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Should all companies and funds be forced to broadcast AGMs online?

Having digital access would be a convenient way to engage with more investors

It would be nice to see more companies and funds broadcast their shareholder meetings via the internet so that more investors have a chance to watch what directors and fund managers have to say about current events. Annual general meetings (AGMs) can also be valuable sources of investing information, as I explain later in this article.

Companies and funds often go to a lot of trouble producing annual reports, yet they are missing a trick by not embracing digital channels to publish their AGM meetings. It is very easy to film someone talking and upload it to a platform like Youtube.

Some make it hard for investors to attend AGMs as they hold the meetings early in the morning in inconvenient locations. Having a digital broadcast would solve this problem, although we wouldn't want AGMs going online-only as that would deny investors the chance of asking difficult questions face-to-face and could see the company or fund have too much control over the questions they are willing to answer.

There should still be an option to attend the meeting in person to give shareholders a chance to meet the board of directors and interact with other investors.

VALUABLE INFORMATION

It is fair to say that a lot of investors are quick to dismiss AGMs, saying they are a waste of time. If you share that view, I urge you to watch **Fundsmith Emerging Equities Trust's (FEET)** recent AGM which is an excellent example of the effectiveness of online AGM broadcasts, plus how you can learn an awful lot in an hour.

The presentation by fund manager Terry Smith contained valuable lessons on investing in general, blended with information about his investment trust. One of the points that really caught my attention was his explanation of how returns are derived from equities. Smith shot down the widely-held view that most returns come from reinvesting dividends. He said that was wrong.

The fund manager said returns were driven by a company reinvesting profits back into the business and achieving a greater return than the cost of investment. 'High return on operating capital employed in cash is the single most important measure of whether a company is creating value for you,' he said.

The fund manager argued that if you reinvest the dividend, you may pay tax on the dividend and you can use that cash buy more shares at the current market price. If it is a good company, the market price will be a multiple of the book value. He argued that reinvesting dividends were nowhere near as efficient as the company retaining the money to reinvest in its business.

'Equities are the only asset class where a portion of the return you are being given by the company is automatically retained – around half of cash flow and profit on average – and reinvested in the business. That reinvestment, if done well, generates the compounding that equities produce better than any other asset class.'

I highly recommend you watch the Fundsmith video for education purposes. As for AGMs in general, I urge you to contact your investee companies and funds to see their thoughts on filming shareholder meetings and putting them online for your convenience. Some may not have given it prior consideration, so you could be the catalyst for change. (DC)

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Act now to take advantage of a superb buying opportunity in ASOS shares

Global fashion store remains an exciting long-term growth pick

A share price plunge from £65 to £59 at global online fashion destination **ASOS (ASC:AIM)** since a poorly-received third quarter trading statement (12 Jul) presents a compelling new entry point.

We rate this as a superb business and highlight that spending money on infrastructure improvements is the right thing to do to support future growth, even if it means a drag on earnings short-term.

WHY DID THE SHARES FALL?

A highly-rated stock with elevated growth expectations baked-in, ASOS' total group revenue growth of 21% to £823.9m for the four months to 30 June came in below the 25.8% called for by analyst consensus forecasts.

Furthermore, the pure-play online fashion seller focused on 20-somethings warned full year sales growth will likely be 'towards the lower end' of its previously guided 25%-to-30% range, with ASOS embedding new infrastructure and flagging a temporary demand impact from its actions around new data regulation.

Nevertheless, ASOS remains on track to deliver in-line full year pre-tax profit, upgraded full year gross margin guidance and it left current year capital expenditure guidance intact at £230-£250m.

Chief executive Nick Beighton also insisted fourth quarter trading had started well and remains confident of delivering yet another year of strong growth.

WHY IS IT SPENDING SO MUCH MONEY?

Back in April ASOS said spending would need to rise materially on logistics and distribution to support its rapid and internationally-derived growth. The ambitious retailer has just appointed former **ITV (ITV)** head honcho Adam Crozier as chairman as it looks to go to the next level.

Despite the recent disappointment, ASOS remains a structural winner with fantastic growth momentum at its heels. In the period, retail sales were up more than 20% in the UK, EU and US, while Rest of the World revenue was 11% ahead.

Excitingly, the number of active customers, defined as having shopped in the last year, was up 20% year-on-year at 18m.

Numis Securities believes ASOS' 'outstanding' customer proposition and significant investments are supporting and driving a vast long-term profitable growth opportunity.

Liberum Capital believes the drop in the share price is an overreaction, arguing 'confidence should be taken from the acceleration into July and the benefit from greater gross margin expansion than was previously guided.'

Likely to face a small headwind due to US online sales tax changes, the broker views ASOS as 'a structural winner, benefiting from scale and first mover advantage as it entrenches its position through a centralised distribution network alongside a best-in-class product offer and engagement strategy.' (JC)

BROKER SAYS: 16 3 6

Disappointing Chinese data inflates trade war fears

Yet a longer-term shift from export to domestic consumption driven growth could be positive for Chinese stocks

The latest Chinese growth figures are spooking the markets. Growth slowed from 6.8% in the first three months of 2018 to 6.7% in the second quarter. These figures come against the backdrop of an escalating trade dispute with the US.

China has appealed to the World Trade Organisation over the tariff exchanges and the International Monetary Fund has argued there could be a $430bn hit to the global economy from a trade war.

The negative news from China has an outsized impact on UK stocks and the FTSE 100 in particular, thanks to the bias towards commodity-focused stocks. A slowing Chinese economy puts pressure on global commodities because it is a leading consumer of metals and energy.

A recent report from **Henderson International Income Trust (HINT)** revealed nearly 30% of UK dividends come from oil and mining stocks, more than double the proportion from the same sectors internationally.

In the longer term slower Chinese growth may be an inevitable consequence of a transition from an export-driven to a domestic consumer-driven economy. As investment bank UBS observes this will result in 'lower but more sustainable growth'.

It adds: 'In addition to China's significant size, the country is undergoing important structural shifts which should offer tremendous investment opportunities.'

Historically investing in the domestic Chinese equity market has been difficult due to restrictions on foreign ownership. However, access is opening up.

Asset manager Schroders recently launched a fund focused exclusively on onshore China A-shares called **Schroder ISF China A-Share (BF0W0Z5)**.

Choosing from a universe of 3,500 stocks, the fund focuses on small and mid-cap names in fast-growing areas like technology, healthcare and consumer goods. (TS)

Brexit rebellion averted

May survives for now amid continuing ructions over EU exit

BY SQUEAKING HOME in a key vote on joining a customs union with the EU, Prime Minister Theresa May demonstrates she can just about command the support of House of Commons heading into negotiations with Brussels.

Pro-European Conservatives hoped to push through an amendment which would have committed the Government to joining a customs union if it couldn't secure a trade deal after Brexit but the proposal was rejected by a majority of six.

After an initial rise after the vote, sterling sank as investors priced in the decreased likelihood of a so-called 'soft' Brexit. (TS)

What investment trusts' first half performance tells us about the markets

We look at some of the standout performers including Scottish Mortgage and Monks

Stockbroker Numis Securities' review of the first half of 2018 for equity-focused investment trusts fits the pattern of the wider markets through the period.

It is very much a tale of two halves. In the first quarter trusts struggled amid a big setback for global stocks before a strong recovery in the second half.

Numis notes UK shares were among the top performers in this recovery with the FTSE All-Share up 9.2% in the three months to June for its strongest quarterly performance since the first three months of 2013.

Good progress was seen with global equity investment trusts with a focus on growth such as **Scottish Mortgage (SMT)** and **Monks (MNKS)**.

The average discount to net asset value for equity investment trusts widened slightly in the period from 4.7% at the start of 2018 to 5.3%. Numis notes this is a tight level of discount relative to historical levels – with the average discount hitting 9.7% in mid-2016 following the Brexit vote.

The broker comments: '40 funds (29% of the equity investment companies universe by value) are trading at premiums and a further 30 funds (18%) at a sub-3% discount. Many of these funds are issuing new shares to meet investor demand.'

The report also finds that discounts have widened for funds investing in Europe and emerging markets and some healthcare trusts have moved from premiums to NAV to modest discounts.

Numis added two names to its recommended list in the period. One is **Law Debenture (LWDB)** which it notes benefits from a unique structure.

This includes a traditional investment portfolio managed by James Henderson from asset manager Janus Henderson and a financial services business, covering areas like pension funds, governance and whistle blowing, which provides a 'consistent revenue stream that has provided a boost to Law Debenture's yield'.

Numis notes sentiment towards the stock has been impacted by the soft performance of its UK-focused equity investments.

The team also highlights **Vietnam Enterprise (VEIL)** which has been hit by a sharp correction in the Vietnamese stock market since early April. (TS)

LEADERS BY SHARE PRICE PERFORMANCE IN H1 2018 (TOTAL RETURN IN STERLING)

FUND	SECTOR	% RETURN H1 2018		% PREM (+) / DISC (-)	COMMENT
		PRICE	NAV		
Independent IT	UK Equity	22.5	8.1	20.4	Premium expansion
Allianz Technology	Global Technology	21.9	20.9	0.4	Strong NAV
BlackRock Throgmorton Trust	UK Smaller Companies	19.1	10.0	(8.7)	Solid NAV, rerating
BlackRock Smaller Cos	UK Smaller Companies	18.9	9.3	(6.0)	Solid NAV, rerating
Scottish Mortgage	Global Equity	18.4	18.2	3.8	Strong NAV

Source: Numis

What do recruiters' results tell us about the global economy?

Latest updates from the staffers suggest a positive outlook

Recent results from two of the big UK-listed recruitment businesses offer a relatively encouraging picture of the world economy.

Staffing firms are a good indicator for global growth as companies tend to hire in strong economic conditions and delay hiring when times get tough. Recruiters obviously tend to do well if people are moving jobs which is also a by-product of economic strength.

A trading update for the three months to 30 June from **Hays (HAS)** showed growth across all its regions. Even the UK and Ireland business, affected by Brexit uncertainty, grew 5% on a like-for-like basis.

Though notably the growth in the UK is coming from placing people in temporary positions, implying firms are keen to maintain some flexibility in their hiring policy and that they aren't sufficiently confident to appoint new permanent staff.

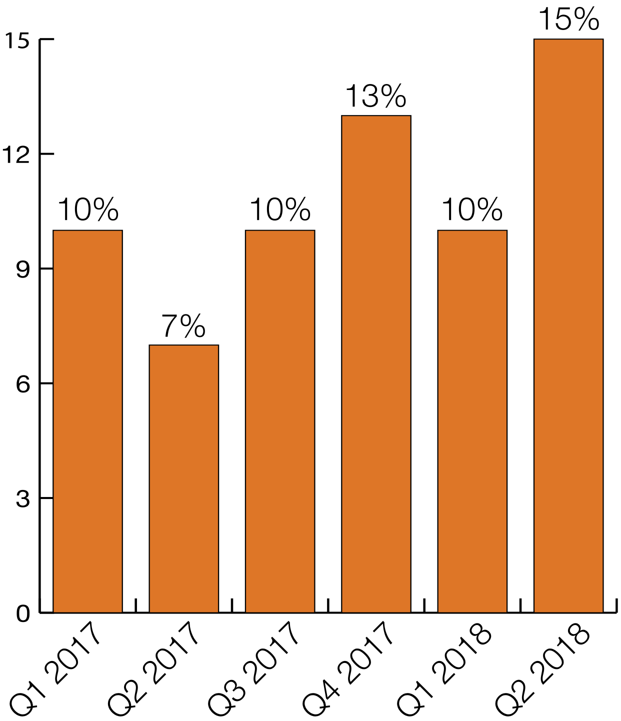
Rival **PageGroup (PAGE)** guided for full year profit to be 'slightly ahead of expectations' although this was driven by international growth as its own UK division saw income fall 1.9%.

The charts show the quarterly growth figures from Hays and PageGroup going back to the beginning of 2017.

An economic barometer - recruiters' quarterly performance since start of 2017

Hays

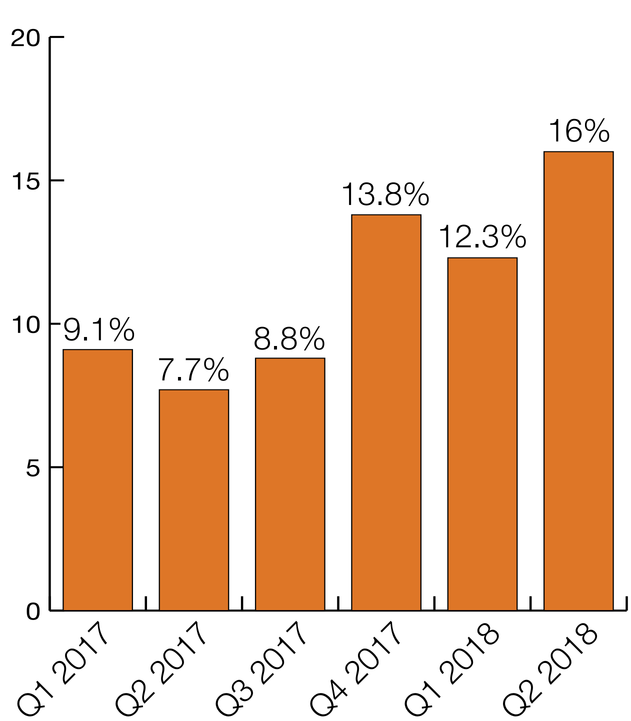
Like-for-like net fee income growth



Source: Company reports

PageGroup

Gross profit growth*



*At constant currencies. Source: Company reports

THE SCOTTISH Investment Trust

AIC DIVIDEND HERO

Shopping around – opportunities in retail

If you look at the share prices of conventional retailers today, you'd be forgiven for thinking that the high street is on its last legs. Meanwhile, the eye-watering valuation of Amazon's stock already reflects a very optimistic future, leaving little room for any disappointment. Amazon now trades on over 130 times this year's earnings. In contrast, Marks & Spencer is on just 11 times and Gap 12 times.*

Does this gulf in valuations point to the extinction of the high street? We believe it's misguided to assume that online will be the only way to shop. Online transactions are here to stay, but investors shouldn't underestimate the staying power of shops.

