STOCKS FUNDS INVESTMENT TRUSTS PENSIONS AND SAVINGS

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SHARES

WE MAKE INVESTING EASIER

BREXIT

6 MONTHS UNTIL D-DAY

HOW COULD A NO-DEAL IMPACT INVESTORS?

SECOND WORST SEPTEMBER FOR US TECH STOCKS IN 10 YEARS

IS IT TIME FOR WHITBREAD TO SELL PREMIER INN?

THE INVESTMENT TRUST PAYING TWICE AS MUCH AS CASH SAVINGS

CREATE YOUR OWN SIMPLE SHARE PRICE TARGET

Are you brave enough to sell an investment when circumstances change?

It is a good discipline to continuously reappraise your holdings

One of the best investing skills is the ability to weigh up the evidence in hand and not be swayed by preconceptions or be so emotionally attached that you fail to recognise deterioration in the investment case.

Not being obsessed with a specific stock can often help you make an important decision to sell if circumstances have changed.

You should never be embarrassed about putting your hand up and admitting defeat with a losing trade. Recognising that something has gone wrong could help you make more considered investment decisions in the future. It also shows you are willing to move on and not sit tight praying for a recovery.

Even making the decision to exit a profitable trade shows you have given thought to an investment's situation, hopefully examining the facts in hand and considering the potential upside or downside in the future.

Challenging yourself and asking why you should continue to hold something is as important as questioning why should make a new investment in the first place.

With this thought process in mind, I am always interested to discover why fund managers decide to sell certain stocks. Fortunately many managers are open about their actions, and so they should be.

They are being paid by investors to manage money and should therefore be transparent with their actions and thought process. After all, would you trust someone if they didn't explain what they were doing with your money?

For example, Keith Ashworth-Lord, fund manager of **CFP SDL UK Buffettology Fund (BF0LDZ3)** has been fairly frank with his decision to dump **Domino's Pizza (DOM)**. The position was exited after Domino's disappointed with recent like-for-like sales, even though the World Cup should have given it a trading boost.

'I have been getting increasingly wary of this business recently,' he says. 'Domino's is becoming more capital intensive, cash conversion has started to tail off and debt levels increase. I have doubts about the international expansion and lastly the CEO has gone through three finance directors in four years. We therefore sold the entire holding.'

Other examples of getting out when circumstances have changed include **Mid-Wynd International Investment Trust (MWY)** fund manager Alex Illingworth selling his position in Chinese tech giant Tencent. The Chinese government has recently labelled one of Tencent's games as 'poison' and blocked the sale of another of its games.

'Analyst growth rates, to our mind, had not readjusted down enough and we were concerned that this heightened regulation was likely to stymie the growth rate for a while,' explains Illingworth.

Leigh Himsworth sold his position in **Sainsbury's (SBRY)** earlier this year from **Fidelity UK Opportunities Fund (BH7HNZ8)** as he was worried about management being distracted for a potentially long time while a tie-up with Asda was scrutinised by the competition authorities.

Having the discipline to weigh up positive and negative factors with existing investments should hopefully lead to better portfolio decisions. If you can only see positive factors, ask a fellow investor if they can see any negatives so you can help form a more balanced view. Having someone challenge your views can be refreshing and potentially make you see investments in a different light. (DC)

It pays to revisit the classics.

LET'S TALK HOW.

FIDELITY EUROPEAN VALUES PLC

Fads come and go and we all have a favourite one-hit wonder, but more often than not, we turn back to the classics.

Europe is home to some of the world's classic companies – genuinely dynamic and well-resourced multinational household names. While new businesses can hit the heights but fall away, these companies are famed for standing the test of time, even through periods of economic uncertainty. It's these qualities we seek out for our European Values investment trust.

PAST PERFORMANCE

	Jul 13 – Jul 14	Jul 14 – Jul 15	Jul 15 – Jul 16	Jul 16 – Jul 17	Jul 17 – Jul 18
Fidelity European Values PLC Net Asset Value	**1.0%**	**15.2%**	**9.4%**	**19.6%**	**12.6%**
Fidelity European Values PLC Share Price	**1.3%**	**24.4%**	**-0.7%**	**29.0%**	**8.4%**
FTSE World Europe ex-UK Index	**4.1%**	**9.6%**	**7.1%**	**24.6%**	**5.8%**

Past performance is not a reliable indicator of future returns.
Source: Morningstar as at 31.07.2018, bid-bid, net income reinvested. ©2018 Morningstar Inc. All rights reserved. The comparative index of the Investment Trust is FTSE World Europe ex-UK Index.

Using Fidelity's extensive European research team, manager Sam Morse aims to select well-established European companies with proven business models, attractive valuations and the ability to grow dividends both now and in the future.

So, if you're looking for steady growth from some of the world's best-financed companies, renew your interest in the European classics with Fidelity European Values PLC.

Past performance is not a reliable indicator of future returns. The value of investments can go down as well as up and you may not get back the amount you invested. Overseas investments are subject to currency fluctuations. The shares in the investment trust are listed on the London Stock Exchange and their price is affected by supply and demand. The investment trust can gain additional exposure to the market, known as gearing, potentially increasing volatility.

To find out more, go to fidelity.co.uk/classics or speak to your adviser.

Fidelity™ INTERNATIONAL

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Second worst September start for US tech stocks in 10 years

The Nasdaq index is struggling amid political intervention and profit taking

As we write the US technology-heavy Nasdaq index is enduring its second worst September start since 2008. Only 2011 had a worse showing.

A decade ago makes for a notable point of comparison given that on 15 September 2008 investment bank Lehman Brothers collapsed.

With more than $639bn worth of its assets it was the largest bankruptcy in US corporate history and arguably represented the zenith of the financial crisis.

No-one is suggesting we are heading for anything similar in 2018 but given the technology sector has been a big driver in the bull market of recent years it is worth looking at what lies behind Nasdaq's recent weakness.

It could simply be a bit of natural profit taking. In the last five years alone, the index has more than doubled in value as the so-called FAANG stocks (Facebook, Amazon, Apple, Netflix and Google (Alphabet)) have soared.

Simmering away in the background is an ongoing effort by US lawmakers to scrutinise foreign attempts to use social media to influence the outcome of elections. Executives from Facebook and Twitter both appeared before Senators although Google-owner Alphabet failed to show.

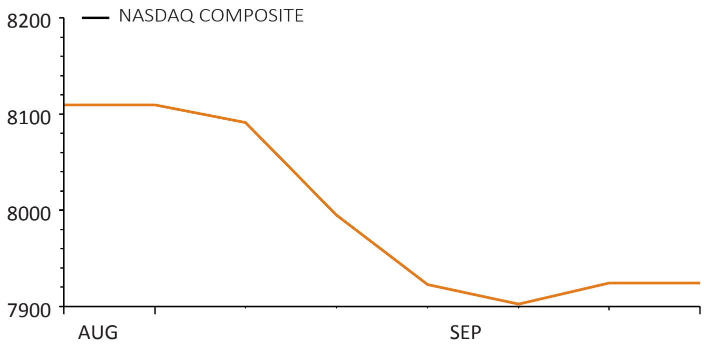
The index weakness could also reflect the latest intervention by President Donald Trump. He tweeted on 8 September that if Apple wanted to avoid tariffs on Chinese goods it should manufacture its products in the US.

Bank of America Merrill Lynch estimates Apple would have to increase the price of the iPhone by 20% to offset the implied increase in labour costs if it were to take Trump up on his advice.

UK investment trusts with exposure to the FAANGs have been hit by the tech sell-off. Since the start of September **Scottish Mortgage Investment Trust (SMT)** is down 5.5% and **Polar Capital Technology Trust (PCT)** is down 3.9%. (TS)

TOP 10 SECURITIES BY WEIGHT	
Apple	7.98%
Amazon	7.23%
Microsoft	6.64%
Facebook	4.09%
Alphabet Class C	3.41%
Alphabet Class A	2.98%
Intel	2.03%
Cisco Systems	1.77%
Netflix	1.49%
Pepsico	1.35%

Source: Nasdaq



NASDAQ IN A NUTSHELL

Founded in 1971, Nasdaq is the second largest stock exchange in the world by total market capitalisation behind the New York Stock Exchange. Attracting growth companies like Microsoft and Apple since the 1980s, it is now significantly weighted towards the technology sector.

Is this the beginning of the end for Whitbread?

One analyst argues Premier Inn should not be a standalone company

Speculation has been brewing over what will happen to **Whitbread (WTB)** following the agreed sale of Costa Coffee to Coca-Cola for £3.9bn.

Coca-Cola is buying Costa to develop the coffee chain and make cold-brew and ready-to-drink coffee products under a strong global brand.

Canaccord Genuity analyst Nigel Parson believes this potentially signals 'the beginning of the end' for Whitbread, claiming its other core brand, hotel chain Premier Inn, should not exist in isolation and should be taken over by rivals.

Parson argues competitors such as Holiday Inn-owner **InterContinental Hotels (IHG)**, Marriott and Accor could work with a property investor to split the property from its operations.

Without Costa, Whitbread would own Premier Inn, along with pub and restaurant chains Brewers Fayre, Beefeater, Bar + Block, Table Table, and in-house restaurant Thyme.

Whitbread is expected to use the proceeds from selling Costa to return cash to shareholders, cut debt and boost the pension fund.

Nigel Parson claims that Premier Inn should be taken over by rivals

Numis analyst Tim Barratt notes Premier Inn is gaining positive momentum with trading improving in London.

'We expect the potential for further corporate activity to underpin a premium valuation for the hotel business,' comments Barratt. (LMJ)

Are UK markets finally ready to shed their Brexit discount?

State Street study is encouraging but UK is still weak versus other global markets

A THIRD QUARTER 2018 survey shows 21% of institutions are thinking about increasing stakes in UK assets, up from 13% in the second quarter, according to State Street. The equivalent figure was 16% for the third quarter of 2017, suggesting investors in increasing numbers are willing to bat back Brexit worries.

However, this still implies barely a fifth of institutions are confident enough in UK economic prospects to increase exposure.

'The story of Brexit so far is that fears of economic disruption and capital flight have been unfounded and investors have been willing to give the UK the benefit the doubt,' says Michael Metcalfe, head of global macro strategy at State Street Global Markets.

The UK's FTSE All Share index has underperformed several leading global indices this year, including both the S&P 500 and the MSCI World Index. (SF)

Will Unilever exit the FTSE 100?

Consumer goods giant details plans for cancelling dual-share structure and moving HQ

Consumer goods giant and current FTSE 100 constituent **Unilever (ULVR)** is poised for a crucial shareholder vote on moving its headquarters to the Netherlands.

On 11 September the company published the full details of a plan to scrap its dual UK-Dutch stock market listing and make the move to Rotterdam, having first outlined the proposals in March.

The timing of the move has seen many observers link it to Brexit although Unilever itself argues it is a long-needed simplification of its corporate structure.

Assuming the plans are approved at meetings on 25 October and 26 October then the new shares will commence trading on Christmas Eve. It will have to receive 50% approval from its Dutch shareholders and 75% approval from its UK shareholders.

Many institutional investors have complained about the move as they will be forced to sell their Unilever shares as the company is widely expected to lose its place in the FTSE index.

Could we see the owner of Marmite move its headquarters to the Netherlands?

In its prospectus for the new shares Unilever concedes it is 'extremely unlikely' they will be allowed to remain in the FTSE.

At present the company is the third largest by market cap on the UK's index of leading shares.

Index operator FTSE Russell responded to the publication of the prospectus by saying the new format Unilever shares would not be eligible for the FTSE 100. (TS)

Investors braced for potential dilutive equity fundraise from Sirius Minerals

Miner needs to find a solution to a large funding shortfall

INVESTORS ARE very worried about the price at which **Sirius Minerals (SXX)** could issue new shares to address a funding shortfall for its polyhalite mine development in Yorkshire.

Nearly a fifth of the company's market value has been wiped off in the past week after the FTSE 250 miner updated on its capital requirements.

Sirius says it now needs an additional $400m to $600m which is mainly connected to higher costs from its transport system tunnel. It can either get the money by issuing new stock to investors and/or a new strategic partner. Or it can turn to debt or a third party to finance any cost overruns.

The market now appears to anticipate a share-based fundraising around the 26p level, being the point at which the share price has settled following last week's shock decline.

Coinciding with the funding shortfall is news that the target for financial close of its $3bn stage 2 financing has been pushed back from December this year to the first quarter of 2019.

We flagged risks to the investment case in our July *Under The Bonnet* article on Sirius, saying that investors must recognise that securing financing would not be straightforward – and that is clearly proving to be the case. (DC)

Share price decline implies Debenhams is at death's door

Will the fading retailer survive to see Christmas?

Ailing department store **Debenhams' (DEB)** shares plunged to fresh lows on media reports it had called in accountant KPMG to consider its options, as the chill wind blowing through the high street threatens to claim another victim.

The fear is the decision to bring in KPMG is a prelude to a company voluntary arrangement (CVA) or perhaps worse.

Debenhams' response (10 Sep) failed to address investors' key concern.

Chairman Ian Cheshire says: 'The board continues to work with its advisers on longer term options, which include strengthening our balance sheet and reviewing non-core assets. This activity is in order to maximise value for shareholders and protect other stakeholders, including our employees.'

