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SHARES

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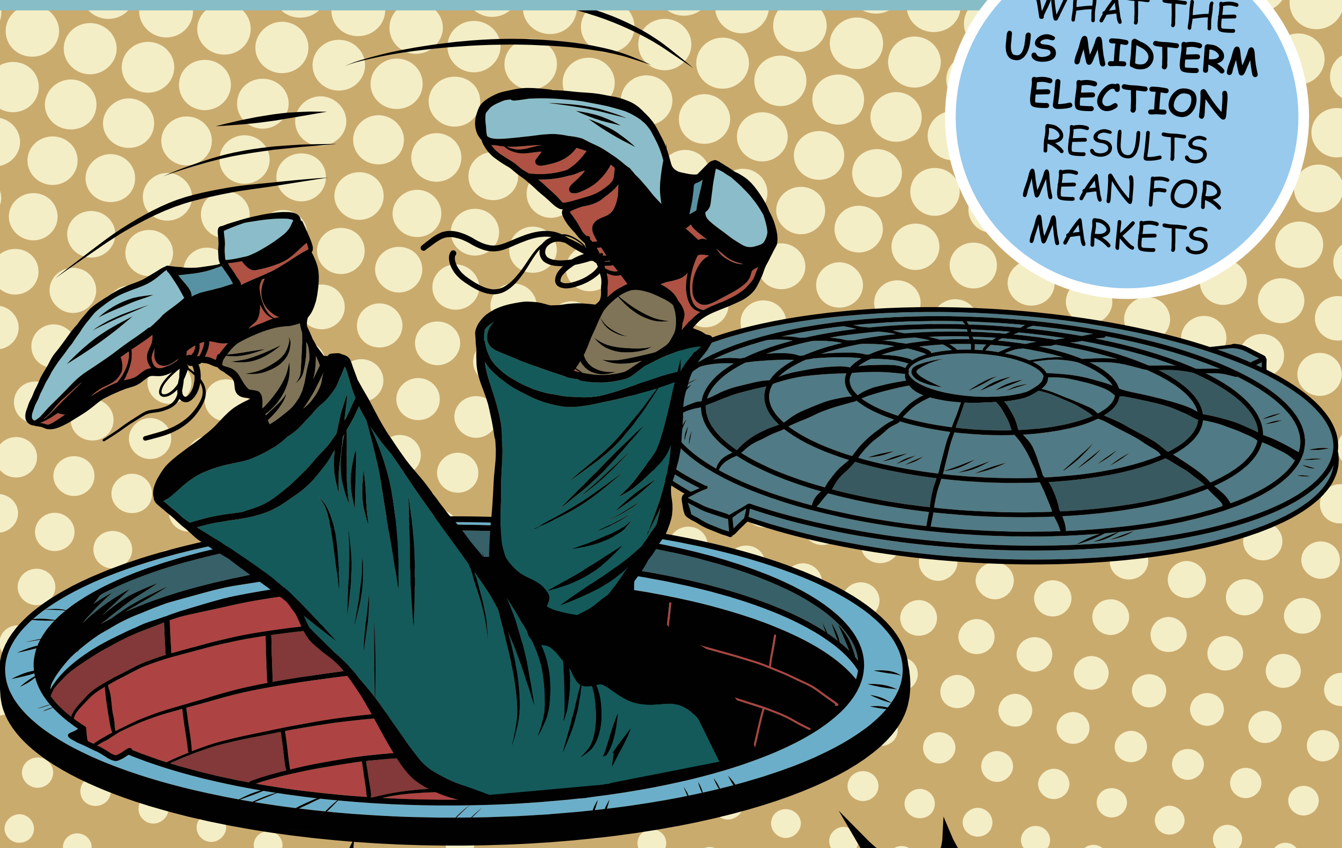
WHAT THE **US MIDTERM ELECTION** RESULTS MEAN FOR MARKETS



CAN THE **GOVERNMENT** REALLY SAVE THE HIGH STREET?

SUPERDRY CO-FOUNDER PLOTS BOARDROOM COUP IN A BID TO 'FIX' THE RETAILER

INSIDE: THE MOST EXPENSIVE ETFS ON THE MARKET

Fintech is equally exciting and frustrating from an investment perspective

There are limited options to play this space and even a dedicated investment trust has a few catches

Most companies will inevitably have to adapt to changes at some point in their life as customer preferences evolve and technology opens up new ways of operating. The banking sector is now facing this situation and this is why 'fintech' (or financial technology) has become such a buzzword.

Banks with hundreds of years of history are finding an ever-growing number of smaller businesses snapping at their heels trying to disrupt the sector. Many of the incumbents cannot change fast as they are dependent on legacy IT systems and implementing new, modern innovative technology is not as simple as 'plug and play'.

Most of the large London-listed banks reported solid earnings growth in their latest quarterly figures. Why worry, you might think? The rise of fintech is heavily linked to changing consumer habits, so while the big names like **Lloyds (LLOY)** may look strong today, they are facing a more difficult future. That explains why Lloyds is investing £3bn in its technology and people.

One could argue big banks have plenty of money to invest in new technology. The big problem lies with the costs of dealing with their legacy IT systems and having a large workforce. The new wave of fintech companies are more nimble which gives them an advantage.

Some fintech firms are already worth a considerable amount of money. For example, Monzo has more than 1m current account customers and is now worth £1bn, a near four-fold increase in valuation in a single year. Revolut is valued at \$1.7bn (£1.3bn).

DIFFICULT TO INVEST IN FINTECH

Investing in the fintech space is difficult as most of the better-known names tend to be backed by venture capital and aren't on the stock market (yet).

Augmentum Fintech (AUGM) is circumventing this problem with a portfolio of fintech companies available to retail investors via its investment trust.

'We will see brands that don't exist today become future household names in financial services worth billions of pounds. Our job is to identify some of the future winners,' says its chief executive Tim Levene.

Augmentum's seed portfolio includes stakes in stockbroker Interactive Investor and P2P lending company Zopa. These are more mature businesses than it intends to back in the future and their presence just helps to sell the investment trust's story until it is better known.

Levene has since been snapping up stakes in lesser known names including Tide, an SME challenger bank. He also sees opportunities as tech firms start to disrupt the insurance sector, although he notes this area is less mature than fintech-related consumer banking and foreign exchange.

Names like Monzo wouldn't fit the bill for Augmentum as the trust wants to invest at an earlier stage, plus Levene says digital banks may not be good investments even if they become successful businesses. 'They require significant capital to reach critical mass so there is a dilution risk for investors.'

A NEED FOR PATIENCE

Augmentum really needs to increase scale before it becomes of any interest as a true fintech fund. Diversification is important given the competitive nature of this space and it currently has a mere 11 holdings.

Investors will also need to be very patient as it is hard to predict when unquoted companies will have a valuation uplift – thus Augmentum's own share price performance may also not follow a smooth path. (DC)

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Why isn't the oil price surging on Iran sanctions?

Some observers are confident the oil price could still shoot further upwards

Oil prices appear to be struggling for direction despite the renewal of US sanctions on Iran. The market had previously expected this event to be a major catalyst for crude prices.

Iran was among the factors which helped lift oil prices to multi-year highs above $85 per barrel in early October before the commodity got caught up in the wider market fallout last month. Brent crude, the global benchmark, is currently trading at around $73 per barrel.

'Benchmarks have been under pressure of late as major producers, including Saudi Arabia, the US and Russia, have ramped up output to near-record levels, while weak economic figures in China have cast doubt on the demand outlook,' says broker Cantor Fitzgerald.

Some analysts believe the impact of Iranian sanctions is being underestimated. In a *Bloomberg* interview Goldman Sachs' global head of commodities Jeff Currie said he expected oil to bounce back to $80 per barrel before the end of the year citing oil stocks below the five-year average and 'relatively good' demand.

Ultimately the direction of oil prices may be led by how committed the US administration is to punishing Iran even if it means higher prices at the pump for US citizens.