Instead, the market's disdain for conventional retailers should be a buying signal for contrarian investors. Shopping is a major leisure activity for a great number of people – not just a necessity, but a social activity, even a hobby. The convenience of clicks can't compete with that.

Meanwhile, many bricks-and-mortar retailers are meeting the e-commerce challenge head on, by creating multi-channel offerings with mobile apps and 'click and collect'. Some are also adding other leisure services to their sites, increasing footfall and encouraging spending. And many have powerful brands that e-commerce has yet to rival. Gap and Marks & Spencer provide two good examples.

Although Gap has fallen from favour since its peak of popularity in the 1990s, a turnaround is underway. The company is refocusing on its popular Old Navy and Athleta brands, while reducing Gap branded stores and bringing products more quickly to market to capitalise on current trends. All of this should boost earnings and improve margins. So too should its drive to move away from a reliance on promotions – which has encouraged consumers only to buy when there's a sale on.

Marks & Spencer is also reducing promotions as part of its own turnaround plan. Revivals in its fortunes have been heralded before, but we believe that this time really is different. Led by veteran retailer Steve Rowe and turnaround specialist Archie Norman, the company is shedding excess stores, revitalising product lines and improving its pricing strategy. Its food division is still very popular, and its investments in IT and infrastructure are creating a robust multi-channel offering.

We see these and many other retailers as 'ugly ducklings' – unloved shares that most investors shun. Although they have been under pressure from online competitors, they have considerable potential to defy the market's pessimistic expectations and turn their circumstances around. And while we wait for our ugly ducklings to become swans, most – like Gap and M&S – offer higher-than-average dividend yields. We believe that the depressed shares of high-street operators conceal compelling opportunities. Smart investors should look out for high street bargains.

* As at 29 June 2018.

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Takeover activity means infrastructure funds are back in demand

Bid for John Laing Infrastructure is acting as a catalyst for renewed sector interest

The 145.2p per share cash takeover offer for **John Laing Infrastructure (JLIF)** on 16 July has renewed investor interest in a sector dogged by political risk of late.

Infrastructure as an asset class had been gaining greater traction over the last five years or so. It is relatively uncorrelated to the equity market and can provide a predictable stream of income, often rising ahead of inflation, over the long term.

However, in the UK a resurgent Labour party offered a threat to the whole concept of private money being invested in big public projects. Investors started to worry about what would happen to infrastructure funds should Labour win the next general election and share prices in the sector started to wobble.

The collapse of outsourcer Carillion in early 2018 helped fire these kinds of arguments as both JLIF and **HICL Infrastructure Company (HICL)** had direct exposure to Carillion's facilities management contracts with health care assets.

Having traded at significant premiums to net asset value (NAV) for some time, infrastructure funds were suddenly trading at discounts to NAV.

These discounts had then started to narrow and the potential acquisition of JLIF by Dalmore Capital and Equitix Investment Management, which would also include the payment of a 3.57p dividend upon the closing of the transaction, acted as a catalyst for these discounts to narrow further.

The transaction has not been recommended by the JLIF board yet, but the language of the statement suggests this takeover situation could be 'when' not 'if'.

The offer price does not look massively generous at a 19.8% premium to net asset value, perhaps reflecting the ongoing political pressures in this space.

Emma Bird, research analyst at financial services firm Winterflood, notes that JLIF's shares were trading at a 10% premium to NAV only 12 months ago. Therefore some investors may feel the takeover offer isn't very generous.

However, she believes the majority of shareholders will welcome the potential cash offer, given the impact on the share price of not just this fund but others in the sector as well.

'In a year of low returns, takeover bids are particularly welcome. John Laing Group, the fund's investment manager, could well take a different view, not least as it received an investment fee of £12.6m from the fund in its last financial year.'

WHAT HAS HAPPENED TO THE OTHER INFRASTRUCTURE NAMES?

Both HICL Infrastructure and **International Public Partnerships (INPP)** rose sharply in response to the takeover news, while the likes of **GCP Infrastructure (GCP)**, **BBGI (BBGI)** and **3i Infrastructure (3IN)** also posted more modest gains.

The investment trust team at Numis note that other recent transactions have provided support to valuations, highlighting HICL's sale of its interest in Highland Schools PPP2 project in Scotland in April 2018 at a 21% premium.

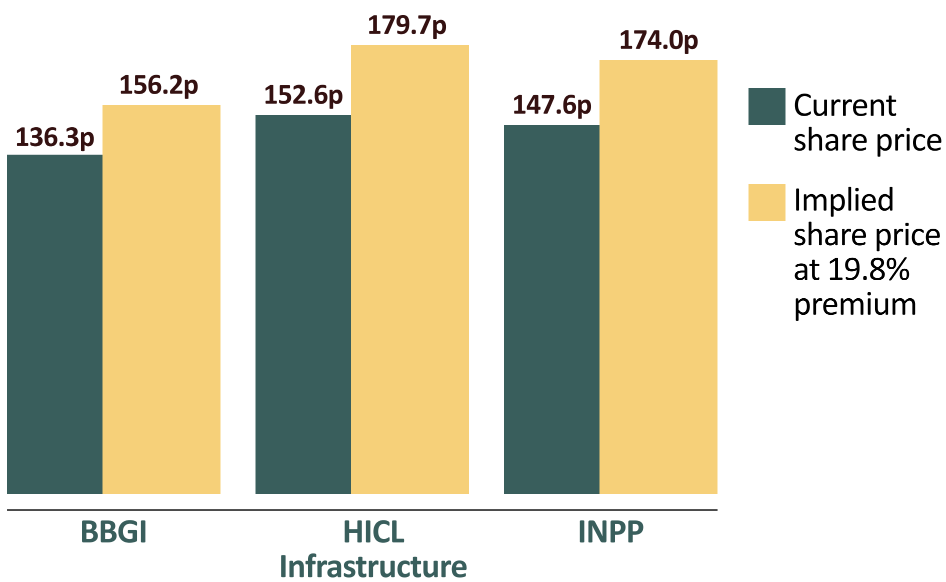
They comment: 'While the offer is not yet formal, we believe the premium sets an interesting pricing precedent for the sector as a whole, and we believe that current prices offer an attractive buying opportunity. In addition, we believe that some of the other funds in the sector have higher quality portfolios.'

The bar chart, using data from Numis, compares the current share prices of selected infrastructure investment trusts compared with the implied share price at the 19.8% premium to NAV being offered for JLIF.

Winterflood's Emma Bird says news of a potential bid is testament to the value that these funds offer at present.

She also believes the sector's rating will be 'materially stronger' in the future because the JLIF approach illustrates there is value in the sector, particularly given the limited availability of the underlying assets. (TS)

WHAT THE DEAL MEANS FOR VALUATIONS IN THE INFRASTRUCTURE SPACE



Source: Company & Numis Securities, prices at 9:20am on 16 Jul 2018

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Grab a 6.2% yield with touchscreen engineer Zytronic

Bullet-proof balance sheet limits downside and secures generous payout

With many investors becoming increasingly worried about perceived sky-high ratings of UK equities we believe little technology engineering business **Zytronic (ZYT:AIM)** is a firm value opportunity.

The stock is currently trading on 13.9 times forecast earnings for the year to 30 September 2019 and offers a prospective dividend yield of 6.2%.

The Newcastle-based company designs and builds rugged touch interactive displays. It built its reputation on outdoor applications such as cash machines and is increasingly tapping new markets.

Gaming is the really exciting opportunity and last year was the first time revenues from this market segment overtook financial industry sales as its number one contributor. Gaming revenue jumped 30% last year to £7.7m and up 17% in the first half this year.

Other growth markets include vending machines, medical appliances, entertainment displays and other industrial applications where touch-screen controls tend to get used heavily and bashed about a fair bit.

This is a largely project-based business and forward visibility on contacts can be limited. This was evidenced at half year results published in May when a large financial sector customer put the brakes on orders after seeing its own end demand weaken.

ZYTRONIC BUY
(ZYT:AIM) 442.5p
Stop loss: 354p

Market value: £71m

That explains the hefty share price sell-off on 15 May from 457p to 402p. Encouragingly, the company did say at the time that financial industry prospects had since started to pick up.

These issues have happened several times over the years but Zytronic always manages to bounce back. This is because of the effort the company puts into technology and product development and the investment it makes in protecting intellectual property.

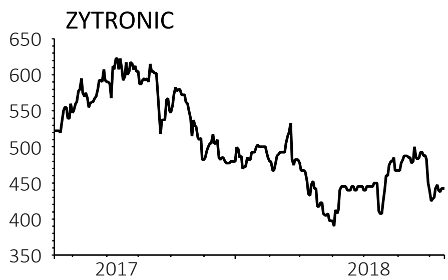
This can be seen in the larger, and sometimes curved, 30 inch-plus touchscreens it is making in increased numbers. This is a plus for Zytronic because it means more capacitive technology components are used per unit, boosting profit margins that should offset lower volumes from smaller devices.

The business has been run by the same cautious management team for years. Chief executive Mark Cambridge has been with the firm since 2000 while finance head Clare Smith has more than 10 years under her belt.

Further reassurance comes from Zytronic's bullet-proof balance sheet backed by £13.7m of net cash (that's 19% of the firm's market value). The company has also been paying generous and steadily growing dividends for years.

Stockbroker N+1 Singer forecasts a slight dip in pre-tax profit to £5.2m in the current financial year (2017: £5.4m) before surging next year to £6m. (SF)

BROKER SAYS: 1 0 0



Recent investments should make Gear4Music a stronger business

Snap up the musical instruments retailer amid a rare moment of share price weakness

A share price pullback at online musical instruments retailer **Gear4music (G4M:AIM)** presents a sweet-sounding buying opportunity at 672p.

Geared into the channel shift online, Gear4music is emerging from a heavy investment phase. Fiscal year 2019 should see profit growth coming through strongly and its global market share remains modest, implying plenty of profitable growth to come in the years ahead.

COME ON FEEL THE NOISE

Gear4music is a fast growing business benefiting from the migration of high street sales online combined with its successful customer-first strategy. It sells its own-brand wares as well as premium third-party brands such as *Fender*, *Roland* and *Yamaha*.

Operating from a head office in York and distribution centres and showrooms in York, Sweden and Germany, the largest UK-based online musical instruments retailer has identified a niche which appears less susceptible to the threat from Amazon.

The US tech titan seems more focused on accessories and lacks the showrooms that physically showcase Gear4music's products and build local brand loyalty and repeat business.

Fast-growing Gear4music still only speaks for around 6% of the UK market and 1% of the European market, suggesting it is still early days in the group's global growth story. Expansion into Europe is powering strong international growth, and there's long-term potential in the US and other global markets.

GEAR4MUSIC ↗ BUY
(G4M:AIM) 672p
Stop loss: 530p

Market value: £140m

SOLID REVENUE GROWTH

Results for the year ended 28 February revealed sales up 43% to £80.1m, although EBITDA was broadly flat at £3.5m, reflecting investments in its European operation and customer proposition to support growth and drive market share.

'We've invested ahead of the growth curve,' CEO Andrew Wass informed *Shares* on results day.

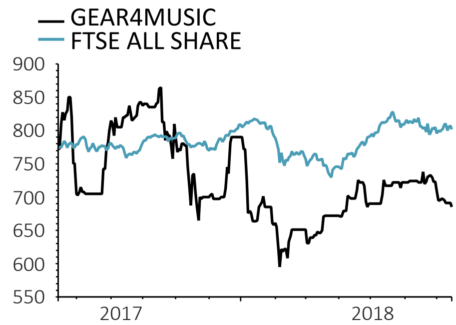
Peel Hunt is a buyer with a £10 target price, implying almost 50% potential upside, arguing Gear4music is simply becoming a bigger and more effective retailer, whose relationships with suppliers are 'clearly improving'.

Furthermore, own-label product is growing as rapidly as branded product sales, demonstrating the appeal of the Gear4music brand with less affluent shoppers.

For the year to February 2019, Peel Hunt forecasts £105.3m revenue which should translate into 87% growth in adjusted pre-tax profit to £2.8m. The following year is expected to show £132.9m revenue and £4.6m pre-tax profit.

Based on the current year's 11.2p earnings per share estimate, Gear4music trades on a premium 60-times rating. Yet with EPS forecast to grow by 67%, the PEG ratio of 0.9 looks palatable and the PE ratio falls to 37-times based on the following year's forecast 61% growth in EPS to 18p. (JC)

BROKER SAYS: 2 0 0



ACCESSO

(ACSO:AIM) £26.40

Gain to date: 60%

Original entry point:

Buy at £16.50, 20 July 2017

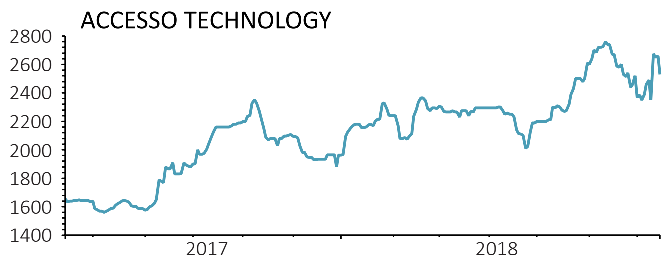
SHARES IN ATTRACTIONS software supplier **Accesso Technology (ACSO:AIM)** have shot more than 12% higher in the past week or so, leaving the stock not far shy of its £27.60 all-time high.

Apparently a stock trading technical issue was behind the jump. Without labouring the details, some stock seems to have been mis-priced temporarily, and as normal trading resumed the share price adjusted back to the market level.

