defence expenditure. That in turn led to share price weakness among its peer group including **BAE Systems (BA.)**, **QinetiQ (QQ.)** and **Babcock (BAB)** as investors worry they might be next in line for bad news.

The aerospace and defence sector is now down more than 8% in the last month, although it is still up 4.7% year-to-date.

The FTSE 100 is up by a similar amount this year but is beginning to lose momentum and there are some cracks appearing beneath the performance of the headline index.

According to SharePad just nine of the 37 sectors in the FTSE 350 are in positive territory in the last month and just three of the top 10 performing sectors year-to-date traded higher over the same time frame.

## LOTS OF DIFFERENT SECTORS HAVE BEEN AFFECTED

The 75 profit warnings recorded in the third quarter is significantly above the average levels of warnings (62) for that time of year, says accountant EY.

Although retail has been a big offender, companies from a diverse set of industries have disappointed the market of late.

On 19 October serviced office business **IWG (IWG)** lost a third of its market value as it warned annual profit would be 'materially below' forecasts. On the same day consumer goods giant **Unilever's (ULVR)** third quarter results were below the consensus estimate.

And even supposedly defensive sectors like healthcare have served up disappointments with

generic drugs specialist **Hikma Pharmaceuticals (HIK)** slashing guidance for the third time in just six months on 9 November.

These are just a selection of the setbacks UK shareholders have had to face over the last few months, not to mention the damage endured by the likes of **Carillion (CLLN)**, **Provident Financial (PFG)** and **Dixons Carphone (DC.)** earlier in the year.

It highlights the importance of running a diversified portfolio. If too much of your investment pot is in just one individual company the impact of a profit warning on the scale of some of those detailed in this article could have a devastating impact on your ISA or pension. (TS)

## TOP PERFORMING FTSE 350 SECTORS IN LAST MONTH

	1 month performance (%)	Year to date performance (%)
Software & Computer Services	5.6	25.1
Oil & Gas Producers	5.2	3.9
Electronic & Electrical Equipment	4.3	32.6
Mobile Telecommunications	3.2	9.9
Industrial Transportation	0.9	-1.2

## WORST PERFORMING FTSE 350 SECTORS IN LAST MONTH

	1 month performance (%)	Year to date performance (%)
Household Goods & Home Construction	-7.9	9.0
Aerospace & Defence	-8.4	4.5
Health Care Equipment & Services	-8.7	4.8
Fixed Line Telecommunications	-9.9	-30.9
Industrial Metals	-11.9	44.4

Source: SharePad, 14 November 2017

# Insurer opens doors to retail investors with £600m IPO

Sabre Insurance is expected to offer a dividend yield in excess of 6%

**R**etail investors are being given the opportunity to take part in the IPO (initial public offering) offer for **Sabre Insurance**, owner of the *Go Girl* brand and underwriter for policies sold by the likes of Tesco Bank and others.

We understand the specialist motor insurer will pay a 6%+ dividend yield and the business should be worth around £600m once it floats on London's Main Market in December.

Sabre claims to have a significantly lower combined ratio (72.4% average over the 10 years to 31 December 2015) than its peer group average (111%).

That's the sum of claims, commissions and expenses as a percentage of premium income. The lower the ratio, the better; a figure below 100% indicates profitable underwriting.

'We tend to write business which is ignored by major insurers, such as a young graduate who has moved to London and is driving their first car,' says chief executive Geoff Carter. 'There is a right price for every risk.' It also insures taxis and vans. 'We quote 90% of the market versus 50-60% from the major

insurers,' adds Carter.

Two thirds owner BC Partners, a private equity firm, is selling down some of its holding at IPO, so too some other shareholders and Sabre's management team. Sabre previously considered a trade sale but is rumoured not to have attracted BC's desired take-out price.

Carter says the business is highly cash generative, does not need any money to top up capital or pay down debt. Seventy per cent of its business is sold through brokers. It is targeting pure organic growth. (DC)



## UK construction in recession

THE LATEST OFFICE for National Statistics figures on UK construction suggests the industry is in recession. Output fell by a deeper-than-expected 1.6% between August and September as new work slipped by 1.3%. For the third quarter, output was down 0.9%, representing the first fall for two consecutive quarters in five years. (TS)

## IQE cash call gets huge backing

INVESTORS HAVE given **IQE (IQE:AIM)** a massive vote of confidence by backing a £95m share placing.

Priced at a zero discount to the 140p market price at the time of the fundraise is a positive sign of investor support. Indeed, demand has since pushed up the shares to a record 174.75p. (SF)

## Bakkavor's renewed appetite for IPO

JUST DAYS AFTER pulling its Main Market IPO citing volatile market conditions, food provider **Bakkavor (BAKK)** has done a U-turn and will join the stock market today (16 Nov) at a lower valuation than its previous target. Shares in the UK's biggest manufacturer of hummus have been priced at 180p versus an earlier target of 195p. (TS)

# Brighter prospects for drugs giant AstraZeneca

Analysts predict return to profit growth in the near future

**D**rug developer **AstraZeneca (AZN)** is at an inflection point, says well-known fund manager Neil Woodford. He believes growth is now beginning to emerge.

This comment followed news last week from AstraZeneca which guided for full year earnings to be towards the 'favourable end of a low to mid-teens percentage decline'.

The company's adjusted pre-tax profit has steadily declined for many years and is forecast to bottom out at \$5.12bn in 2018, according to Thomson Reuters' data. It is then forecast to rise to \$6bn in 2019 and \$7.5bn in 2020.

Investec analyst Andrew Whitney is optimistic about AstraZeneca's 'rich product pipeline' and flags

several potential drug approvals by the US Food and Drug Administration over the next six months.

Berenberg analyst Alistair Campbell says management want to improve operating margins. 'AstraZeneca is approaching the end of its patent cliff and sales should stabilise through 2017/18. New product launches should then underpin a prolonged period of substantial growth,' he comments.

'The oncology franchise is the most important sales driver in our forecasts. The rise of oncology should ultimately help AstraZeneca's margins rebound towards peer-average levels of 35%. As a result, we expect strong double-digit earnings growth beyond 2017, which is not reflected in the valuation.' (LMJ)

## Can Workspace fight off WeWork's competitive threat?

Trading is fine so far yet there are reasons to become more cautious

AMERICAN SHARED OFFICE group WeWork is aggressively expanding with a presence in 16 countries including the UK. This is creating intense competition for the likes of **IWG (IWG)** which recently issued a profit warning wiping off a third of its market value.

Sector peer **Workspace (WKP)** has so far proved to be a resilient player – but for how long?

Results for the six months to 30 September showed strong tenant demand with like-for-like rental growth of 4.1% to £46.1m and an adjusted trading profit of £29.4m.

WeWork has a big balance sheet which has enabled it to expand at a rapid pace and offer substantial



discounts. In contrast, Workspace chief executive James Hopkins says: 'Owning our properties in the right locations across London, combined with a deep understanding of and direct relationships with our customers, provides us with a key market advantage and further prospects for growth.'

Workspace's half year dividend

was hiked by 30% to 8.84p. Despite this robust performance the market remains relatively unconvinced with the shares drifting back after an initial rise in response to the results on 8 November.

Stockbroker Numis warns Workspace's claim to have differentiated product may be tested as competition continues to ramp up.

Analyst Paul Gorrie says: 'This adds a layer of caution to the Workspace outlook – as supply grows, particularly if heavily discounted, it will become increasingly difficult for Workspace to drive prices and rental growth forward.' (TS)

A woman with long brown hair in a ponytail, seen from behind, is climbing a grey rock wall. The wall is covered with various colorful climbing holds in shades of orange, yellow, red, blue, and purple. Some holds are shaped like crabs or other abstract forms. The woman is wearing a dark tank top and a climbing harness. The background is a plain, light-colored wall.

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# CityFibre strikes ultra-fast fibre deal with Vodafone

20-year agreement is a 'big tick' say analysts

**C**ity-focused fibre broadband operator **CityFibre Infrastructure (CITY:AIM)** is on a growth path as it seals a landmark agreement to bring ultra-fast broadband to up to 5m UK homes by 2025.

The £500m-plus 20-year contract with mobile network giant **Vodafone (VOD)** will bring full fibre-to-the-home (FTTH), with Vodafone guaranteeing connections to at least 20% of homes by the end of the first 10 years.

One million homes in 12 UK cities currently supplied by CityFibre will have their fibre connection upgraded by 2021. The agreement has an option to expand this amount to 5m homes by 2025.

## BIG JUMP IN DOWNLOAD SPEEDS

The network will triple maximum broadband speeds available in the UK. Virgin Media's fibre broadband can reach download speeds of up to 300Mbps (megabits per second). The average broadband speed in the UK is around 23Mbps.

Download speeds on the gigabit fibre networks can reach as high as 1,000Mbps. This would allow users to download a two-hour high definition movie in less than 30 seconds.

Work will begin in 2018 with first customers likely to get switched on shortly after, with Vodafone retaining exclusive marketing rights for the first two to four years.

In theory, the new network would deliver half of the UK Government's full fibre 10m homes and businesses target. It could also be used to provide fibre backhaul connections needed to deliver next generation (5G) mobile services.

## WIDESPREAD CITY SUPPORT

Most analysts are fans of the new agreement, with Peel Hunt's telecoms team saying 'this is a huge tick in our minds in terms of validation for CityFibre, and completely removes the overhang from the rumours around Vodafone entering the FTTH market.'

That latter point refers to previous speculation that Vodafone may have entered the UK fibre optic market as a competitor to Cityfibre rather than as a partner.

But some analysts have raised questions about the company's cost assumptions. CityFibre estimates a £415 average cost to connect each home. But Numis analysts point towards **BT's (BT.A)** Openreach estimates which are 8% higher at £450 per connected home, and Virgin Media's £630 network build assumptions.

One possible answer to that discrepancy is CityFibre's use of what is called 'dark fibre'. This is fibre optic cabling already in the ground that is not currently being used. This is either bought or rented and saves considerable civil engineering costs.



## SHARES SAYS: ↗

This agreement looks like a big step forward for CityFibre. But investors need to understand that this is a medium-to-long term growth opportunity, and one which may mean CityFibre stays loss-making for several years. (SF)

**BROKER SAYS:** 4 0 1

## FURTHER EVIDENCE OF HIGH STREET PAIN -5.2%

UK HIGH STREET sales in October suffered their worst month since April 2016, according to the latest BDO tracker report. It blamed a fall in spending, a drop in consumer confidence and unseasonably warm weather.

Total like-for-like sales fell 5.2% in the month – representing the worst October ever recorded by the survey.

Fashion sales were down 7.9%, perhaps because shoppers didn't feel cold enough to buy the winter clothes being stocked by retailers.

## GEARING FIGURES IMPLY GREATER CAUTION AMONG FUND MANAGERS



A REDUCTION in the level of gearing used by investment trusts suggests that fund managers in the closed-end space are becoming more cautious.

Financial services group Winterflood calculates the average level of net gearing among the 200 investment trusts invested in equities has fallen from 8% at the start of 2017 to 6% at present.

It says the number of trusts with gearing above 10% has fallen from 45 at the start of the year to now sit at 36. The number of ungeared trusts has risen from 75 to 84 over the same period.

Gearing involves a fund manager using debt to invest in more companies or other assets in order to boost the value of a portfolio. It creates a bigger pool from which to earn dividends and/or generate capital gains.

## CASH REPRESENTS NEARLY TWO THIRDS OF BOWLEVEN'S MARKET VALUE

WEST AFRICAN focused oil and gas company **Bowleven (BLVN:AIM)** is sitting on cash of \$86m according to its latest accounts. That compares with a market cap in dollars at current exchange rates of around \$133m.

The money in the bank is what is left from a \$165m payment associated with the farm-out of its Etinde field offshore Cameroon in 2015.

In March, arguing that this windfall was being squandered, Monaco-based investor Crown Ocean Capital ousted the majority of the board and new chief executive Eli Chahin has drastically scaled back costs.



# Why now is the perfect time to invest in security giant G4S

Its shares look good value and current issues aren't as bad as the market fears

**F**TSE 100 support services firm **G4S (GFS)** was once the whipping boy of its sector. It had well-documented problems with its contracts including providing security for the London Olympics, electronic tagging of criminals and housing asylum seekers.


The company has spent a long time trying to regain investors' favour. News in early 2016 of a 39% decline in full year pre-tax profit didn't help matters, yet the share price eventually enjoyed a recovery rally between July 2016 and June 2017.

Everything was going well until the company flagged new issues in August this year. That subsequently resulted in the share price losing nearly all the gains enjoyed earlier in 2017.

We're now at the point at which the shares are starting to look good value, hence our 'buy' rating. At 256.2p, it trades on 12.6 times forecast earnings for 2018.