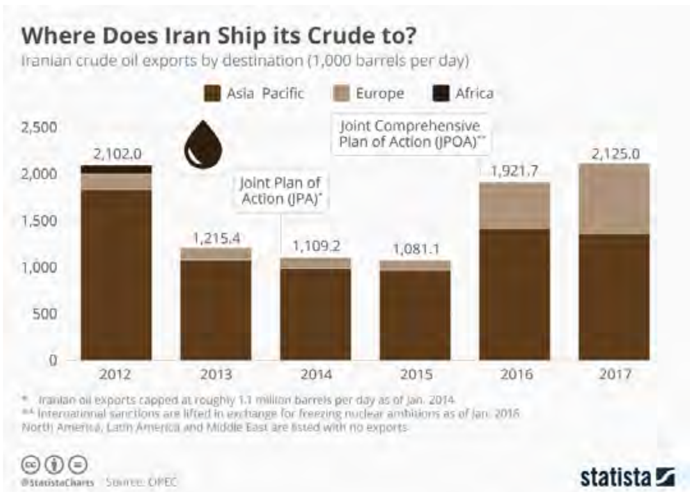
At present eight countries, including China, have been presented with waivers allowing them to still import a reduced rate of Iranian oil for another 180 days. But Currie thinks these allowances will be cut more sharply than similar waivers offered under sanctions first imposed by President Barack Obama in 2012.

UK investors will likely feel the gyrations in the oil price most keenly in the share price performance of FTSE 100 index heavyweights **BP (BP.)** and **Royal Dutch Shell (RDSB)**.

These companies saw contrasting fortunes with their recent third quarter updates. Every set of quarterly numbers so far for 2018 has seen BP do better than forecast and Shell do worse.

The 37% increase in Shell's key measure of profit to $5.6bn, reported on 1 November, was short of the $5.8bn analysts had been expecting although cash flow reached nearly $15bn, the highest level since 2008.

BP was able to beat even elevated expectations and tellingly its $10.5bn acquisition of assets from **BHP Billiton (BLT)** are now going to be funded without a fundraise thanks to the robust cash flow performance. (TS)



What the US midterm election results mean for markets

Congressional gridlock is usually good news for US stocks but that may not be the case this time round

The markets are digesting the prospect of political gridlock in Washington as, in a widely predicted outcome, the Democrats secured the House of Representatives while the Republicans held on to the Senate.

Data from Bank of America Merrill Lynch shows historically the best S&P 500 returns under a Republican president were achieved with a split Congress. This scenario generated annual returns of 12%.

However, there are reasons to believe the trend may not hold true this time. Given the divisive nature of US politics at present the Democrats are unlikely to support any Trump administration initiatives.

This limits the prospect of further fiscal stimulus for the US economy, which, in turn, could reduce the pressure to increase interest rates and put the US dollar on the back foot.

This would be positive for emerging market countries with lots of dollar-denominated debt. The impact on corporate earnings may also make US stocks less attractive than their counterparts elsewhere after a period of divergent performance.

Trump has a freer hand with foreign policy, so anyone hoping the political shift will lead to a softer tone with China on trade, a key market concern, is likely to be disappointed. (TS)

Aberdeen plans global private-market sustainability trust

The new investment trust is hoping to hit the stock market just before Christmas

WHEN ETHICAL investing began in the 1970s it was very much a niche market. The first funds were launched by Methodists (the Pax Fund in the US) and Quakers (the Stewardship funds in the UK).

According to the Sustainable Investment and Finance Association there are now over 100 UK ethical funds with a total market value of £10bn.

The latest fund hoping to launch in the sustainable space is the **Aberdeen Global Sustainability** investment trust which aims to generate a total annual return of between 6% and 8% (capital gains and reinvested dividends).

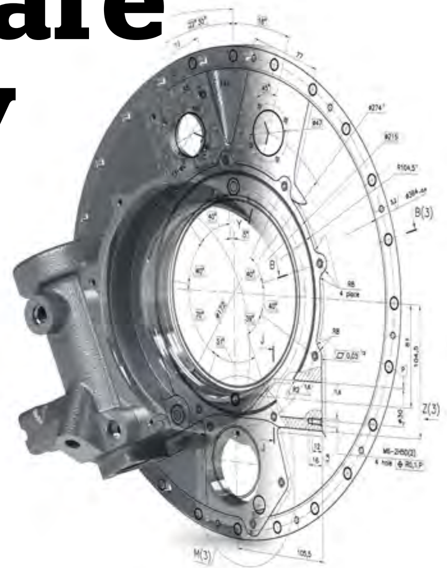
What makes Aberdeen's offering unique is that it will invest in private markets around the world in assets which produce a positive, measurable impact in environmental and social terms.

Aberdeen has 400 investment professionals looking at private markets and already manages £67bn of unquoted assets, so adding a sustainability overlay is a natural extension.

'Investors want to align their investment decisions with their personal values, and private markets are an ideal home for impact investing as we can take an active role in managing the assets,' says manager Roger Pim.

The trust is hoping to raise £200m and its shares to start trading on 17 December. (IC)

UK metal bashers are facing uncertainty as Brexit looms



Leading engineers and industrial firms have material exposure to Europe

It is becoming increasingly apparent there are high stakes for UK engineering and industrial companies if Brexit talks fail to smooth trade routes between the UK and the EU.

Businesses including FTSE 250 constituents **IMI (IMI)**, **Bodycote (BOY)**, **Spirax-Sarco (SPX)** and **Vesuvius (VSVS)** generate more than a third of their annual revenues from doing business across the Continent, and analysts calculate that the sector average is 26% of annual sales coming from Europe.

The wider UK engineering and industrials sector provides a wide range of skills, equipment and services to industries as diverse as automotive, construction, electronics, heating, power, mining, steel production and various manufacturing segments.

Share prices across the sector have come under particularly heavy pressure during October's hefty stock market sell-off.

'The industrials have taken their share of pain in the recent sell-off,' points out stockbroker Numis Securities.

Numis flags sector declines of 18% across the UK-quoted automotive space, engineers down 13% and electricals also 13% off. That compares to a wider UK stock market fall of nearer 7% since the correction began early last month.

Investors will have a clearer picture by the end of November with third quarter updates anticipated from most of the wider sector's larger companies.

Early indications are so far mixed, with updates from **Weir (WEIR)** and Vesuvius going down well with investors, while refractory kit maker **RHI Magnesita (RHIM)** slumped 8% on its 5 November announcement. (SF)

Investors see value in emerging markets

CFA UK study shows improved sentiment towards shares in developing economies

A THIRD QUARTER survey from investment professionals body CFA UK shows institutional investors are seeing increasing value in emerging market shares following a widespread sell-off earlier in 2018.

Emerging market equities are seen by 53% of respondents as being undervalued, up from 42% in the second quarter. By way of contrast, developed market stocks were seen by 65% of respondents as being overvalued.

About half of the respondents saw gold as being fairly valued, with 76% seeing corporate bonds as overvalued and two thirds seeing government bonds as overvalued.

CFA chief executive Will Goodhart says: 'Not all has been positive for emerging market equities recently; we've seen raising rates, a strong dollar and US trade tensions – all of which do not bode well for them – and we may see investors' perceptions shift to a more neutral position in the coming months. Our respondents continue to see these as uncertain times.' (TS)

Living wage increase: which stocks are most impacted?

Increased staffing costs could be a real headache for some businesses

Consumer-facing firms in the restaurant, leisure and hotel sectors could be worst affected by a 4.9% increase in the national living wage to £8.21 next April, as announced in last month's Budget.

Canaccord Genuity Wealth Management has used its in-house research tool to identify listed businesses with the highest percentage of wages to sales, flagging the likes of **Halfords (HFD)**, **Pets at Home (PETS)** and **Mitchells & Butlers (MAB),** among others.

'A higher wage bill has to be funded somehow, and money could be shaved from directors' stipends, research and development funds and it could also potentially hit shareholder dividends,' says senior equities analyst Simon McGarry.

For example, budget bakery **Greggs (GRG)** could in theory face a 24% decline in its operating margin off the back of a 5% increase in wages, with a wage bill that stands at nearly 40% of total sales, says McGarry. (TS)

WHO COULD TAKE A LIVING WAGE HIT?