Helping feed investors' optimism towards the Accesso growth story was a note from analysts at Peel Hunt this week hinting that the arts and music festivals space may be the next target niche ripe for Accesso's form of technological disruption.

It certainly suffers from the long queues Accesso's other target markets try to manage, such as theme parks and tourist attractions.

With festival-goers willing to spend up to several hundred pounds over a weekend, Peel Hunt argues that an extra £25 on an Accesso Prism wearable device could be a big hit. 'We'd argue £25 for a queueless/cashless product letting you know when your burger is ready or when the next toilet is free, is worth getting a potential six hours back over a weekend.'



SHARES SAYS: ↗

This is long-run growth story expected to achieve near-35% profit growth a year over the next few years, hence a premium rating is justified. (SF)

BROKER SAYS: 5 0 0

DP EURASIA

(DPEU) 168.6p

Loss to date: 26.7%

Original entry point:

Buy at 230p, 9 November 2017

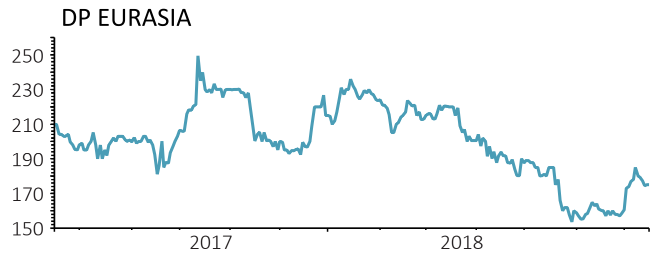
SHARES IN **DP Eurasia (DPEU)** haven't travelled in the direction we first expected. While the business continues to sell more pizzas in Turkey and Russia, the sterling-dominated shares have been hit by devaluation of the Turkish lira which is the company's reporting currency.

This is simply a translational issue and there is nothing wrong with the underlying business.

High inflation is a recurring issue in Turkey and DP Eurasia says it can cope with these pressures better than its peer group. 'We have the highest purchasing power in the quick restaurant sector in Turkey and we pass on all extra costs,' says CEO Aslan Saranga.

Inflation has been in a declining trend in Russia but real wages started to improve last year. That bodes well for consumers having spare cash for treats like pizza, and indeed the company claims it is the value leader in the Moscow pizza sector.

First quarter like-for-like system sales growth in Turkey at 10.9% is above the company's medium-term guidance of high single digit growth. In Russia, 18% like-for-like system sales growth is also ahead of medium-term guidance of low-mid teens growth.



SHARES SAYS: ↗

The currency issue is frustrating yet the fundamental business is still doing really well. We remain buyers of the stock. (DC)

BROKER SAYS: 6 0 0

GAMMA COMMUNICATIONS
(GAMA:AIM) 790p

Gain to date: 21.9%
Original entry point:
Buy at 648p, 18 January 2018

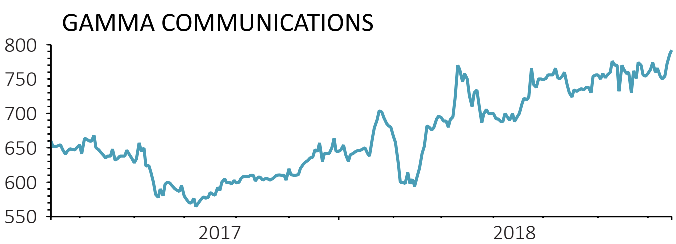
ANY CONCERNS INVESTORS may have had over the retirement of **Gamma Communications' (GAMA:AIM)** long-standing chief executive officer Bob Falconer in May were quickly swept aside by a typically positive trading update on 12 July.

In the 15 years that Falconer worked at the telecoms technology developer, including the past four as an AIM-quoted company, a reputation of beating well-managed market expectations had become almost set in stone.

Now with his replacement in the hot seat, Andrew Taylor, little seems to have changed on that front with the company saying it anticipates full year results to 31 December 2018 to be 'at the higher end of expectations.'

That comment was based on earnings before interest, tax, depreciation and amortisation of £46.3m on £263.6m of revenue, according to consensus at the time.

Those figures have nudged up as analysts revisit forecasts in light of Gamma's optimism; Peel Hunt increased its estimates 2% to 3% higher, even though 'we were already a couple of million higher on revenue.'



SHARES SAYS: ↗
We called Gamma 'an outstanding growth story' originally and that view has only strengthened. Still a buy. (SF)

BROKER SAYS: 4 1 0

MARLOWE
(MRL:AIM) 510p

Gain to date: 19.7%
Original entry point:
Buy at 426p, 28 June 2018

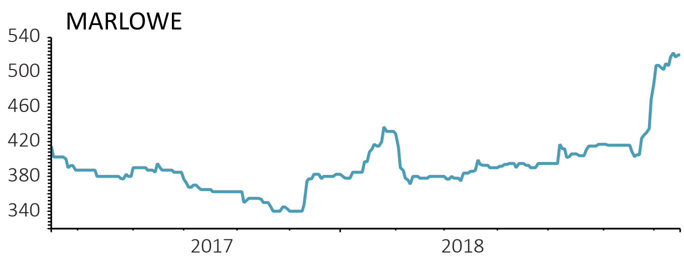
THE FIRE AND water safety expert has raised £20m to help fund new acquisitions. The money came from issuing new shares at 475p which was a 9.1% discount to the closing mid-market price on the day before the fundraise was announced.

Investors should note that share placings are likely to be fairly frequent with Marlowe as it operates a buy and build model. Issuing new stock at a discount is a way of getting institutional investors to back the company's plans and give them a reward by having stock cheaper than they could get on the market.

Companies often unveil an acquisition immediately after raising new cash but Marlowe's fundraise looks to have been an opportunistic move off the back of a very strong share price run since its full year results in June.

In Marlowe's case, it didn't announce a new deal. It has previously told *Shares* that it wants to move into refrigeration and air conditioning.

Finance director Mark Adams said to us last month that it could fund bolt-on acquisitions simply by accessing existing debt facilities rather than issuing new stock. This implies the £20m placing could be a precursor to a much larger deal, albeit this is pure speculation.



SHARES SAYS: ↗
Expect a deal or two round the corner. Keep buying. (DC)

BROKER SAYS: 1 0 0

Crunch time for Sirius Minerals as it tries to secure $3bn

The aspiring potash miner still needs to secure more offtake deals in order to satisfy the banks

With three years to go until the North Yorkshire-based Woodsmith potash mine starts production, it's a long waiting game for the 25,000 shareholders in **Sirius Minerals (SXX)**. However this period is likely to be far from uneventful.

Aside from successfully building the mine infrastructure, one of the biggest tests for investors is the ability for Sirius to secure stage 2 financing and that's something on the schedule for later this year.

The FTSE 250 miner needs to raise up to $3bn which it hopes to secure entirely through debt. Commitment letters and proposals from banks have started to appear although Sirius' June target to have everything in place has been missed.

Chief executive Chris Fraser says the only point at which Sirius would need to tap shareholders for more cash via issuing new shares would be if it couldn't get the full $3bn in debt.

PLAN OF ACTION

The company intends to have binding commitment letters by the end of September. At this point it hopes to get support from the Infrastructure and Projects Authority (IPA) to cover any shortfall. This is a UK scheme offering a government-backed guarantee to help infrastructure projects access debt finance.

Sirius has already been pre-approved for IPA backing. 'The IPA is the last piece of the jigsaw puzzle,' says Fraser. 'It only comes, if it comes, once they've seen the bank process.'

The UK guarantee scheme would see Sirius raise the necessary funds by issuing corporate bonds with a government guarantee attached, reducing the risk for bond investors to that of a gilt. The interest rate would match that agreed with the banking syndicate and the government would take the difference between the gilt and the coupon rate.

NEED FOR MORE OFFTAKES

Nothing is ever simple in the world of mining and investors should appreciate that the banking syndicate component of the debt finance is still dependent on Sirius achieving more offtake agreements. The financiers will want reassurance now that there are future buyers lined up for Sirius' production.

'We need more offtakes before the funding would be unconditional,' confirms Fraser.

Sirius intends to extract polyhalite, a form of potash containing potassium, sulphur, magnesium and calcium, via underground mining.

It will then transport the material via a conveyor and crush and grind it to a fine powder, and then re-granulate it to Poly4 which is Sirius' unique multi-nutrient fertiliser.

The company is targeting maiden polyhalite production in May 2021, ramping up to 10m tonnes a year by late 2024.

It hopes the product will be used by farmers to help improve crop yields. So far it has signed offtake agreements with a variety of parties including an agribusiness group, a fertiliser supplier and a peony seed oil producer.

Importantly, none of the offtake deals so far have been structured so Sirius gets the market price at the time of delivery. 'Each agreement has a different configuration. It is defined by the customer's view, in a downsize scenario what would they have to compete against as a substitution? The price points of those products are how they derive the price they pay us,' says the CEO.

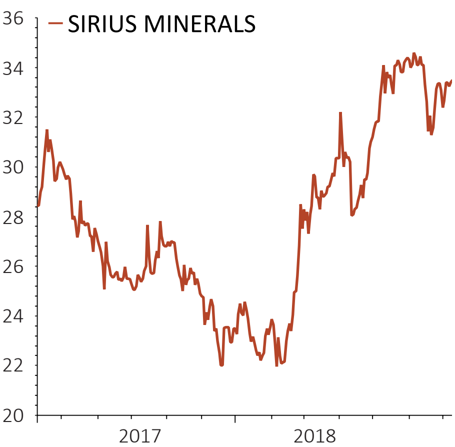
Fraser adds that the first round of offtake deals were signed before Sirius had planning permission to build its mine. 'That's how keen they were for the product,' he adds.

'The value of polyhalite is always going to be the value the farmer is willing to pay. We can see where that will be in time – a $200 to $300 price point is where polyhalite could settle. That could be five to 10 years away.'

CHANGING BUYING HABITS

The agriculture industry has historically bought fertiliser for a single growing season. As such, Sirius faces the difficult task of getting potential buyers to think differently and agree to longer term supply deals.

'There is no doubt that polyhalite does the job. That question has been answered for years. A lot of the discussion we're having with potential customers is about the nature of the risk. Banks are trying to get us to transfer risk to the customer so they can model and understand the revenue side.'



Sirius believes its operating costs will be around $30 per tonne. Investment bank Liberum currently models a $125 per tonne achieved selling price by Sirius for the first seven years' production. That suggests Sirius could make a decent profit margin, generating cash to rapidly pay down debt. Indeed, Liberum forecasts the business will be in a net cash position by 2028.

Fraser says he wants Sirius to start paying shareholder dividends before the company achieves a net cash position. 'Efficient capital structures mean you don't repay all the debt, you restructure it and create capacity to pay dividends as quickly as possible,' comments the CEO.

SHARES SAYS: ↗

Liberum believes the share price could re-rate to approximately 50% of its 110p net present value calculation upon stage 2 financial close, so in the region of 55p. That implies shareholders could see the value of their stock (currently 33p) increase by about two thirds, potentially by the end of 2018.

That's a compelling reason to own the shares, although you should recognise that securing the financing is not straightforward.

We're also enthused by comments from Fraser that there is greater interest from institutional investors in Sirius' shares. He says many investors in this category haven't previously been interested in the stock because their time horizon is only three years and Sirius is a longer term story. However the CEO says there is now more interest given first production is now three years away.

We reckon more investors will want to own the stock once the finance issue has been de-risked. Buying now is higher risk, but the rewards could be greater. Whichever your entry point, we rate Sirius as an excellent business to have in your portfolio for decades to come. (DC)

BROKER SAYS: 2 0 0

10-YEAR GROWTH WINNERS

EXCEPTIONAL STOCKS THAT CONSISTENTLY BEAT THE MARKET

Have you ever considered that past performance IS a guide to future performance? We're regularly told this is not the case by financial regulators, asset managers and investment experts, yet banking group Mirabaud reckons can you learn a lot from history.

It believes that past performance can steer you towards future performance, at least when looking for certain types of growth stocks.

Mirabaud has been running an exercise for the past 17 years that tracks the performance of stocks that have beaten the FTSEurofirst 300 index over periods of at least a decade.

The banking group believes stocks which consistently outperform the market over a prolonged period have rare attributes. It suggests the superior performance reflects a stock's inherent advantages, such as superior technology or barriers to entry, rather than simple luck.

SUBSTANTIAL RETURNS

Each year it runs a screen on the market to develop a portfolio which it calls '10-Year growth Oscars'. These portfolios have beaten the index more often (14 times) than they have lagged it (twice), plus only drawn once.

Its rolling annual portfolios have delivered 9.15% annualised returns since the exercise started in March 2001. The portfolios have risen by 342% in value over the 17 years, beating the index by 330%.

Some of the credible growth, multi-year winners in Mirabaud's exercise include food supplier **Cranswick (CWK)**, wealth manager **St James's Place (STJ)** and fashion retailer **Ted Baker (TED)**.

The highly-rated information is normally restricted to institutional investors. Fortunately, we've been given permission to open it up to *Shares* readers.

MECHANICAL SELECTION

It is important to stress that this is purely a quantitative exercise, mechanically selecting stocks because they meet specific criteria rather than uncovering them through qualitative research by an analyst or fund manager.

You must consider that some industries are experiencing structural change and so what worked in the past may not necessarily work in the future. Several of the stocks on the list have their fair share of critics as well as fans, such as safety group **Halma (HLMA)** and property portal **Rightmove (RMV)**.

Even though Mirabaud's performance statistics are very impressive, we'd advocate that you still thoroughly research any stock of interest on the list to understand both the risks and rewards before making an investment.

THE KEY CRITERIA

Although companies can get lucky and do well for an extended period of time, Mirabaud says the law of mean reversion appears very hard to 'cheat' over periods much in excess of five years.

By this it means most industries would see competition drive a 'normal' company's returns down to the average over time, as reflected by a relatively small number of stocks qualifying for its 10-year growth Oscars portfolio each year.