Structurally-challenged Debenhams has issued a series of profit warnings amid rising costs, squeezed disposable incomes, heavy discounting and changing shopping habits, while rival House of Fraser lurched into administration over the summer.

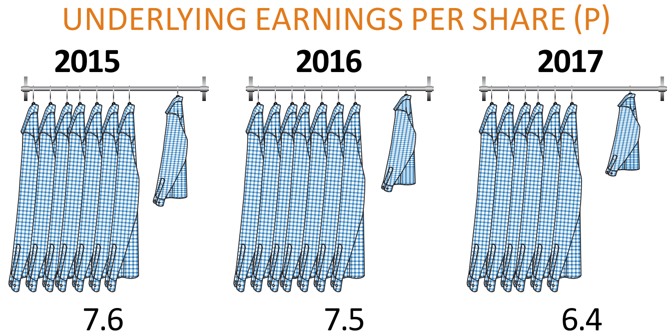
The latter was acquired by Mike Ashley's **Sports Direct (SPD)**, whose near-30% Debenhams stake implies the possibility of a corporate tie-up; combining House of Fraser and Debenhams would cut costs and create the opportunity to rethink the merged entity's strategic direction.

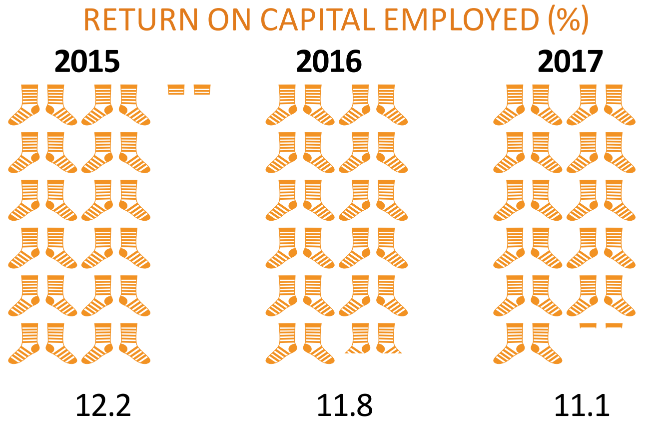
Debenhams now expects to report pre-tax profit before one-off items for full year 2018 of around £33m, within the range of the £31m-to-£36.5m company-compiled consensus, yet in fact a downgrade on the £35m-to-£40m guidance provided by the retailer in June.

With the early weeks of the new season having shown more positive trends, Debenhams believes 'any sustained upturn would result in a rebound in our profit performance' and CEO Sergio Bucher insists 'the product and format improvements we have tested are gaining traction and we are ready to scale up some of our strategic activity.'

Yet Patrick O'Brien, UK retail research director at GlobalData, is scathing: 'While it would seem too early to try to foist a CVA on landlords who are already seething at what they deem to be an inherently unfair process being abused by retailers, Debenhams appears to be softening them up for some form of negotiation.

'Debenhams may still be profitable and has the possibility of bringing in £200m-plus from the sale of Magasin du Nord, but its long term performance is still going to be under huge pressure, and with it carrying £4.6bn of lease commitments, both it and its landlords know that these will need to be addressed soon unless there is a marked upturn in the fortunes of the UK high street.' (JC)





Source: Shares, Debenhams' annual report & accounts 2017

Bargain hunting in the investment trust sector

Seeking embedded value in alternative areas

Over the past 3 years, Miton Global Opportunities (MIGO) has returned 78% by exploiting inefficiencies in the closed-ended sector. Looking forward, we are continuing to see structural shifts throwing up interesting and exciting opportunities, where we are able to buy £1 worth of assets on occasions for as little as 70p. Closed-ended funds (generically known as Investment Trusts) are bought and sold on the stock market. This means that the price that an investor pays can differ dramatically from the value of the underlying assets, often at a discount.

Discrete Performance

	30/06/2017 to 30/06/2018	30/06/2016 to 30/06/2017	30/06/2015 to 30/06/2016	30/06/2014 to 30/06/2015	30/06/2013 to 30/06/2014
Miton Global Opportunities Plc	14.4%	49.6%	4.2%	3.7%	10.4%
IT Flexible Investment Sector	3.4%	22.1%	2.5%	5.4%	3.4%

Past performance is not a guide to future returns. Source: FE Analytics as at 30/06/2018 Retail units in Sterling, net income reinvested, bid to bid basis.

Historically, the dominant traditional owners of investment trusts have been private client stockbrokers buying on behalf of their clients. The rapid consolidation of these broking firms into a handful of major wealth management chains has effectively removed the traditional buyer of many investment trusts. This is because it is difficult to acquire sufficient shares to complete orders given the vast assets these firms now manage. This evaporation of demand has created an ideal hunting ground for MIGO.

The nature of MIGO's portfolio dictates that returns have come in fits and starts. Sometimes there are significant moves once some of our investments are noticed by the wider world. At other times it feels like we are watching paint dry as our holdings remain below the radar. The portfolio has seen little movement in recent months. Nevertheless, value has been building and the seeds of our next run are in place.

The rise in both the US dollar and US interest rates has applied pressure on emerging market company shares and bonds[1]. Many investors trade this asset class as a block, therefore, they fail to differentiate between the fundamentals of specific markets. Should a retail investor watch a negative report on events in Turkey or Argentina, they are most likely to sell a generic emerging markets exchange-traded fund[2]. When they do this, they will also be dumping shares from countries that are at an interesting stage of their development, such as India and Vietnam, where we are seeing opportunities arise as these markets have declined.

Falling portfolio values combined with a widening discount is a powerful combination which quickly throws up value opportunities. We have been adding to our positions in Vietnam Opportunities Fund and India Capital Growth Fund. At the time of writing these trade on discounts to the share price[3] of 23% and 16% respectively. India Capital Growth Fund was trading on a 6% discount earlier this year highlighting how the share price has fallen much further than the underlying assets.

We believe that a significant proportion of market concerns are already priced into these investment trusts. Their potential is being overlooked. India has entered a period of structural change reducing the endemic bureaucracy and corruption which has blighted the economy. This process will benefit the formal sector allowing listed companies to take an ever-larger share of growth. This will enable Indian equities to generate much faster earnings growth than available in developed markets.

Vietnam is also at an exciting stage of its development. Like India, the demographics are very favourable in comparison to those in the West with 57% of the population under the age of 35. In the past few years, Vietnam has been moving from mainly state-owned enterprises to privately owned. The country has also positioned itself as an exporter to neighbouring countries such as China, triggering strong economic growth which we anticipate continuing in the coming years.

We have also added to Phoenix Spree Deutschland and Macau Property Opportunities Fund. We remain extremely bullish about the outlook for residential property in Berlin. Apartments remain cheap in comparison to most major European cities and the population of Germany's capital continues to grow at a time when new supply is muted. Macau Property Opportunities trades on a significant discount despite the trust entering its realisation phase where the assets are being sold and cash being handed back to shareholders. The imminent opening of the Hong Kong to Macau bridge will stimulate the local economy driving property prices higher creating a perfect sellers' market.

We have also bought Stenprop, which moved to London in June. Prior to obtaining its London listing its shares could still be bought in Johannesburg at a 20% discount despite offering an attractive yield[4]. It is refocusing its portfolio on UK mixed light industrial properties which are located in unfashionable locations such as Mytholmroyd and Huddersfield. Supply is contracting as urban sites are converted to housing whilst demand increases. A greater proportion of business is being conducted over the internet, which has removed the requirement for many businesses to locate so many of their operations close to their customers, allowing them to rent cheaper provincial space.

The diverse nature of the underlying investments means that MIGO is little correlated to wider markets. We find good assets trading at a discount where we see a catalyst for the value to be realised. Over the past six months we have been uncovering and adding to trusts where conditions are ripe for a narrowing of the discount to occur. We will now wait to unlock the hidden value.

RISKS

Forecasts are not reliable indicators of future returns.

The value of investments can fall as well as rise and investors may not get back the full amount invested.

Currency exchange rate fluctuations may, when not hedged, cause the value of your investments to increase or decrease.

Miton Global Opportunities plc may borrow money which can then be used to make further investments (gearing). In a rising market, this 'gearing' can magnify the gains or losses on your investment.

DEFINITIONS

[1]**Bond** – A loan in the form of a security, either issued by a UK or overseas government (government bonds) or company (corporate bonds), which pays a fixed rate of interest over a given time period, at the end of which the initial amount borrowed is repaid.

[2]**Exchange Traded Fund (ETF)** – An exchange traded fund is a fund that tracks an index, a commodity or a basket of assets like an index fund. Most ETFs track an index, such as the FTSE All-Share.

[3]**Discount/premium to share price** – The discount/premium to share price is the difference between the share price and the underlying value of an investment trust.

[4]**Yield** – The income return on an investment. Fund yields are a measure of income earned by the fund's portfolio, net of the fund's expenses.

Shares in gigantic payments group Worldpay are cheap versus its growth prospects

The benefits of its multi-billion dollar tie-up with Vantiv are now starting to be realised

We think the earnings potential for payment processing firm **Worldpay (WPY)** is not being fully recognised by the market and reckon now is a good time to buy the stock as it reaps the benefits from its $10bn combination with Vantiv in early 2018.

A trade-off from that deal was that the combined entity ended up having its main stock market listing in New York. Despite retaining an additional listing in London it no longer qualifies for the FTSE 100 index. That's no reason to ignore the stock as you can still freely buy and sell it on the London market.

WORLDPAY BUY
(WPY) £74.42
Stop loss: £59.54
Market value: £23.2bn

WHAT DOES IT DO?

Worldpay processes more than 40bn payment transactions a year across 146 countries and 126 currencies.

It makes money by collecting fees on these transactions. It also generates an income by advising customers on how to lower costs to credit issuers, card networks and other intermediaries, by settling these transactions in a currency of their choice as well as offering subscription-based data insights and fraud solutions.

As a leader in e-commerce payments, the company is well positioned to benefit from the continuing growth of online shopping across the globe.

UPGRADED GUIDANCE

Alongside first half results on 9 August Worldpay upgraded guidance on cost synergies from the Vantiv tie-up from $45m to $50m.

As well as the cost savings from aspects like combining back office functions, mergers and acquisitions can also deliver so-called revenue synergies from initiatives like cross-selling products and services.

For the first time Worldpay put a number on the latter, targeting $100m by 2020. This adds up to total synergies of $200m by this date.

Often when a company talks about the synergies from a big merger, they can feel quite intangible and there can be a suspicion the numbers have been massaged to help justify the money and time put into a big transaction.

However, there is solid logic behind the argument that

WORLDPAY FACTS AND FIGURES

	2018E	2019E	2020E
Earnings per share	3.99 cents	4.87 cents	6.07 cents
Operating margin	44.2%	47.8%	50%
Net debt	$7.48bn	$6.48bn	$5.39bn

Source: Berenberg

Worldpay and Vantiv make a good fit and reason to believe that, if anything, the targeted synergies are conservative. Indeed, investment bank Berenberg sees synergies of $280m by 2020.

HOW DO THE COMPANIES SIT TOGETHER?

Vantiv was the number one merchant acquirer in the US, specialising in the retail, restaurant, grocery and drug sectors, and business-to-business markets. Worldpay specialised in digital services, the travel sector and online retail, and was the number one merchant acquirer in the UK.

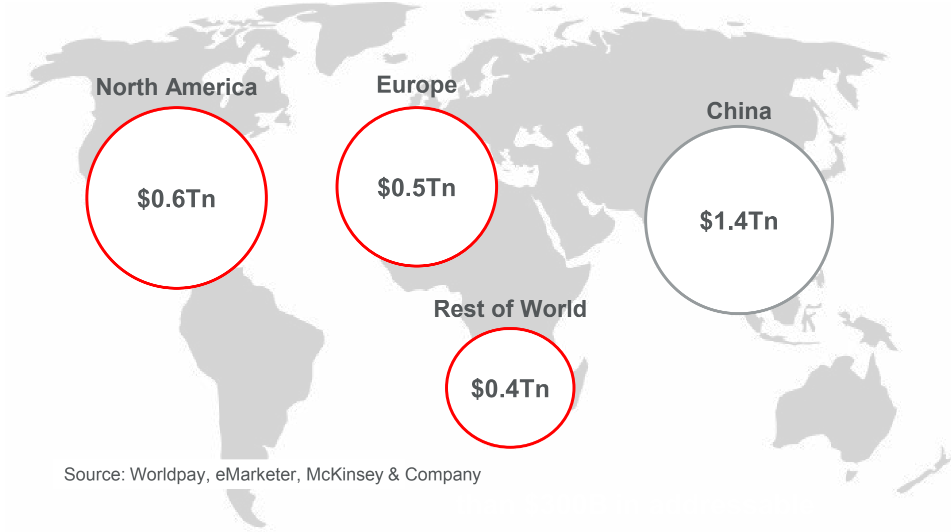
Neither of the two parties had much of a presence on the opposite side of the Atlantic, meaning little geographic crossover.

The enlarged business recently secured its first two joint cross-sell contract wins with 'large and well-known digital players', showing how combining forces has already led to financial success.