Company	% decline in operating margin if wages rise 5%
Greggs	24%
Restaurant Group	23%
JD Wetherspoon	21%
Halfords	16%
Devro	12%
Pets at Home	12%
Hotel Chocolat	12%
Mitchells & Butlers	11%

Source: CGWM

Trustpilot IPO could provide big bucks exit for seed backer Draper Esprit

Early stage technology business investor has seen its stake value soar

BUSINESS REVIEWS platform Trustpilot is believed to be mulling over a stock market flotation as it looks to raise extra growth funding, an event that could provide a mega-profit exit for **Draper Esprit (GROW:AIM)**, the UK venture capital investor.

Draper has been backing Trustpilot for several years, helping to fuel the rapid growth of the internet economy company.

The platform, which provides analytics tools for businesses on customer feedback to help boost engagement, logged its 50 millionth review covering more than 200,000 businesses in October.

Draper Esprit's stake in the business increased in value from £34.3m to £49.5m in the six months to 30 September.

Reports suggest that Trustpilot has engaged investment banks to look at its options, with an IPO (initial public offering) seen as a natural step in its growth road map.

'Trustpilot looks to be on a path to IPO in 12 to 18 months at an attractive valuation,' said one analyst. (SF)

We've warmed to Magners maker C&C, so should you

The drinks group offers an attractive 4.8% prospective dividend yield and is starting to look much healthier

C&C ↗ BUY
(CCR) €3.34
Stop loss: €2.50

Market cap: €1bn

Irish brewer **C&C (CCR)**, the premium drinks company which makes and distributes brands including *Bulmers*, *Tennent's* and *Magners*, looks an appealing pre-Christmas value tipple at €3.34.

Shares has previously been lukewarm on the beverages stock, but C&C is at a turning point following the acquisition of Matthew Clark and Bibendum (MCB) out of the ashes of Conviviality and with other parts of the business making palate-pleasing progress.

The Dublin-headquartered cider, beer, spirits and soft drinks play is a new position in investment trust **Fidelity Special Values (FSV)**, managed by value-contrarian Alex Wright.

Buying unloved companies and holding them until their potential value is recognised by the wider market, Wright was attracted to C&C following its acquisition of drinks distributor Matthew Clark, transforming a previously struggling UK business.

C&C has made progress in stabilising the previously distressed MCB, with customer service levels normalising, suppliers repaid and the UK taxman (HMRC) paid all overdue balances.

Half year results (25 Oct) included signs of positive progress in C&C's core business, with net revenue up 6.4% and operating profit 4% ahead in the six months ended 31 August; boosted by balmy weather and the World Cup, plus *Bulmers*, *Magners* and *Tennent's* each increased share in their key markets.

Excitingly, C&C's distribution deal with AB InBev has given its cider portfolio a stronger route to market into UK retailers.

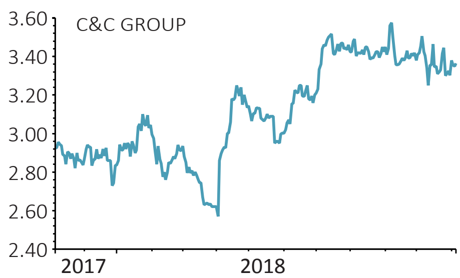
As well as boasting an earnings boosting minority stake in the Admiral Taverns tenanted pub group, C&C makes US craft cider brand *Woodchuck* and recently bagged the exclusive rights to distribute leading Chinese beer *Tsingtao* across Ireland and the UK.

For the year to February 2019, Shore Capital forecasts adjusted pre-tax profit improvement to €92.2m (2018: €79.2m), rising to €105.7m in the following year.

Besides the competition, one risk to consider is net debt of €278.9m, equating to a net debt-to-EBITDA ratio of 2.1 times.

Yet C&C is generating strong free cash flow and targeting 2-times leverage by the end of full year 2020.

Shore Capital forecasts a 15.3c dividend for this financial year, rising to a 16.1c shareholder reward the year after. On next financial year's 29.5c earnings per share estimate, a prospective price-to-earnings ratio (PE) of 11.3 leaves re-rating scope and C&C also offers a juicy prospective dividend yield of 4.8%. (JC)



Pubs operator EI looks very appealing for drinkers and investors

We outline potential catalysts to drive significant value at the business previously called Enterprise Inns

We are confident that the UK's largest pub company **EI Group (EIG)** is making good progress with its transformational strategy and is on the verge of generating significant value for shareholders.

With a portfolio of 4,500 pubs, EI has recently enjoyed a surge in its share price, up 134% from its near-three year low of 72.9p in February 2016.

EI is arguably in a sweet spot with its wet-led focus as pubs are currently reporting much stronger demand for drinks rather than food.

Berenberg analyst Owen Shirley says EI trades on a discount of around 50% to net asset value (NAV) which is 'too big to ignore'. As of 31 March, NAV was £1.52bn compared to the £795m market cap.

EI had a hard time during the financial crisis of 2007-2008 as it struggled with very high levels of debt.

Shirley says EI's investment in its pub estate has driven returns on investment, a measure of how profitable an investment is, to over 20%. A figure of over 15% is generally seen as desirable.

The analyst argues its decision to sell the Commercial Properties portfolio could generate £300m to pay down debt, trigger a re-rating closer to NAV and potentially lead to a special dividend.

EI GROUP ↗ BUY
(EIG) 171p
Stop loss: 136.8p

Market cap: £795m

'Through a combination of disposals and free cash generation, the company should deleverage at a rate of over £100m per year, which could drive a material debt to equity shift,' comments Shirley.

The bulk of EI's pubs (3,856) fall under Publican Partnerships where the tenant pays a discounted rent but is obligated to buy beer from the group.

Under the Commercial Properties division are 351 independent pubs that pay rent to EI under a lease that generally lasts between 10 to 20 years.

In 2015, the strategy changed from running pubs at arms' length by tied tenants with changes occurring in the Managed Operations and Managed Investments divisions with a total of 319 pubs.

In Managed Operations, pubs are now operated via The Bermondsey Pub Company and Craft Union.

Craft Union focuses on selling drinks in community pubs and is similar to a franchise model. These pubs are led by self-employed operators taking responsibility for organising and paying staff while receiving 18% of sales.

Managed Investments involves EI leasing an estate with 'significant upside potential' to a partner with equity typically split 70% and 30% with EI traditionally taking the lion's share.

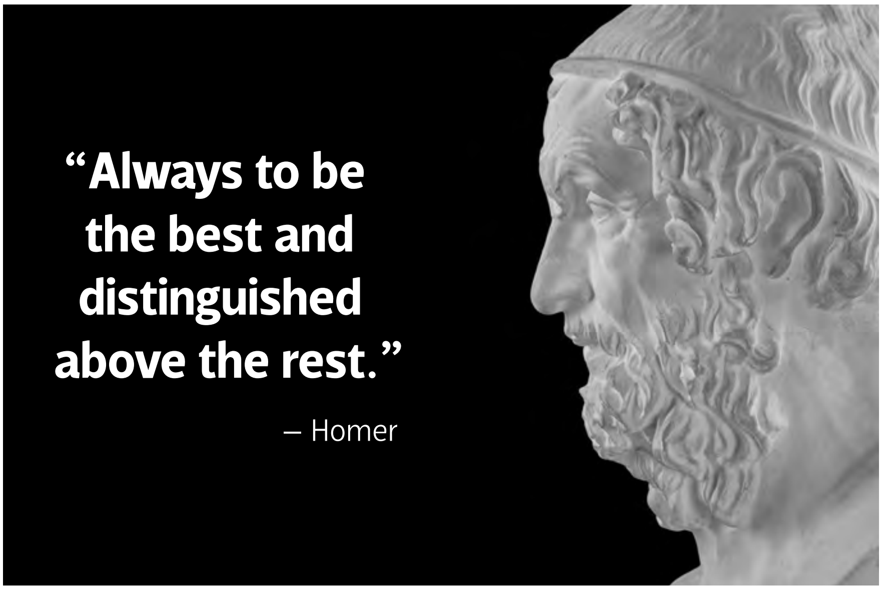
Liberum analyst Joe Brent is optimistic the pub group can more rapidly deleverage and undertake disposals as trading has improved across the board. (LMJ)

EDISTON PROPERTY INVESTMENT COMPANY

EPIC FOR INCOME

If you're looking for monthly income, you want it to be built on firm foundations. At Ediston, we take that seriously – and literally. All of our investments are in properties we know inside out and from top to bottom.