## WHAT DOES THE COMPANY DO?

G4S is the global leader in security services including guarding,

**G4S**  **BUY**  
[GFS] 256.2p  
Stop loss: 200p

aviation screening, mobile patrols, prison management and prisoner escorting. It has a technology offering that includes installation and monitoring of alarms, CCTV, access control and biometric systems.

The company is also the European leader and second biggest player globally of cash/valuables transport, cash processing and ATM services.

## WHY HAVE THE SHARES RECENTLY BEEN WEAK?

G4S in August flagged a lack of growth in the Middle East and India. A trading update on 7 November reminded investors about this issue, plus a downgrade to organic growth forecasts, now 3% to 4% versus a previous 4% to 6% range.

We don't think there is anything wrong with the business; instead, reading analyst comments it seems some of the weaker revenue growth is just a

short-term issue around when new cash management contracts will properly start to contribute to earnings.

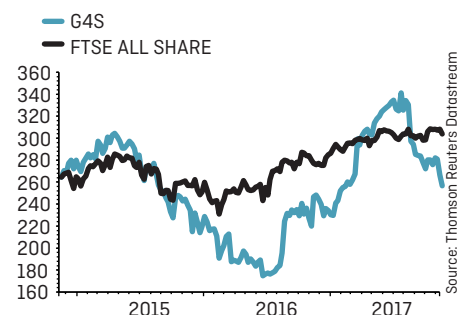
Jefferies analyst Kean Marden believes the outlook for the group is much better in 2018. He reckons a new cash management contract will contribute 2% to organic revenue growth from the end of 2017 and emerging markets momentum should also improve over the next 12 months.

Marden also says US wage inflation has accelerated sharply which should benefit the company.

Furthermore, we note a comment in G4S's latest trading statement about positive momentum with winning new contracts.

Like many companies in the support services sector, investors will have to be patient with G4S. However, we believe the rewards could be good in the medium term. You also get a nice 4% dividend yield while you wait. (DS)

**BROKER SAYS:**   



**IT HAS A TECHNOLOGY OFFERING THAT INCLUDES INSTALLATION AND MONITORING OF ALARMS, CCTV, ACCESS CONTROL AND BIOMETRIC SYSTEMS.**

BIO SYSTEM

# THE SCOTTISH Investment Trust



## We're investing in ugly ducklings...

At the Scottish, we take a contrarian approach to global stock markets.

We are high-conviction investors and focus on stocks that are out of favour with mainstream investors, as we believe these offer the greatest potential for long-term gains. This is because popular stocks tend to be overvalued – while out-of-favour stocks are often too cheap. We aim to exploit this inefficiency for our shareholders.

The investment environment is inherently cyclical. We see cycles in industry fundamentals, corporate behaviour, analyst views and investor sentiment. These cycles are closely linked: when an industry's fundamentals have been strong for some time, management teams, analysts and investors tend to be overly optimistic about its future. This leads to irrational investment decisions. Some of our best opportunities arise at the opposite point in the cycle – when a downturn leads to excessive pessimism about a company's prospects. When this happens, we can buy stocks precisely when the profit opportunity is greatest.

### An innovative investment approach

We believe investment returns are driven by a change in a company's prospects and an accompanying change in market perceptions. Often good companies are overly admired and consequently become overvalued. A company that has been badly run or is down on its luck may offer much more potential for improvement and, eventually, for outstanding returns. As contrarian investors, we see three distinct investment categories.

We categorise the first as **ugly ducklings** – unloved companies that most investors shun. These firms face fundamental challenges, and the market has become extremely pessimistic about their prospects. But we see their out-of-favour status as an opportunity.

The second category is where **change is afoot**. These companies have made significant changes to their prospects, but the improvements are not yet recognised by the market. So, while other managers continue to steer clear, we see the potential for profit.

In the third category are companies that have **more to come**. Unlike the first two categories, these companies are generally recognised as good businesses but we see an opportunity as the market does not appreciate the scope for further improvement.

### A painstaking process

To identify the right opportunities, we use a qualitative and quantitative analytic framework to research companies' fundamental prospects. We carefully assess any management change and restructuring actions, and consider the likely extent of any earnings recovery.

Companies in our portfolio can move along an axis from "ugly ducklings" to "change is afoot" and then "more to come". When ugly ducklings become fully fledged swans, we're looking to sell. Until then, we keep portfolio turnover to a minimum.

**For more information visit [www.thescottish.co.uk](http://www.thescottish.co.uk)**

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# Profit as oil producer Soco plays catch up

The firm is back on a growth track following years of declining production

A recovery in the oil price has yet to be reflected in the shares of oil and gas producer **Soco International (SIA)**, so get in quick before the market realises this anomaly.

We think the improved commodity price environment, under a new executive team, can help switch focus from several years of managing decline to a renewed focus on growth, backed by an extremely strong balance sheet.

In the last three months Soco's peers **Cairn Energy (CNE)** and **Premier Oil (PMO)** have advanced 25.9% and 37.8% respectively and even sector juggernauts **BP (BP.)** and **Royal Dutch Shell (RDSB)** have posted double-digit share price gains as oil prices have firmed to two-year highs above \$60 per barrel. Over the same period Soco is nearly 5% lower.

Why? Investors seem to have lost patience as Soco's production from its flagship TGT field in Vietnam has tailed off due to a lack of development drilling. The table illustrates how

## SOCO INTERNATIONAL BUY

(SIA) 114.5p

Stop loss: 91.6p

Market value: £382.2m

production has declined over recent years.

However, in 2017 activity has been ramped up with five development wells drilled and new capacity being brought on stream which should lay the platform for production growth over the coming two years.

Peel Hunt forecasts 10,000 barrels of oil equivalent per day (boepd) for 2018 and 14,000 barrels of oil equivalent per day in 2019. Guidance for 2017 is for between 8,000 boepd and 9,000 boepd.

## SIGNIFICANT APPOINTMENT

This week's appointment of Mike Watts as managing director (MD) could be significant. He was among the architects behind Cairn's successful exploration strategy in India which for a time

propelled the company into the ranks of the FTSE 100.

Backed by net cash of \$132m, Watts and fellow Cairn alumni Jann Brown, who is Soco's joint-MD and chief financial officer, may add some exploration upside to the portfolio through acquisitions.

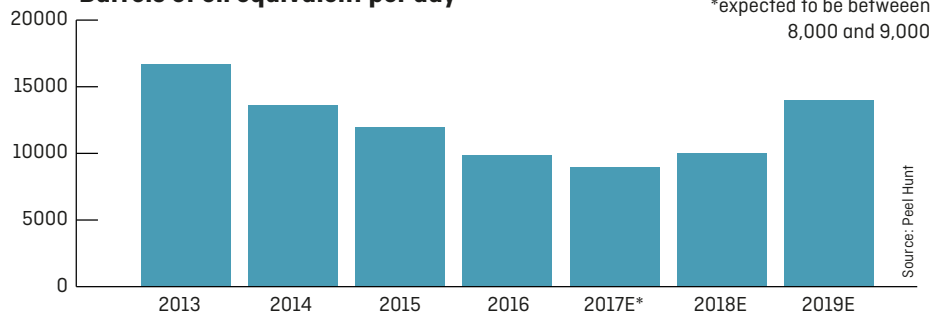
The company said two months ago it was 'vigorously reviewing... growth opportunities and options to maximise value from its current assets'.

On 30 October the company announced that it had secured a 17% interest in two exploration blocks offshore Vietnam which it had been chasing for several years although any exploration drilling will have to wait until 2021 at the earliest.

Earnings and cash flow are likely to be constrained by investment next year but a free cash flow yield of 16.6% and price-to-earnings ratio of 6.3 times based on Peel Hunt's 2019 forecasts is attractive for those prepared to look that far ahead. (TS)

## BROKER SAYS: 2 6 2

Barrels of oil equivalent per day



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# Reappraising four stocks in our Great Ideas portfolio

All investors make mistakes and we're no different

The purpose of the *Great Ideas* column is to present strong investment ideas to readers every week. While our track record of success is good, such as a 10.1% average share price gain over the past 12 months, we don't always get it right.

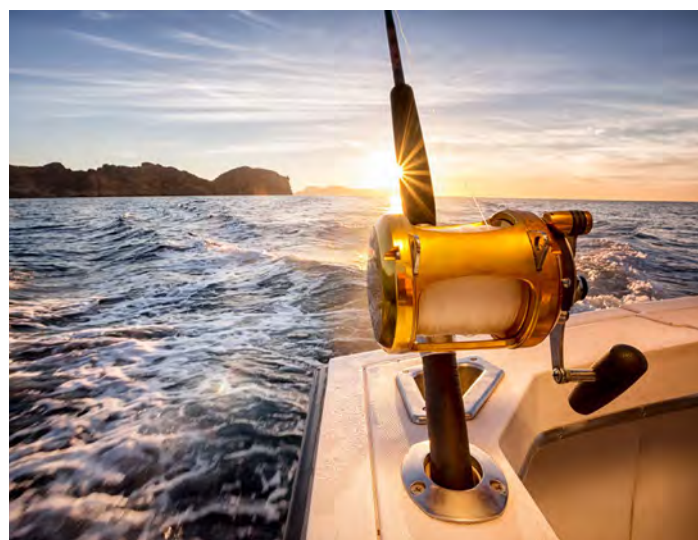
Many factors can weigh on a share price including trading setbacks, negative market sentiment and broader economic or political factors.

We always strive to update readers when something important has happened to one of our running *Great Ideas* trades.

Sadly some bits of news are as much a surprise to us as to you, hence why we don't always have the chance to forewarn readers about bad news before the share price moves.

## NOT A GOOD CATCH

A good example is AIM-quoted **Fishing Republic (FISH:AIM)** whose share price nearly halved in value on 13 November when it said the company would make a loss in 2017 after a 'significant deterioration' in trading over the past two months.



“MANY FACTORS CAN WEIGH ON A SHARE PRICE INCLUDING TRADING SETBACKS, NEGATIVE MARKET SENTIMENT AND BROADER ECONOMIC OR POLITICAL FACTORS”

We were very frustrated with the announcement given the company had only said a mere seven weeks ago that trading was going well.

Fishing Republic reported 'a substantial increase' in price cutting by competitors and independent stores in recent weeks, rivals fighting hard to maintain their own market share, particularly at the end of the main fishing season.

That caused Fishing Republic's like-for-like sales to slump 13% in October, a worryingly sharp downturn given the 16% growth delivered in the nine months to September.

The only potential bright spot is the appointment of former **SuperGroup (SGP)** e-commerce chief Steve Griffin as acting chief executive. Griffin has announced a strategic review to look at how the group can grow online sales.

However, we're concerned about the lack of cash to fund any major changes to the business, given it had less than £700,000 in the bank as of 30 June. Any fundraise would likely to be done at a discount to the current depressed market value, so we don't believe it is worth buying the stock as a recovery play.

### ULTRA'S MAJOR SETBACKS

Defence firm **Ultra Electronics (ULE)** lost nearly a quarter of its market value on 13 November after warning on 2017 profit and announcing the exit of veteran chief executive Rakesh Sharma.

Citing 'difficult' conditions in the UK defence market, the company says underlying profit will be £120m against a forecast of £132m on revenue down 4% year-on-year. In hindsight we should have looked closer at the track record when selecting Ultra as a *Great Idea* in May.

Ultra has missed growth targets for the last four years and the company has previously flagged risks regarding defence spending.

### CHANGE IN INVESTOR SENTIMENT

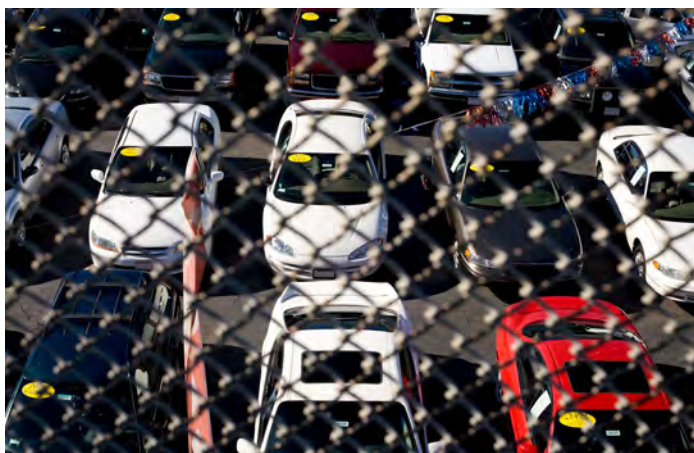
Sometimes share prices can fall due to external factors rather than a negative trading update or poor financial results.

Amazon's competitive threat is a well-known issue facing the retail sector – but have you considered the tech giant could flex its muscles in other industries?