'E-commerce is a $3 trillion industry with volume growing mid-teens overall and 25% in cross-border e-commerce,' says Worldpay's chairman Charles Drucker. 'We are the largest player in global e-commerce, targeting the fastest-growing area of the market, including global brands and large digital natives. This allows us to grow faster than the market, even though we are already a leading player.

'As spending continues to move online, our opportunity continues to grow as the market adds approximately $300 billion

Global e-commerce payments is a $3Tr market, growing in mid-teens...

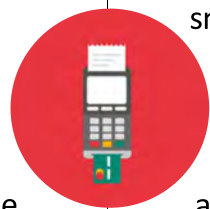


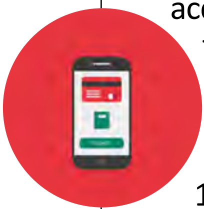
Source: Worldpay, eMarketer, McKinsey & Company

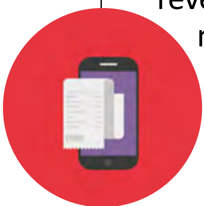
of new growth annually.'

A RISK TO CONSIDER

One issue to note is the UK Payment Systems Regulator's proposal to conduct a market review into the supply of card acquiring services. It wants to see if banks and payment specialists have taken advantage of a lack of competition to overcharge smaller businesses and prevent them from moving to alternative service providers.







Worldpay is among approximately 30 card-acquirers which dominate the UK market including Barclaycard and Lloyds Bank Cardnet. Worldpay's UK business contributes 15% of total company net revenue with its UK small-to-medium business acquiring portfolio contributing approximately 5% of total company net revenue.

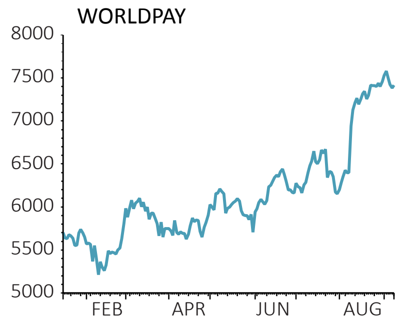
'We believe the merchant acquiring market is competitive as evidenced by recent new entrants and industry SMB churn rates averaging 15% to 25%,' insists Stephanie Ferris, Worldpay's chief financial officer.

'The PSR will likely conduct its market review in 2019 following a consultation period that ends in September of this year. Therefore, while it is impossible to predict the outcome of the review, we do not currently expect a near-term impact.'

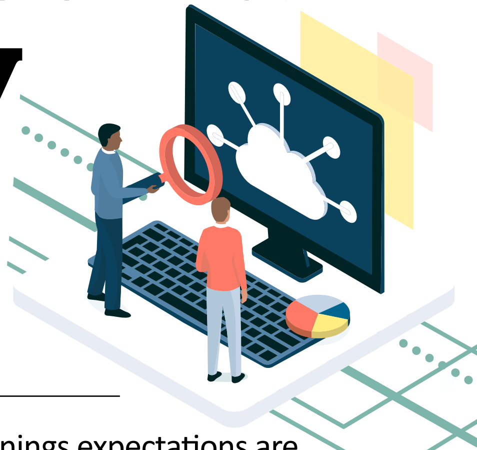
OUR VIEW ON THE INVESTMENT CASE

While that is certainly an issue to monitor, we remain bullish on Worldpay's investment case and certainly believe its shares are worth buying.

A price-to-earnings to growth or PEG ratio is a good way of valuing the business and Worldpay is very attractive on this basis. It trades on a 2019 PEG ratio of 0.9-times based on forecasts from Berenberg – a figure below 1.0 is considered good value. (TS)



Keep buying Sopheon as its share price rally has further to run



Expanding markets and more predictable revenue should take the stock higher

Some readers will remember the name **Sopheon (SPE:AIM)** since we have updated many times on our previous *Great Idea* from 2 June 2017 at 330p. We actually first flagged the company in August 2016 at 202p.

The shares have been on a rampant run, nudging above £10.00 twice this year. We still think there is very decent upside from current levels. Before we explain our reasons, it's first important to understand what Sopheon does.

The Surrey-based software company helps streamline the research and development process for clients and provides product lifecycle management tools. From early roots as a provider of process automation tools, it has emerged as an innovation management solution to complex manufacturers.

Sopheon has more than 60,000 users across 50-plus countries worldwide, featuring the likes of NASA, Merck and BASF. Its Accolade platform is used on innovation projects worth an estimated £25bn.

Analysts at stockbroker FinnCap calculate a fair value over the next year or so of roughly £13.00, and here's why we agree.

SOPHEON BUY
(SPE:AIM) 930p
Stop loss: 651p

Market value: £97m

EXPANDING AND MORE PREDICTABLE

Sopheon is successfully expanding beyond its traditional industrial engineering-type space. Areas like consumer goods, food and drink, and technology development are proving to be useful new growth areas, while the company is also closing watching insurance, automotive and other industries.

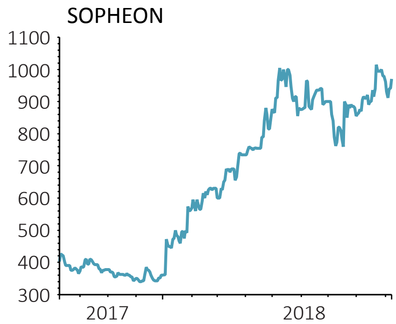
Bit by bit Sopheon's revenues are becoming more predictable. Half year to 30 June 2018 figures reveal recurring revenue grew to \$13.7m from \$10.5m a year earlier. Recurring revenue has roughly doubled in about three years.

Once you factor in contracted maintenance income from multi-year licences, \$27.2m of the current full year's \$31m forecast revenue is effectively in the bag, and that's before the typically busy fourth quarter for new licence sales.

FinnCap suggests current earnings expectations are pitched conservatively. That means there is ongoing potential for guidance upgrades, something the company has been able to do multiple times over the past few years.

Forecast \$0.432 earnings per share (EPS) this year will be less than the \$0.472 achieved in 2017 but not something to worry about. It goes back to the conversion last December of loan notes into equity, a one-off event that will not impact the financial performance beyond 2018. FinnCap's 2019 estimates call for EPS of \$0.537 on unbroken revenue growth to \$35m.

The business had \$15.5m net cash at the end of June this year (2017: \$6.6m), forecast to rise to \$21.4m by the end of 2019. It has also started paying dividends, although this year's prospective yield is very small at 0.3%. (SF)



MELROSE INDUSTRIES
(MRO) 216p

Loss to date: 1.1%

Original entry point:

Buy at 218.5p, 26 July 2018

PERHAPS THE MOST important point to be gleaned from **Melrose Industries' (MRO)** half year results is that 'no black holes' have been found to date under the bonnet of GKN, the £8.1bn aero and auto engineer that is management's next turnaround project.

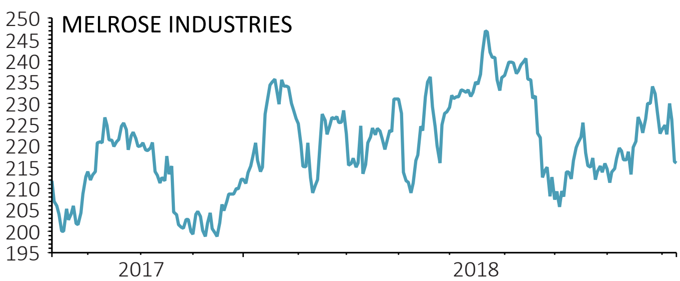
If nothing else, comments accompanying the numbers strongly suggest that Melrose has not bitten off more than it can chew with its largest acquisition ever.

Substantial bid costs and just a couple of months of business from GKN saw Melrose run up a statutory pre-tax loss of £303m in the six months to 30 June, versus a £48m pre-tax profit a year ago.

As we explained in the original article, Melrose is still in the process of selling parts of its Nortek business, which continues to perform patchily, and we wouldn't be surprised to see progress on this front before year-end.

But GKN is likely to dominate the agenda at Melrose for the next few years so having a better handle on the scope and scale of operational improvements and savings, and ultimately value extraction, remains a key share price catalyst.

Getting the GKN project right would be the ultimate endorsement of Melrose's buy, improve and sell model.



SHARES SAYS:

It is very early days with GKN and we remain firmly behind the Melrose investment story. (SF)

TEAM17
(TM17:AIM) 230p

Loss to date: 8%

Original entry point:

Buy at 250p, 5 July 2018

ALTHOUGH OUR 'BUY' call on video games outfit **Team17 (TM17:AIM)** is in the red, we're impressed by solid half year results (11 Sep) and the AIM newcomer's future earnings growth potential.

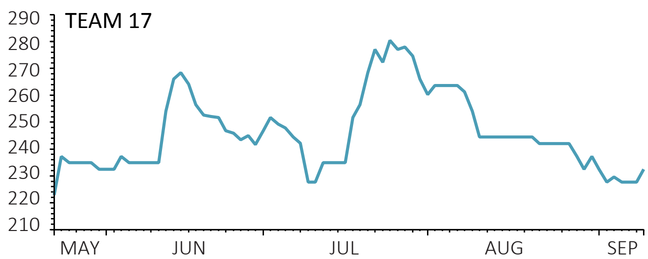
One of the longest-running independent video games companies, Debbie Bestwick-led Team17 develops its own games and helps independent creators bring their games to market; the focus is on premium rather than free-to-play games and Team17's winning portfolio includes *Overcooked* and the *Worms* franchise.

For the six months to June, revenue shot up 48% to £15.4m and adjusted EBITDA rose 36% to £4.9m, although taxable profits were lower after IPO-related costs.

As expected, the full year performance will be second-half weighted due to the usual games release schedule. Revenue growth is set to be driven by new product launches and continued growth from a strong back catalogue.

New franchises include *My Time at Portia*, the first game published by Team17 with a Chinese label partner, as well as *Yoku's Island Express*.

Gross margins will also improve in the second half driven by the revenue mix.



SHARES SAYS:

Given the momentum in Team17's chosen indie games market and a building cash position, we're keeping the faith at 230p. (JC)

JD SPORTS FASHION
(JD.) 490.9p

Gain to date: 8.8%
Original entry point:
Buy at 451.3p, 12 July 2018

OUR BULLISH SUMMER call on globally expanding **JD Sports Fashion (JD.)** is being rewarded with a rapid 8.8% gain.

And with the sports, fashion and outdoor brands purveyor firing on all cylinders, we're staying positive on the stock.

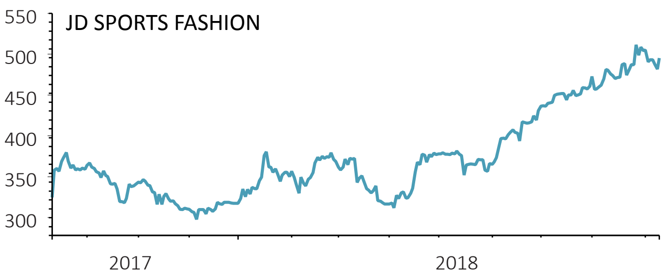
Riding the 'athleisure' boom among youthful gym-goers and fashion-conscious consumers, Peter Cowgill-led JD Sports continues to buck the wider high street doom and gloom and we're excited by the overseas potential of the core *JD* franchise.

Forecast-beating half year results (11 Sep) showed strong sales growth, a 19% rise in pre-tax profit to a record £121.9m and a very promising early showing from the US.

While like-for-like sales growth in UK stores was slightly negative, double digit online growth ensured a positive outcome overall, while in store like-for-like growth in Europe was positive.

The acquisition of US footwear seller Finish Line has given JD Sports a new growth platform across the pond.

For the year to January, broker Peel Hunt forecasts a jump in adjusted pre-tax profit from £307.4m to £345m.



SHARES SAYS:
We're really happy with the share price progress and highligh JD Sports' qualities and overseas growth potential. (JC)

IDEAGEN
(IDEA:AIM) 147.5p

Gain to date: 20.4%
Original entry point:
Buy at 122.5p, 17 May 2018

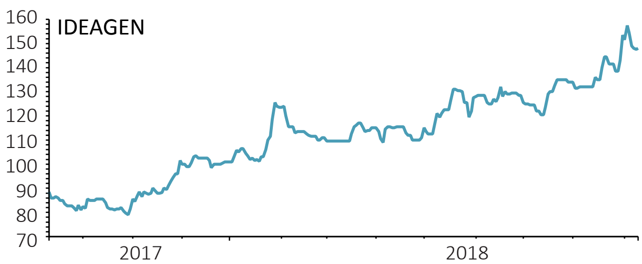
COMPLIANCE AND SAFETY rules software supplier **Ideagen (IDEA:AIM)** appears to be striking while the iron is hot, swooping on its second US acquisition in six months. This makes sense since North America represents one of the best, if not *the* best, growth market for it right now.

The $5m deal (plus up to $2m extra in deferred performance payments) of InspectionXpert bolsters its exposure in the aerospace industry, one of its core target markets. That roughly 95% of InspectionXpert's revenues are of a recurring nature underlines Ideagen's eye for an opportunity.

The news builds on very decent full year results announced in July showing acquisition-boosted pre-tax profits up 40% at £9.7m, and organic revenue growth of 11%.

Re-jigged forecasts now call for £11.4m of pre-tax profit this year to 30 April 2019, and £12.9m in the following 12 months, implying a 2020 price-to-earnings multiple of 27.2.