This in-depth understanding of our investments assures us that the income we provide to our investors is as solid and secure as it can be. That's why we're able to pay a highly competitive dividend in monthly instalments – allowing our investors to rely on a steady income stream to cover everyday expenses.



A growing dividend

Ediston currently offers a 5.3%* annual yield. Our income payments stem from a diversified portfolio of properties, helping the sustainability of the overall dividend. We have maintained the dividend since the inception of the fund, and we expect it to grow in future. The dividend is also well covered – meaning there's something in reserve if underlying earnings fluctuate.

*as at 30th September 2018

A wealth of experience

The strongest support for our dividend comes from the expertise of our team. We live and breathe property. While the Ediston Property Investment Company listed on the London Stock Exchange (LSE: EPIC) in 2014, the broader Ediston business has been operating in the UK market since 2004. On average, each member of our team has more than 20 years' experience in property investment and development.

Beyond bricks and mortar

When we consider any investment, our focus is always on cash flow. We want to be sure that our properties are not just paying for themselves but also paying out sustainable income for our investors.

To do this, we look well beyond the physical buildings themselves to understand how the properties 'live and breathe' – how they fit into their location and their economic environment. We go to great lengths to ensure that risks to the cash flow are minimised and that occupancy rates and tenant satisfaction are maximised.

We have a profound understanding of all aspects of managing real estate for the benefit of our tenants and investors. This spans the range from change-of-use applications, through to refurbishment and redevelopment, to tenant liaison, lease negotiations and rent reviews. Each of these aspects offers opportunities for improving the income stream available from property.

ediston

Intensive, entrepreneurial and unconstrained

Our approach to property investment is intensive and entrepreneurial. No holding in our portfolio is left to look after itself. We sweat the small stuff, and we do it at every level of the process – from developing new properties to ensuring that existing tenants are satisfied and that no potential for improvement is missed. And with no benchmark, we're free to focus on the areas where we see the greatest potential for sustainable income and steady capital growth.

We're confident that our record of steady income and sustainable capital growth is a compelling combination. So, if you need a regular income stream from actively managed investments, we've got you (and your dividend) covered. ■

EDISTON PROPERTY INVESTMENT COMPANY ('EDISTON') IS A UK-LISTED REAL ESTATE INVESTMENT TRUST (REIT) INVESTING IN COMMERCIAL PROPERTY THROUGHOUT THE UK WWW.EPIC-REIT.COM

WH SMITH
(SMWH) £19.60

Loss to date: -3%
Original entry point:
Buy at £20.20, 14 June 2018

THE RETAILER IS to pay £155m to buy US airport chain InMotion, propelling the size of its travel arm and further reducing its reliance on the UK high street. It also provides a platform from which to expand across the US which is the world's largest travel retail market.

Strategically this acquisition is very good as the travel arm is the main growth driver for group earnings. The market is clearly pleased, given how its share price has rocketed by 15% since the deal was announced on 31 October 2018.

It is worth putting that movement in some wider context as WH Smith's share price had taken a beating earlier in the same month when full year results (11 Oct) showed a 4% decline in full-year pre-tax profit.

Excluding any future contribution from InMotion, WH Smith's travel arm accounts for over half of group sales and two thirds of its profit. The travel division grew trading profit in the year to 31 August by 7% versus a 3% decline from its high street operations.

SHARES SAYS:
The InMotion deal provides fantastic growth opportunities to a business which many people (incorrectly) think is in terminal decline. We remain big fans and continue to rate the shares as a solid 'buy'. (DC)

RELX
(REL) £15.31

Gain to date: 2.1%
Original entry point:
Buy at £15.00, 1 March 2018

THE WIDER market correction has taken some of the shine off **RELX's (REL)** shares but the publishing firm remains a bastion of reliability as reflected in its recent nine-month trading update (25 Oct).

This reaffirmed full year guidance with underlying revenue growth for the period of 4%, bang in line with the recent trend.

RELX augments this steady growth with M&A activity and has acquired seven assets for a combined £943m year-to-date while selling four assets for £28m.

The Scientific Technical Medical division, a key concern for the market given fears that education institutions might push back on the pricing of academic journals, managed reassuringly solid growth of 2%, although this was down slightly on the 3% growth seen in the first half of the year.

The company has also completed a simplification of its structure whereby the Anglo-Dutch firm has abandoned its dual-share structure and retained a PLC listing in London.

Numis analyst Steve Liechti says that 'against a volatile broader market backdrop RELX remains a safe place to hide in the media sector'.

SHARES SAYS:
We continue to view RELX as a quality stock to hold for the long term. Keep buying. (TS)

SCOTTISH MORTGAGE
(SMT) 482.5p

Gain to date: 0.2%
Original entry point:
Buy at 481.4p, 18 October 2018

IMPRESSIVE HALF year results on 2 November have helped to put our positive call on leading investment trust **Scottish Mortgage (SMT)** off to a steady start.

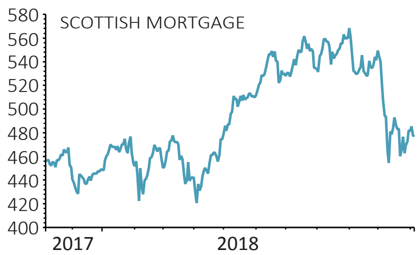
The trust's net asset value increased by 19% in the six months to 30 September compared with an 11.4% gain for its FTSE All-World Index benchmark.

This period does not encompass the recent stock market correction when Scottish Mortgage was hit thanks to its exposure to growth stocks and, in particular, US technology businesses.

If, as the managers point out, six months is too short a time over which to measure their success then a matter of weeks certainly is.

By sticking to a consistent approach of investing in both public and private firms with the potential to grow substantially on a five or 10-year view the trust has delivered an average annual return for its shareholders of 23% over the last decade.

The latest financial results also demonstrated the advantage of being able to invest in unquoted firms. Since June 2010 when it made its first investment in a private company, these unquoted firms have delivered a total return of 419%.



SHARES SAYS: ↗
We remain confident in Scottish Mortgage. Keep buying. (TS)

Superdry co-founder plots boardroom coup in a bid to 'fix' the retailer

Julian Dunkerton talks to *Shares* about his plans to regain control of the business

Shares in branded fashion retailer and wholesaler **Superdry (SDRY)** have shed almost 60% of their value since the start of January, dropping from £20.76 to a bombed-out 875p on disappointing trading and earnings downgrades.

This share price fall from grace has stirred Superdry co-founder Julian Dunkerton to try to get his old job back running the business.

Dunkerton was chief executive until 2014 before switching to the role of brand director. He left the business completely in March this year in order to devote more time to other interests, yet he has clearly been unhappy about a change of strategy.

THE COMEBACK KID

Dunkerton is now mounting a campaign to build shareholder support for a return to Superdry, supported by co-founder James Holder (holding sway over 9.7% of the business). He tell *Shares* that he is getting very positive shareholder feedback.

The co-founder's goal is to correct what he insists is a fundamentally flawed strategy by the current management team led by CEO Euan Sutherland.

Entrepreneur Dunkerton has been meeting with Superdry's leading institutional investors in a bid to wrestle back control of the trendy jackets, hoodies and t-shirts designer, and has met with chairman Peter Bamford to express his concerns over the direction Superdry is taking.