It was brought to investors' attention last week that the distribution sector could also face a new challenger in the form of Amazon, hence why shares in FTSE 100 services group **Bunzl (BNZL)** have fallen by nearly 8% in recent days to £21.32.

Investment bank Morgan Stanley issued a research note looking at the Amazon risk to Bunzl's investment case, saying the company looked 'vulnerable'.

Bunzl has historically commanded a premium equity valuation thanks to a long track record of earnings growth. We've been big fans of the stock over the years with previous articles pointing out its impressive performance with dividend growth



SOMETIMES SHARE PRICES CAN FALL DUE TO EXTERNAL FACTORS RATHER THAN A NEGATIVE TRADING UPDATE OR POOR FINANCIAL RESULTS

and making good acquisitions.

In our March 2017 article we wrote: 'Bunzl is quite simple to understand. It supplies things that companies need in order to do business; but not items they would sell to their customers. It buys companies and makes them better, leading to increased profitability and cash flow.'

Morgan Stanley is concerned about declining margins driven by customer price pressures and industry competition. It believes Amazon's entry in to the distribution market could aggravate the margin squeeze and justify Bunzl trading on a lower rating.

Our *Great Ideas* trade on Bunzl is now just under 5% below our £22.39 entry price eight months ago. Fundamentally we like the company but recognise the Amazon threat could increasingly weigh on investors' minds. We therefore cut our losses and exit the trade in the belief that market sentiment could become even more negative towards Bunzl in the short term.

### AUTO TRADER IN REVERSE

Also potentially impacted by the threat posed by Amazon is second hand car marketplace **Auto Trader (AUTO)**. At 324.1p shares in the company are now 16.7% below the price we flagged the stock just under a year ago.

The market appeared underwhelmed by a fairly solid looking set of first half numbers on 9 November as the focus remains on the pressure on the wider car market amid Brexit uncertainty.

Websites like Amazon and Facebook are also seen as potential competition to Auto Trader.

Management have consistently delivered yet, noting a good stock in a bad sector can underperform a bad stock in a good sector, we now adopt a cautious stance towards Auto Trader. (TS/DC)

## FRIDAY 17 NOVEMBER

## INTERIMS

NextEnergy Solar Fund	NESF
Record	REC

## AGMS

Amur Minerals	AMC
Central Rand Gold	CRND
Kier	KIE
Seeing Machines	SEE
Sylvania Platinum	SLP

## MONDAY 20 NOVEMBER

## FINALS

Diploma	DPLM
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## INTERIMS

NEX	NXG
TCS	TCS

## ECONOMICS

## UK

Rightmove HPI
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## TUESDAY 21 NOVEMBER

## FINALS

Compass	CPG
CYBG	CYBG
EI	EIG
EasyJet	EZJ
Renew	RNWH
Stride Gaming	STR
Focusrite	TUNE
Utilitywise	UTW

## INTERIMS

AFI Development	AFRB
AO World	AO.



**ELECTRICAL GOODS RETAILER AO World (AO.)** will issue half year results on 21 November, the first time it has commented on trading since July.

There are low expectations given how the share price has steadily fallen this year, now down 42% year-to-date amid tough trading conditions in the retail sector and rising competition.

Losses from its European arm wiped out profits from its UK business in the financial year ending 31 March 2017.

Babcock International	BAB
Bank of Cyprus	BOCH
Big Yellow	BYG
CML Microsystems	CML
Halma	HLMA
Homeserve	HSV
Imimobile	IMO
Johnson Matthey	JMAT
Severfield	SFR
Telecom Plus	TEP
VP	VP.

## TRADING STATEMENTS

Intertek	ITRK
Kingfisher	KGF
Spectris	SXS

## AGMS

Harvest Minerals	HMI
Pan African Resources	PAF

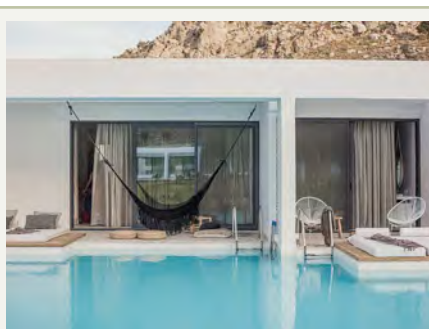
## WEDNESDAY 22 NOVEMBER

## FINALS

Cambria Automobiles	CAMB
Creightons	CRL
Countryside Properties	CSP
Euromoney Institutional Investor	ERM
Sage	SGE
SSP	SSPG
Thomas Cook	TCG

## INTERIMS

Assura	AGR
Accsys Technologies	AXS



**INVESTORS SHOULD** scan travel agent Thomas Cook's (TCG) full year results on Wednesday 22 November to find out the full impact of Hurricane Irma on performance.

Earlier this year, the company warned that September was operationally challenging as it helped customers affected by bad weather in the Caribbean and Florida.

Investors should also look at whether bookings over the traditionally difficult winter period have increased over the last few months.

Biffa	BIFF
Charles Stanley	CAY
NewRiver Retail	NRR
United Utilities	UU.

## TRADING STATEMENTS

Spirax-Sarco Engineering	SPX
--------------------------	-----

## AGMS

Base Resources	BSE
F&C UK Real Estate Investments	FCRE
Ovoca Gold	OVG
Pantheon International	PIN

## ECONOMICS

## UK

CBI Realised Sales
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## THURSDAY 23 NOVEMBER

## FINALS

Paragon	PAG
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## INTERIMS

Caledonia Investments	CLDN
CMC Markets	CMCX
First Property	FPO
Hogg Robinson	HRG
Mothercare	MTC
Pets At Home	PETS
Severn Trent	SVT
Majestic Wine	WINE

## TRADING STATEMENTS

Centrica	CNA
Rotork	ROR

## AGMS

CAP-XX	CPX
Crystal Amber Fund	CRS
Netcall	NET
F W Thorpe	TFW

## EX-DIVIDENDS

Balfour Beatty	BBYB	5.38p
CVS	CVSG	4.5p
Downing Planned		
Exit VCT 2	DP2F	2.5p
Downing Planned		
Exit VCT 2	DP2G	2.5p
Downing Planned		
Exit VCT 3	DP3F	2.5p
Downing Three VCT	DP3H	2.8p
Volution	FAN	2.8p
Finsbury Food	FIF	2p
Hotel Chocolat	HOTC	1.6p
London Finance & Investment	LFI	0.55p
Octopus Apollo VCT	OAP3	1.6p
River and Mercantile	RIV	6p
St Ives	SIV	1.3p
J Smart & Co	SMJ	2.17p
Tiso Blackstar	TBGR	0.26p
Ten Entertainment	TEG	3p
Yu	YU.	1p

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# How the “Boy Wonder” made \$100m

With this method a legendary investor made \$100 million.  
Now there's a simple version you can use.

In the summer of 1891 a fourteen-year-old farmer's son ran away from home. In his pocket he had just five dollars.

Thirty-eight years later, having spent his entire adult life as an investor and trader, he was worth over \$100 million. His name was Jesse Livermore.

With a luxury mansion, a 300-foot yacht, a beautiful wife, and Wall Street and the press hanging on his every word, Livermore was the most famous investor of his day.

He achieved so much at a young age that he was known as “the boy wonder”. And his huge success was largely due to one particular investment strategy - a strategy which remains just as effective today, over a hundred years later.

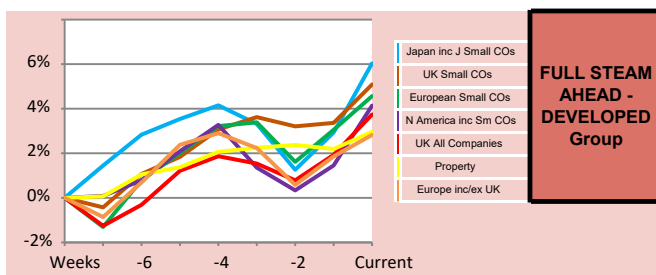
How do I know it still works?

Because seventeen years ago, in 2000, I created my own simple investment system based on this strategy. And since then my money has multiplied many times over. In fact, over the last 5 years I've outperformed the FTSE Total Return by 73%.

I've made 12% return a year, on average, every year for the last five years. (In fact my successful track record goes back to 2000, but unfortunately I didn't keep all seventeen years' worth of paperwork to be able to prove it).

I'm no financial whizz-kid. Far from it. But I've proved that there's no need to accept pitifully low returns. Nor do you need to resign yourself to a roller-coaster ride with your wealth – seeing your investments plummet just as often as they go up.

**Spot new trends, with clear, easy-to-follow charts & data**



If you're prepared to take a more active role in your investments, you too could make consistent, market-beating gains, without taking on crazy risks.

This investment approach is known as momentum or trend investing. It's about identifying market trends early, and then riding them as they go up. Think it sounds complicated, or something only traders should do? Well, it isn't. Lots of ordinary investors are using my approach, extremely successfully.

The key is having the right information – performance data and charts - and some simple rules to follow. You look at the numbers and charts (see a chart example at the bottom of the page), and follow the rules.

When a particular sector goes up, you switch your money into it. And when a sector heads down, you move your money out into better-performing sectors, or even out of the market entirely.

My method is perfectly practical and easy to use for anyone who wants to take more control of their investments. As I say, using it I've beaten the FTSE by 73% over the last 5 years.

For a full explanation of how our trend investing system could give you better – and less volatile – returns from the stock market, please take a look at our website: [www.saltydoginvestor.com](http://www.saltydoginvestor.com)

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*Douglas Chadwick, Founder, Saltydog Investor*

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# What to look out for in the Budget

We look at some of the possible changes relevant to investors

**P**hilip Hammond will face some difficult choices when he delivers his first post-election Budget speech on 22 November.

The Chancellor will be keen to offer giveaways where possible, particularly to younger voters who gave the Conservatives a bloody nose at the general election. However, the economy isn't exactly motoring at the moment and Hammond will be equally keen to demonstrate his commitment to spending discipline.

With that in mind, here are some of the ways the Chancellor could cut savings perks – and a few vote-winning giveaways for savers.

## POSSIBLE CUTS



### PENSIONS – HIGHER RATE TAX RELIEF

As sure as night follows day, so rumours of cuts to pension tax relief precede the Budget.

Pension tax relief is currently granted at your marginal rate, so a basic-rate taxpayer

gets 20% relief, a higher-rate taxpayer 40% and an additional rate taxpayer 45%.

However, some fear a Government desperate to raise cash could ditch this system and replace it with one where everyone gets 20% relief, regardless of income.

If this happened it would have a significant impact on the saving potential of millions of people. A 30 year-old higher rate tax payer saving £500 a month would lose out on around £115,000 by the time they are 65 if pension tax relief was restricted to the basic rate.

### PENSIONS – ANNUAL ALLOWANCE

It seems more likely the Chancellor will go after the annual allowance (set at £40,000 a year) or the lifetime allowance (currently £1m).

The annual allowance is 'tapered' down for anyone with

total relevant earnings above £150,000, reaching a floor of £10,000 for those with total earnings of £210,000 or more.

The lifetime allowance is due to increase in line with inflation in April 2018 to £1,030,000 so it feels unlikely this will be cut, although by no means impossible.

The annual allowance would be the simplest tax relief lever to pull, and cutting this from £40,000 to £30,000 or even £20,000 – in line with the ISA allowance – would only hit the wealthiest savers.

While nobody knows for sure



## PENSIONS

## ISAS

## POTENTIAL GIVEAWAYS



what will happen at the Budget, recent history suggests a cut in pension savings incentives is fairly likely. So if you are planning to make a big contribution this tax year, it may be worth doing it before 22 November.

**THE PERSONAL ALLOWANCE**

The personal tax-free earnings allowance has almost doubled from £6,035 in 2008/09 to £11,500 in 2017/18. Under current plans this will rise to £12,500 by 2020/21. The last rise in the personal allowance (from £11,000 to £11,500) cost the Exchequer around £2bn a year, so a further £1,000 increase would cost the Chancellor billions at a time when he can least afford it.

Given the price tag on hiking the personal allowance there may be a temptation to delay the increase to £12,500 or even halt it altogether.

**ISA ALLOWANCES**

British savers will be keeping an eye out for any increases to ISA contribution limits. However, given the main annual ISA contribution amount was increased significantly to £20,000 just 18 months ago, any increase here may be wishful thinking.

If the Chancellor wants to specifically target younger voters, an increase to the annual Lifetime ISA allowance may be more realistic.

The Lifetime ISA only launched in April this year and there are still very few providers offering it.

At the moment savers aged 18 to 39 can pay in up to £4,000 a year and receive a 25% Government bonus. You can keep paying in until age 50, and access the money tax-free from age 60, or earlier without penalty

for the purchase of a first home or if you become terminally ill.

An increase in the amount people can contribute each year to £5,000, for example, would be a boost to younger savers and may encourage more providers to enter the market.