Disappointment-free execution of the business plan, to us, justifies this premium rating. And remember, management have their own 200p internal share price target, and we would not bet against such optimism.



SHARES SAYS:
A now largely proven quality business, investors should stick with the stock for further share price upside. (SF)

BREXIT

6 MONTHS TO D-DAY

HOW COULD A NO-DEAL IMPACT INVESTORS?

As the UK prepares to leave the EU on 29 March 2019 at 11pm, there are many questions left unanswered for investors, businesses and the general public.

Stock markets in recent months haven't been troubled too much by the Brexit negotiations as investors have had plenty of other distractions such as the US/China trade war and volatility in emerging markets. The situation may soon change given we're now six months away from the big day of separation.

The type of exit from the economic block is still unclear with political infighting dominating the agenda. And while it is impossible to predict the precise impact on investors' portfolios, it is worth understanding the different scenarios and how they may affect markets, economics and currencies.

A transition period is scheduled to begin on 29 March 2019, lasting to 31 December 2020, to let businesses and individuals prepare for the time when the new post-Brexit rules between the UK and EU begin.

Free movement will continue during the transition period and the UK can strike trade deals, although they won't be able to come into force until 1 January 2021. But failure to strike a withdrawal agreement by the deadline next March would scupper this transition period, hence why a 'no deal' outcome could spook the stock market.

UNDERSTANDING THE DIFFERENT SCENARIOS

SOFT BREXIT

This type of withdrawal from the EU should appease large swathes of the population who voted to remain and has been dubbed BRINO (Brexit in Name Only). In this scenario, the UK would remain part of the customs union in a similar fashion to Norway's model.

A customs union sees EU member states all charge the same import duties to countries outside the EU. Member states can trade freely with each other, without customs checks at borders. In contrast, a free trade area charges no tariffs, taxes or quotas on good and services moving within the area but members are free to strike their own external trade deals.

Both Prime Minister Theresa May and Labour leader Jeremy Corbyn have ruled out staying in a single market. May has also said the UK will not remain in the customs union as it prevents Britain negotiating free trade agreements with other countries. It would mean every single lorry going from the UK to the EU would face mandatory customs checks.

Mark Ward, head of trading at investment firm Sanlam, implies that a soft Brexit would limit a sharp drop in the stock market as it would essentially mean little change to the current system. However, after the Government released its white paper dubbed the Chequers Accord, the political mood has changed somewhat.

HARD BREXIT (WITH AGREEMENT ON GOODS AND SERVICES)

In this situation, the UK would no longer be a member of the single market or customs union. Instead, it would come to an agreement that maintains the flow of goods and services similar to Canada's Comprehensive Economic Trade Agreement with the EU.

This would still be disruptive as flows of goods would no longer be as free, causing supply chain disruption. In reality this would probably depress sterling's value and may soften the UK economy.

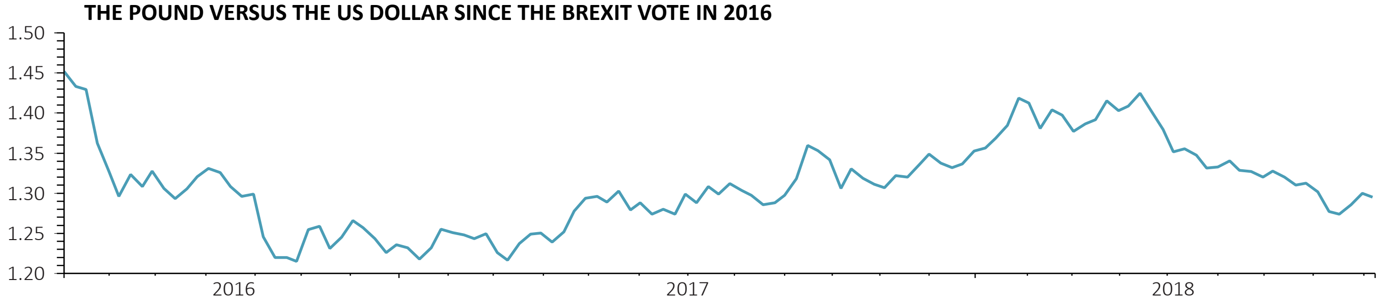
However, it would not be a disaster for equities and has been priced in to some extent. Paul Jackson, head of multi-asset research at Invesco Powershares, gives this outcome a 30% probability.

HARD BREXIT (WITH AGREEMENT ON GOODS ONLY)

In this situation, the UK would be able to trade with the EU in goods pretty much as now but not in services. The UK Government seems to think this would be a good outcome but the service industry would suffer which is bad as it accounts for about three quarters of the UK economy.

Sterling would more than likely suffer in this situation, possibly pushing the pound/dollar exchange rate down to $1.20 (versus $1.30 at

THE POUND VERSUS THE US DOLLAR SINCE THE BREXIT VOTE IN 2016



the time of writing) with the potential for a recession.

The services sector is very important, particularly as many companies which provide goods also provides associated services such as **Rolls-Royce (RR.)** which derives a large chunk of profit from engine maintenance.

The range of service companies is very broad and includes transport, communication firms, banks, hotels and restaurants. They are widely represented by well-known firms on the UK stock market, meaning any setback to the service industry as a whole could negatively impact investors.

NO DEAL

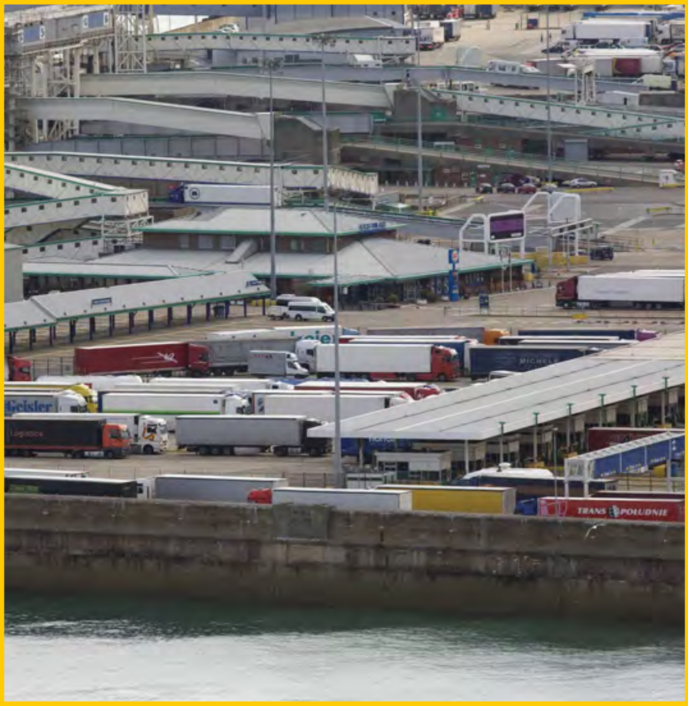
A no-deal result would mean the UK's relationship with the EU would be conducted via World Trade Organisation rules. Given the increase in tariffs, inflation would probably rise and a recession could happen as it would be more costly to trade goods with many overseas partners.

Growth could be boosted in the long term when new trade deals are struck although there are currently no concrete plans in place. Shares in UK domestic companies may suffer compared to global indices as sterling would most certainly tumble.

Philip Smeaton, chief investment officer at Sanlam, says since the Government released its Brexit white paper the market is certainly pricing in a no-deal outcome.

While this may seem a potential disaster, Smeaton comments: 'Even a "no deal" provides clarity and something you're working with and you know whatever happens afterwards will be an improvement.'

That's being optimistic. In reality the Government would have to rethink its spending plans which could have major repercussions. Various think-tank research papers have also suggested food prices could go up and we could see some shortages of goods, but this may only be a temporary phenomenon.

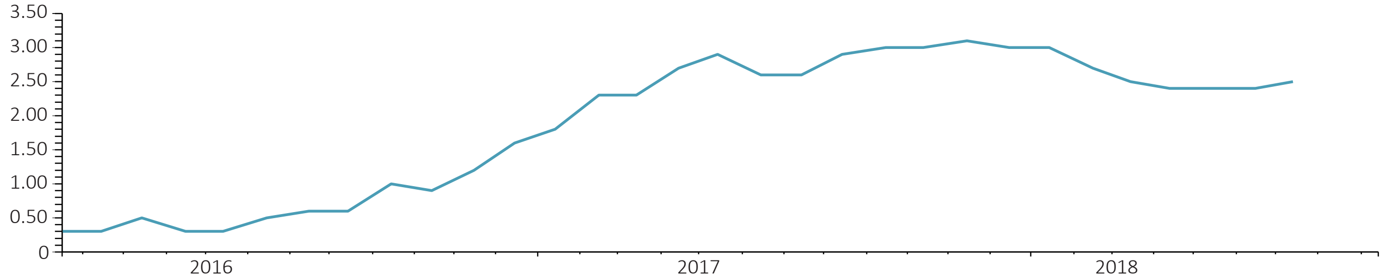


From an investment perspective, we believe the stock market could experience a short period of volatility upon a no-deal outcome which could prove to be a good time to go bargain hunting for stocks.

NO BREXIT (REMAIN IN THE EU)

We think a 'no Brexit' outcome is highly unlikely despite continued calls for a second referendum from various camps. These include GMB, one of Britain's biggest unions, and **Superdry (SDRY)** co-founder Julian Dunkerton who recently gave £1m to the People's Vote campaign for a referendum on the final Brexit deal.

UK CPI INFLATION ANNUAL PERCENTAGE CHANGE



OTHER POINTS TO CONSIDER

WHAT'S HAPPENED TO THE UK ECONOMY SINCE THE BREXIT VOTE?

The British economy has disappointed since the referendum vote two years ago as businesses have become more cautious with spending and consumers have battled with rising inflation.

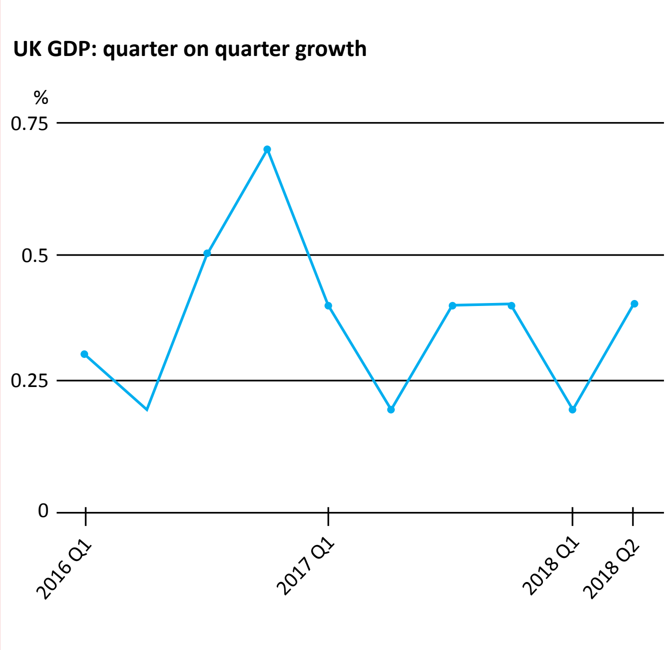
In 2017, the savings ratio — measuring the proportion of UK household income that is not spent — dropped to 4.1%, its lowest rate for more than 50 years.

Economic growth slowed in 2017 and started 2018 poorly due to snow disruption. Figures now show an improvement as the year progresses, helped by good weather over the summer. The latest figures show 0.6% growth for the three months to July.

Ultimately the UK economy has been sluggish but the performance hasn't been disastrous and unemployment rates are low.

Yet investment bank UBS believes UK GDP is already 2.1% lower than where it would have been without Brexit. 'Investment is 4% weaker, inflation 1.5% higher, consumption is 1.7% lower and the REER (real effective exchange rate) is 12% more depreciated,' it says.

'To put 2.1% cumulative decline in real growth in context, that's roughly a quarter to a third of the total Brexit costs estimated in the most pessimistic assessments done prior to the EU referendum (eg. HM Treasury, OECD) and almost



WHAT'S THE LATEST STATE OF PLAY?

Michael Barnier, the EU's chief negotiator, says an agreement on the terms of the UK's exit is possible by early November this year. The UK and EU are hoping to clarify the terms on their future economic co-operation in time for an EU summit in mid-October or by the end of the month. That would leave enough time to consider and vote on the proposals before next March's deadline.

equal to the full costs of some of the more optimistic assessments. But the UK has not even left the EU yet!

'Why is it going largely unnoticed? Because the global economy started to accelerate strongly right after the mid-16 referendum, allowing UK GDP growth to move sideways rather than dive lower,' explains UBS's economists. 'Without Brexit, however, we think UK GDP could have been 100 basis points per year higher.'

The key point to now consider is whether companies get even more jumpy as the Brexit deadline approaches. We believe it is plausible that companies could scale back employment and investment decisions unless there is firm progress with the talks between the UK and EU.

'The UK Treasury estimated that UK GDP might fall by 3.6% to 6% over two years in a 'cliff-edge' Brexit. This probably an underestimate – failing to account for the legal/regulatory basis for EU/UK trade suddenly being eliminated,' says Conall MacCoille, chief economist at stockbroker Davy. 'We illustrate a hard Brexit scenario where UK GDP falls by 4% in 2019 and 2% in 2020.'