However, its survey does indicate that exceptional businesses can consistently outperform the markets for upwards of 15 years.

To qualify for its portfolio, a stock must have various characteristics including:

- 10 years of price history.
- Outperformed the market by at least 50% over the same period.
- A relative price level within 30% of their 10-year high against the market – that helps to screen out stocks that may be going ex-growth.
- A 10-year relative price low no later than March 2013 – i.e. has to have happened in the first half of the 10-year period. Mirabaud assumes genuine growth stocks trend high over time. It says eights year of decline, for example, followed by two years of 'scorching outperformance' are characteristics of a mean-reverting recovery stock, not a growth stock.
- Better than median earnings revisions in the month when the annual portfolio is selected.

One reason why some stocks fit the bill is their ability to generate significant amounts of cash that can be reinvested into their business to help them stay competitive.

Capital-light business models certainly help, such as stocks that do a lot of their business online and can service additional customers at little or no extra cost.

There are also a few industrial companies on the list which you would expect to have large capital expenditure requirements such as new equipment. They make the grade thanks to having niche interests, so generic competition isn't biting at their heels.

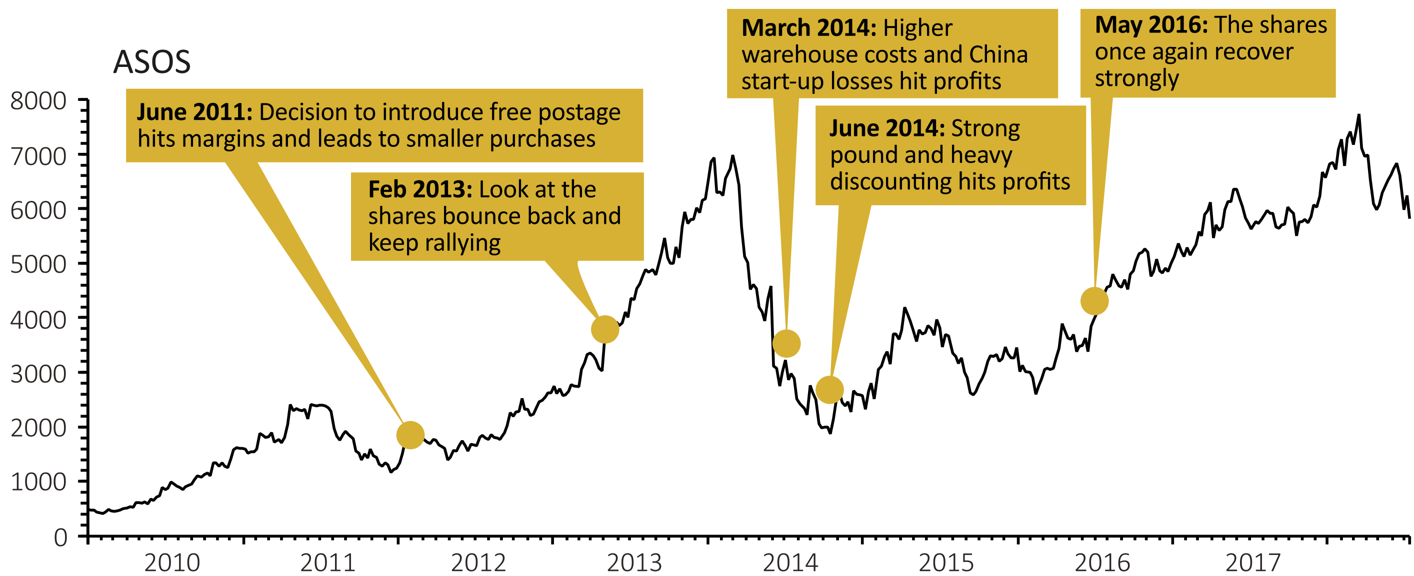
This year 252 names make the grade, of which 67 are listed on the London Stock Exchange. Mirabaud says the overall portfolio size is unusually large; for example, last year had 175 stocks overall.

THE GOOD AND THE BAD

Daniel White, head of strategy at Mirabaud, says most investors tend to underappreciate growth stocks. 'People get cautious about these stocks continuing to do well,' he adds.

Admittedly some good companies do go through bad spells and can experience share price weakness on the slightest bit of bad news.

For example, shares in retailer **ASOS (ASC:AIM)** have recently been weak because growth rates missed expectations. The business has also been juggling the day job with lots of development projects which has put pressure on management.



It's not the first time ASOS has been through a rocky patch on the stock market, but it's important to note that it tends to bounce back.

Indeed, Mirabaud says the best gauge of the market's belief in the durability of exceptional returns is not the length of a stock's unbroken string of Oscars – referring to its 10-year growth portfolio – but 'how quickly and how often it returns to the podium' after periods in the doldrums. ASOS features in its current portfolio.

LOOKING FOR LEADING INDICATORS

The banking group pays close attention to earnings upgrade or downgrade trends. Many of the stocks in its Oscars portfolio show superior levels of earnings upgrades versus the broader market, as you may expect from a group of companies referred to as 'exceptional'.

Not all stay this way. It looks for companies whose share price is continuing to outperform the market but where earnings revisions versus a specific universe of stocks are worse than average.

This is like the jaws of a shark – the gap between the top and bottom layers (the price and earnings trend) are getting wider and at some point, they have to close.

'Where you have the earnings relative to market drifting down, but the price relative is going up, it could be a sign that there is trouble ahead,' says White. 'There are only two ways it is going to close: the earnings revisions start going up again or the price goes down.'

Examples of stocks in its current portfolio displaying this 'jaws' trend include animal genetics firm **Genus (GNS)** and building materials group **Kingspan (KGP)**.

> **Most investors tend to underappreciate growth stocks. People get cautious about these stocks continuing to do well**

Some investors have been worried about Genus moving from market leader to joint number two in the dairy genetics industry, plus earnings are expected to be hit by unfavourable foreign exchange rates.

Investment bank UBS last week downgraded its rating on Kingspan to 'sell', saying the share price rally over the past year has gone too far and that the market was pricing in 13% EBITA (earnings before interest, tax and amortisation) margins into perpetuity whereas current margins are only circa 10%.

The average duration of a stock's membership in Mirabaud's list is three years, although there are plenty of examples of companies which have featured for longer periods. Construction equipment rental group **Ashtead (AHT)** is now in the portfolio for the ninth time, asset manager **Schroders (SDR)** is now in its sixth year (although not consecutive), so too fuel and healthcare products distributor **DCC (DCC)**.

THREE OF OUR FAVOURITE OSCAR WINNERS

The accompanying table shows some of the UK-listed names in the portfolio this year. Overseas-listed constituents include footwear group Adidas and Amplifon, the world's leading hearing aid specialist.

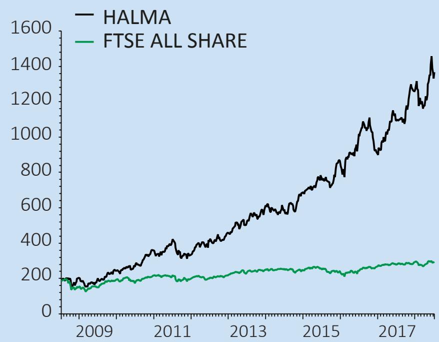
We'll now discuss three of the companies in more detail. We rate this trio as superb investments and stocks to buy for the long term.

10-YEAR GROWTH OSCARS: A SELECTION OF UK STOCKS IN THE 2018 PORTFOLIO

3i	Micro Focus
Abcam	Paragon
Ashtead	Persimmon
ASOS	Polar Capital
Bodycote	Rathbone Brotherss
Computacenter	Redrow
DCC	Renishaw
EasyJet	Rightmove
Ferguson	Robert Walters
Hargreaves Lansdown	Senior
Hiscox	Sky
IG	Spectris
JD Sports Fashion	UDG Healthcare
Jardine Lloyd Thompson	Unite
London Stock Exchange	Wetherspoon

Source: Mirabaud

HALMA (HLMA) £13.66 BUY



Halma is a global manufacturer and seller of a wide range of equipment largely demanded by health, safety and environmental rules. This includes hazard detectors, sensors and assorted environmental protection kits. The approach allows the FTSE 100 member to consistently perform almost regardless of the economic cycle.

Organic growth is supplemented by carefully selected bolt-on acquisitions. Halma is very careful in how it chooses its business areas, seeking resilient growth drivers based on advances in safety regulations, ageing and urbanising populations, and other demographic trends.

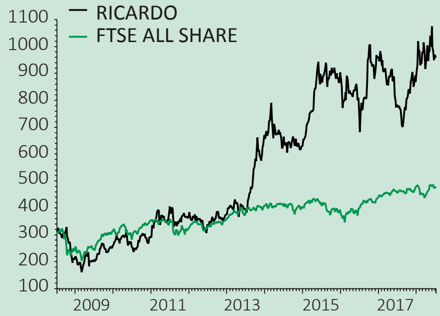
It also buys niche market businesses that generate strong returns and which it can help to develop – under a strategy called Halma 4.0.

'Halma entered the FTSE 100 last year, reflecting the group's 30-year track record of 11% compound revenue growth,' says Shore Capital analyst Ben McSkelly.

'While past performance cannot always be extrapolated, we believe the consistent delivery on the set business model can continue, with opportunities for further M&A bolstering the group.

'The Halma 4.0 initiative should protect the company as its markets adapt to technological opportunities, but the group does not intend to massively pivot its operating model in order to become a service or software led offering.'

RICARDO (RCDO) 964P
BUY



The engineer is best known for its expertise in the automotive industry, helping vehicle manufacturers to measure emissions and increase performance efficiency.

It also has expertise with environmental issues such as water resource management and environmental impact assessment.

Furthermore, it has a growing rail business where it helps clients to navigate the industry's operational, commercial and regulatory issues.

Much of the market's focus over the past few years has been on Ricardo's exposure to the combustion engine and what may happen to its earnings if the world shifts to electric-powered vehicles.

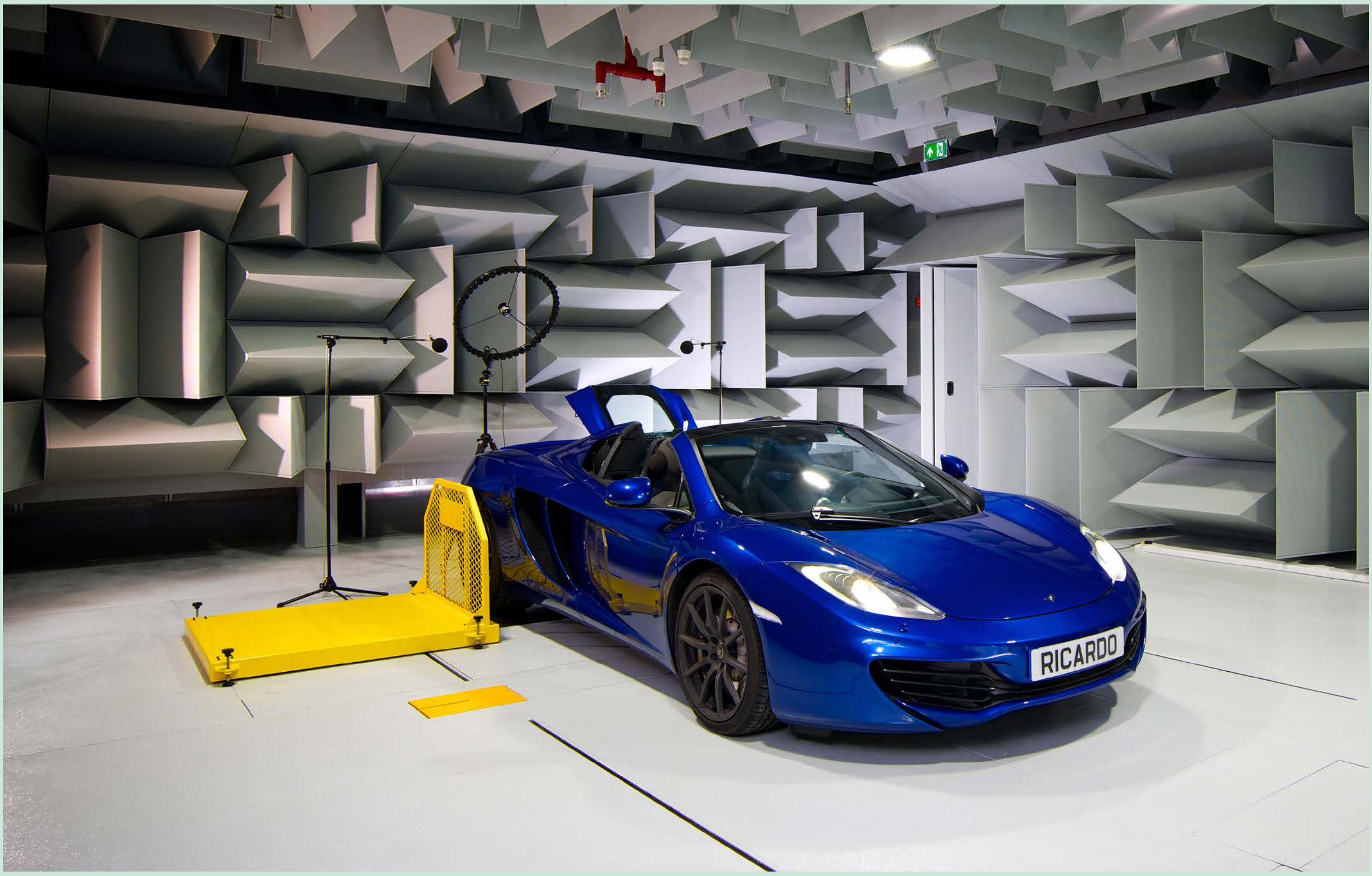
Ricardo has long stated that its business would adapt and the message now seems to be getting through. It has a growing presence in the electric vehicle industry and also has a strong balance sheet which could help it fund bolt-on acquisitions.