**INCREASING THE PENSION CONTRIBUTION LIMIT FOR NON-EARNERS**

Another simple change the Chancellor could look at announcing is an increase to the amount non-earners can pay into a pension. This limit is currently set at £3,600 and has been in place for well over 10 years, so is overdue a boost.

Given the Money Purchase Annual Allowance – which applies to anyone who has accessed taxable income from their pension from age 55 – is now set at £4,000 it would make sense to bring the non-contributory limit up to this level and in the process at least marginally reduce the complexity of the UK's pension tax framework.

**STAMP DUTY HOLIDAY**

The Chancellor will be very keen to include something that can help people get their foot on the housing ladder.

Stamp duty is a significant barrier for many people and so a stamp duty holiday for first time buyers, combined with a potential increase in the Lifetime ISA allowance, could go some way to solving the home ownership equation for younger people.

Tom Selby, senior analyst,  
AJ Bell





# SHARES

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**London – Tuesday 28 Nov  
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### Companies presenting

#### 28 November

**ANGLE (AGL)** is a commercially driven medical diagnostic company specializing in the development of pioneering products in the fields of cancer diagnostics and fetal health.

**Royal Road Minerals (TSXV:RYP)** is a gold and copper focused exploration and development company. The Company's objective is to advance the exploration and development of its projects in Colombia and Nicaragua.

**ThinCats** are one of the pioneers of the peer-to-peer business lending industry; specialising in loans with security and linking retail and institutional investors directly with established business borrowers to provide a serious alternative to high street banks.

**Touchstone Exploration (TXP)** is a UK listed but Canadian-based, international upstream oil and gas company currently active in the Republic of Trinidad and Tobago.

#### 29 November

**Avation (AVAP)** is a specialist commercial passenger aircraft leasing company managing a fleet of aircraft which it leases to airlines across the world.

**GAN (GAN)** is a leading developer and supplier of online gaming content and enterprise-level business to business gaming software systems as well as a provider of supporting operational services.

**Metminco (MNC)** is an ASX and London AIM listed exploration and mining company. MNC has a portfolio of gold and copper exploration projects located in Colombia, Peru and Chile.

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#### Contact

Chris Williams, Spotlight Manager  
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# Why Hollywood Bowl has the right credentials to thrive

The leisure group enjoys high margins, has plenty of earnings growth drivers and is highly cash generative

**B**owling is a more robust industry than you might imagine. Market demand is growing at approximately 6% per year even though there is no supply growth, according to stockbroker Peel Hunt. It is an affordable leisure treat, meaning consumers continue to bowl even in tougher economic conditions.

While we have previously expressed a preference for the cinema industry as the most robust part of the leisure sector, a closer look at **Hollywood Bowl (BOWL)** leads us to conclude that bowling is also attractive from an investment perspective if you back the right operator.

Hollywood Bowl is the UK market leader. It has grown revenue at a 15% compound annual growth rate and has almost trebled its EBITDA (earnings before interest, tax, depreciation and amortisation) since 2013, according to investment bank Berenberg. That's been achieved through investment in sites and technology.

Just under half of its estate has yet to be refurbished, leading us to conclude that decent gains could be made from owning the shares over the medium term judging by how previous



site upgrades have boosted Hollywood Bowl's earnings.

## TASTY PROFIT GROWTH

The company is forecast by analysts to report £20.6m pre-tax profit when it issues full year results on 11 December. That figure is expected to rise to £22.7m in 2018 and £24.8m in 2019. Investors should also expect a special dividend to be declared in December judging by the company's remarks at the half year results in May and October's trading update.

The group is able to self-fund its refurbishment and rollout programme as it is highly cash generative. It had £13.5m net debt as of 31 March and that figure is forecast by analysts to be under £10m as at 30 September 2017, with the

potential to be in a net cash position by the end of the 2019 financial year if it doesn't return cash through a special dividend.

Chief financial officer Laurence Keen says the current cost of refurbishment is between £350,000 and £450,000 per site, undertaking between seven and 10 sites a year. 'We're upgrading everything the customer experiences in our centres, from replacing seating, upgrading the diner and bar areas, to signage, carpets, and so on; all of which is helping drive excellent returns on investment at over 50% in year one.'

## MULTIPLE EARNINGS DRIVERS

Making the sites smarter is clearly having a positive effect on customers and it isn't the only way Hollywood Bowl is driving up

earnings in a mature industry.

It is having success with VIP lanes where the customer pays an extra £1 to bowl in a roped-off area with big black sofas, coloured pins and bowling balls that look like pool balls.

‘We introduced the VIP lanes as a way to let people upgrade and feel that little bit more special. It’s only an extra £1 but people love it and it is an easy upgrade to make. Each site costs £30,000 to convert and there is an average 24 month payback.

‘Our average rack rate price to bowl is just £6 which is less than rival **Ten Entertainment (TEG)** which prices its headline bowling at between £7.45 and £7.95 in its mature sites,’ says Keen.

Bowling accounts for a little less than 50% of Hollywood Bowl’s earnings. The rest comes from food and drink (28%) and amusement arcade machines (23%). It has managed to increase the contribution from food from 8% to 10% in the past four years by opening up its kitchens so customers can see fresh food being prepared on a griddle rather than operating a bank of microwaves.

Another driver has been training staff to ask bowlers towards the end of their game if they would like to reserve a place in the diner and have their food ready five minutes after they finish bowling. That’s been a success, says the CFO.

On a broader basis, the company uses various means by which to further drive sales including dynamic pricing which adds up to £1 to the price of bowling when demand is high.

Its scoring system is able to send follow-up emails to



“**WE INTRODUCED  
THE VIP LANES AS A WAY  
TO LET PEOPLE UPGRADE  
AND FEEL THAT LITTLE BIT  
MORE SPECIAL**”

customers about their last game and include offers to return. Customers can also use their own shoes when bowling and not have to waste time queuing to change into special bowling shoes. All of which have helped contribute to revenue growth.

## PROPERTY STRATEGY

Peel Hunt forecasts Hollywood Bowl will add three more sites to its estate over the next two years. The company opens new-build sites as part of retail and leisure developments or it acquires sites from rivals and rebrands them. Its preference is high footfall areas such as shopping centres rather than out-of-town sites.

For example, it recently

opened a site in Dagenham that was formally a Namco Funscape centre. ‘The landlord wanted more restaurants on the broader leisure park and thought we’d be a better fit as an accompanying leisure attraction,’ reveals Keen.

Hollywood Bowl is increasingly seeing landlords pay money towards site development because of the importance of leisure to retail. For example, its Southampton Watermark centre cost £2.4m to build, of which £1.1m was paid by the landlord.

Importantly, the company is being very selective with acquiring sites from rivals. It only wants locations with the capability to provide superior return on investment and be able to survive a market downturn.

Keen says, as a leasehold business it is in a strong position given it has no loss making sites. He credits Hollywood Bowl’s choice of new sites and acquisitions, as well as delivering a great customer experience.

A decline in consumer spending would most likely affect Hollywood Bowl’s amusement arcade income first, he adds. It’s the obvious place where parents or adults would think twice about spending, instead prioritising a game of bowling as the activity lasts much longer.

Thankfully Hollywood Bowl does have a cushion in the form of high profit margins should life become more difficult. Peel Hunt forecasts 19.7% EBIT (earnings before interest and tax) margins in 2018, rising to 19.8% in 2019.

**SHARES SAYS:**   
**Buy at 183.75p. (DC)**

**BROKER SAYS:**   

# WHAT A DIFFERENCE 18 MONTHS MAKES!

**Tom Holl**, co-manager, BlackRock  
Commodities Income Investment Trust

The global mining sector has seen a remarkable turnaround over the past 18 months. At the start of 2016, its fortunes appeared precarious, but today some companies in the sector have seen profits and cash flow improve, and dividends resume. This has been reflected in significant share price growth. The question for investors from here is whether this strength can endure. Mining shares will typically experience above average volatility when compared to other investments and trends in the wider equity market may not be reflected in the performance of mining securities.

The improvement in the performance of a number of mining companies has been helped by an improvement in commodity prices, but the costs of production have also fallen, which has helped profitability. There has also been considerable action within the companies themselves to improve their businesses. A number of the largest companies in our BlackRock Commodities Income Investment Trust plc portfolio have paid down debt, improved cash flow and are paying higher dividends.

This strength has been reflected in the share prices of some mining companies. The Euromoney Global Mining Index is up 17% over the year to 29 September<sup>1</sup>. This is undoubtedly a strong run, and investors may be asking whether there is any further scope for share price appreciation from here.

We had been confident that January 2016 marked the bottom of the mining cycle for a number of reasons. The market was pre-occupied about the potential for a 'hard-landing' in China – i.e. that growth would be far worse than expected. This did not happen - Chinese policymakers took measures to boost the economy and economic growth rates were sustained<sup>2</sup>.

From here, we recognise that China remains the key risk for investors in the mining sector. It is a huge economy and creates a considerable part of global demand for commodities. However, we believe the Chinese administration has shown itself willing and able to step in to support the economy. Reform measures put in place by the government across a range of industries, including steel, coal and aluminium, to tackle pollution and waste have been more effective than many expected and have improved the profitability across a number of sectors. This should be a key benefit for companies in the longer term. China should also benefit from a spillover effect from the wider improvements seen in global economic growth in recent months<sup>3</sup>.

This gives a more favourable macroeconomic backdrop for mining companies, but the companies themselves also continue to make improvements. For example, some balance sheets are in better shape than 18 months ago with, in particular, considerably lower debt. This improvement should help companies deliver more stable profits looking forward.

While the mining sector has performed strongly, it is still some way below the peak in 2011<sup>4</sup>. Commodity prices have stabilised and we believe this stability will continue. There has also been some supply taken out of the system. There has been underinvestment from mining companies in recent years, with global mining sector capital expenditure down 66% since the peak in 2012<sup>5</sup>. This means that there are fewer commodities being mined and

put onto the market which we believe will help the supply/demand balance and support prices.

With this in mind, we remain optimistic on a continued recovery in the mining sector. In spite of the recent rally, we believe a combination of improvements within the companies themselves and external factors such as strong global growth and an improvement in China will conspire to support the sector. There are always vulnerabilities – an economic slowdown in China, or in the US or idiosyncratic difficulties at individual companies would certainly derail the sector's growth. However, we believe the outlook has improved over the last 18 months.

All financial investments involve an element of risk. Therefore, the value of your investment and the income from it will vary and your initial investment amount cannot be guaranteed.

**Trust specific risks:** Overseas investment will be affected by movements in currency exchange rates. Emerging market investments are usually associated with higher investment risk than developed market investments. Therefore the value of these investments may be unpredictable and subject to greater variation. Mining shares typically experience above average volatility when compared to other investments. Trends which occur within the general equity market may not be mirrored within mining securities. Investment strategies, such as borrowing, used by the Trust can result in even larger losses suffered when the value of the underlying investments fall.

To find out what the BlackRock Commodities Income Investment Trust has to offer, **click here**.

<sup>1</sup>Euromoney Indices, as at 29 September, 2017 ([www.euromoneyindices.com/indices/euromoney-global-mining-indices/euromoney-global-mining-index](http://www.euromoneyindices.com/indices/euromoney-global-mining-indices/euromoney-global-mining-index))

<sup>2</sup>Reuters, April 2017 ([www.reuters.com/article/us-china-economy-gdp/steel-stimulus-drive-chinas-strongest-economic-growth-since-2015-idUSKBN17J04E](http://www.reuters.com/article/us-china-economy-gdp/steel-stimulus-drive-chinas-strongest-economic-growth-since-2015-idUSKBN17J04E))

<sup>3</sup>International Monetary Fund, October, 2017 ([www.imf.org/en/Publications/WEO/Issues/2017/09/19/world-economic-outlook-october-2017](http://www.imf.org/en/Publications/WEO/Issues/2017/09/19/world-economic-outlook-october-2017))

<sup>4</sup>Euromoney, as before

<sup>5</sup>BlackRock, September 2017

BlackRock has not considered the suitability of this investment against your individual needs and risk tolerance. To ensure you understand whether our product is suitable, please read the Key Features or Key Information Document (KID), when implemented. Investment Trusts will provide the KID by 1 January 2018. Investors should read the fund specific risks in the Key Features or KID which give more information about the risk profile of the investment. The Key Features, KID and other documentation are available on the relevant product pages at [www.blackrock.co.uk/its](http://www.blackrock.co.uk/its). We recommend you seek independent professional advice prior to investing.

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# GET RICH SLOWLY

There is increasing talk among investment professionals that we're long overdue a market correction, namely for share prices to fall by 10% or more in a short period. While not trying to be pessimistic, we do believe now is a prudent time to protect the wealth you've created during the current bull-run.