MacCoille believes a cliff-edge Brexit is a low probability event. In July, UBS strategist

John Wraith says recent developments make a no-deal outcome more, not less, likely.

ISSUES FACING QUOTED COMPANIES

Tim Ward, chief executive of the Quoted Company Alliance (QCA), has been talking to small companies who are concerned with recruiting. Without the free movement of people, this limits the potential pool of talent available to UK nationals.

This is a key point of contention in the whole Brexit debate and yet again one that is unclear. However, Sajid Javid, home secretary, has said that free movement of people will end, with no automatic right for anyone from the EU to come to the UK and work. Others in Government have said the UK will offer work visas to EU nationals for UK employment.

Ward of the QCA says companies he's surveyed are finding it hard to retain and attract talent given the uncertainty surrounding the status of workers after 29 March 2019.

There are numerous sectors in the UK which employ large amounts of people, many of whom have come from abroad to seek work. For example, the construction, retail and services sectors could be significantly affected if this pool of workers shrinks.

From another perspective, many UK companies with large operations across multiple countries should be able to adapt to the Brexit landscape, particularly if they need to operate across the EU.

For example, **EasyJet (EZJ)** has been making preparations for a new base in Austria as airlines must have an air operator certificate in an EU member country to allow it to continue flying between member states after Brexit.

HSBC (HSBA) has shifted ownership of its Polish and Irish subsidiaries from its London-based entity to its French unit, and plans to do the same for seven more European branches, as it prepares for Brexit.

And asset manager **Ashmore (ASHM)** is setting up an office in Ireland to ensure continued access to EU-based institutional clients.

> **Small companies are concerned with recruiting. Without the free movement of people, this limits the potential pool of talent available to UK nationals**

CORPORATE SPENDING: WAITING FOR BREXIT CLARITY

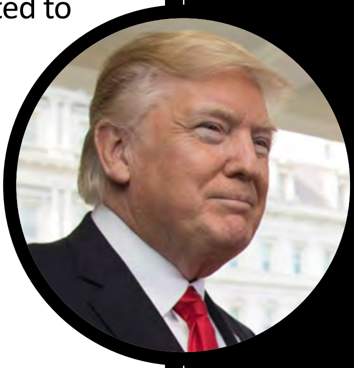
While some companies can make contingency plans, there is still plenty of evidence that businesses are delaying investment spending until there is clarity over how Brexit will play out. After all, why make a decision now when you can wait a short time and know what's going on?

Consultancy Vendigital says since the referendum vote in 2016, businesses have invested £22bn less than they would have done

based on pre-Brexit trends.

UK business investment grew at a mere 1.6% in 2017. And a survey of finance directors by Deloitte covering the second quarter of 2018 found that just 15% of UK CFOs expected to increase capital expenditure.

'The April 2018 pan-European Deloitte CFO survey revealed that UK CFOs are the most pessimistic and risk averse across 20 countries surveyed,' comments Conall MacCoille at stockbroker Davy.



Even the recent UK Government note to financial service firms warning them to prepare for a no-deal has not really quelled fears as much as was clearly intended.

Andrew Pilgrim, government financial services leader at accountant EY, comments: 'While this paper reiterates that the UK Government is doing all it can to maintain continuity in that scenario [no deal], there is a limit to what they can promise unilaterally. Whether there would be similar flexibility from the EU is likely to remain unclear for some time. Until then uncertainty remains the word of the moment.'

CHALLENGES AROUND THE WORLD... NOT JUST THE UK

It's a truism that one thing markets hate is uncertainty and given the transition period following Brexit it may be some time until we know the true lay of the land.

Invesco's Paul Jackson says: 'It has to be remembered that the UK has yet to leave the EU and has yet to agree on what terms it will do so. Hence, we expect a renewed build-up of uncertainty, which could eventually lead to a decline in investment spending and potentially recession.'

One thing is perhaps certain, in a global context Brexit may not rank as highly as those in Europe and especially Britain think.

US President Donald Trump's trade war rhetoric has being spooking the markets much more than the details of the manner in which the UK exits the EU. A trade war between the US and China has far more repercussions for the global economy than a member of an economic block leaving after its citizens voted to do so in a democratic process.

> **"A trade war between the US and China has far more repercussions for the global economy than a member of an economic block leaving after its citizens voted to do so in a democratic process"**

Mike Coop, head of multi asset portfolio management EMEA at Morningstar, says many UK investors are focused on Brexit but they forget that other areas of the world have uncertain macro issues.

'For example, there are trade policy concerns in the US; Continental Europe has its own challenges, such as dealing with fiscal policy and the immigration crisis; and China is managing a large debt cycle. You need to view Brexit in the broader context of what else is happening in the world.'

He concludes: 'There will be a material change in how the UK trades with Europe and the impact on profitability could be significant from Brexit, but less so than people think.'

The takeaway for investors is not to panic and try to second guess what will happen with Brexit. There is going to be a considerable amount of noise over the next six months and you shouldn't make knee-jerk reactions to your portfolio as events unfold with the Brexit negotiations.

Ultimately it is imperative you have a diversified portfolio which provides coverage to lots of different parts of the world and not heavily concentrated on the UK and only on a handful of companies.

Make sure you also have cash to hand should there be a sharp decline in the stock market in the run-up to the March 2019 Brexit deadline, so you can pick up bargains if there is a big share sell-off. (DS/DC)

What does a no-deal Brexit mean for your pensions and personal spending?

Important points to consider around credit cards, investments and online shopping

The Government has released the first of a tranche of papers outlining how different industries would be affected by a no-deal Brexit. They include details on how the financial services industry, covering banking, insurance and pensions, would change as a result of a 'no deal'.

Much of the information in the technical papers raised potential issues, but provided few solutions on how to overcome the problems raised, or in some cases how exactly the problems would occur. But using those papers, we've summarised the biggest issues facing your finances in the event of a no-deal Brexit.

HIGHER CARD CHARGES

If we left the European Union with no deal it's clear for two reasons that Brits would pay higher debit and credit card charges when they travelled abroad.

First, the UK would no longer be part of a central payment system used to process transactions in euros. This means that processing payments made by a British person, using their UK bank card while they are in Europe, would take longer and be more costly.

Second, a ban on so-called rip-off fees would no longer apply to UK customers. In January this year an EU-wide ban was brought in for certain card charges, which stopped companies being able to charge you based on the method you used to pay.

> Much of the information in the technical papers raised potential issues, but provided few solutions on how to overcome the problems raised

Before this ban everyone was familiar with the issue of, for example, booking cheap flights on Ryanair and then discovering that to use certain credit or debit cards charges would cost them an extra £5 or £10.

There were often also higher charges at online retailers for using online payment systems, such as PayPal. The EU ban put an end to charging based on how you pay. However, the Government warns that in a no-deal Brexit the UK would be outside this EU law, and so this ruling would no longer apply – leaving retailers able to charge these 'rip-off' fees once again.

PENSIONERS ABROAD

The biggest warning in the technical papers was for the 300,000+ UK pensioners who live in another EU country, and are using bank accounts, insurance or pensions in the UK.

The technical papers state British citizens living in the European Union could be denied access to their own money: 'In

the absence of action from the EU, EEA-based customers of UK firms currently passporting into the EEA (European Economic Area), including UK citizens living in the EEA, may lose the ability to access existing lending and deposit services, and insurance contracts due to UK firms losing their right to passport to the EU.'

Put simply, a no-deal Brexit could result in some UK firms not having the right permissions to operate in EU countries. This includes the insurance companies which pay out an annuity, which is a pension income for life, to UK individuals living in the EU.

There are ways around this though. The financial services companies could set up an EU base, or create a reciprocal agreement with an EU-based company, to give them the right permissions to continue operating. However, until it's clear that they need to invest this money and make these changes, they are unlikely to do so.

Hugh Savill, director of regulation at the Association of British Insurers, says: 'Obviously insurers want to meet their commitments to their customers, but this problem has the potential to affect millions of insurance customers, including UK pensioners overseas. It can be fixed by co-operation between the UK and EU regulators – if the EU authorities wish to do so.'

HIGHER COSTS OF ONLINE SHOPPING

In addition to the aforementioned extra card charges, in a no-deal Brexit the Government warns that Brits buying items from EU retailers and sellers could face higher costs.

This is because currently across the EU there is a VAT waiver on small packages. This means that for online orders under a certain value, the retailer doesn't have to pay VAT on the item. The idea is that the amount collected would be too small, and so not worth the taxman's time collecting it.

However, if we move out of the EU under a no-deal scenario, this 'Low Value Consignment Relief' will no longer apply, and so VAT will be due. More than anything, the represents a major admin task for retailers, and those who do minimal business in the UK may not deem it worthwhile to continue.

For the vast majority that do continue selling to UK customers, the costs to those consumers are likely to rise, to pay for the VAT due and the man-hours put in to process those payments. The Government says it will aim to introduce an automatic, online payment system to record and collect the additional VAT payments, which would help to cut the costs involved.

Laura Suter,
personal finance analyst, AJ Bell

THE IMPORTANCE OF INCOME

One advantage of contrarian investing is that the out-of-favour stocks we look for often offer higher-than-average dividend yields. But we never consider a high yield an attraction in its own right.

All that glitters is not gold – and an enticing dividend is worth little if it can't be sustained. That's why we look for companies with a yield that is both attractive and sustainable over the long-term. As part of a 'belt and braces' approach we often look for a reliable dividend to provide us with a return while we wait for our investment thesis to play out. As we typically invest in companies where major change is planned or already afoot, this can be crucial. Executing an effective turnaround can require time and patience and we want to be sure that the company has the wherewithal to maintain shareholder payouts through potentially turbulent times.

Being paid for our patience

If our research shows that the dividend is sustainable, then we can afford to be patient – secure in the knowledge that we are being paid to wait. That's an ideal situation for us: a strong dividend yield that gives us a consistent and attractive level of income while we await the return of health to the business – and hence its share price.

We value dividends not only because they boost portfolio returns, but also because we understand the importance of regular income to our investors.

Making income more predictable

We announced a step-change increase in our dividend in December 2017. This boosted the regular dividend by 48%, the total dividend increased by 11%. As our investment style tends to generate an above-average dividend income, compared with global equities, we have rewarded our shareholders with a higher and more predictable income stream than previously. Also, we have moved from semi-annual to quarterly dividend payments. This provides a more regular income to our shareholders. Of course, it should be remembered that dividend income is not guaranteed and can go down as well as up.

Thirty-four not out

Another key objective is to achieve dividend growth ahead of UK inflation. We have increased our net dividend in each of the last 34 years and the net dividend has been increased or maintained since at least the Second World War. Just as with our portfolio of investments, the sustainability of our own dividend is important to us and this is helped by revenue reserves of more than three times the regular dividend. This provides a strong foundation, so were the portfolio to experience a temporary shortfall in income the company would still be able to maintain its dividend policy.

Drip, drip

Finally, it is always worth emphasising the potential impact of reinvesting dividends. Dividends form a large part of total returns and this is especially true when the income is reinvested. Certificated shareholders can take advantage of our Dividend Reinvestment Programme (DRIP), allowing them to harness the power of compounding and potentially enhance returns significantly over the long-term. As at the end of July 2018, an investment in The Scottish Investment Trust would have returned 3 times its value over the last 20 years. With dividends reinvested, this would have increased to 3.7 times the original investment – an uplift of 25%. This underscores the importance of income – and shows how a steady drip of dividends can swell to a sizeable flow. ■

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City of London: 4.4% yield offers twice the return of best-buy cash accounts

We explore why this investment trust is so popular among investors managing their own portfolios

Launched in 1891, **City of London Investment Trust (CTY)** has become one of the most popular investment trusts with investors seeking to run their own portfolios rather than use the services of financial advisers or wealth managers.

It is easy to see why the trust appeals to so many investors, in *Shares*' view. City of London currently yields 4.4%, based on the past year's dividend payout, an income return significantly better than you would get on cash in the bank at present. Furthermore, the trust has raised its dividend for 51 years in a row, so investors are enjoying a growing income stream.

To put that into context, the dividend yield is more than double the current best-buy one-year fixed term savings account, being ICICI Bank UK's product with a 2.02% interest rate.

However, investors should always appreciate that investment trusts – and even individual company shares – aren't obliged to keep paying dividends and they can cut or cancel payments at their own discretion.

This year has seen Carnival's debut in City of London's portfolio

THE INVESTMENT APPROACH

'City of London's investment style is value and income,' explains fund manager Job Curtis. 'Value, because share price valuation is the most important consideration of stock selection. And income, because we look at dividend yield first and foremost when we are valuing shares.

'We take a long term view,' adds Curtis. 'My philosophy is partly valuation driven. Share price valuation is critical. But we're looking for companies that have the cash flows not only to grow the dividend but also to spend on capital expenditure to grow the business.'

The investment trust has a bias towards FTSE 100 stocks but investors also get exposure to a healthy sprinkling of mid-caps and overseas investments. The latter include global healthcare giant Merck as well as technology titan Microsoft, purchased before current CEO Satya Nadella took over in the hot seat and helped drive a stellar performance.