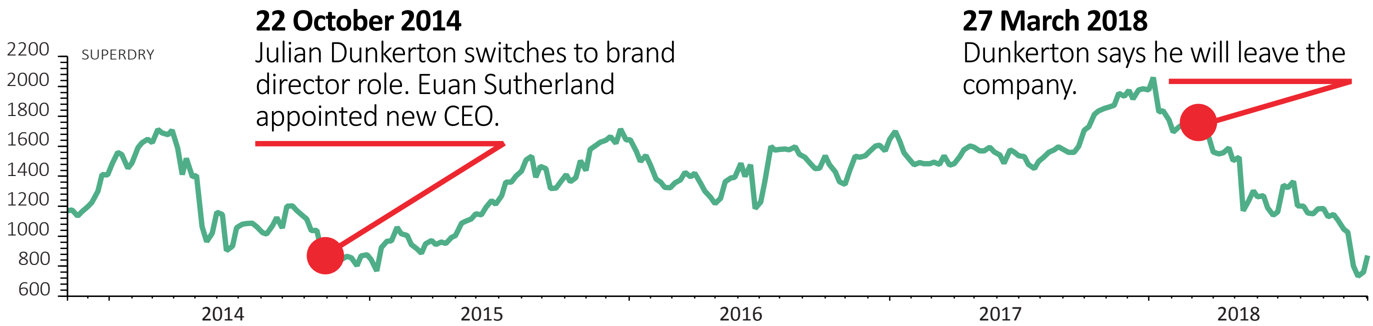
Dunkerton is particularly critical of Superdry's tactic of reducing product lines, when competitors are doing the opposite, and of the 'penny pinching' mindset of the management team, insisting Superdry's eroded gross margin is 'absolutely there to be recaptured'.

CLASPING THE FALLING KNIFE

'My personal losses are considerable,' he tells *Shares*. 'I've still got a huge stake (18.45%) and I just can't watch a falling knife destroy the 33 years of what I've built up.'

The self-styled proper old school retailer adds: 'I've been pointing out the mistakes in the strategy for a long time. It is patently obvious it is not working, but it is totally rectifiable. We can sort this out very quickly.'

Dunkerton says Superdry is a successful global brand. 'To start making the wrong decisions and



missing the opportunities which are just enormous, it baffles me to be perfectly honest. I think the current management strategy has a negative outlook.'

He is highly critical of management's current strategy to save money by having a single stock pool.

'You can save some money by doing that,' he explains. 'And what they're trying to do is have the same product in store, online and in wholesale. If that then stops you from expanding your product range, as is currently the thought process, what you're going to stop doing is pushing the boundaries for the consumer.'

Dunkerton is also scathing on current management's ability to get the retail basics right and is angered by the decision to sack Superdry's entire visual merchandising team.

'The only reason you would do that is if you think you can save a few quid, but the reality is your consumer experience is reduced. If you are just shoving product onto rails with no visual artistry to it, in the end, the brand is damaged, because people are buying into an experience. They don't have to buy product from you, they *want* to buy product from you.'

FIXING THE PROBLEMS

Dunkerton says these issues will be resolved if he is successful in returning to the business.

'This is a brilliant brand that just needs pointing in the right direction. There may be some changes necessary around me, but in essence it is obvious and clear to everyone I meet that the strategy I am proposing is logical and sensible.

'We can turn it around, but we have to act now. I am meeting all the shareholders and getting very positive feedback. You can't dispute the obvious strategic logic, so this is just about mechanics now.'

It seems clear that Dunkerton wants to keep the company as a listed entity rather than take it private, perhaps with the backing of a private equity consortium. 'When investors realise what the growth opportunity and the scale is, the public arena is the place to deliver the price that makes sense. The rating will come based on that vision.'

We expect Dunkerton's next move will be to request an emergency general meeting whereby shareholders will be asked to vote on the co-founder replacing Euan Sutherland as CEO. (JC)

THE OFFICIAL SUPERDRY RESPONSE

Superdry's chairman Peter Bamford responded to Dunkerton's campaign by saying: 'The board of Superdry has huge respect for Julian Dunkerton as an entrepreneur and founder of the business.

'Julian has raised a number of issues with the board regarding strategy since he left the business. We have reviewed and discussed these issues and, while we have some sympathy with some of his points, we have a different view on the best strategy or approach to addressing them.

'Superdry is an ambitious, global, multi-channel brand and the board believes that Julian's viewing of strategy has not evolved with the needs of the business.

'We remain fully committed to our successful Global Digital Brand strategy and the board is confident that Superdry has in place the right leadership to ensure the continued development of our highly relevant brand.'

HOW TO AVOID BAD INVESTMENTS

AN EASY WAY TO SPOT COMPANIES WITH FINANCIAL HEALTH ISSUES

Investors tend to spend most of their time looking for assets that will appreciate in value over time. Yet according to loss aversion theory, most of us get a bigger kick out of side-stepping disaster than picking runaway successes.

We are not talking about share prices falling 15% or 20% as the market mood takes a downswing, as we have all witnessed during recent weeks. Those sort of events will burn the financial fingers of anyone who takes the widely received wisdom of staying invested for the long-haul.

Instead, we are talking about dodging the bullets fired by the likes of Carillion, **Crawshaw (CRAW:AIM)**, Conviviality and **Patisserie (CAKE:AIM)** – all of whom ended up in administration and shareholders were wiped out, or they have recently experienced major financial problems.

But were these disasters, and many like them, really out of the blue? Perhaps not, according to academics who believe the warning signs are often there for those willing to read them.

If the boffins are right, how much would you be willing to pay for a predictive toolkit that could have flagged up Carillion long before it went to the wall in January 2018?

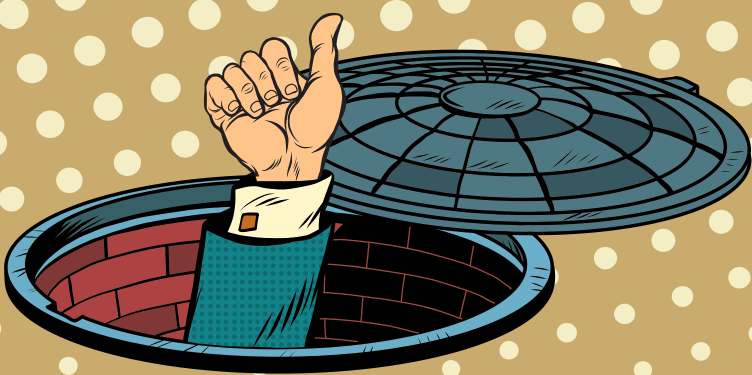
That sort of financial distress weapon could have been wielded to prevent losing thousands of pounds, getting you and other investors out long before the firm's ultimate collapse, having alerted you to the soaring risk before the bottom fell out of the share price.

This is a job with which Altman Z-scores are supposed to be able to help. Later in this feature we'll show you a handful of companies, large and small, potentially open to a financial bombshell.

A simple Z-score is a statistical measurement used to compare data points from different data sets to find correlations. Z-scores can be positive, negative or plain zero.

This concept was adapted to the business and finance world by Dr Edward Altman in the 1960s who used the metric to predict the likelihood that a company would go bust.

His calculation, now called the Altman Z-score, looks at several weighted financial ratios and compares them to a graded scale. The lower the score, the more likely the company is to declare bankruptcy.



HOW THE SCORING WORKS

The higher the Altman Z-score, the better.

Above 2.99:
A company is very unlikely to face financial collapse

1.80 to 2.99:
This grey area flags caution, with a decent chance of company failure

Below 1.80:
This is red alert territory where high financial distress means there is a very good chance of corporate ruin

INVESTOR APPLICATIONS

Altman, a New York University professor, evaluated 66 companies where 50% of them had already filed for bankruptcy between 1946 and 1965. He analysed these companies using 22 ratios, which were classified into five categories: liquidity, solvency, leverage, profitability and activity.

Initially the Altman Z-score showed itself to be 72% accurate when it came to predicting that a company was going to the wall. But the accuracy improved with time.

Further studies over the subsequent decades (1969 to 1996) involved researching another 300 or so companies. The Altman Z-score got better, and better, first improving to 82% accuracy, then 94%.

Yet the applications for the Altman Z-score can help investors discover more about companies than whether or not they are facing collapse.

A study in 2009 by Graham Secker, a strategy analyst with investment bank Morgan Stanley, compared Altman Z-scores with the share prices of a basket of European stocks.

He discovered that companies with weaker balance sheets underperformed the market more than two thirds of the time. He also found that companies with an Altman Z-score of 0.99 or less were likely to underperform the wider market by more than 4% a year, with a probability of 72%.