We've previously discussed taking profit in the higher-rated stocks in your portfolio as one way of locking in profit. Another strategy is to consider switching some of your money into capital preservation funds.

This type of investment collective has two benefits. First, it has a good track record of helping investors to avoid large losses. Second, it can actually grow your wealth as well, albeit slowly.

A lot of people may think capital preservation funds are simply defensive investments. That's not true. Many of the products have a good track record of delivering decent annual returns.

For example, **RIT Capital Partners (RCP)** achieved 14% annual return in 2013, 13.3% in 2014, 22.7%



in 2015, 14.2% in 2016 and 5% in 2017, according to Morningstar data. Its strategy is to preserve shareholders' capital AND deliver long-term capital growth.

Fund manager Peter Spiller says **Capital Gearing Trust (CGT)** has enjoyed a 185-fold increase in its share price in the 35 years he's been running the fund. He credits the flexibility of asset allocation, saying there are many levers to pull to shift assets in accordance with valuation and/or opportunities for capital gains.

'On a net asset value basis, I've only had one bad year in the last 35 and that was only down 2%,' he reveals.

### WHAT'S IN A CAPITAL PRESERVATION FUND?

Many capital preservation funds have a lower exposure to equities (namely stocks and shares) than a standard income or growth fund. Instead, portfolios are likely to have a large position in government and corporate bonds plus assets such as gold.

Their guiding principle is that generating more modest gains is a price worth paying for not suffering the bigger losses that come from greater risk taking.

Capital preservation is a money management

“ON A LONG TERM BASIS, CAPITAL PRESERVATION STRATEGIES CAN BE APPROPRIATE FOR INVESTORS TAKING THEIR FIRST STEPS IN THE INVESTMENT WORLD AS THEY OFFER AN ELEMENT OF MARKET EXPOSURE BUT OFTEN WITH LOWER VOLATILITY”

strategy designed to avoid losing money at all costs, in which the protection of the wealth you have already garnered is deemed to be more important than generating additional growth or profits.

It is also sometimes taken to mean protecting the inflation-adjusted purchasing power of an asset, so that the pile of hard-earned cash an investor has amassed can still purchase the same goods and services by the end of the holding period.

#### CAPITAL PRESERVATION-STYLE INVESTMENT TRUSTS: ANNUAL RETURNS

	2012	2013	2014	2015	2016	2017
Capital Gearing Trust	13.3%	-9.0%	3.3%	1.2%	15.4%	6.0%
Personal Assets Trust	4.2%	-4.8%	10.3%	1.7%	14.2%	4.9%
RIT Capital Partners	-5.4%	14.0%	13.3%	22.7%	14.2%	5.0%
Ruffer Investment Company	2.1%	7.3%	4.3%	-0.8%	12.9%	0.0%
Strategic Equity Capital	25.6%	61.5%	32.7%	14.2%	-9.0%	17.7%

Source: Morningstar

#### CAPITAL PRESERVATION-STYLE OPEN-ENDED FUNDS: ANNUAL RETURNS

	2012	2013	2014	2015	2016	2017
CF Odey Absolute Return Acc	36.3%	45.0%	4.9%	7.0%	-18.3%	10.7%
Jupiter Absolute Return Acc	0.9%	2.2%	-0.2%	5.9%	10.2%	-1.8%
Newton Real Return Acc	3.1%	5.3%	3.1%	0.9%	3.9%	2.5%
Ruffer Absolute Return Acc	n/a	10.6%	5.8%	0.5%	13.1%	0.0%
Troy Trojan Fund Acc	1.6%	-3.6%	8.4%	2.6%	11.7%	3.0%

Source: Morningstar

## WHAT TO EXPECT FROM OWNING CAPITAL PRESERVATION FUNDS

In general, capital preservation funds are likely to underperform a rising market, although investors should still participate in a good chunk of the upside. They should outperform in a falling market and hopefully have minimal or no losses – although the latter is never guaranteed.

Spiller at Capital Gearing Trust says his fund is designed to look after all financial assets for someone who has a long term view. He says it is aimed at people who choose returns in the form of capital gains rather than income plus have an aversion to losing money but would like to outperform the markets over time. That's a good description which we'd apply to all capital preservation funds.

'On a long term basis, these types of strategies can be appropriate for investors taking their first steps in the investment world as they offer an element of market exposure but often with lower volatility,' says Ryan Hughes, head of fund selection at AJ Bell.

He warns that these types of strategies still have the potential to lose money and therefore investors worried about short term market volatility should tread very carefully.

'Ultimately, these strategies are designed to be long term investments and should not be thought of as a "parking bay" for equity exposure when times are more challenging. If you are very worried about short term market conditions, then cash offers certainty that other investments just don't offer.'

Ryan makes a good point that cash should be considered as a place for your money, particularly if you are very bearish.

'If people are bearish then they may prefer to hold a lot of cash. But that won't save you if there is rising inflation,' comments Spiller. 'You have to not mind underperforming markets during a bull run – but Capital Gearing Trust hasn't fallen (most of the time) when markets were down in the past.'

Inflation can eat into the real returns on your cash. For example, inflation is currently 3% and the best paying easy access savings account currently pays 1.31% (offered by Paragon Bank). Assuming inflation stays the same, the real return on your cash in a Paragon savings account would be -1.69% after a year.

Some people might argue that's a small price to pay compared to the potential losses you could incur in a stock market correction.

**“IF PEOPLE ARE BEARISH THEN THEY MAY PREFER TO HOLD A LOT OF CASH. BUT THAT WON'T SAVE YOU IF THERE IS RISING INFLATION”**



## WHY CONSIDER CAPITAL PRESERVATION FUNDS NOW?

Following a prolonged rally in world stock markets, many of which are 'priced for perfection', prudent investors should now be placing an increasing emphasis on capital preservation.

As the global bull market is maturing, many experts are now prioritising the preservation of capital following a prolonged period of capital growth in both bonds and equities. The FTSE 100, S&P 500, Dow Jones Industrial Average, NASDAQ and Nikkei 225 indices are testing new highs, all of which is giving many experts the heebie-jeebies.

Among them is Howard Marks, the well-followed co-chairman of Oaktree Capital Management, who says investors should be wary of high-flying markets now but not panicky.

One of the most prominent voices raising concerns about the ongoing exuberance of markets this year, Marks recently said: 'I think it would be a huge mistake for people to get nervous and fear that we're heading for another crash'. A correction of 20% or 30% could still be 'very unpleasant' according to Marks, who warns investors not to interpret his calls to avoid panic to mean 'there's nothing worrisome going on'.

Marks said Oaktree's investment team is approaching the current environment under the battle cry of moving ahead 'with caution' and *Shares* believes savvy investors should heed this advice.

Hughes at AJ Bell says it is crucial for investors to think about their risk profile, tolerance of potential loss and investment objectives. 'When that is understood by an investor it allows them to consider which types of investment are suitable for them.

'Funds taking a capital preservation approach can still have an important role to play even for

investors seeking long term growth as they add useful diversification to a portfolio.'

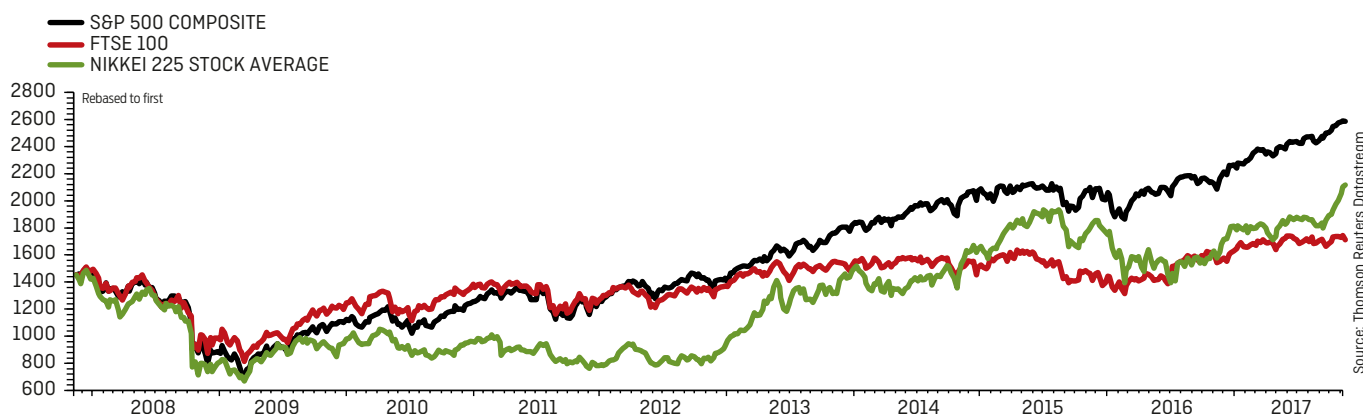
He reiterates that this type of fund will often lag a rising market but will likely come into its own when times become more challenging.

## A SELECTION OF CAPITAL PRESERVATION INVESTMENT TRUSTS

There are many investment trusts and open-ended funds with a capital preservation strategy including the aforementioned RIT Capital Partners, set up to manage some of the wealth of the Rothschild family, which seeks to preserve wealth through a multi asset approach.

**Ruffer Investment Company's (RICA)** principal objective is to achieve a positive total annual return, after all expenses, of at least twice the Bank of England base rate. It invests in internationally-listed shares or bonds issued by corporates, supranationals or government organisations.

Managed by Hamish Baillie, Steve Russell and Duncan MacInnes, the fund aims to maintain returns under a range of market conditions, with assets allocated towards bonds, cash, gold and equities ranging from **Lloyds (LLOY)** to Walt Disney.



## RELEVANT OPEN-ENDED FUNDS

Within the funds universe, Troy Asset Management is renowned for its distinctive method of investing that prioritises the avoidance of permanent capital losses through cautious asset allocation and careful selection of high quality companies.

Founded in 2000 by Sebastian Lyon, Troy's first principle is that 'those who have capital should concentrate on not losing it. We consider risk management to be the avoidance of permanent capital loss.'

Troy elaborates: 'We are investors in long-term assets. Therefore our investing time horizon is long and we measure performance against returns available from keeping cash on deposit. We do not seek to manage risk by closely tracking a benchmark, hedging our risks, or going "short" investment securities (namely placing a bet that a share price will fall, upon which you make a profit).'

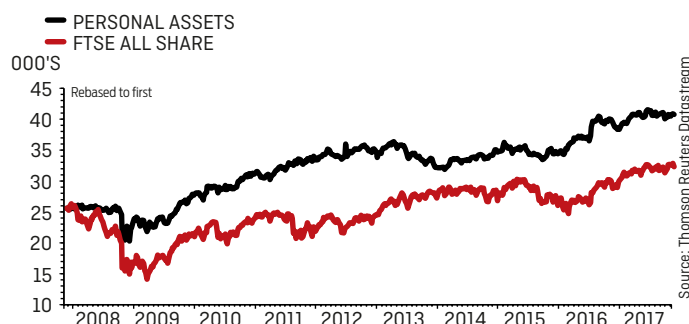
'Risk management is instead conducted through a conservative allocation of capital among high quality and easily traded securities, together with the selection of excellent businesses when they are available at reasonable prices.'

Lyon himself manages the **Troy Trojan Fund (GB00B01BP952)**, which seeks to achieve growth in capital and income in real terms over the longer-term.

As at 30 September, the Trojan Fund's asset allocation was 12% to UK equities, 24% to overseas equities, 8% to gold related investments, 29% in cash and with 18% and 9% allocated to US and UK index-linked bonds respectively.

Top 10 equity holdings include **British American Tobacco (BATS)**, Microsoft, Berkshire Hathaway and Dr Pepper Snapple.

Lyon also manages investment trust **Personal Assets Trust (PNL)** which offers investors exposure



to a defensive combination of high quality equities. Holdings include **Unilever (ULVR)**, Coca-Cola, Colgate Palmolive, US and UK government bonds, gold and cash.

Shares in Personal Assets Trust have increased by 58% over the past decade, more than twice the 26% return from the FTSE All-Share over the same period.

## OTHER FUNDS WITH RELEVANT STYLES

Another product from the Troy Asset Management stable is **Troy Spectrum (GB00B2990B27)**. Strictly speaking it isn't a capital preservation fund yet the fund manager centres on high-quality picks including stakes in many third party investment funds and has a firm eye on downside protection.

Fund manager Tom Yeowart explains: 'We seek a growing long-term equity-like compound return with lower volatility, but we're focusing on downside risk rather than trying to chase returns. We are trying to protect capital on the downside and keep up on the upside and we tend to do best versus the index during periods of market turmoil.'