CITY OF LONDON: ANNUALISED TOTAL RETURN

	3 years	5 years	10 years
Share price	8.0%	7.0%	10.4%
Net asset value	8.2%	7.1%	9.6%
FTSE All-Share	10.4%	6.7%	8.0%

Source: Morningstar, data to 7 September 2018

Addressing the portfolio's positioning relative to interest rate sensitivity, with the Bank of England having increased the base rate to 0.75%, Curtis points out 'this is still an exceptionally low interest rate compared with the time that a lot of us remember'.

He points out that 10-year gilt yields are still fairly low at 1.3%. 'Our portfolio of dividend-paying equities does look very attractive compared to the very low interest rates that are available in UK government bonds or in bank deposit accounts.'

MAJOR HOLDINGS

The portfolio is invested in high yield names including **Royal Dutch Shell (RDSB)** and **BP (BP.)** and lower yielders including publisher **RELX (REL)** and alcoholic beverages behemoth **Diageo (DGE)**.

'It is a blend,' says Curtis, 'but I do like my stocks to pay a dividend and almost all of our stocks have a yield of 2% or more. And I believe in running my winners,' an exemplar being precision engineer **Renishaw (RSW)** which he describes as being an incredibly strong stock for the portfolio over the years.

It shouldn't come as a surprise that City of London's performance has been lacklustre this year, given its portfolio contains so many FTSE 100 companies. In the first eight months of 2018 the FTSE 100 declined by 3.3% in value. In contrast, City of London's net asset value dipped by 0.7% according to Morningstar – slightly disappointing for investors but still outperforming the market.

> Carnival seems to be delivering on its profits and growth

Investors shouldn't panic about such a short performance period. City of London's longer term track record is far more impressive.

Over the past decade, it has delivered 10.4% annualised total return (share price gain plus dividends) versus 8% from the FTSE All-Share which is made up of the FTSE 100, FTSE 250 and FTSE Small-Cap indices.

Nonetheless, investors should always appreciate that no investment trust is guaranteed to achieve the same level of success in the future as it has done in the past.

PORTFOLIO MOVEMENTS

'Diageo is a long term holding and it has been a great stock for me,' says Curtis. He describes the *Johnnie Walker* whisky-to-*Tanqueray* gin producer as 'one of our best companies in Britain, a world leader in Scotch whisky, and strong in America and emerging markets.'

In June this year, City of London purchased a debut stake in **Carnival (CCL)**, the world's largest cruise company.

'We've never held Carnival before; cruising is a very competitive holiday but it is one area where it's quite hard to see how they would be disrupted by Amazon,' explains Curtis.

'Cruising has quite a good demographic – it has been favoured by the ageing populations who like it – but Carnival does have brands for younger passengers as well. Carnival seems to be delivering on its profits and growth and if there was a setback in the oil price, that would be quite a good catalyst and in the portfolio it is quite a good hedge against (oil price beneficiaries) BP and Shell.'

Another new holding is wealth manager **St. James's Place (STJ)**. 'It is operating at the higher end of the financial services market and is very much the leader in the UK,' enthuses Curtis, attracted to the company's fast-growing assets under management.

Curtis also believes the Real Estate Investment Trust (REIT) space is an interesting area and has put shareholders' money to work with positions in **British Land (BLND)** and **Land Securities (LAND)**. 'Both are trading on discounts because of Brexit worries and the effect on the office market. And those discounts look very attractive to me.' (JC)

CITY OF LONDON: TOP TEN HOLDINGS

Royal Dutch Shell	6.6%
HSBC	4.5%
BP	3.9%
British American Tobacco	3.7%
Diageo	3.3%
Unilever	3.0%
Prudential	2.9%
RELX	2.9%
Lloyds Banking	2.6%
GlaxoSmithKline	2.4%

Source: Janus Henderson Investors, as of 31 July 2018

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Whatever your ultimate investment goals if you are looking to grow your portfolio then investing in investment trusts can offer many benefits. In some investors' minds investment trusts are solely synonymous with income, but there are many trusts that have a growth mandate, or a combination of growth with income.

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Fundsmith Emerging Equities Trust
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Fidelity Special Values Trust
An actively managed contrarian trust, with a UK focus, that invests in what it believes to be undervalued stocks with growth potential.

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Event details

Registrations 18:00
Presentations start at 18:30
Complimentary drinks and buffet available after the presentations

Registration contact

Lisa Frankel
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EVENT CHAIR

Daniel Coatsworth
Editor
Shares Magazine

Could financial funds benefit as interest rates rise?

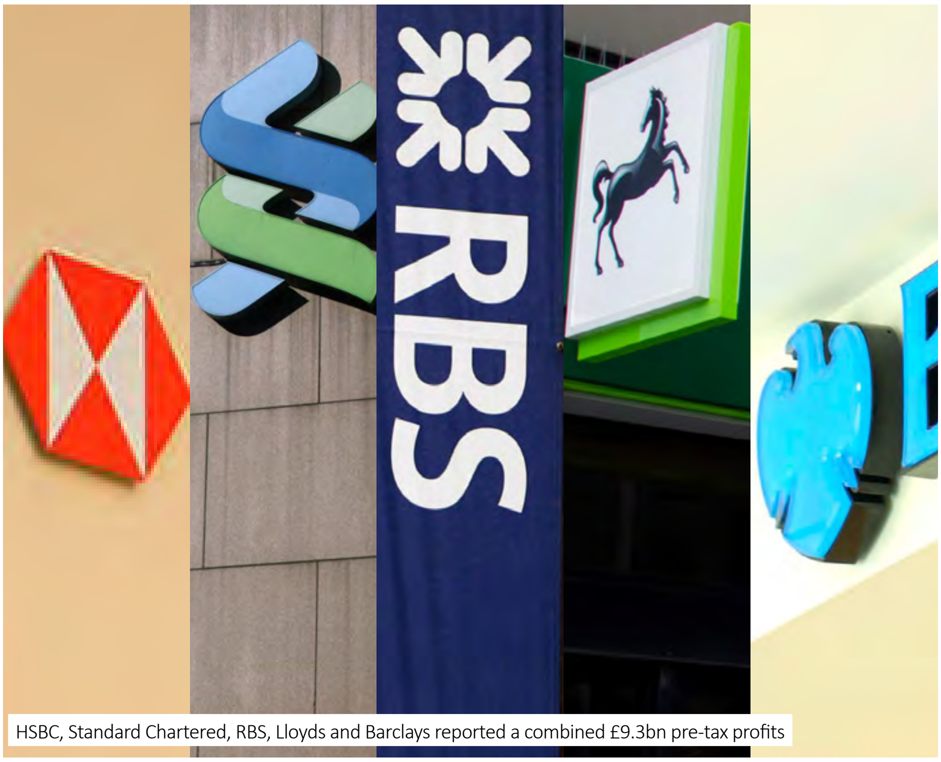
We look at the products to play a stronger backdrop for banks and insurers.

After months of speculation, the Bank of England finally raised interest rates on 2 August. With rates so low for so long, banks have seen their margins squeezed but, with interest rates now rising, will profitability improve and if so, could specialist financials funds be worth considering?

UK banks are still paying off the excesses of the years preceding the financial crisis, with vast sums set aside to cover PPI claims, litigation costs and writedowns, but these liabilities should now be nearing their end.

The Big Five FTSE 100 banks reported £9.3bn in pre-tax profit in Q2 2018, their best three-month showing in five years.

Barclays (BARC) and **Lloyds (LLOY)** both raised their interim dividends, while **Royal Bank of Scotland (RBS)** and **Standard Chartered (STAN)** resumed first-half dividend payments, putting them on track for their largest combined payout since 2007. However, these encouraging signs are not yet being reflected in share prices.



HSBC, Standard Chartered, RBS, Lloyds and Barclays reported a combined £9.3bn pre-tax profits

BACK TO BANKING

Ryan Hughes, head of active portfolios at AJ Bell, says banks have not been a great place to be invested, but the focus is now back on the day job.

'Banking is and should be the most simple business in the world: you lend money at one rate, you pay depositors another and you earn the margin between the two.

'Banks have got back to doing that and, as rates go up, the amount they can earn on that differential increases too so we should see an increase in profitability and an interesting opportunity for investors.'

He added UK banks are showing a commitment to pass those increases on to investors as dividends, and this should be rewarded in share price performance.

THE LINK WITH RATES

However, the relationship between interest rates and banks' bottom lines is not a one-for-one correlation, notes Mike Coop, head of multi-asset portfolio management at Morningstar.

'This link with interest rates is not stable and is not a reliable way of assessing what is going to happen,' he says, pointing to other factors like the interest they pay on their own funding sources, the quantity of money they can lend, and the amount of bad debt on their books.

He points out that income for European and UK banks has actually risen since 2013, even though interest rates came down over that period and stayed low. This is because banks were able to reduce their costs and the interest they paid on their loans.

His view is that relative valuation based on sustainable earnings is a more reliable guide to bank performance than the direction of rates. On this metric, banks look better value than expensive global equities at the moment, says Coop, although he warns they are 'not cheap and are inherently risky'.

ACTIVE FUND PICKS

There is more to the financial sector than just the big banks. It incorporates a wide spectrum including general insurers, reinsurers, asset managers and sub-prime lenders.

Hughes explains that some of insurers' profitability comes from what they earn on their cash balances, so they could look attractive in a rising interest rate environment. He suggests **Polar Capital Global Insurance (B530JS2)** as a specialist fund which should benefit from this trend.

Financials make up a large part of the UK stock market, around 20%. Any investor who owns a FTSE All Share tracker or an active UK equity fund is likely to already have reasonable exposure. In the US, around 14% of the S&P 500 is in financials, but it is made up of more investment banks than retail banks.

If you want more exposure, a handful of active funds exist with long track records, headed by experienced managers. Hughes highlights **Jupiter International Financials (B58D9P3)**, managed by Guy de Blonay, and **Janus Henderson Global Financials (3191923)**, which had a manager change last year.

Morningstar fund analyst Samuel Meakin points to the much larger **Fidelity Global Financial Services (BJVDYZ3)** fund, run by Sotiris Boutsis. Because the manager invests in quality financial stocks, the fund is more likely to outperform in a falling market, he says.

In the closed-ended space, one option is the **Polar Capital Global Financials (PCFT)** investment trust, which has around 64% in global banks and 11% in insurers.

Meakin adds: 'If you are looking to invest in specialist financials funds, given you are taking on the style risk of the manager, you want to hold them as long-term holdings for at least three to five years.'

> **Banking is and should be the most simple business in the world: you lend money at one rate, you pay depositors another and you earn the margin between the two**

A PASSIVE APPROACH

All three fund experts say passive products like exchange-traded funds are a good starting point for investors interested in financial stocks.

Hughes says investors should think about why they are going into the sector, how long they plan to keep their exposure, and whether an active manager can do well enough over that time to justify their fees.

'There is not a huge amount of evidence of [active manager] skill and alpha that is consistent over time so I think that would push me towards simply taking the passive option and buying pure exposure to either banks

PERFORMANCE OF A SELECTION OF FINANCIALS FUNDS

FUND	1y return (%)	3yr return (%)	5yr return (%)
Jupiter International Financials	11.1	53.0	85.7
Lyxor UCITS ETF MSCI World Financials	6.0	51.0	73.7
Fidelity Global Financial Services	6.3	46.9	72.7
Janus Henderson Global Financials	8.5	41.3	63.1
Polar Capital Global Financials Trust	7.4	39.3	50.9
Polar Capital Global Insurance	8.5	0.6	106.9

Source: FE. Performance values rebased to pound sterling.

or financials.' He points to the **Lxyor MSCI World Financials ETF (FINW)**, which at 30 basis points is low cost and tracks a broad-based index so it is well diversified.

'It is a good 40-50 basis points cheaper than any active strategy so the active managers would have to work very hard to outperform that.'

Coop agrees, noting that investors' go-to product type for exposure to a compelling part of the market should be through a cheap ETF as a starting point, before they decide whether it's worth paying for active management.

'There's no one size fits all, but the cost of more specialised exposure particularly for retail investors means you want to be thinking twice. At the moment we don't think the opportunities are attractive enough to go down that route.' (HS)

2018 ESTIMATED PRICE/EARNINGS AND DIVIDENDS FOR THE BIG FIVE UK QUOTED BANKS

BANK	Price/earnings (P/E)	Price/book	Dividend yield	Dividend cover
HSBC	11.3	0.9	6.0%	1.5x
Lloyds	8.2	0.9	5.7%	2.1x
Royal Bank of Scotland	9.5	0.6	2.5%	4.3x
Standard Chartered	10.9	0.5	2.7%	3.4x
Barclays	8.8	0.5	3.7%	3.1x

Source: FE

Why September is an important month for Japan (if not the world)

Monetary policy update and leadership contest top the agenda

By Russ Mould, investment director, AJ Bell

September is going to be an important month for those investors who have exposure to Japan.

First, the Bank of Japan (BoJ) is scheduled to provide its latest monetary policy decision on 19 September. Although Governor Haruhiko Kuroda is publicly still pressing ahead with qualitative and quantitative easing (QQE), the BoJ is undershooting its bond-buying targets and finding it an increasing struggle to bend the market for Japanese government bonds to its will.

Second, Prime Minister Shinzō Abe must fight a triennial contest for the leadership of the ruling Liberal Democratic Party (LDP) on or before 20 September. A loss could see his position as PM become untenable and the so-called 'Three Arrows,' or 'Abenomics' programme come under threat, to the potential consternation of those who have warmed to Japanese equities because of his targeted reforms.