ALTMAN Z-SCORE NUTS AND BOLTS

The calculation looks like this:

$$Z\text{-}SCORE = 1.2A + 1.4B + 3.3C + 0.6D + 1.0E$$

If you're one of those people who were endlessly befuddled by mathematical conundrums (algebra, calculus?) back in your school days, stand easy as the equation looks more baffling than it is.

To fill in the relevant values all you'll need is a set of readily available company accounts (the full year results or annual report will do), and the following recipe.

Each ratio gets a weighting to make it less or more influential to the Altman Z-score rating depending on the relevance as per professor Altman's research. You add them together to get the final score.

You can find the scores on many well-known financial websites such as SharePad if you don't want to calculate them yourself.

THE FORMULA

A = Working capital / total assets (multiple this figure by 1.2 for the Altman Z-score)

This ratio measures liquid assets. The companies in trouble will usually experience shrinking liquidity.

B = Retained profit / total assets (multiply by 1.4)

This ratio calculates the overall long-run profitability of the company. Dwindling profitability is a warning sign.

C = Trading profit / total assets (multiply by 3.3)

This ratio shows how productive a company is in generating earnings, relative to its size.

D = Market capitalisation / total liabilities (multiply by 0.6)

This ratio suggests how far the company's assets can decline before it becomes technically insolvent (liabilities become higher than assets).

E = Revenue / total assets (no multiplication needed, 1:1)

This is the asset to turnover ratio and is a measure of how effectively the firm uses its assets to generate sales.

COMPANIES IN Z-SCORE ‘RED ALERT’ TERRITORY

FTSE 350	Share price (p)	Z-score
AA	106.2	-0.6
Capita	127.1	0.1
Premier Oil	107.4	0.2
Tullow Oil	215.9	0.5
Thomas Cook	54.5	0.8
Mitchells & Butlers	264	0.9
ContourGlobal	195.3	0.9
Spire Healthcare	132.7	1.0
Inmarsat	469.1	1.1
Avast	298.1	1.2

SMALL CAPS	Share price (p)	Z-score
Lonmin	48.2	-5.4
STV	390	-2.0
Circassia Pharmaceuticals	62.2	-1.3
Gem Diamonds	104.5	-0.5
Puretech Health	162	-0.1
Acacia Mining	158.7	-0.1
EnQuest	28.3	0.02
Premier Foods	39	0.03
Debenhams	8.8	0.09
Charles Taylor	235	0.3

Source: SharePad

GOING BEYOND THE ALTMAN Z-ZONE

Altman’s original research has been used as the platform for further analysis over the years by other academics, such as Professor Richard Taffler. He is currently a finance professor at Warwick Business School and is a leading authority on behavioural finance and investment and has published over a hundred academic and professional papers and books.

Using decades of research he has developed his own Performance Analysis Score, or PAS for short, a system rooted in the Altman Z-score.

This is a financial analysis prediction machine designed to spot the financial fault lines buried within a company’s balance sheet that are all too often ignored by the wider investment community.

It is able to ping alerts when a company’s financial risk flashes red yet where the market has been slow to reflect this in the share price.

It claims to have flagged up rising risk levels in all 20 of the UK stock market bankruptcies since 2010. Another 32 companies that were eventually crushed under financial strain were also flagged by PAS.

Familiar names on this black list include Clinton Cards, Blacks Leisure, HMV, JJB Sports, Luminar and Snoozebox.

Perhaps its most striking red flag was at Carillion, which popped up on the PAS black list back in 2013, when its share price was riding high at more than 300p. The stock made steady progress lower right up until the company began its death throes in 2017.

GAIN AS WELL AS PAIN

PAS is also capable of highlighting names which may be in better shape than is suggested by their share price.

The system indicated earlier this year that

COMPANIES IN Z-SCORE 'CAUTION' TERRITORY

FTSE 350

	Share price (p)	Z-score
Babcock	618.8	1.8
Sainsbury	318.7	1.8
Tesco	216.1	1.8
Sirius Minerals	23.78	1.8
DS Smith	389.9	1.8
British American Tobacco	£33.43	1.8
RPC	782.4	1.8
Cobham	107.35	1.8
AstraZeneca	£57.32	1.9
Balfour Beatty	275.6	1.9

SMALL CAPS

	Share price (p)	Z-score
McBride	130.2	1.9
Reach4entertainment	1	1.9
Sportech	52	2.0
Georgia Healthcare	230	2.1
ITE	60.9	2.1
Norcros	217	2.2
Communisis	71	2.2
Chemring	183.4	2.3
Mitie	145	2.3
Vp	£10.10	2.3

Source: SharePad

Marks & Spencer's (MKS) financials were quite sound, the opposite of what the market appears to be saying given its downwards share price performance over the past three years.

The PAS data also implied there is still life left in *Mr Kipling* baker **Premier Foods (PFD)** despite significant debt levels.

Taffler hopes to develop a range of tools for retail investors using the PAS system after teaming up with small cap investment advisory Equity Development.

NO SILVER BULLET

While PAS and the Altman Z-score have interesting applications for investors, it is also important to recognise the limitations.

For a start, a weak ranking does not necessarily mean a company is going bust. While it is difficult to imagine a corporate collapse that doesn't show up with a weak Altman Z-score, plenty of companies have staged recoveries and escaped from the jaws of financial oblivion.

Another point worth noting is that the Altman Z-Score does not work very well for all companies.

The formula simply doesn't stand up for the business model of most financial companies (banks, insurers, etc.). Utility firms also score poorly, skewed by low returns on assets and typically large debts, while ignoring enormous and stable cash flows, making them highly unlikely to get into too much distress.

The Altman Z-score also penalises young companies that haven't been around long enough to build up lots of retained profit. New businesses do have higher bankruptcy rates but they can also be the source of huge profits for an investor if the company gets its growth and funding requirements right.

The Altman Z-score is not meant to be a stock selection tool in its own right; think of it as an extra thing to check when you're running over companies that might have piqued your interest for various reasons. (SF)

Z-SCORES: A BREAKDOWN OF THE NUMBERS ON 3 STOCKS

(£m)	John Wood	Marks & Spencer	Halma
Current assets (x)	4,050	1,317.9	435.4
Current liabilities (y)	3,270	1,826	172.0
Working capital (x – y)	780	-508.1	263.4
Total assets	12,414	7,550.2	1,446.9
Retained profit	4,856	2,199.4	685.5
EBIT (trading profit)	212.4	670.6	223.7
Market cap	4,624	4,877	5,042
Total liabilities	7,181	4,593.5	618.5
Revenue	5,394	10,698	1,076
A x 1.2	0.08	-0.07	0.22
B x 1.4	0.55	0.41	0.66
C x 3.3	0.06	0.29	0.51
D x 0.6	0.39	0.64	4.89
E x 1.0	0.43	1.42	0.74
Z-score	**1.51**	**2.69**	**7.02**

Source: Reuters Eikon, Shares

Can the Government really save the high street?

The Treasury promises local shops for local people

In the Budget last week Chancellor Philip Hammond announced three measures to try to revive beleaguered UK high streets.

The first is the creation of a £675m Future High Streets Fund to support and finance local areas' plans to re-invigorate their high streets and town centres making them 'fit for the future'.

The second is a one-third cut in business rates for companies with a rateable value of less than £51,000 for the next two years.

The third is a digital sales tax intended to turn the tables on global platform businesses which create value in the UK but don't pay their 'fair share' of taxes in the Chancellor's opinion.

Together these measures are a welcome shot in the arm for high-street businesses but it's debatable how big their impact will be and whether or not they can actually get people back to town centres.

The cut in business rates will supposedly help 90% of small shops, cafes and bars, but the 10% of businesses which are too large to qualify actually pay 70% of the total raised through business rates.

Similarly the unilateral digital sales tax is unlikely to dissuade shoppers to stop using Amazon and the like even if some of the tax is passed on to them.

> **In-store sales have barely grown this year despite the 'barbecue' summer and the brief lift from the World Cup**

'SOMETHING MUST BE DONE'

Due to the explosion in online shopping and changing consumer habits footfall on the high street is in freefall.