The automotive industry itself is going through significant change and it will need experts like Ricardo to help navigate this journey.

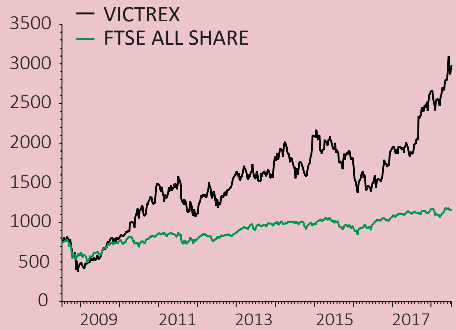
Alongside these activities are other interests in the defence sector and the assembly of high performance engines for McLaren, plus designing and producing an advance hypercar transmission for Aston Martin.

The rail business continues to go from strength to strength and is well positioned to take advantage of positive trends in the global rail market, such as high levels of new-build activity. Relationships with major international rolling stock manufacturers Hitachi Rail and CRRC has led to helping them introduce their vehicles into the European, North American and Australasian markets.

Pre-tax profit for the year to 30 June 2018 is forecast to be £41m (2017: £38.3m), rising to £43m next year.



VICTREX (VCT) £29.80P
BUY



This is a specialty chemical company which supplies polyetheretherketone, also known as PEEK resin.

This super-strong, heat resistant and lightweight plastic is used as an alternative or replacement for metal in areas like transport, the industrial sector, electronics and medical devices.

The firm also has the capability of manufacturing finished and semi-finished products for its customers.

This added value allows it to charge a premium price, particularly given its materials and products often deliver higher performance and greater efficiency than the alternatives.

Internal estimates suggest if producers of materials running from medical implants to oil equipment substituted materials with PEEK in their supply chain its market would increase seven-fold.

The company has already invested heavily in extra production capacity and product innovation. It now faces an end-market environment that is near universally positive for volumes, said investment bank Berenberg last year.

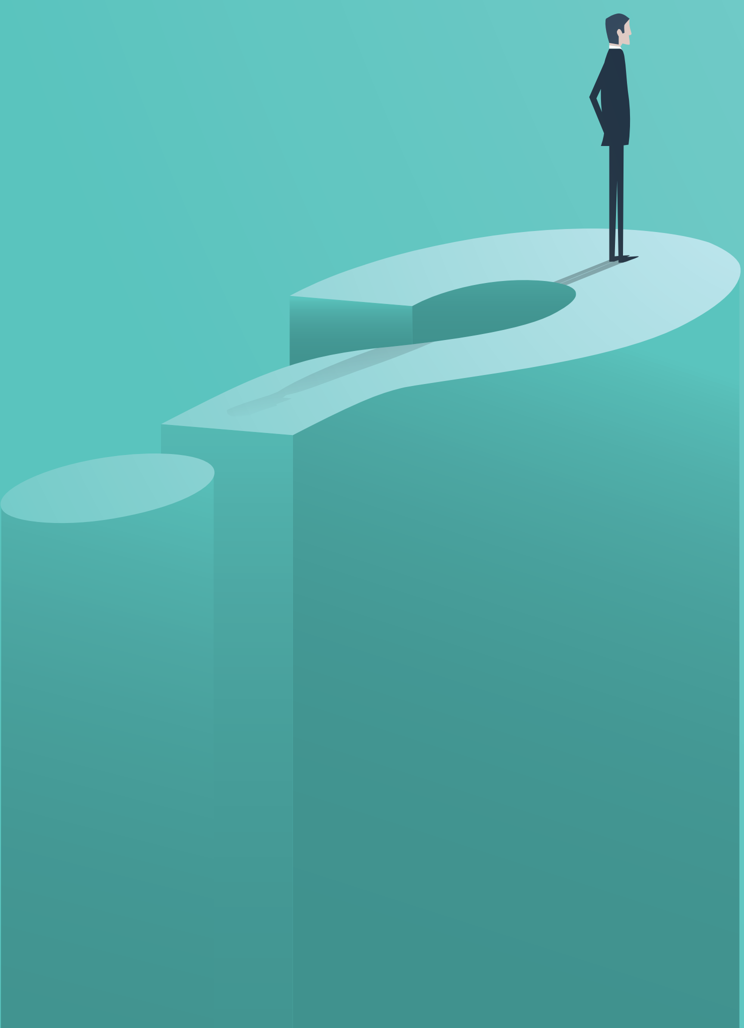
A recent management shake-up doesn't look like it will result in a radical change in strategy. Chief executive Jakob Sigurdsson is fairly new in the job, having only started last September. His career includes four years running global polymer manufacturer Promens before it was taken over by packaging group **RPC (RPC)**. Finance director Richard Armitage started in April this year, joining from food manufacturer Samworth Brothers.

Liberum said last December that Sigurdsson seemed like he would accelerate and support PEEK business opportunities and not invest in new chemistries, make transformative acquisitions or change the manufacturing strategy.

That should reassure investors who enjoyed significant returns under the previous leadership of Dave Hummel who had overseen 10% organic compound annual growth in earnings per share and an eightfold increase in revenues since the company listed in 1995. Hummel had been CEO since 1993. (DC)

THE BIG DECISION

TAKE PROFITS OR RUN YOUR WINNERS?



For many investors, the value of their portfolios and the share prices of the stocks within it will – if they choose correctly – rise gradually and steadily over time. Bouts of volatility are to be expected and there might be the occasional sharp drop or quick swing upwards after good or bad news.

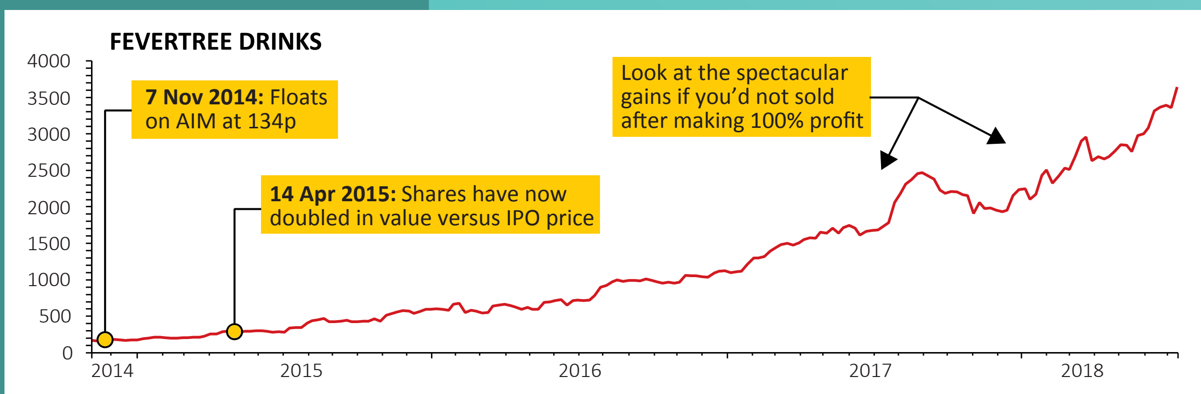
But sometimes shares can soar. A company with a new innovation or a business brought back from the brink can suddenly surge beyond all expectation. At that point, investors are faced with a choice: pocket the profits or see how far the shares can go.

HOW QUICKLY SHOULD YOU CASH IN PROFITS?

Premium mixer drinks maker **Fevertree (FEVR:AIM)** is a recent example of a staggering success story. The company floated on the stock exchange in November 2014 at 134p and quickly gained a following from investors who thought the company had spotted a gap in the market, benefiting from the so-called 'ginaissance' and consumer shift to luxury tonics.

Investors would no doubt have been delighted to have doubled their money by April 2015. But if they had sold their shares then they would likely be kicking themselves by now: the shares have increased by 27-fold since they started trading, now priced at £36.15.

But would you have been brave enough to keep holding the shares while they climbed and climbed? When a share price soars, how do you know when it's time to take those profits and when it's got further to run?



RUN YOUR WINNERS IF THE INVESTMENT CASE STILL STACKS UP

Ben Peters, co-manager of investment fund **Evenlode Income (BD0B7C4)**, says: 'If a share price has doubled, so what? What is important is whether the company still fits my criteria for investing – if it does, we continue to hold the shares.'

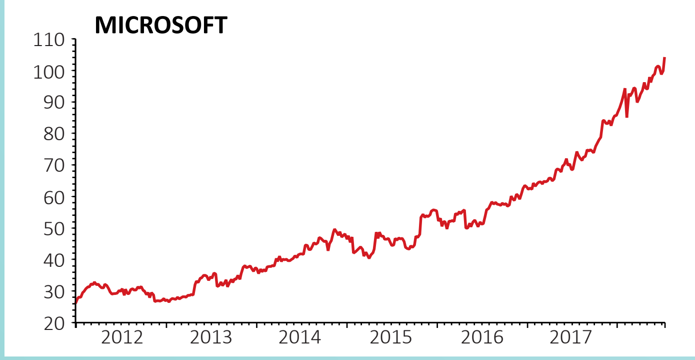
Peters and his colleague Hugh Yarrow look for quality companies with high barriers to entry to stave off the competition and those which are not bogged down with lots of debt.

He invested in computer company Microsoft in 2012. At the time it was seen as a dinosaur compared with the likes of fast-growing tech firms such as Apple and Amazon.

Peters says: 'But we saw some attractive qualities – it had a dominant market share and was sorting out its cloud computing business.' Over the past two years the share price has doubled to more than $100.

THINKING ABOUT THE POTENTIAL UPSIDE AND DOWNSIDE

Alex Wright, fund manager of **Fidelity Special Situations (B4566K2)**, says with all his investments,

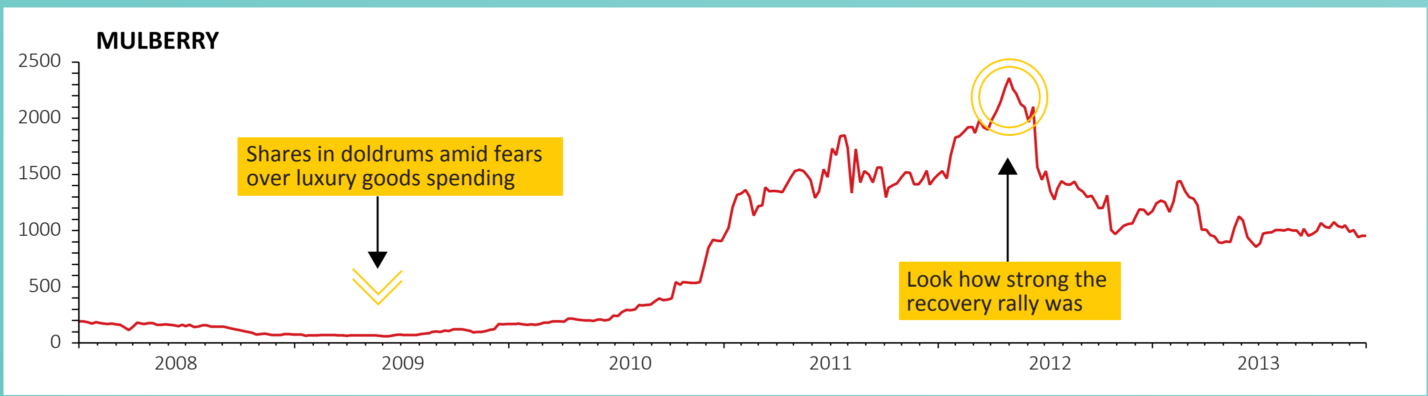


he thinks about how much it could potentially go up and how much it could potentially go down.

One of his most successful investments was luxury handbag maker **Mulberry (MUL:AIM)**. He bought shares in 2009 in the middle of the financial crisis when there were widespread fears that consumers would stop spending on luxury items as well as worries about a slowdown in China.

Wright thought the issues were short-term and bought the shares at 65p. Two years later they had rocketed an incredible 2,000%. Had he held on a little longer, they finally peaked in mid-2012 at £24 a share.

He says: 'As a contrarian investor I tend to sell early – when other people start to get interested in a stock, I start to worry.'



Simon Gergel, fund manager of **Merchants Trust (MRCH)**, explains: 'The key is to have a good idea of what a company is worth – but you have to constantly re-evaluate that.'

It's not just individual stocks which can defy investor expectations either. Only last year the FTSE 100 broke the 7,500 mark for the first time – something which many investors never envisaged. The MSCI North America index, meanwhile, has returned more than 220% over the past decade.

BUYING WHEN PEOPLE ARE WORRIED... AND SELLING WHEN A STOCK RETURNS TO FAIR VALUE

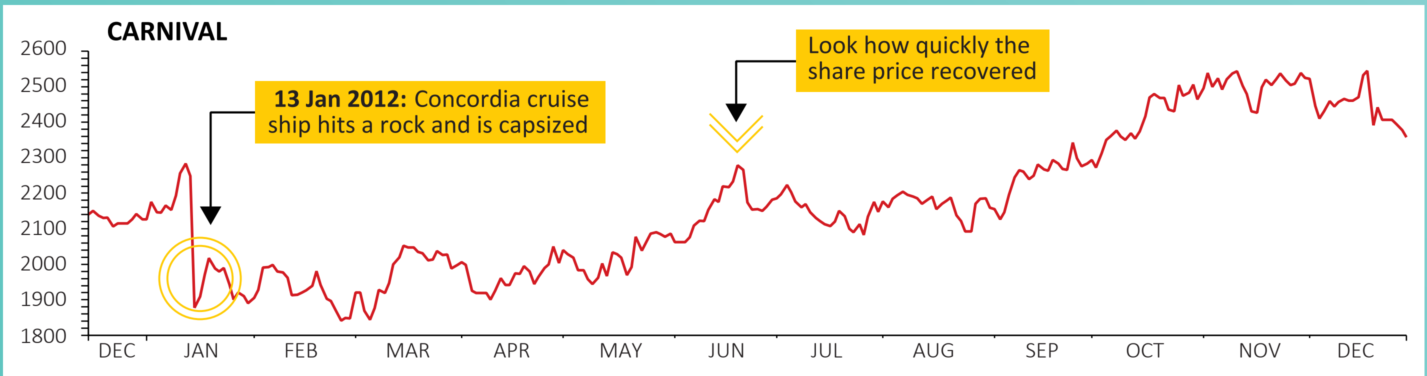
One of Gergel's recent successes is an investment in marketing group **St. Ives (SIV)** which had seen shares plunge after profit warnings. After a restructuring, which involved selling off several parts of the business, it said adjusted pre-tax profit was up 35% in its latest half year results. The share price has nearly doubled in the past year alone.