LEADERSHIP FIGHT

Nothing can be taken for granted in Japanese politics (or so it seems anywhere else these days) but Prime Minister Abe is expected to prevail in the LDP leadership poll, barring some grievous self-inflicted wound.

The opposition on paper does not look strong, not least because leading malcontents defected to the short-lived Tomin First party of Yuriko Koike, only for it to implode immediately after her crushing defeat in the 2017 General Election.

At the time of writing his only confirmed opponent is former Defence Minister Shigeru Ishiba. Abe saw him off to win the LDP leadership in 2012 so he does not look overly threatening especially as former Foreign Minister Fumio Kishida's decision to support the PM looks to snuff out any room for dissent within the party ranks.

As such, it seems that Abe's political colleagues like what they see, every bit as much as anyone with portfolio exposure to the Tokyo markets.

The Nikkei 225 index is up by 130% since Abe's landslide win in 2012 in local currency terms (it is up by 114% in sterling, compared to a 23% gain in the FTSE All-Share over the same period) thanks at least in part to the Three Arrows programme, which comprises:

- Fiscal stimulus
- Economic and social reform, including a shake-up of corporate governance and how companies interact with investors, an area of great improvement but one where there is still scope for further advances in return on equity and dividends in particular
- Huge monetary stimulus – and this is where the Bank of Japan comes in

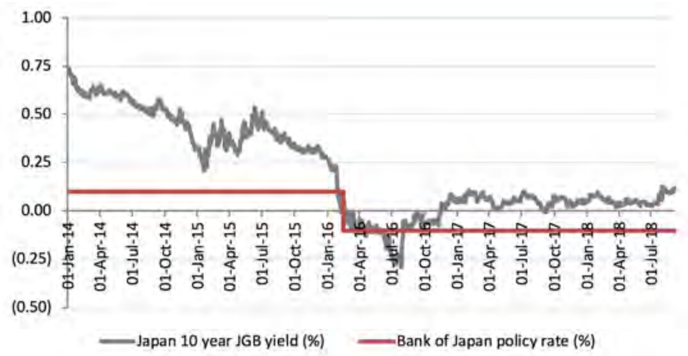
POLICY POSER

To support Abenomics, help Japan cope with its 250% debt-to-GDP ratio and try to boost both growth and inflation, the BoJ has run ultra-loose monetary policy for two decades and more. But it has been taken to a new level by Governor Haruhiko Kuroda.

Since October 2014, the BoJ has been buying ¥80tr a year in Government bonds, real estate investment trusts (J-REITs) and equity exchange-traded funds (ETFs) – that is the equivalent of £550bn a year, more than the Bank of England has done in QE in total since it started with its scheme in 2009.

Yet inflation is still not at the BoJ's 2% target and the yield on the headline JGB is starting to break out above the central bank's intended 0.1% cap, in a direct threat to its monetary authority.

JAPANESE BENCHMARK BOND YIELDS ARE CREEPING HIGHER

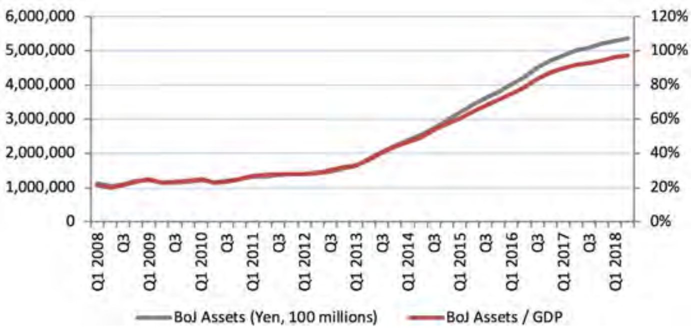


Source: Thomson Reuters Datastream

The 10-year JGB may be feeling the strain as Japanese GDP starts growing again, after a stumble in the first quarter, but also because there are suggestions that the BoJ is starting to stealthily taper – or cut back on – its QQE scheme, either because it wants to, or because it has to do so.

BoJ assets already represent more than 90% of GDP, compared to 24% of GDP for the Bank of England in the UK and 20% for the Federal Reserve in the US.

BANK OF JAPAN BALANCE SHEET CONTINUES TO EXPAND THANKS TO ITS QQE SCHEME



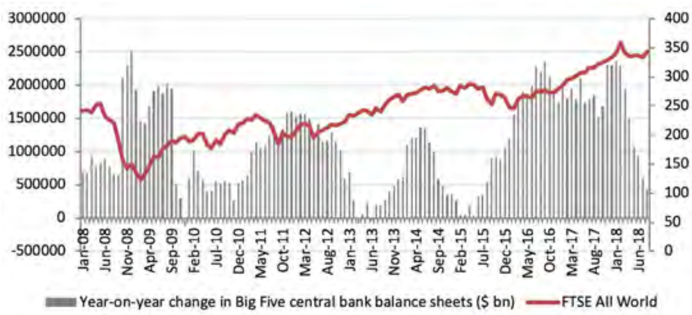
Source: Bank of Japan; FRED – St. Louis Federal Reserve database; Thomson Reuters Datastream

Although tapering and now withdrawal of QE by the US Federal Reserve has not knocked the US stock market off its path, one reason may have been the BoJ (and European Central Bank) stepped up and poured on policy stimulus just as the Americans stopped.

But even a modest withdrawal of QE and liquidity by the US has caused chaos in emerging markets, where currencies such as the Argentine peso, Indian rupee and Russian rouble have all cratered.

If Japan starts to taper QE then another source of cheap cash will start to dry up, especially as the ECB plans to stop adding to its QE programme in December. That could have wider implications than we realise, looking at this final chart, which shows how growth in the assets of the world's five leading QE proponents may have helped to goose global share prices.

GROWTH IN GLOBAL CENTRAL BANK ASSETS LOOKS POISED TO SLOW VERY RAPIDLY (EVEN BEFORE JAPAN CONTEMPLATES TAPERING QQE)



Source: Bank of England; Bank of Japan; FRED – St. Louis Federal Reserve database; Swiss National Bank; Thomson Reuters Datastream; US Federal Reserve

So while the BoJ is not expected to make any dramatic changes this month, investors may need to check any subtle changes in Governor Kuroda's scripts, whether they have direct exposure to Japan or not.

Understanding liquidity and why it matters to buying and selling investments

You can't always get what you want with certain stocks and funds

Liquidity is one of those investment words which sounds rather too vague and complex to really worry about. Yet liquidity can determine whether you make a profit or loss on an investment and, crucially, whether or not you can get your hands on your money when you want it.

In plain English, liquidity is about being able to buy or sell an investment when you want, in the amount you want, at the price you want.

If an investment is deemed to be illiquid it could mean you aren't able to put your money into it when you would like or, perhaps more importantly, get your money out.

Why does this happen? Because there are not always the same number of buyers and sellers in the market.

SUPPLY AND DEMAND ISSUES

Think of it like going into the supermarket to buy three loaves of bread and finding there is only one for sale. There's nothing you can do about it, you just have to wait until more become available. On the other side of the trade, it's like having an item to sell that no one wants.

Particular types of investment are more prone to illiquidity than others and it's an important consideration when choosing where to allocate your money.

Smaller companies, for example, tend to have fewer people trading their shares, particularly the very small businesses. That means when you want to buy or sell some of the stock it could take longer to find someone to take the other side of the trade than, say, a FTSE 100 company.

> There will (nearly) always be a trade to be done but in a panic, it may be at a price that is a lot lower than you want

The downside of this situation is that the price can change while you are waiting, meaning you could end up paying more than you want to buy or selling for less than you had hoped.

THE PERILS OF LIQUIDITY

Russ Mould, investment director at AJ Bell, says: 'There will (nearly) always be a trade to be done but in a panic, it may be at a price that is a lot lower than you want. Liquidity is never there when you really need it, so you should never depend on it.

'This is why it's best to invest in things for the long-term and because you believe they are fundamentally strong and attractively priced, not just because you think shares will go up and you can quickly sell them to someone else.'

Property is a prime example of an illiquid asset – while a company share might take a few days to offload, a property can take months or even years to sell.

The consequences of this were felt around the financial crisis in 2008 and again after the EU referendum in 2016 when property funds suspended trading, preventing any investors from buying or selling units in various funds.

Fund managers were worried that so many people would try and sell units in property funds that they would be forced into a fire-sale of their assets just to meet investor redemptions.

For this reason, investment trusts are often viewed as a less risky way to access illiquid investments. While their share price may fall, they won't suspend trading and a manager won't be forced to sell their assets because there are a set number of shares in issue, unlike funds where units are created and disposed of depending on demand.

In the property turmoil, for example, property investment trusts continued trading – investors may have had to endure a share price plummet but they could sell if they wanted to.

THE FUND MANAGER'S VIEW

As fund manager of **Miton UK MicroCap Trust (MINI)**, Gervais Williams is well versed with the challenges of liquidity. His investment trust focuses on businesses with a market capitalisation of £150m or less (to put that into context, the market cap of companies on the FTSE 100 ranges from **Rightmove (RMV)** at £4.4bn to **Royal Dutch Shell (RDSB)** at £204.6bn).

Because investing in the smaller end of the market brings illiquidity risk, Williams invests in a greater number of companies than other funds might typically hold, with at least 100 stocks in the portfolio. He says when there is a market sell-off it can take several weeks to complete a 'sell' order.

'Liquidity is always a consideration and there are some companies whose shares hardly ever trade, so you have to be confident and understand it will take longer to get out of those positions. You need to balance those risks by having a well-spread portfolio,' he adds.

'In the most extreme cases, it can take several months to buy or sell shares. We are ok with that because we are long-term investors and know that we also have investments we can liquidate within a couple of days if we need to.'

OTHER ISSUES TO CONSIDER WITH LLIQUIDITY

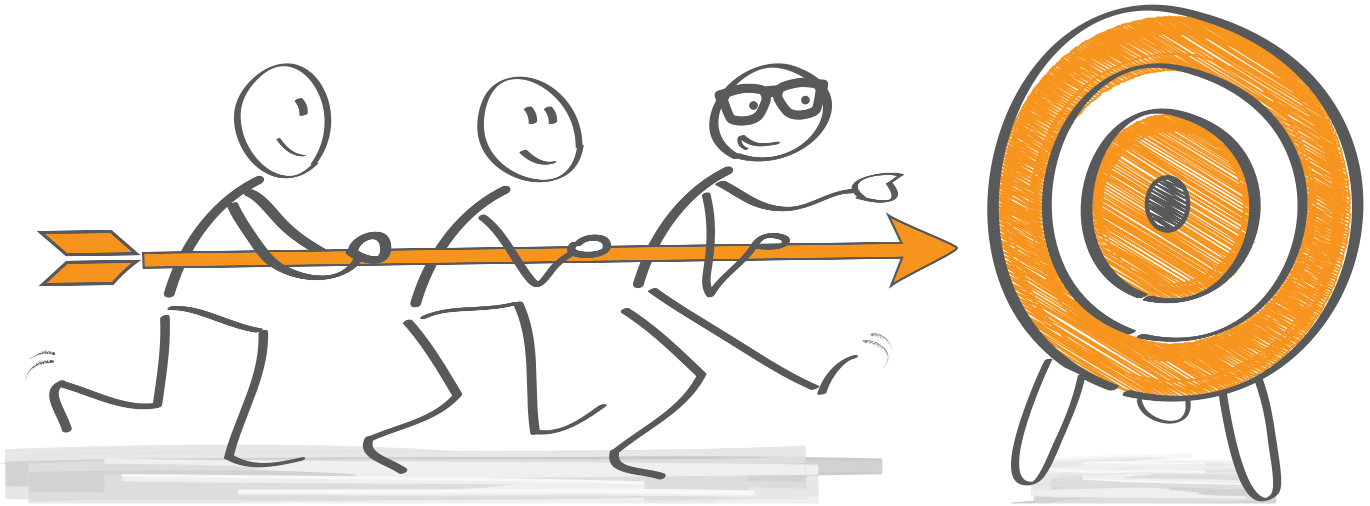
Williams says illiquidity can also be your friend. He explains that smaller companies can often prove more resilient when there is a market shock precisely because they are difficult to sell, whereas it is very easy to trade large-cap stocks so investors can easily dump these shares.

While liquidity is often talked about in the context of not being able to offload an investment, it can also stop you accessing an asset if it is in demand and there is a lack of sellers. In this instance investors may have to wait to invest or be forced to pay a premium for the asset.

A recent example of this situation is infrastructure investment trusts, many of which have traded at double-digit premiums in recent years because investors have been attracted by the reliable, high-income they pay. Other illiquid asset classes which have been popular in recent years include private equity and specialist assets such as renewable energy. (HB)

Create your own simple share price target

Having a medium-term goal for a stock can act as a focal point for your investment process



Investors buy shares in the hope they rise over time and create value. The question is, by how much should a share rise, and over what timeframe, to qualify as a successful investment?

For some investors earning a 10% return in six months would be a decent result. Others may have more aggressive ambitions, perhaps 50% on a 12 to 24 month view.

There is no right or wrong answer as we each have to come to our own conclusions regarding expectations.