According to Barclaycard's monthly consumer spending report, in-store sales have barely grown this year despite the 'barbecue' summer and the brief lift from the World Cup.

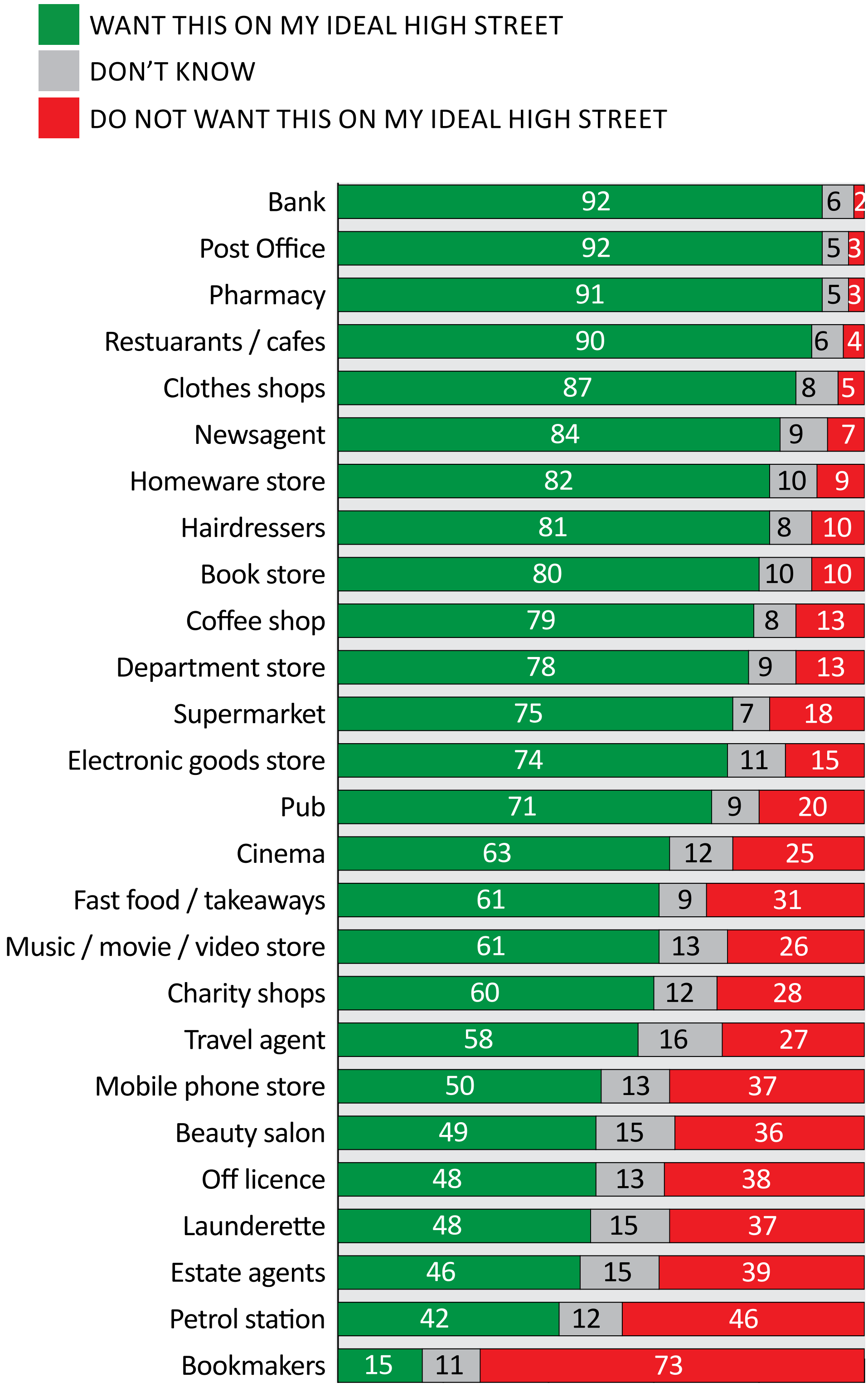
Figures from retail consultant Springboard show footfall on high streets and in shopping centres is in inexorable decline while out-of-town retail parks have seen footfall rise slowly but steadily.

The big question is, if we're going to get people back to the high street, what do we want it to look like?

This is exactly what polling company **YouGov (YOU:AIM)** asked shoppers in a survey carried out in May. The results are as surprising as they are confusing.

BRITAIN’S IDEAL HIGH STREET

WHICH OF THE FOLLOWING TYPES OF SHOPS WOULD YOU WANT OR NOT WANT TO SEE ON IT? (%)



Source: YouGov

THE IDEAL HIGH STREET DEPENDS ON WHO YOU ASK

The top five shops on the ‘dream’ high street are a bank (92% of respondents), a post office (also 92%), a pharmacy (91%), a restaurant or café (90%) and a clothes shop (87%).

This seems somewhat ironic as banks and post offices are among the shops disappearing most rapidly with over 700 high street bank branches and nearly 600 post offices shutting up shop last year alone.

Also with in-store clothing sales contracting dramatically as shoppers take their habit online – as illustrated by the likes of **Next (NXT)** – the hankering for more clothing shops is something of a mystery.

The least popular shops are bookies (with 73% of respondents specifically voting against rather than for) followed by estate agents, dry cleaners, off-licences and beauty salons.

Broken down by demographics, the results are even more startling. While the 65s and over voted for travel agents, newsagents, homeware and book stores, the 18 to 24-year olds voted for fast food shops, video game stores, cinemas and mobile phone shops.

By gender, more women than men voted for coffee shops, charity shops, book stores and beauty salons while in stereotypical fashion more men voted for off-licences and bookmakers.

Sadly department stores failed to fire up the young or the old, as borne out by the ongoing demise of **Debenhams**

THE 2018 RESULTS: UK WIDE

THE TEN 'UNHEALTHIEST' UK HIGH STREETS	
POSITION	LOCATION
1	Grimsby
2	Walsall
3	Blackpool
4	Stock-On-Trent
5	Sunderland
6	Northampton
7	Bolton
8	Wolverhampton
9	Huddersfield
10	Bradford

THE TEN 'HEALTHIEST' UK HIGH STREETS	
POSITION	LOCATION
1	Edinburgh
2	Canterbury
3	Taunton
4	Shrewsbury
5	Cheltenham
6	York
7	Brighton & Hove
8	Eastbourne
9	Exeter
10	Cambridge

Source: RSPH

(DEB) and the ignominious exit of House of Fraser.

HIGH STREETS AFFECTING OUR HEALTH

Another study, published last week by the Royal Society for Public Health, shows a sharp divide between high streets in northern England and those in the south and paints a worrying picture of our town centres.

As well as identifying the healthiest and unhealthiest high streets out of 70 towns and cities in the UK, the study makes some hard-hitting recommendations.

First, it says there are too many fast food and betting shops so the Government should allow local authorities to restrict more shops opening where there are already clusters. It also suggests there should be no hot food takeaway shops to open within 400m of a school.

Second, it recommends all businesses selling food on the high street need to reduce the calories in their products while health-promoting businesses should be offered discounted advertising including on social media sites.

Third, it suggests rents and rates should be set according to health-promotional efforts of each business, with those that try to improve public health favoured the most.

If the Treasury is able to build a coherent regeneration strategy using surveys such as these along with its promise to bring planning 'expertise' and a 'hands-on approach' then maybe there is hope for the high street.

All these issues are relevant to various London-listed stocks with high street exposure including **Marks & Spencer (MKS)**, **Card Factory (CARD)**, **Domino's Pizza (DOM)** and **William Hill (WMH)**.

One way to encourage shoppers back to the high street would be to encourage free parking. However with councils making record amounts in parking fines (£819m in the financial year 2016-17 according to figures from the Department for Communities and Local Government) there are probably too many vested interests to allow such a simple fix to work. (IC)

"Why am I being taxed so much on a pension withdrawal?"