He also invested in cruise operator **Carnival (CCL)** six years ago, shortly after the tragic sinking of the Costa Concordia. A restructuring, cost-cutting and a lack of ship capacity benefiting prices in the industry eventually saw the share price climb 150%.

Typically, as a share price starts to get close to what Gergel calls 'fair value' he starts to sell it gradually rather than wait for it to hit a certain number and sell all at once. He says: 'You have to be disciplined because the danger is that it gets expensive and the price falls again.'

Fund managers often use strict criteria to help them in these decisions as it helps them avoid making a decision driven by emotion. But Peters at Evenlode adds: 'Our job is to identify high-quality companies and work out what their value is, regardless of what the share price does. But sometimes, when shares have appreciated rapidly, you do wonder whether it can continue.' (HB)

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



COMING SOON 26 July

Don't miss our follow-up article on 26 July looking at when to cut your losses and when to remain patient with underperforming stocks.

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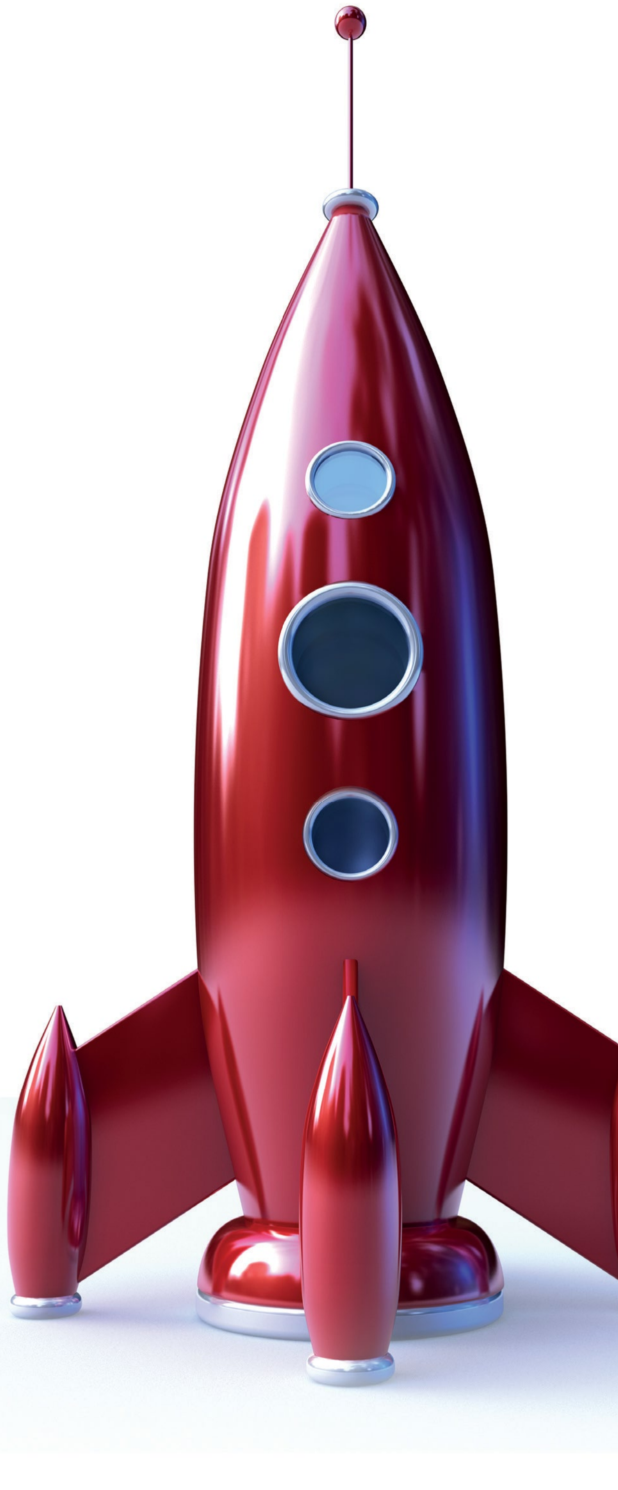

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How refinancing debt could unlock more dividends and value for investment trusts

Many trusts carry the legacy of long-term borrowings secured at comparatively high rates of interest

Recent activity at **Brunner Investment Trust (BUT)** helps shine a light on the expensive debt carried by some investment trusts and how refinancing these borrowings could be a catalyst for trusts to trade on higher valuations and pay out more in dividends to their shareholders.

Unlike traditional funds, investment trusts can borrow money to invest. This is known as gearing and in a rising market it can help to boost returns, although it can work against shareholders when markets fall by magnifying short-term losses.

"The ability to borrow money can be a useful tool for the manager of a trust"

WHY DO INVESTMENT TRUSTS CARRY DEBT?

The level of gearing varies from trust to trust, but the overall average has stayed fairly level for the last two years or so and is currently 7.2%.

The ability to borrow money can be a useful tool for the manager of a trust. It means, for example, they don't always have to sell holdings when they find another opportunity to invest in.

A critical point is that the fund manager must be confident they can earn a better return on the additional investments accessed via debt than the cost of borrowing the money.

There are different methods by which a fund manager can look to gear up their portfolio including bank debt, loan stock, debentures, foreign currency loans or preference shares.

Much of the debt taken on by trusts comes in the form of debentures. In corporate finance, a debenture is a medium to long-term debt instrument used to borrow money at a fixed rate of interest.

The long-term nature of much investment trust debt is significant as some trusts secured their borrowings at much higher rates of interest than are available in the market now.

RECENT INVESTMENT TRUST REFINANCINGS

TRUST	DATE	INTEREST RATE
Brunner	June 2018	2.84%
Foreign & Colonial IT	March 2018	2.92%
JPM Global Groth & Income	January 2018	2.93%
Merchants Trust	December 2017	2.96%
Murray Income	November 2017	2.51%
British Empire	November 2017	2.93%
City of London	November 2017	2.94%
Witan	November 2017	2.74%
Temple Bar	October 2017	2.99%

Source: Numis

In the 1990s trusts locked in borrowing costs when interest rates were in high single or even double digits.

Given that rates have been historically low for more than a decade, the previous agreements on high rates now look like a mistake. It also raises the prospect that a manager might pursue higher returns at a higher level of risk in order to help meet the costs of borrowing.

COST OF REPAYING EARLIER

Brunner was faced with substantial interest payments on legacy borrowings until 1 June this year when it revealed the early repayment of the last remaining high-cost debt in its portfolio totalling £28m.

There are often penalties for redeeming debt early but by placing a £25m note at a record low rate of 2.85% for 30-year debt and meeting the remaining £14.4m costs (including interest) to repay the outstanding borrowings from bank debt and existing assets, the investment trust was able to reduce its overall interest costs from 7.7% to 2.9% a year.

Looking at the borrowings in question in more detail, the first tranche of £15m was issued in 1993 at an effective interest rate of 9.3%. The second tranche of £13m was assumed from an existing borrower in 1998 at an effective interest rate of 6%.

As Edison analysts Mel Jenner and Sarah Godfrey observe: 'Coupled with the lower cost of debt, a potentially higher yield could lead to a narrowing in the trust's discount (to net asset value). Brunner has a distinguished distribution track record, growing dividends for the last 46 consecutive years.'

Brunner currently trades at an 8.9% discount to NAV. Over the past 12 months its widest discount has been 11.3% and the narrowest 5.9%.

Higher interest debt is likely to have a material impact on net asset value. As a reminder NAV is calculated by subtracting a company's liabilities from its assets.

The level of liabilities will depend on whether the debt is being valued at its nominal value or if the level of interest is being factored in to reflect

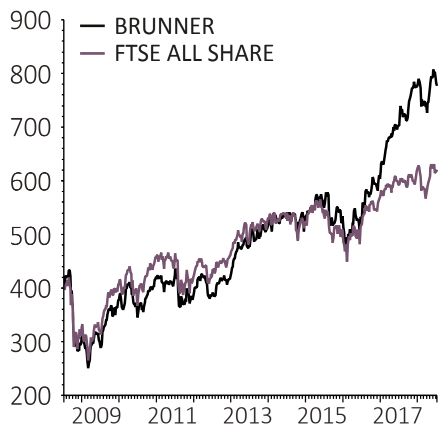
TRUSTS DOGGED BY DEBT

NEGATIVE IMPACT OF INCLUDING DEBT AT FAIR VALUE IN NAV	
Value & Income	-6.4%
Aberdeen Diversified Income & Growth	-5.4%
Mercantile	-3.9%
Merchants	-3.6%
Picton Property Income	-3.5%
Law Debenture	-3.5%
Scottish Investment Trust	-2.9%

Source: Numis, 21 June 2018

The accompanying table shows investment trust names where valuing debt at fair value has a large negative impact on NAV, implying these trusts may also be paying high rates of interest on their borrowings.

Brunner's portfolio includes a stake in AbbVie



'fair' value.

Higher interest payments will also mean a company has less cash to pay out to shareholders in dividends.

OTHER TRUSTS WITH EXPENSIVE DEBT

Brunner is not the only trust that has been burdened with expensive debt and we now explore a few more examples which are worth watching closely to see if and when they might shift their borrowings to enjoy a lower level of interest.

One such trust which has already moved to reduce the cost of its long-term borrowing base is **JPMorgan Claverhouse (JCH)**.

> Higher interest payments will also mean a company has less cash to pay out to shareholders in dividends

In November 2017 the trust, which focuses on UK stocks and has a good track record of paying out income and generating capital returns, agreed to issue £30m fixed rate 25-year unsecured notes at an annualised coupon of 3.22%. The issue will take place at the point its current 7% debenture matures in March 2020.

Managed by a team at Invesco Perpetual, **Edinburgh Investment Trust (EDIN)** has a £100m debenture which matures in 2022. Issued in 1997 it carries a fairly onerous rate of 7.75%. (TS)

MERCANTILE:
ANOTHER TRUST DEALING WITH RELATIVELY HIGH DEBT

STEERED BY HIGHLY rated manager Guy Anderson, **Mercantile Investment Trust (MRC)** has a £175m, 6.125% debenture which is repayable in February 2030. The company issued the debt at the beginning of this century at what it felt at the time were 'attractive rates' of interest.

Launched in 1884, one of the oldest trusts in existence pays quarterly dividends and aims to grow its dividend at least in line with inflation.

'We're looking to generate long term capital growth and the dividend has been on a pretty encouraging trajectory over the last four or five years, as income coming into the portfolio has been growing quite nicely,' says Anderson.

He says Mercantile has a really exciting investment universe, looking at the FTSE 250 and small caps and it can also invest in stocks listed on AIM. 'In practical terms, we could be looking at a company that has got a market cap of £50m up to something valued at £4bn or £5bn at the top. We don't buy companies that are in the FTSE 100, but we have the latitude that when existing holdings are promoted into the FTSE 100, we don't have to sell them on that point.'

Mercantile's managers focus on valuation. 'We look at a range of metrics but the key thing we look at is the cash the business generates because that should be the ultimate arbiter of what it is worth,' says Anderson, seeking firms with solid fundamentals.

'We meet about 300 management teams a year – asking them what they think are the prospects for the business and how they allocate capital.'

Anderson wants to know what they're hoping to achieve and then he will assess what they actually do versus what they say. He is also looking to identify positive change, such as a management-led restructuring, a cyclical turning point or a company with underappreciated growth momentum. (JC)

Mercantile's holdings include Bellway

Why it's all about yield for Merchants Trust

Its fund manager argues against focusing on dividend growth in the quest for income

The manager of **Merchants Trust (MRCH)**, Simon Gergel, doesn't share the widely-held view that dividend growth is more important than dividend yield.

As an example, let's compare a hypothetical company offering a dividend yield of 8% but no dividend growth with another company offering a 2% dividend yield but growing the payout at 10% each year.

Gergel says it would take 15 years for the dividend payments from the low yield, high dividend growth company to exceed those of the high yielder.

He also argues high yielding stocks have generally outperformed lower yielders, citing a US study covering the 50 years from 1953 to 2003.

At Merchants Trust, Gergel targets stocks yielding at least in line with the market within 18 months.

Recognising that a high yield can be a signal for a dividend cut, yield alone is never seen as sufficient justification for buying a share and Merchants' investments are not automatically sold if a yield drops below the market level.

HOW HAS THE TRUST PERFORMED?

Gergel's approach underpins a dividend yield of 4.8% and the trust has a 36-year track record of raising dividends.

A recent addition to the portfolio which underlines the focus on yield is tobacco stock **Imperial Brands (IMB)**. Although admitting to having some reservations about the tobacco industry, Gergel believes these are 'now in the price' on a price-to-earnings ratio of 10 and dividend yield of 7%.

He says the company enjoys significant barriers to entry and that tobacco is a resilient product. He sees the business as being well positioned in emerging vaping products.