Using absolute share price percentage performance is an arguable measure, albeit perhaps the ultimate arbiter, since a stock price at any moment in time really reflects market sentiment, or how investors 'feel' about a company's prospects.

As you may have experienced yourselves, the market's mood can change on a relative whim even if forecast revenues, profit and cash flow do not dramatically change.

This is where a share price target can fit in. These are subjective calculations and perhaps because of that many investors are fairly sceptical about their value. But they can act as loose goal around which your hopes and expectations can coalesce.

A share price target can be found on most analyst research notes (although not all) and they typically signal what analysts think is a reasonable destination for a share price on the assumption that current expectations are met.

Publication of these targets have the power to move share prices. Just last week analysts at Liberum cut their share price target on engineering firm **IMI (IMI)** by 20%, from £12.75 to £10.20. Slowing growth and flat margins were behind the change.

IMI shares have since slipped 6.5% to £11.25, not huge but reversing the past few weeks of share price strength for the company.

DIFFERENT STROKES, DIFFERENT FOLKS

There are a number of valuation methodologies used in establishing a share price target, some relatively straight-forward like the enterprise value-to-earnings before interest, tax, depreciation and amortisation (EV/EBITDA). Others are more complex, such as the fairly common discounted cash flow (DCF).

But most investors tend to use price to earnings, or PE for short.

They are usually set around a 12 to 18 month timeframe, but can be longer or shorter-term depending on the stock.

We now show you how to set your own share price target based on some very simple sums.

One way analysts (and journalists) often summarise a stock's valuation trajectory is to explain how a forward PE declines over time. For example, let's assume Test Company plc's share price is 150p and the company is forecast to deliver earnings per share of 10p in the current 12 months.

Let's also assume analysts predict steady growth of 15% over the next few years.

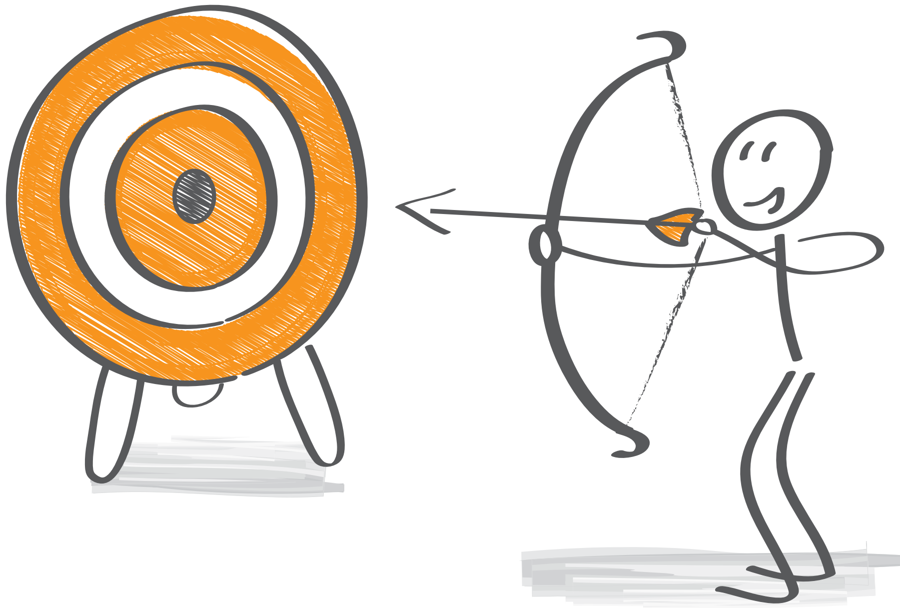
On this simple basis, 10p EPS this year would rise to 11.5p in forward year one, and increase again to 13.2p in forward year two, and 15.2p in forward year three.

This might be explained something like – 'this would mean that the PE falls from the current 15 to 13 next year, to 11.4 in year two and to 9.9 in forward year three'.

But you can flip that around and create a share price target. Since the share price should move higher to reflect rising earnings it is not unreasonable to think that the PE might remain at least stable at 15-times over the next two years.

So let's roll that calculation forward and work it out.

As the table shows, the implied potential share price returns are impressive. Given that the market looks forward, our back of envelope sums suggest something like 50% share price upside is quite possible by the time we get towards the end of forward year three.



In some cases, such steady growth might also justify a higher PE rating than 15. In our simple example a re-rating to a PE of 18 by forward year three could imply extra upside to 273.6p. Similarly, if earnings growth was to speed up (or slow down) you are in a position to recalculate your share price target accordingly.

READING BETWEEN THE LINES

Importantly, doing your own sums means you can read between the lines of what a company is saying and judge whether current forecasts are pitched too high or low, and accommodate this in your own share price target.

	CURRENT YEAR	FORWARD YEAR ONE	FORWARD YEAR TWO	FORWARD YEAR THREE
EPS	10p	11.5p	13.2p	15.2p
Share price*	150p	172.5p	198p	228p
*Implies PE stays at 15				

Cloud-based communications technology company **Gamma Communications (GAMA:AIM)** is a good example of managing market expectations to the point where it frequently beats forecasts. Little IT projects firm **SciSys (SSY:AIM)** is another example of this habit.

But beware, many investors believe that hitting a target price is a trigger to sell a stock. We think this is a cock-eyed approach. Instead, we suggest that attaining a predetermined share price is the time to reassess the investment case.

You might decide that selling the stock is the right thing to do. You might equally end up thinking that progress has moved sufficiently forward to justify retaining the stock for future upside. There's no one size fits all answer; it should be balanced on a case-by-case basis. (SF)

Amigo Loans distances itself from Wonga in bid to gain investor interest

The loan company recently joined the stock market and has a fairly cheap rating

The summer stock market float of **Amigo (AMGO)** brought the UK's best known guarantor loan company to the London Stock Exchange with a market cap of £1.3bn.

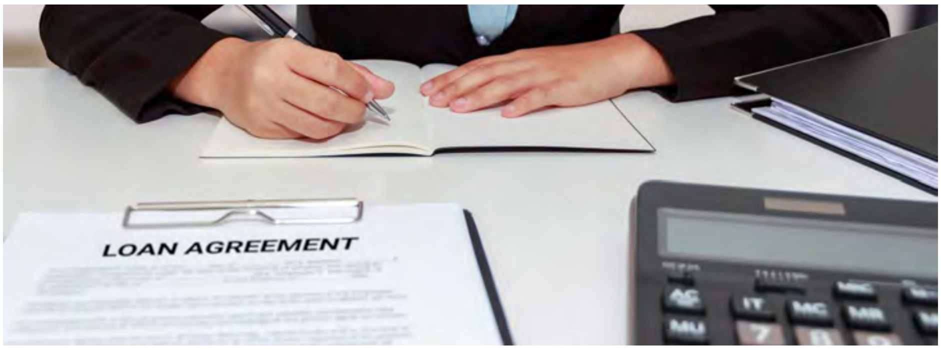
Given the trouble of some companies in the sub-prime lending sector, notably Wonga, it is worth asking if all companies in this bracket, including Amigo, can be tarred with the same brush?

Amigo's chief executive Glenn Crawford is quick to dismiss comparisons with payday lenders like Wonga, who have fallen foul of regulatory scrutiny in recent years. 'We are a very different business to Wonga and there's no read across to what's happening to them,' says Crawford.

Wonga was rocked by a series of compensation claims over improper sales practices and its customers are thought to still owe the company around £400m despite it being in administration. Amigo argues it does not have these problems as it targets a different part of the market.

WHO IS ITS TARGET CUSTOMER?

Described as a non-standard lender, Amigo's rate of interest or APR is the middle ground between mainstream lenders and half of what sub-prime lenders



are allowed to charge since reforms were introduced in 2015.

At 50% APR, the loans are by no means cheap but still a long way off the 100% that is now the maximum a short term lender can charge.

The company works by giving those excluded from mainstream lenders access to credit. The catch is that they need someone with a better credit history to guarantee the loan repayments will be paid. These guarantors will typically be a friend or family member.

Crawford says this is only part of the story as debt consolidation is another reason people use Amigo. He states that a quarter of its monthly lending is to allow people to consolidate more costly debts.

Amigo also caps the interest it charges, so if a customer gets into trouble they don't get sucked into a spiralling debt vortex, the so-called 'payday trap'.

Crawford says a number of the company's customers have been prime borrowers in the past but a 'bad event' happened to them such as relationship breakdown or loss of job severely limiting their options and affecting their credit status.

'We are a credit rehabilitation company and want to help rebuild credit scores and we don't discourage people from moving away from us,' says Crawford.

Even if customers do graduate from Amigo to more mainstream lenders, guarantor loans still account for just 0.4% of the UK unsecured consumer finance market according to a review by the Financial Conduct Authority in 2017.

With other parts of this market under regulatory pressure and traditional lenders retreating from the space, Amigo estimates there are 7.8m-9.8m potential untapped customers in the UK.

POLITICAL RISKS

Despite Crawford's apparent desire to help people rebuild their credit and ergo no longer need his company's services, it should remembered that Amigo is still the target of certain people's ire.

Labour MP for Walthamstow, Stella Creasy has been a long-time critic of payday loan companies. She doesn't distinguish between the likes of Wonga and Amigo, going as far to call the latter a 'loanshark'.

In a recent article in *The Sun* by Creasy, she attacked the practices of high cost lenders and said 'Amigo lets friends guarantee loans, so has two people to chase if the debt goes bad'.

Crawford says he tried to engage Creasy in dialogue but given the amount of money the company has spent on advertising, it may have inadvertently have made itself a target.

One reason that Amigo has such a dominant position in the guarantor loan market, with an 88% share, is its brand awareness.

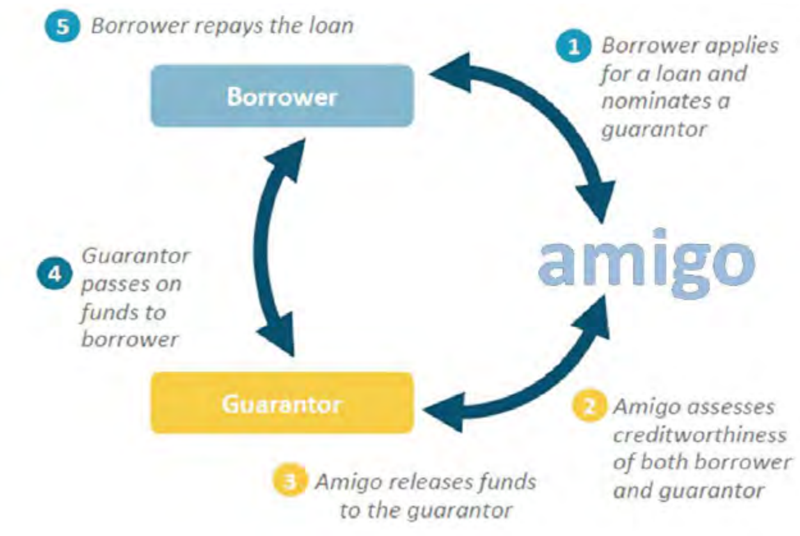
But being a well known name clearly has its downsides as seen with Creasy's attack on the company.

CASH MACHINE

Despite the downsides of being a whipping boy for left leaning members of Parliament, there's no denying the strength of Amigo's business model.

Releasing first quarter results recently, the company increased its revenue by 47% to £62.9m on a year-on-year basis. Its profit after tax only increased by 4% to £12.3m, and this disappointed investors as shown by a 6% price decline on the day. However, it is worth noting the profit figure was constrained by IPO costs.

THE AMIGO CIRCLE OF LENDING



Source: Company reports.

A look at the company's shareholder register suggests that institution investors believe the company is a winner. Names include Investec Asset Management, Woodford Investment Management and Janus Henderson Investors.

Amigo plans to pay out 35% of its post-tax profits as dividends and looking at forecasts from JPMorgan Cavenove, this equates to a maiden dividend yield of 2%, rising to 3.4% in 2020. Also given the share price slump following the release of its first half results, Amigo is trading on 12.3 times 2019's 20.9p of earnings using market forecasts – an undemanding rating.

> **Amigo lets friends guarantee loans, so it has two people to chase if the debt goes bad**

JPMorgan says: 'The primary aim of this (guarantor) structure is to encourage repayment of the Amigo loan; this has proven effective, with less than 13% of payments on average over the past five years coming from guarantors.'

In other words because of the link to a close friend or family member Amigo's borrowers don't want to let guarantors down by not paying back the cash.

Amigo has spent a lot of money on advertising and this is part of the company's efforts to create a high barrier to entry to its niche market.

While some companies have attempted to launch guarantor loan products, given that Amigo was first out of the stalls in 2005 it could take a long time for these rivals to catch up. (DS)

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KEY ANNOUNCEMENTS OVER THE NEXT SEVEN DAYS

Final Results

14 Sep: JD Wetherspoon. **17 Sep:** Finsbury Food, MJ Gleeson. **20 Sep:** Kier, Inland Homes.

Half Year Results

18 Sep: Keywords Studios, Spire Healthcare.
19 Sep: Kingfisher, Alliance Pharma.
20 Sep: French Connection.

Trading Statements

4 Sep: Investec. **17 Sep:** Dairy Crest. **18 Sep:** Ocado.
19 Sep: Babcock. **20 Sep:** IG.

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