“WE TEND TO DO BEST VERSUS THE INDEX DURING PERIODS OF MARKET TURMOIL”



‘We have a real focus on boutique fund managers and we tend to be long-term partners. We are picking truly active managers. Typically, they have a high degree of courage in their convictions. Where we find a manager we like, we want to hold them for the long term.’

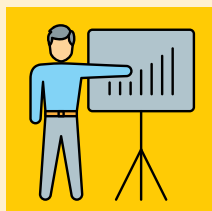
Portfolio exemplars include **Aurora Investment Trust (ARR)**, a concentrated book of high quality businesses bought at bargain prices and managed by Phoenix Asset Management’s Gary Shannon. Aurora invests in UK equities using a value-based philosophy inspired by famous investors Warren Buffett, Charlie

Munger, Benjamin Graham and Philip Fisher.

Other Troy Spectrum positions include the **TB Evenlode Income (GB00BD0B7C49)** fund managed by Hugh Yarrow, which focuses on long-term total returns with an emphasis on income.

Elsewhere, investment trust **Caledonia Investments (CLDN)** is a less obvious contender for a capital preservation fund, yet one that is relevant in our view. Its aim is to grow net assets and dividends paid to shareholders over the long term, while managing risk to mitigate the volatility of return. It has a conservative approach.

## CAPITAL PRESERVATION SPECIALIST REVEALS CURRENT STRATEGY



Peter Spiller at Capital Gearing Trust is widely considered to be one of the experts on

capital preservative strategies. He thinks, as a result of QE (quantitative easing) distortion, the prospective returns after inflation on every asset class at the moment are very poor. However, he still believes there is a way to make money, as he now reveals.

‘The share price return on a compounded basis for Capital Gearing Trust is 16.3% average per year over the past 35 years. We think the best way of outperforming over the long term is to vary duration with accordance to values offered.

‘For example, our model suggests 0% return from US equities after inflation. Real returns from bonds are very modest. When prospective returns are poor, you lock in

those returns for a short time. When returns look good, you lock in for a long time. We vary our bond duration by that measure.

‘Today we are very defensive but believe valuations offered in the future (should there be a market correction) will provide opportunities for us to pick up assets (at better prices). In particular, we’ve always done well in bad markets in terms of picking up investment trust holdings from distressed sellers.

‘We are currently underweight in equities and have short duration bonds. The only asset class with significant interest to us at present is TIPS (Treasury inflation protected securities, backed by the US government).

‘Index linked gilts in the UK will see huge real losses over time. The yield is higher in the US and I think they will go negative, providing us with a good capital gain. Debt is at elevated levels in the world and the only way to

pay it down is through financial repression. Interest rates have to be lower than inflation. In that circumstance, you will see negative real interest rates in the US.’

Turning to property, Spiller says the investment trust has made ‘fantastic returns’ on German property; 38% in the 12 months to 30 September 2017. ‘We’ve had a good drain of that glass but there is more to come. The German economy is booming but monetary policy is determined by the ECB which has a bias towards Italy.’

Capital Gearing Trust is now investing in the Swedish commercial property market. ‘The country has 3.5% economic growth, low unemployment, a huge budget surplus; which suggests that now is a classic time to hike interest rates. Yet Sweden is trying to keep the krona competitive against the euro. It creates favourable circumstances for property.’

## ABSOLUTE RETURN FUNDS

Although bear markets and corrections can stoke panic, it is important to remember volatility also provides opportunities for investors to make profits.

One way of positioning portfolios for a correction is to put money to work with absolute return funds, which seek to make positive returns regardless of underlying market conditions.

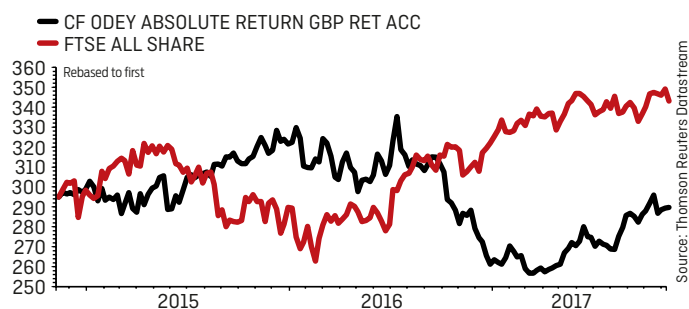
Absolute return strategies provide an alternative prospect to traditional equity and bond funds as they can use a variety of instruments across different asset classes as well as a blend of short and long stock positions to generate positive returns from falling or rising markets.

“IT IS IMPORTANT TO NOTE THAT ABSOLUTE RETURN FUNDS ARE NOT LOW RISK INVESTMENT PRODUCTS”

Their number includes **CF Odey Absolute Return (GB00B55NGR79)** and **Newton Real Return (GB00B7VVF60)**. The latter uses a global thematic framework that identifies the key long-term forces of change and ways to invest in them.

It is important to note that absolute return funds are not low risk investment products. Their use of shorting strategies makes them high risk. Their bad years can be punishing, as illustrated by the 18.3% loss experienced by the aforementioned Odey fund in the 12 months to 31 October 2016.

Newton Real Return has a more consistent track record with positive returns in each of the past six years, as illustrated by the table included earlier on in this feature.



## ONE FINAL FUND TO CONSIDER

Admittedly, a smaller-companies trust might not seem an obvious downside protection pick, but **Strategic Equity Capital (SEC)** merits mention in this feature. A 12.4% discount to net asset value should also pique the interest of value-seekers.

The trust's investment manager GVQIM is a specialist in applying private equity investment techniques to public markets, with a process that focuses on proprietary research and drawing upon the real-world input of an industry advisory panel of industrialists and private equity professionals.

Fund manager Jeff Harris seeks to identify high quality coveted assets with attractive cash flows from firms that are too small for the FTSE 250 at the time of purchase.

GVQIM believes SEC is better positioned in weaker markets than peers for a number of key reasons. For example its portfolio holdings, which include payments and administration play **Equiniti (EQN)** and teleradiology provider **Medica (MGP)**, have strong balance sheets.

Harris' focus on quality holdings with real intellectual property as opposed to domestic cyclicals means companies in the fund are coveted assets which may be acquired.

Finally, the trust doesn't employ gearing (using debt to boost the portfolio) and typically has a net cash position which offers protection and capital to deploy when markets are weak and new investment opportunities arise. (JC/DC)



DISCLAIMER: Editor Daniel Coatsworth has a personal investment in Evenlode Income referenced in this article

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# Dummies' guide to compounding

Reinvesting dividends over the long term can make a huge difference to your portfolio

**C**ompounding was once described by Albert Einstein as the eighth wonder of the world because of the seemingly magical way it can super-charge investment growth. We've compiled some figures and tables to show you how it works in practice.

## WHAT IS COMPOUNDING?

Compounding describes the process where investment returns themselves generate future gains. The value of an investment can increase exponentially because growth is earned on both the initial sum of money plus the accumulated wealth.

Imagine you invest £1,000 in a stock and it increases by 5% in year one to £1,050. If the stock rises by another 5% in year two, it will be worth £1,102.50. In the first year you earned £50 and in the second year you earned £52.50.

## THE EFFECT OF COMPOUNDING OVER THE LONG-TERM

The impact of compounding becomes very powerful if you invest for a long time. In fact, it takes around a decade for the effects to be really noticeable. It is perhaps why legendary American investor Warren Buffett once asserted: 'If you don't feel comfortable owning a

stock for 10 years, you shouldn't own it for 10 minutes.'

To truly harness the power of compounding you need to start investing early. If you invested £200 a month from age 20 until age 65 you could end up with a pot more than three times bigger than someone who started at age 40 saving the same amount each month.

START INVESTING £200 P/M AT	FUND VALUE AT AGE 65
Age 20	£402,444
Age 30	£227,607
Age 40	£120,272

Source: AJ Bell Youinvest

These figures assume an annual growth rate of 5% after charges.

Even if you invest a greater amount each month in your later life, you won't benefit from the same growth as someone who started investing a smaller amount earlier.

“IF YOU DON'T FEEL COMFORTABLE OWNING A STOCK FOR 10 YEARS, YOU SHOULDN'T OWN IT FOR 10 MINUTES”



START INVESTING	TOTAL AMOUNT INVESTED	FUND VALUE AT AGE 65
£100 a month at age 25	£48,000	£152,208
£200 a month at age 45	£48,000	£83,326

Source: AJ Bell Youinvest

For example, a 25 year-old who invests £100 a month will have a total fund value at age 65 that is almost double that of a 45 year-old who starts putting aside £200 a month. This is despite the total amount invested being the same.

These figures also assume an annual growth rate of 5% after charges.

#### WHY REINVESTING DIVIDENDS REAPS REWARDS

You can make compounding work even harder for you by reinvesting dividends – as that means you own more shares. You then receive more dividends next time, which you reinvest to get more shares, and so on.

‘The cycle becomes a virtuous one, providing the dividend payments are maintained or, better, still keep growing. The strategy breaks down if dividends are reduced or – in a worst case – cut altogether if a firm gets into trouble of some kind,’ explains Russ Mould, investment director at AJ Bell Youinvest.

By looking at the compound annual returns from the FTSE 100, you can really notice the difference that harvesting and reinvesting dividends makes.

To turn this into hard numbers, a £4,000 investment in the FTSE 100 in 1987 with dividends banked rather than reinvested would now be worth around £32,000 (excluding fees).

With dividend reinvestment,

“THE CYCLE BECOMES A VIRTUOUS ONE, PROVIDING THE DIVIDEND PAYMENTS ARE MAINTAINED OR, BETTER, STILL KEEP GROWING. THE STRATEGY BREAKS DOWN IF DIVIDENDS ARE REDUCED OR – IN A WORST CASE – CUT ALTOGETHER IF A FIRM GETS INTO TROUBLE OF SOME KIND”

it would be worth more than £59,000 (excluding fees) had it matched the total return from the index. That clearly illustrates compounding benefits.

#### HOW TO EXPLOIT COMPOUNDING

When it comes to building an investment portfolio there are two main ways to harness the power of compounding: pick the individual stocks yourself or choose a fund where the fund manager does it for you.

Mould says if you’re looking for individual stocks that will be reliable long-term dividend compounders, you must carry out thorough checks to ensure the company’s competitive position is strong enough and the finances are in order.

Issues to consider include the company’s competition, how easy is it for customers to defect, pricing power, how sound are the finances and management competence. The latter two in particular will have a bearing on the likelihood of the company being able to maintain or increase dividends, regardless of the broader economic and stock market conditions.

ANNUAL RETURN		
TIME PERIOD	FTSE 100 – DIVIDENDS NOT INVESTED	FTSE 100 – TOTAL RETURNS*
Last 5 years	5.7%	9.0%
Last 10 years	3.4%	5.7%
Last 15 years	5.6%	8.9%
Last 20 years	4.8%	6.0%
Last 25 years	6.3%	8.0%
Last 30 years	7.1%	9.1%

Source: AJ Bell Youinvest. \*Capital gains and all dividends reinvested

‘If this all sounds like hard work, that’s where a good fund can help,’ says Mould. ‘There is a plentiful selection of so-called income funds which target stocks capable of paying healthy and sustainable yields in the UK or farther afield.’

## HOW TO CHOOSE FUNDS

When choosing a fund in order to exploit the powers of compounding, the key is to buy the accumulation units. They will have ‘acc’ somewhere in their name, highlighting the fact they will effectively reinvest dividends for you. Income (or ‘inc’) units

“IF THIS ALL SOUNDS LIKE  
HARD WORK, THAT’S WHERE  
A GOOD FUND CAN HELP”



will pay out dividends as cash at regular intervals.

If you want an actively-managed fund, Mould suggests considering **Newton Global Income (GB00B7S9KM94)**, the UK-focused **CF Woodford Equity Income (GB00BLRZQ737)** and **JP Morgan Emerging Markets Income (GB00B5T0GN09)**.

Passive funds dedicated to income are rarer, but one which automatically reinvest dividends is **SPDR FTSE UK All-Share UCITS ETF (FTAL)**. The yield on the underlying index, the FTSE All-Share, is around 3.8%. (EP)

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# WHAT IS THE GOLD PRICE? HOW IS IT CALCULATED?

*For many, the word gold conjures up a sense of the exotic, beautiful items of immense value, or perhaps a secure vault stacked with bars or ingots. For most investors, the nearest they come to gold is typically by trading exchange traded products (ETPs) or holding gold coins. Underlying the gold market as a whole is a comprehensive wholesale market, which comprises a variety of financial intermediaries, gold miners, refiners, and other gold consumers, who are primarily responsible for the pricing of gold.*

**GOLD PRICE TENDS TO APPRECIATE WHEN INFLATION AND INTEREST RATES ARE ON THE RISE, AS GOLD IS VIEWED AS A STORE OF VALUE AND AS AN INFLATION HEDGE**

## GOLD COMES AT A PRICE

Like other commodities, gold can be traded through the spot price or through derivatives, predominantly futures on exchange, or swaps and forwards traded over-the-counter (OTC).