On a sector basis, Gergel is positive on the opportunities in financial services, aerospace and defence firms and construction and materials, with limited exposure to 'expensive defensives'. (TS)

MERCHANTS TRUST PORTFOLIO INVESTMENT THEMES

Large core holdings in well financed global, 'mega' caps with strong franchises and good yields
Example: **GlaxoSmithKline (GSK)**

Exposure to emerging market consumer spending growth
Example: **Informa (INF)**

Inflation 'tail risk' – real assets, inflation-linked revenues attractive
Example: **Greene King (GNK)**

Recovery situations with industries recovering and companies on modest valuations
Example: **Bovis Homes (BVS)**

Financials for exposure to rising interest rates and volatility
Example: **HSBC (HSBA)**

Can a fund manager perform to the best of their abilities if they have to run multiple funds?

We consider the risks of using a fund manager whose services are needed in many different places

Anyone paying for the services of a fund manager should expect to have access to sensible decision making and hopefully wealth creation. Investors are placing their trust in two key areas: the asset management business overseeing the investment fund and the fund manager themselves to make the correction decisions.

While a lot of consideration is often given to the credentials of these parties, less is given to whether the fund manager's expertise is being spread too thinly. Numerous managers are responsible for more than one investment fund, meaning they risk becoming distracted by trying to do too much at once.

This can certainly be the case if the fund manager is working on products that have a different strategy such as overseeing an income fund and a specialist fund such as a small cap focus or one that invests in private, early-stage entities. The latter can require the fund manager to spend a considerable amount of time meeting and understanding business developments.

One industry insider who wished to remain anonymous thinks some of the more famous fund managers may have been given extra mandates to increase inflows into products. Many investors are happy to back a well-known manager in more than one situation, thus the asset manager effectively has an opportunity to trade on a fund manager's fame.

Some fund managers run a staggering amount of funds; at the top of the list is Santander Asset Management's Toby Vaughan who runs 27 products. These range from UK and US equity funds to sterling bond funds. Data provider FE Trustnet says out of the last seven years Vaughan has outperformed his peer group in three years, underperformed in three years and matched the performance in one year.

Bambos Hambi has overseen 25 funds at Standard Life since 2011. FE Trustnet says he has underperformed the peer group in six out of the past seven years. A lot of his mandates are multi-manager products or fund of funds, so you could argue the day-to-day decisions of making individual investments are being made by someone else.

Being responsible for multiple mandates doesn't always equal mixed or bad performance. For example, bond specialist Ian Fishwick at Fidelity is responsible for 16 funds as lead or co-manager and FE Trustnet says he has outperformed the peer group in nine out of the last 10 years.

In the investment trust space, the Association of Investment Companies calculates there are 46 fund managers looking after two or more investment trusts, and 12 that manage three or more.

Simon Molica, a fund manager at AJ Bell Investments, makes the point that perhaps it's not the number of mandates that can impact a manager's effectiveness but rather the size of the mandates. He adds that even if a manager seems to be running numerous funds, they should be well supported by colleagues, especially true of the larger asset houses.

Indeed, fund managers often operate as a part of a team and while there is someone's name attached to the product as lead manager, in reality there are lots of people doing the work. For example, this team approach is seen at asset manager Baillie Gifford. (DS)

How to respond to any potential sterling crisis

We look at how politics can act as a major influence on the direction of the UK's currency

Sterling did not know what to make of Prime Minister Theresa May's Brexit white paper. It dipped, rallied and then dipped again. Even some chatter about a second interest rate increase within the space of a year from the Bank of England on 2 August is offering little support to the currency, at least at the time of writing.

The pound is thus nowhere near to recapturing the levels it held on the day before the EU referendum in summer 2016 and remains prey to short-term sentiment swings related to the Brexit negotiation process.

Sterling has suffered three crises of confidence since 1945. A repeat cannot be entirely ruled out owing to the current political upheaval and lack of clarity on Brexit, although previous notable plunges have been the result of deep-rooted economic problems rather than any games of musical chairs at Westminster.

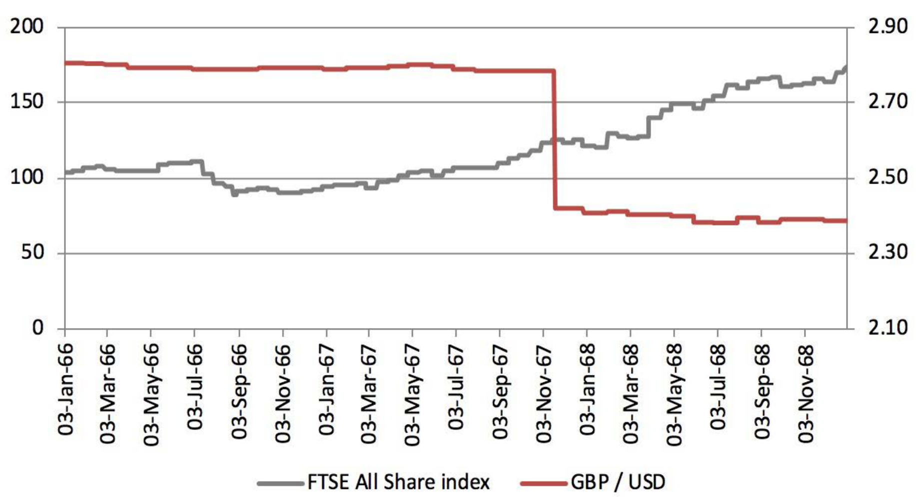
- **1967.** Prime Minister Harold Wilson devalued the pound from $2.80 to $2.40 in 1967 as the UK struggled with a rising budget deficit, a trade deficit and a current account deficit, added to a weakening economy. The UK needed to attract capital to fund its triple deficits, or burn through its foreign exchange reserves, and Wilson chose a devaluation to limit national liabilities and lure investment into the UK from overseas.

- **1976.** Sterling took a battering as then-Chancellor of the Exchequer Denis Healey had to turn to the International Monetary Fund for an emergency loan.

Britain was struggling with weak growth, an inflation rate in the mid-teens and – once more – the combination of a growing budget deficit, trade deficit and thus current account deficit. Gilts were unattractive to buyers thanks to inflation and thus the Government turned to external help for near-term funding. Ironically, the IMF loan was paid back quickly as Treasury estimates for the 1976-77 budget deficit proved far too pessimistic.

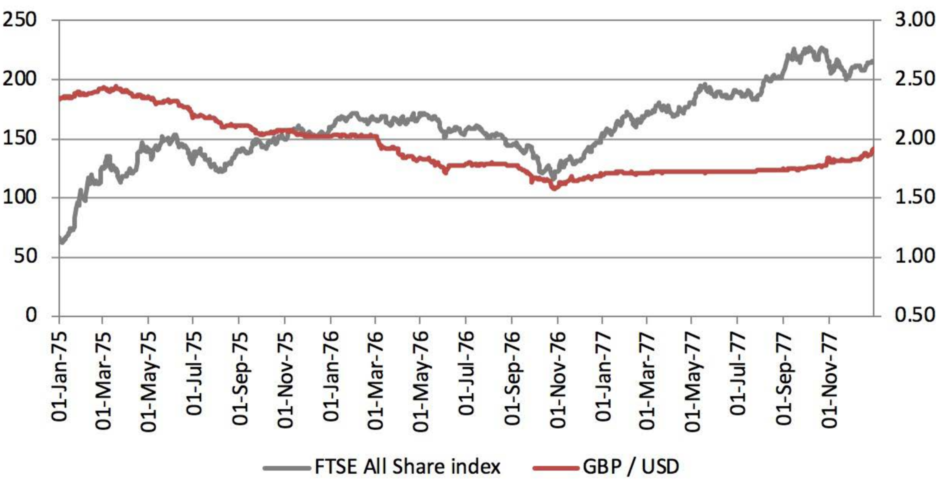
- **1992.** The currency was forced out of the Exchange Rate Mechanism (ERM) in September 1992 when in the care of the Conservative administration of John Major and Norman Lamont. The UK was mired in recession, burdened by what was seen as an uncompetitive, fixed rate relative to the German mark. The devaluation undid 1990's move to join the ERM and demolished a key plank of the Major government's European policy.

RISING DEFICITS AND A RECESSION FORCED STERLING DEVALUATION IN 1967



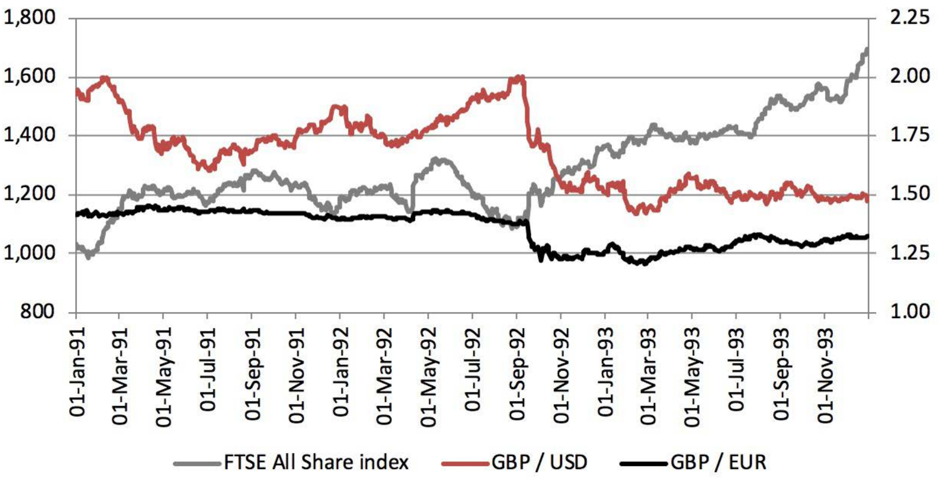
Source: Thomson Reuters Datastream

INFLATION AND TWIN DEFICITS HIT STERLING HARD IN 1976



Source: Thomson Reuters Datastream

RECESSION AND RISING TRADE AND BUDGET DEFICITS CONTRIBUTE TO THE ERM CRISIS OF 1992



Source: Thomson Reuters Datastream

BACK TO THE FUTURE

There are potential similarities between those three instances and the economic circumstances of today.

- The UK is still running an uncomfortably high trade and current account deficit. Thankfully the annual budget deficit is coming down but Britain is still to a degree reliant upon the kindness of strangers to fund itself, to use Bank of England Governor Mark Carney's words.

- Europe was a massive political issue for the Conservative government of the early 1990s and it is every bit as hot a potato today, given how split the party is over the issue of Brexit and how best to implement the withdrawal from the EU mandated by the referendum vote of 2016.

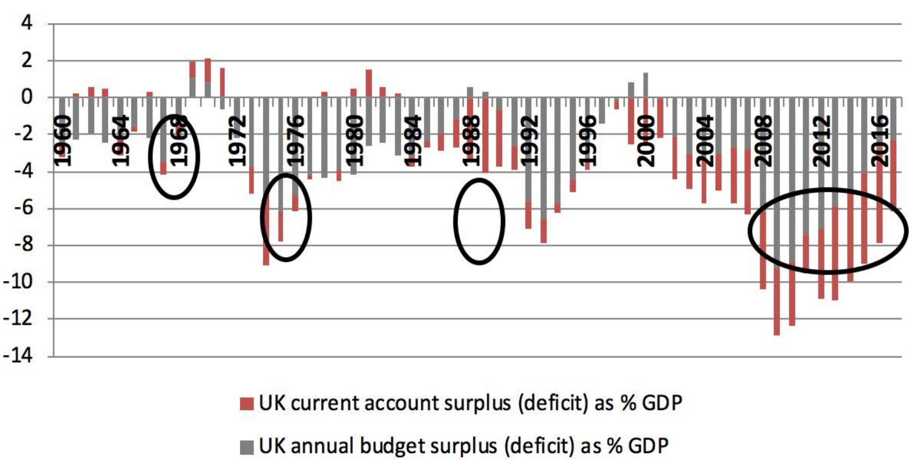
Thankfully there are differences, too

- There is no fixed exchange rate to defend, unlike 1967 and 1992, so the Bank of England does not have a big target on its back.

- Interest rates are still near rock-bottom levels, so it easier for the UK to fund its borrowings.

- The annual budget deficit has come down a lot over the past few years, even if Chancellor Hammond has pushed out plans to

TRADE, CURRENT ACCOUNTS AND BUDGET DEFICITS TEND TO MEAN MORE TO STERLING THAN DOMESTIC POLITICS



Source: ONS. Circles signify plunges in sterling (1967, 1975, 1992, 2016) actually balance the budget to an unspecified date in the next decade.

It is therefore hard to say that a new sterling crisis is inevitable although the pound does seem to trade as if it prefers a 'soft' Brexit to a 'hard' one and particularly to 'no deal'.

Given the prevailing uncertainty in Westminster over the fate of the Prime Minister and the policy framework outlined at Chequers, the pound could remain under pressure.

PORTFOLIO IMPLICATIONS

The performance of the FTSE All-Share before and after those prior crises – and also after the EU referendum of 2016 – could offer some guidance as to what may happen in the event sterling comes under the cosh once more.

In the run-up to 1967 the market did well but then ran out of steam afterwards as interest rates rose to combat inflation.

In the cases of 1976 and 1992, the economy had been struggling but then picked up speed helped by falls in the pound and a lowering of interest rates, to the benefit of share prices.

In 2016 the FTSE All-Share initially tumbled upon news that Britain had voted to leave but then rallied as the heavyweight multinationals and overseas earners of the FTSE 100 in particular dragged it higher. Their foreign assets and income were instantly made more valuable once they were assessed in terms of pounds and pence, thanks to the pound's post-vote plunge.

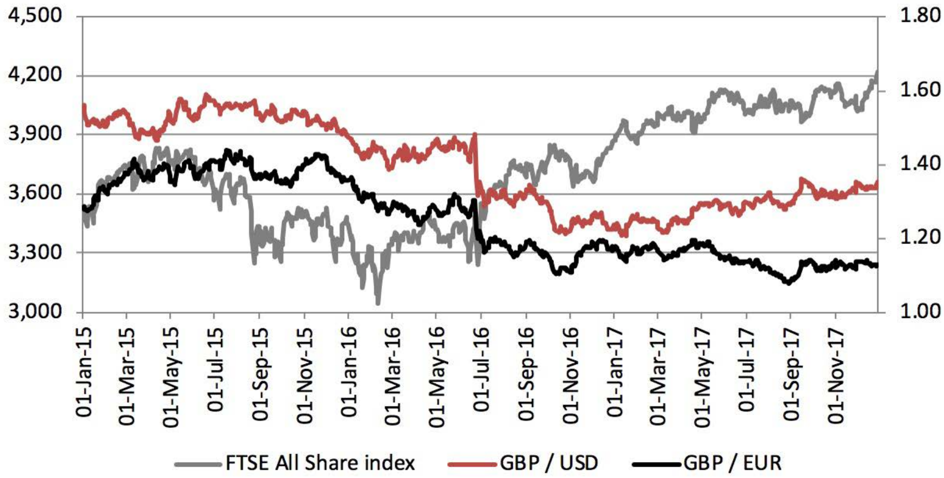
If investors are convinced that debate in Westminster – and subsequent negotiations with the EU-27 – will result for any reason in a weaker pound then another option is to look at buying overseas assets, either directly or through a fund, as their value will rise when translated back into pounds.

However, any such trades bring in other risks, including that their price could fall more than the pound, leaving the client worse off than when they started, and, ultimately, basing a strategy purely on currencies is a mug's game, given how unpredictable they are.

The best reasons for seeking exposure to any asset are (under)valuation and its potential to generate long-term total returns that more than compensate for the risk of holding it. Any currency tailwind is a bonus and no more.

Russ Mould, investment director, AJ Bell

STERLING HAS YET TO RECOVER THE GROUND LOST IN 2016



Source: Thomson Reuters Datastream

FTSE ALL-SHARE PERFORMANCE PRIOR TO AND POST PREVIOUS STERLING CRISIS

		BEFORE			AFTER		
		12 months	6 months	3 months	3 months	6 months	12 months
19-Nov-67	Sterling devalued	39.0%	20.6%	18.1%	1.8%	15.6%	31.7%
28-Sep-76	UK calls in IMF	(5.2%)	(16.2%)	(8.8%)	4.9%	23.2%	59.2%
16-Sep-92	Sterling exits ERM	(11.6%)	(6.2%)	(11.7%)	16.8%	27.7%	33.9%
23-Jun-16	EU referendum vote	(7.6%)	2.2%	1.0%	9.5%	11.5%	18.6%

Source: Thomson Reuters Datastream

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Simon Gergel, Fund Manager – The Merchants Trust PLC

Tony Foster, Senior Investment Manager – Aberdeen Diversified Income & Growth Trust PLC

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New inheritance tax break could save you £140,000 – but how does it work?

We explain how to make the most of a new tax break and avoid being caught out by some tricky conditions

A new Government tax break launched last year will ultimately mean that each couple can leave a £1m property in their estate entirely inheritance tax free. However, the rules around how the new tax-free allowance works are tricky, and homeowners could be caught out.

We explain how the tax break works, and how not to fall foul of the rules.

WHAT'S THIS NEW INHERITANCE TAX BREAK?

Currently everyone can leave £325,000 of assets when they die without having to pay any inheritance tax. Anything above this amount is subject to 40% tax.

The 'residence nil rate band', otherwise known as the family home allowance, is in addition to this allowance and came into effect in April 2017.

In the 2017/18 tax year it gave an extra £100,000 allowance, but this increases by £25,000 every year until 2020. This means for the current year it is worth £125,000, rising to £150,000 next April, and £175,000 the year after.

Per couple, this means you can ultimately save £140,000 in inheritance tax by using the new allowance.

WHEN DOES IT APPLY?

You only get the new allowance if you're leaving your home as part of your estate. This property must be a home that you lived in at some time, rather than a buy-to-let property.

If you own more than one home that you've lived in, the executor of your estate can pick which to use for the purposes of the family home allowance; it doesn't have to be the one you've spent more time in.

One snag is that to be eligible your home must be left to your direct descendants, which the taxman classifies as your children, grandchildren, step-children, step-grandchildren or adopted children. However, the taxman has made it so that if your son or daughter inherit

> "One snag is that to be eligible your home must be left to your direct descendants, which the taxman classifies as your children, grandchildren, step-children, step-grandchildren or adopted children"

your estate along with their spouse, your estate can still claim the allowance.

If you have no children then you can't make use of the allowance. For example, if you leave the property to your nieces or nephews, or siblings, you won't get the family home allowance.

You also do not get the full tax break if your estate is worth £2m or more. For every £2 your estate is above this £2m limit, you lose £1 of the allowance. This means that in the current tax year, when the allowance is £150,000, you lose the entire thing if your estate is valued at £2.3m or more.

Anyone who has used trusts to leave their assets should recheck them too. If a property has been left to children or grandchildren using a discretionary trust, the estate will not benefit from the allowance, as the trust is the beneficiary, rather than the offspring.

CAN I TRANSFER IT TO MY SPOUSE?

The original £325,000 nil rate band can be transferred between spouses or civil partners. This

> **The original £325,000 nil rate band can be transferred between spouses or civil partners**

means that when one half of the couple dies they can leave their estate to their husband or wife. When their partner dies their estate will not have to pay inheritance tax on £650,000 worth of assets.

The family home allowance works in the same way, meaning your partner's estate can make use of your allowance. This is also the case if your spouse died before the family home allowance was introduced – your estate can still benefit from their unused allowance.

As HMRC says: 'This can also be done if the first of the couple died before 6 April 2017, even though the additional threshold wasn't available at that time.'

WHAT IF I DOWNSIZE MY PROPERTY LATER IN LIFE?

This is where the rules get a bit tricky. You don't actually have to own a property when you die to still benefit from the family home allowance.

If you have downsized to a smaller, and cheaper, property, or if you have sold your property to move into care or rented accommodation, your estate can still benefit from the extra tax break. In this situation individuals get an 'inheritance tax credit'. This means they get the tax

> **You don't actually have to own a property when you die to still benefit from the family home allowance**

break equivalent to the value of their original home.

There are certain restrictions. You must have sold the property after 8 July 2015, and then calculate what percentage of the family home allowance your estate would have claimed had you still been resident there at the time of your death. This allowance can then be used on death.

You also must leave both the lower-value property you moved to, if downsizing, and any remaining proceeds from the sale of the house to direct descendants.

Laura Suter,
personal finance analyst, AJ Bell

Should you stick with your auto-enrolment default fund?

New research finds a large variation in performance

Keeping track of your financial affairs is no easy task. Many savers will have their money scattered about in various different products, from ISAs to SIPPs and perhaps a Lifetime ISA or Help to Buy ISA too.

Those looking to the future could even have a Junior ISA or SIPP set up for their children or grandchildren. And that's alongside the management of day-to-day finances like bills and mortgage repayments.

As such, it should probably come as no surprise that many savers have absolutely no idea where their pension is invested.

In fact, according to a recent survey a third of people who have recently entered drawdown don't know where their hard-earned fund is.

Given this is exactly the point individuals should be engaging with their pension, it's likely far fewer people take any notice of their investments when they are building up a retirement nest egg – often referred to as the 'accumulation' phase.

As automatic enrolment is built on apathy – with savers put into a pension scheme by their employer unless they choose to opt-out – you would expect even more people not to bother checking where their money is going or how the fund in which they're invested is performing.

However, savers who stick their head in the sand risk missing out and could end up losing out in retirement.

RETIREMENT LOTTERY

A report by Corporate Adviser Intelligence, an adviser publication, analyses the performance of almost 50 auto-enrolment 'default' funds. These are the investment funds into which you are automatically placed if you make no active decision about how your workplace pension pot is invested.

Because these funds need to cater for all manner of employees of different ages, earning varying salaries and with different appetites for risk, they are by nature a compromise unlikely to fit with your specific retirement goals.

Furthermore, the workplace pension scheme you get for auto-enrolment is chosen by your employer rather than you. And on top of that, each scheme takes a different approach to investing in its default fund with different charges and different outcomes at retirement.

As a result, those who do nothing leave themselves exposed to a retirement lottery based on the performance of a scheme they have never actually chosen.

HOW DID THE DEFAULT FUNDS PERFORM?

The variation in outcomes uncovered by the Corporate Adviser Intelligence research is stark.

The average default fund delivered an annualised return of 8.5% during the 'growth phase' – that is when an investor is a long way from drawing an income from their pension and so generally more able to absorb investment risk.

Investors five years from state retirement age saw average annualised returns of 7.24%. The fact this figure is lower is unsurprising given default funds usually swap equity exposure for lower risk investments and cash to reduce volatility as people reach a point where they are more likely to start taking an income from their pot.

It should be noted that the analysis does not account for charges due to the wide variation among schemes. While there is a charge cap of 0.75% in place, different defaults comply with this in different ways.

NEST, the pension scheme set up by the Government, levies a 0.3% annual management charge (AMC) alongside a 1.8% charge on each contribution you pay, for example.

Now: Pensions, on the other hand, charges a 0.3% AMC and a £1.50 monthly 'administration' fee. Other schemes cover all costs through a single percentage charge.

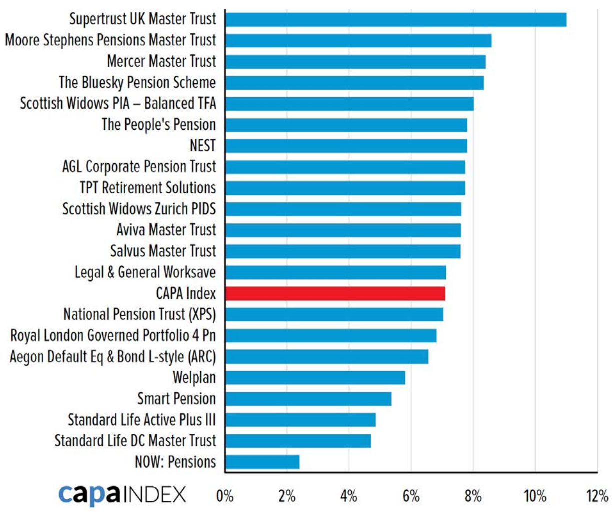
DIGGING DEEPER INTO THE NUMBERS

While the average returns might sound acceptable – and have clearly benefited from the post-crisis market bull run – they mask a large variation in performance.

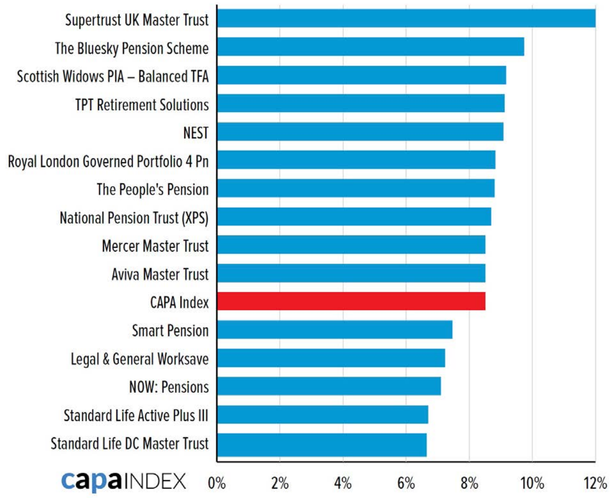
There is a 30% variation between the best and worst performers over a five year period, according to the research.

Asset allocation also varies widely, with equity exposure in the growth phase ranging from 37% to 100%.

30 YEARS TO RETIREMENT – AVERAGE ANNUALISED RETURNS (3 YEAR)



5 YEARS TO RETIREMENT – AVERAGE ANNUALISED RETURNS (5 YEAR)



LESSONS FOR RETIREMENT INVESTORS

The performance of default funds should be of interest to anyone in employment. But it's clear from this research that the outcome you get if you don't make an active choice could vary wildly depending on the approach of the scheme your employer has picked.

Unfortunately most employers will only give you the choice of a single pension scheme, and you can't direct your matched employer contribution through auto-enrolment to a pension of your choosing.

However, the scheme your employer chooses will usually give you the chance to move away from the default if you aren't happy with the way your money is being invested.

You should also remember that while auto-enrolment represents a good start, it's likely you'll need to save over and above the 8% minimum total contribution level that will be in place by April next year.

Any savings you make above this level can go into a scheme of your choosing – including a SIPP – meaning you'll be able to choose from a wider choice of investments.

Tom Selby, senior analyst, AJ Bell

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KEY

- Main Market
- AIM
- Fund
- Investment Trust

KEY ANNOUNCEMENTS OVER THE NEXT SEVEN DAYS

HALF YEAR RESULTS:

24 Jul: Drax, Hammerson. **25 Jul:** GlaxoSmithKline, Croda, ITV. **26 Jul:** Anglo American, AztraZeneca, British American Tobacco, Howden Joinery, Royal Dutch Shell, RELX, Smith & Nephew

FULL YEAR RESULTS:

24 Jul: IG. **26 Jul:** Diageo, Renishaw, Sky

TRADING UPDATES:

25 Jul: Vodafone. **26 Jul:** Johnson Matthey

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.

WHO WE ARE

EDITOR: Daniel Coatsworth @SharesMagDan

DEPUTY EDITOR: Tom Sieber @SharesMagTom

NEWS EDITOR: Steven Frazer @SharesMagSteve

FUNDS AND INVESTMENT TRUSTS EDITOR: James Crux @SharesMagJames

REPORTER: David Stevenson @SharesMagDavid

REPORTER: Lisa-Marie Janes @SharesMagLisaMJ

CONTRIBUTORS Holly Black, Russ Mould, Tom Selby, Laura Suter

MANAGING DIRECTOR Mike Boydell

ADVERTISING
Senior Sales Executive
Nick Frankland
020 7378 4592
nick.frankland@sharesmagazine.co.uk

CONTACT US:
support@sharesmagazine.co.uk

PRODUCTION
Head of Design: Rebecca Bodi
Designer: Darren Rapley

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