The spot price (generally quoted in troy ounces, which are equivalent to approximately 31 grams) refers to gold that is deliverable immediately, or within a two-day settlement period.

The futures price itself is derived from the value placed on the underlying asset, effectively the spot price plus the “cost of carry,” i.e. interest rate, storage and insurance costs. Delivery of physical gold is rare for the small-lot and even institutional investor because of the “cost to carry”.

The difference between the futures price in comparison to the spot price is that the futures price is set today for delivery sometime ahead, for instance three or six months in the future.

FUTURES  
PRICE

=

SPOT  
PRICE

+

INTEREST

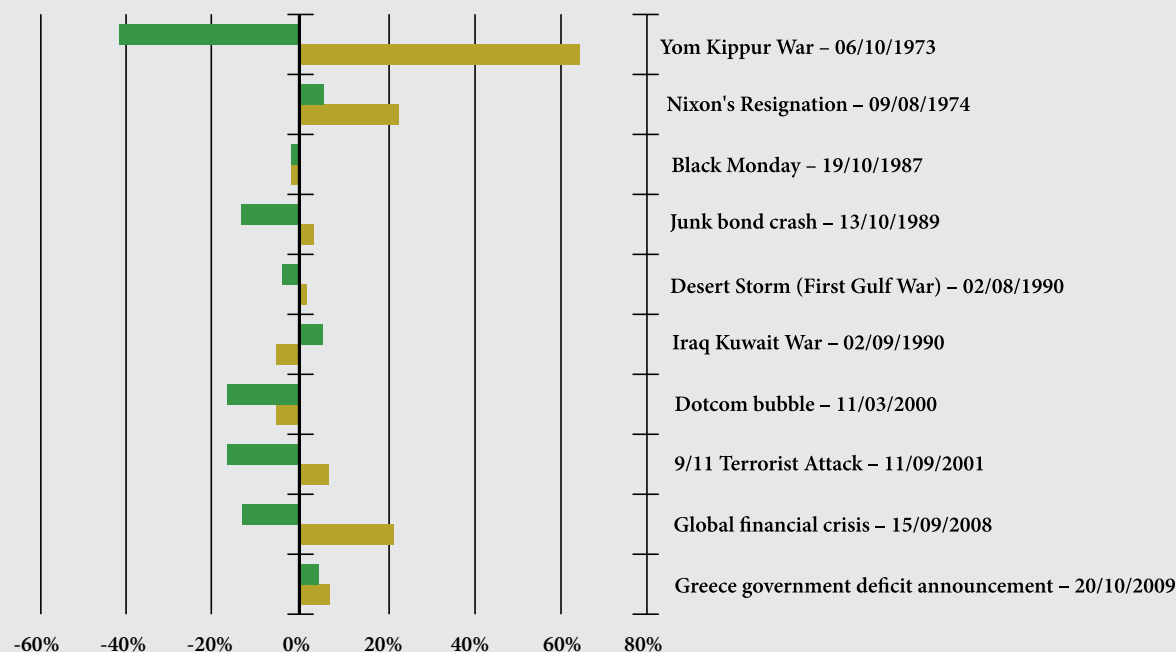
+

STORAGE &  
INSURANCE

**COST OF CARRY**

With a margin facility generally available to investors, typically 5% of the total value of the contract, this can provide investors with cash flow and liquidity benefits. However, it also introduces counterparty credit risk between both sides of the trade, which exchanges mitigate via centralised clearing.

## Gold vs Equities: Geopolitical Events



■ World Equities Price Change 1 year forward  
■ Gold Price Change 1 year forward

Source: Bloomberg, ETF Securities as of close 7 June 2017

### FACTORS INFLUENCING THE GOLD PRICE

Fluctuations in the gold price are driven less by physical demand and supply, and more by investors' views on inflation, potential interest rate movements, geopolitical developments and wider market sentiment. More specifically, the gold price tends to appreciate when inflation and interest rates are on the rise, as gold is viewed as a store of value and as an inflation hedge. We seem to be at that exact juncture (as of November 2017) with the US Federal Reserve (Fed) and the Bank of England (BoE) being on a path of monetary tightening and raising interest rates. Additionally, the European Central Bank (ECB) is now scaling back on its bond-purchasing programme.

The gold price may also rise when sentiment in the market is worsening, as gold can be an effective portfolio diversifier, historically uncorrelated to other assets. Additionally, when the world feels a little more threatening, unsettled and dangerous (witness the North Korean situation), gold is often viewed as the 'go-to' safe haven.

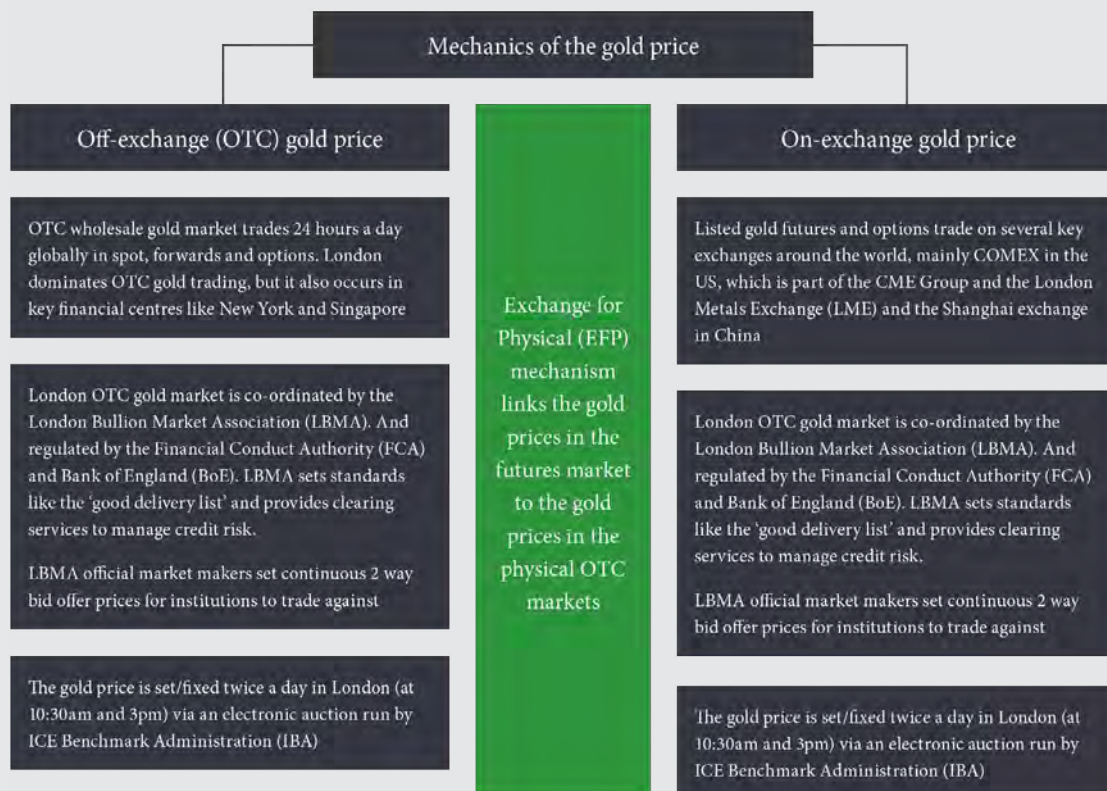
However, gold can be subject to price variations on different exchanges due to currency fluctuations against the US Dollar (gold is universally priced in USD). These movements can be considerable (witness Sterling's decline post-Brexit) and can have a material impact on overall returns. To potentially mitigate risk, currency exposure can be hedged in the investor's local currency. However this, in itself, could have an impact on any profitability.

Additionally, supply and demand in local regions may alter the gold price on different exchanges, creating some arbitrage opportunities. (Arbitrage refers to the simultaneous purchase and sale of an asset, or two different instruments related to an underlying asset, in order to exploit a pricing anomaly and make a profit). For instance, a sophisticated investor or trader may notice the currency-adjusted price of gold is higher in Zurich than it is in London due to strong local demand and so may consider buying gold in London to sell in Zurich, making a turn or small profit.

## THE MECHANICS OF GOLD MARKETS AND EXCHANGES

Gold is effectively a 24-hour-per-day traded asset with prices available from multiple exchanges across the globe. Gold is predominately traded OTC, which

means a price is set between two counterparties via a dealer network and the transaction is not done on exchange. However, gold futures and options can also be traded on-exchange, utilised predominately by the large investment houses.



## ACCESSING PHYSICAL GOLD VIA EXCHANGE TRADED PRODUCTS (ETPS)

As an alternative to investing in gold via the spot price or derivatives, investment through an ETP is an attractive option for many investors. ETPs effectively replicate the movements of the underlying assets that they track. A physical gold ETP is a cost-efficient and popular way to gain exposure to the underlying dynamics of the gold price. A benefit of investing in physically backed ETPs is they provide exposure to the gold price movements, safe in the knowledge that the investment is backed by high quality, safely stored gold.

The price of a physically backed ETP is calculated by multiplying the prevailing gold spot price by the metal entitlement (effectively the amount of metal behind each share of the gold ETP). They are readily realisable and liquid products, and can be accessed on most major exchanges.

ETPs can be accessed in the same way as shares can be bought or sold, on an exchange through a broker or a fund platform. The cost to the investor will reflect the price of the underlying asset plus an expense ratio, comprising the annual management fee and any dealing costs.

For more information, visit [www.etfsecurities.com/gold](http://www.etfsecurities.com/gold)

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# Using funds to invest in Latin America

Active management can make a difference in volatile markets

**L**atin America as a region is dominated by the economic powerhouse that is Brazil. Therefore funds focused on the region that are market cap weighted will tend to have a lot of stocks held on the Brazilian stock exchange, the Brasil Bolsa Balcão (B3).

Brazil had a spectacular fall from grace in 2015 due to the US dollar strengthening against the Brazilian Real which dramatically reduced the B3's market cap.

But Brazil is back. Angel Ortiz, fund manager of the **Fidelity Latin America Fund (LU1033664027)**, says there have been some positive developments recently on the macro/economic picture in Brazil. 'Inflation has come in below expectations in recent months and is now at a decade low which means the central bank has room to reduce interest rates further.'

## GROWING MIDDLE CLASSES

Ortiz says due to this improving economic context, Brazilian stocks in the consumer and financial sectors are reaping the rewards. These sectors are not traditionally associated with Latin America's strengths; it's largely known as a commodity exporter. But after the commodity price crash in 2015, the market further diversified.

Ortiz is confident these sectors will continue to perform. He

says 'benefits will continue as the government passes more business friendly labour reforms through parliament'.

Luiz Carrillo, manager of the **JP Morgan Latin America Equity Fund (LU0522352862)**, is also a fan of these sectors, which he views as having benefited from Brazilian banking reforms.

Carillo says Brazilian banks are poised to increase lending 'which should spur consumer spending and allow the economy to deliver above trend growth'.

While the Fidelity and JP Morgan funds have a heavier weighting towards consumer and financial stocks, given Latin America's prowess as a commodity exporter it would be a mistake to ignore the sector.

## HOT COMMODITIES

Fidelity's Ortiz invests in mining entity Grupo Mexico which he

says has some of the 'best quality copper assets in the world'.

However, Ortiz can't really be described as a commodity bull. He has an underweight position in giant Brazilian steel producer Vale.

'While a stronger iron ore price has been helping the company in the short term, our longer-term forecasts for the commodity are less bullish so I feel that the current valuation is not sustainable,' he says.

Petrobras is one of the largest companies in Brazil but Ortiz is cautious due to its large state ownership. He views the oil refining giant as having a 'debt burden which subsumes all equity value'.

If you chose a passive market cap weighted Brazil fund, it would have a heavy weighting towards Petrobras due to its sheer size.

However, Will Landers,

## LATIN AMERICA: ECONOMIC OUTLOOK (real GDP)

Country	2016	2017	2018
Argentina	-2.2%	2.5%	2.5%
Bolivia	4.3%	4.2%	4.0%
Brazil	-3.6%	0.7%	1.5%
Chile	1.6%	1.4%	2.5%
Colombia	2.0%	1.7%	2.8%
Ecuador	-1.5%	0.2%	0.6%
Mexico	2.3%	2.1%	1.9%
Peru	4.0%	2.7%	3.8%
Uruguay	1.5%	3.5%	3.1%
Venezuela	-16.5%	-12.0%	-6.0%

Source: IMF. Data taken Oct 2017. 2016 data is actual; 2017 and 2018 are forecast data

manager of the **BlackRock Latin American Investment Trust (BRLA)** has Petrobras and Vale as his top three and four holdings respectively. He says 'our commodity positions are predicated on company specific fundamentals that we believe will drive those stocks higher'.

The commodity issue is a good example of how different fund managers view Latin America. While all the funds mentioned have Brazilian financial services company Itau Unibanco as their top holding, the differing views on energy companies could be vital in determining whether a fund generates returns or losses.

### NOT JUST THE BOYS FROM BRAZIL

While Brazil is the largest economy in Latin America, there are other countries with their own merits. BlackRock's Landers plays the inter-region trading between Latin American countries to his advantage.

He says Argentina is 'for sure

### PERFORMANCE IS STARTING TO IMPROVE

Fund	Annualised returns		
	5 years	3 years	1 year
Fidelity Latin America Fund	1.30%	5.26%	7.46%
JP Morgan Latin America Equity Fund	0.34%	3.76%	6.25%

Source: Morningstar

the best candidate for an up and coming country'. He adds Brazil is Argentina's most important trading partner and the recovery in Brazilian activity is an additional positive for Argentina's economy.

JP Morgan's Luiz Carrillo now has its largest ever exposure to Argentina, around 5% of the portfolio, although the bulk is still in Brazil and Mexico.

He says market friendly results from previous elections coupled with improving consumer confidence should create powerful tailwinds for Argentinian equities.

### POLITICAL RISK

One of the biggest dangers investors face when looking at Latin America is political risk.

In Brazil, the impeachment of president Dilma Rousseff in September 2016 drove a strong sentiment-led rally on the hope of economic reform. However, the country's recovery is still fragile since the political turmoil in May this year.

President Michel Temer was caught up in the investigations into corruption involving some of the country's biggest companies. His case wasn't helped when allegations of a tape of Temer discussing 'hush money' emerged.

Mexico was impacted by the election of US president Donald Trump which potentially puts negotiations regarding the North America Free Trade Agreement (NAFTA) into jeopardy. A benign negotiation is vital for economic stability in the country.

On a more positive note, the victory by Argentina's president Mauricio Macri in the country's midterm elections last month solidifies the reform agenda started two years ago. This included a gradual reduction in inflation and improvement in fiscal accounts, allowing for economic activity to recover.

In Peru, one of the world's largest silver exporters, the election of president Pedro Pablo Kuczynski in July 2016 is seen as pro-market. The election also allows for clear visibility during his term in office for the next three to four years. (DS)



# The investment trusts with double discounts

Interesting way to find value in all-time high stock markets

**A**s global stock markets roar to all-time highs investors face an increasingly tricky hunt for value. One of the most popular ways to identify value within the investment trust space is to look at the discount to net asset value or NAV per share.

In other words, how much lower is a trust's share price trading than the NAV attributable to each individual share.

As *Shares* has explained in the past (see *Understanding premiums and discounts to NAV*, 13 October 2016), just because an investment trust trades at a discount to NAV doesn't mean it is automatically an attractive investment.

Even so, this can still be a sensible place to start your research. The trouble is, discount opportunities have dried up significantly this year. That's because average discounts have narrowed substantially.

## DISCOUNTS HAVE NARROWED

As of 31 October, the average investment trust discount to NAV (excluding private equity, hedge funds and property) stood

at 4.9%, according to data from market maker Winterflood. That's a two-year low and represents a decline of more than 25% from 2017 peaks of 6.6%.

“WE BELIEVE THIS COULD PRESENT A VALUE OPPORTUNITY AND RE-RATING POTENTIAL”

‘The market cap weighted average discount for the global sub-sector has narrowed from 6.5% to 2.2% during the past 12 months,’ Winterflood says in its latest investment companies report. That partly reflects strong demand for overseas equities from UK-based investors, where domestic GDP growth and Brexit issues continue to cause concern.

Illustrating the point further, the FTSE Equity Investment Instruments index is up around 15% so far in 2017, far outstripping both the FTSE 100 (up 4.9%) and the FTSE All Share (6.3% ahead).

## LEFT-FIELD ANALYSIS

One investment research house has gone beyond simple NAV discounts in its search for investment trust value, filtering the market for what it calls ‘double discount’ opportunities.

This is where investment trusts are themselves trading at a discount to their NAV, but where their underlying holdings, often other trusts as well as individual companies, are also trading at a discount to NAV. Analysts at Liberum Capital are behind this trust selection process.

The idea is, presuming NAV discounts continue to narrow, the share prices of the portfolio constituents of a potential ‘double discount’ trust will close the gap to their net assets at the same time as the trust itself.

‘We believe this could present a value opportunity and re-rating potential,’ says Liberum.

### FACTS

**4.9%**

AVERAGE INVESTMENT TRUST DISCOUNT TO NAV AS OF 31 OCTOBER

**25%**

DECLINE FROM 2017 PEAKS OF 6.6%.

**15%**

FTSE EQUITY INVESTMENT INSTRUMENTS INDEX IS UP SO FAR IN 2017

## FIVE WITH UPSIDE POTENTIAL

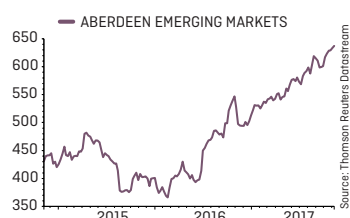
The selection process, which included funds with a minimum 50% portfolio weighting to assets with an identifiable discount, has thrown up five investment trusts which could potentially enjoy further share price upside.

### Aberdeen Emerging Markets (AEMC) 637.75p

**DISCOUNT TO NAV: -11.4%**

**LOOK THROUGH DISCOUNT TO NAV: -20.5%**

Invests in investment trusts and open ended funds which invest in emerging markets.

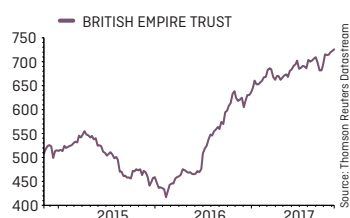


### British Empire Trust (BTEM) 727p

**DISCOUNT TO NAV: -11.6%**

**LOOK THROUGH DISCOUNT TO NAV: -34.5%**

Invests predominantly in operating companies and funds to exploit mis-pricings.



### Lazard World Trust (WTR) 386.5p

**DISCOUNT TO NAV: -8.0%**

**LOOK THROUGH DISCOUNT TO NAV: -29.8%**

Invests predominantly in closed-end funds and to a lesser extent holding companies to exploit mis-pricings, which may include taking short positions.



‘A number of the funds have potential near-term catalysts including continuation votes and realisation opportunities,’ says Liberum. ‘Many of these have been introduced in an effort to improve share ratings.’ (SF)

### Miton Global Opportunities (MIGO) 281p

**DISCOUNT TO NAV: 1.9%**

**LOOK THROUGH DISCOUNT TO NAV: -29.8%**

Invests in closed-end funds to exploit mis-pricings.

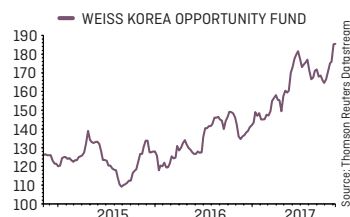


### Weiss Korea Opportunity Fund (WKOF) 183.62p

**DISCOUNT TO NAV: -2.7%**

**LOOK THROUGH DISCOUNT TO NAV: -40.7%**

Invests in the preferred shares of South Korean listed companies which trade at a discount to their ordinary counterparts.



# Should M&S and Next consider a merger of equals?

Seasoned retail watcher sees merit in a marriage between the struggling FTSE 100 clothing purveyors

**H**igh street retailers **Marks & Spencer (MKS)** and **Next (NXT)** are running hard just to stand still amid difficult market conditions. Is it time for a more drastic form of action? One analyst has suggested there is merit for the two companies to merge.

Whitman Howard retail analyst Tony Shiret says some of the UK's large non-food retailers are struggling with too many stores to service customers and pressure on selling prices given the online channel provides greater price visibility to customers (and rival businesses).

'A long term cost cutting led scenario can only go so far and this is why we think that more drastic measures will be considered. Effectively in contemplating a Next/M&S link-up we are positing consolidation of the sort seen in some other under-pressure segments – electricals/DIY.'

Shiret concedes a merger is unlikely near-term, although he believes such a deal would make sense for strategic reasons other than cost cutting.

'We point to the combined market share of the two – say 17% pre-closures and maybe 15% post – which would give enhanced buying and pricing power; and the wider segmentation that the combination would allow of the UK clothing market.'

The analyst thinks it could be another three to four years before Marks & Spencer and Next would be willing to engage in a consolidation debate.

Shiret says he first considered the merits of a merger between the two companies eight or nine years ago. At the time, he says he had no idea how large online retail was going to be. 'Even allowing for the more dominant combined position would that have increased the business capability in this more difficult market or made the enlarged company a bigger target for disrupters?'

So why has he revisited this tie-up concept?

He believes the arguments in favour of scale are more pertinent now, adding: 'A larger strategy re-set would allow both businesses to get on to the front foot and make the capacity reductions necessary rather than the zero currently envisaged by Next and the and the banker-driven way-out-in-the-future 10% net non-food space reduction announced by M&S.'

Elsewhere in the retail sector, the analyst has debated the takeover appeal of retailer **Dixons Carphone (DC.)**. He says the Carphone part of the business is beginning to look like a 'poison pill' given the low transparency of its faltering sales and profit streams, plus its significant physical store capacity.

Shiret suggests one exit route for shareholders would be a bid by Amazon should it choose to use Dixons as the electrical retailing equivalent of its Whole Foods supermarket acquisition.

Investors should note the analyst's comments are fantasy M&A at present, rather than suggestions of solid deals. (JC)



# Vp strengthens tool hire arm with largest ever acquisition

Last year this company was buying businesses in Australia, now it targets the UK



“THE ONLY REAL RISK TO THE DEAL IS THAT IT'S THE BIGGEST WE'VE DONE”

Equipment rental specialist **Vp's (VP.)** acquisition of Brandon Tool Hire from private equity group Rutland Partners is big news for the company and should boost earnings within 12 months.

It might appear a risky departure from Vp's normal strategy but chief executive Neil Stothard says 'the only real risk to the deal is that it's the biggest we've done'. Brandon set Vp back £41.6m in cash and it had to take on its £27.2m net debt as well.

The deal was financed through new bank facilities and Stothard says lenders have been 'very supportive' throughout.

Andrew Nussey, analyst at Peel Hunt, describes the deal as a 'surprising strategic move'. It seems highly likely that Brandon is going to be integrated with Vp's existing Hire Station business.

Combining the businesses should deliver economies of scale to create a 'leading specialist tool hire business' in the UK.

The deal will extend Hire Station's reach substantially. It had 58 branches, with Brandon's stores it will now have over 200. Nussey says 'the businesses look to be a very good fit with limited geographic and customer overlap'.

Brandon has had quite a history, at one point on

the market itself; it was bought by Wolseley in 2006 for around £72m. After the financial downturn, Wolseley sold Brandon to Rutland for £43m.

Stothard says he's very aware of the risks associated with private equity, especially firms trying to 'take off the cream in cash'.

He's planning to invest in Brandon's fleet to get it up to speed with Hire Station.

## BULKING UP THE UK

Vp is no stranger to acquisitions; in its last financial year it acquired businesses in Australia and New Zealand. Management told *Shares* earlier this year that this was done to diversify the risk away from the UK. Now it looks like they want to beef up their presence in the domestic market.

The Brandon deal has caused analysts to make upgrades to Vp's forecasts. N+1 Singer analyst James Tetley has increased his pre-tax profit forecast for the March 2019 financial year by 14% to £46.7m. Stothard says the deal will take 12 months to bed in.

In terms of valuation, with the revisions Vp is trading on 9.1-times 2019's forecast 92.7p of earnings. The shares also offer a 3.6% dividend yield using Tetley's forecasts. (DS)

# INVESTMENT FACTS.

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## KEY

- **Main Market**
- **AIM**
- **Exchange-Traded Fund**
- **Fund**
- **Investment Trust**
- **IPO Coming Soon**

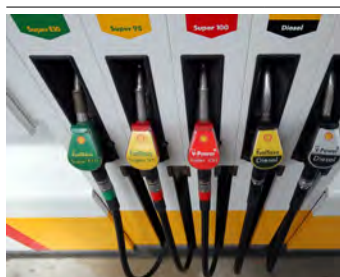
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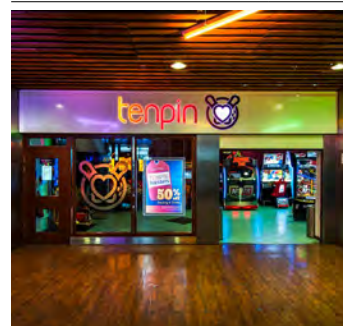


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