AJ Bell expert Tom Selby has the answer to this question

Steve from Stroud

Last month I took a £20,000 uncrystallised funds pension lump sum (UFPLS) payment from my pension to pay for renovations to my house. I don't have any other income so assumed I'd only pay tax of about £1,700.

However, I've just received my payment and it's less than £13,000 – can this possibly be right?

Tom Selby, AJ Bell senior analyst, replies:

Unfortunately it sounds like you're one of tens of thousands of people to fall foul of the pension freedoms tax trap.

Under Government rules anyone who accesses their retirement pot for the first time using the pension freedoms is taxed on a 'Month 1' basis.

This is an emergency tax code and means you receive 1/12th of your usual tax allowances.

So while normally you'd expect any income below £11,850 to be tax-free, where Month 1 is applied this reduces to just £987.50.

Similarly, the size of your basic-rate tax band drops from £34,500 to £2,875, while the higher-rate band falls from £115,500 to £9,625. Any income beyond this will be taxed at the additional rate of 45% under Month 1.

All of that means your hard-earned pension risks being hit with significantly higher tax charges than you would normally expect.

It's worth noting this doesn't affect everyone who accesses their pension flexibly. If someone takes a regular income or multiple payments from their fund in a tax year then HMRC should be able to reconcile their tax position without them doing anything.

In your case, however, the best way to be absolutely sure you get the pension you are owed is by filling out the relevant Government reclaim form. You can find these forms here: www.gov.uk/claim-tax-refund

If the withdrawal used up your entire pension pot and you have

no other income in the tax year, you need to fill in form P50Z.

If the payment used up your fund and you have other taxable income, fill in form P53Z.

Finally, if the payment didn't use up your pension pot and you're not taking regular payments, fill in form P55.

The good news is once you have filled out the appropriate form HMRC should refund you within 30 days. However, if you do nothing then there is no guarantee when your money will be paid back to you.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

Send an email to **editorial@sharesmagazine.co.uk** with the words 'Retirement question' in the subject line. We'll do our best to respond in a future edition of *Shares*.

Please note, we only provide guidance and we do not provide financial advice. If you're unsure please consult a suitably qualified financial adviser. We cannot comment on individual investment portfolios.

Small cap fans: get ready for the return of champion investor Paul Marriage

The former Schroders manager is set to launch Tellworth UK Smaller Companies Fund

A well-known fund manager who in his previous job generated nearly four times as much money for investors than the broader market is back with a new fund.

Paul Marriage made his name at Cazenove and Schroders, particularly with **Schroder UK Dynamic Small Companies Fund (0721936)** which returned 435% versus 114% from the benchmark FTSE Small Cap index in the 11 years he ran the fund.

Marriage left Schroders in 2017 and together with former colleague John Warren set up Tellworth Investments. The pair plan to launch **Tellworth UK Smaller Companies Fund** at the end of November and follow the same investment process as they used at Schroders.

The portfolio is expected to have 15 to 20 of the same holdings as featured in the Schroders small cap fund when they left last year. Overall the fund managers want to build a portfolio of 40 to 60 positions with a three-year typical holding period.

'We had a decent record at Schroders and I'm not going to change the system I developed in 2000. We made good money for investors and I will try to repeat this,' says Marriage.

THE INVESTMENT PROCESS

His process begins by excluding the highest risk areas in the small cap world, namely oil, gas, mining and biotech firms. He also excludes financial brokers to avoid any conflicts of interest.

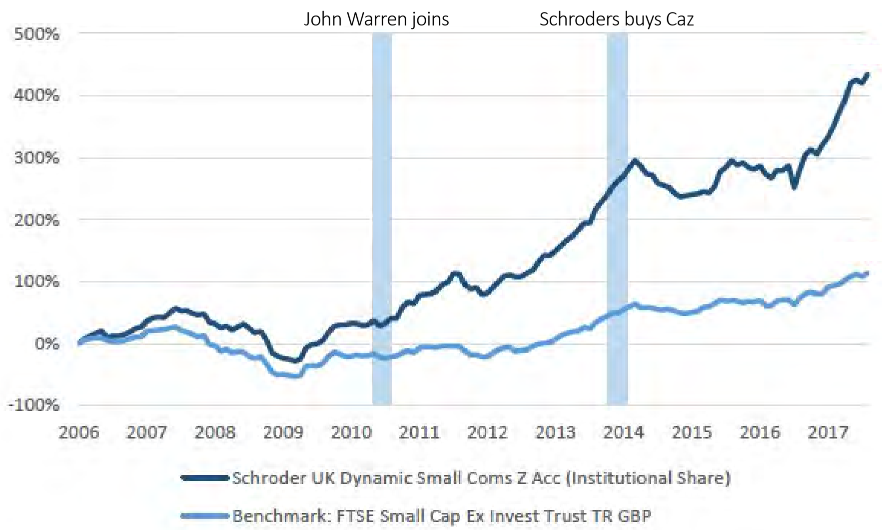
'Small cap investing is a great place to make money but also a place to lose money. I have a history degree, not an exploration or science degree, and history tells me not to bother with resources or biotech.'

Marriage then strips out companies which aren't based in the UK, even though he is happy to own qualifying ones that have international operations. He doesn't want to travel beyond a long train or short plane ride to meet management, plus he wants the flexibility of dropping in on companies if he is near their factories or offices.

Once companies worth less than £50m are stripped out, the fund manager says he is left with an investment universe of 600 stocks. 'Our bread and butter is meeting companies and picking stocks. If we can do 300 company meetings a year, we can get through our investment universe once every two years.'

The Tellworth expert

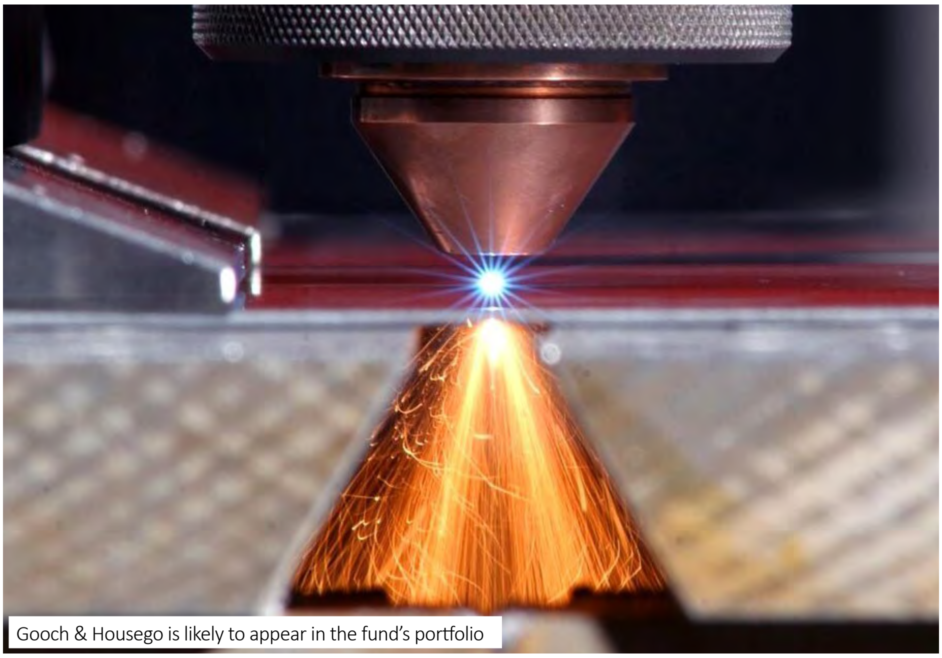
PAUL MARRIAGE'S PREVIOUS PERFORMANCE WITH SCHRODERS SMALL CAP FUND



Source: Bloomberg
Returns quoted denote performance from 01/01/2006 – 31/07/2017. Returns quoted are net of fees on the Z Acc Institutional share class. The index refers to FTSE Small Cap.

narrows down the list by using proprietary data-driven screens. ‘We look at economics via our “Thermostat” screen; we look at red flag companies with persistent accounting issues called the “Sinners” screen; and we use the “Alpha Seeker” screen to find companies whose growth is being undervalued by the market.’

This process throws up stock ideas and it also highlights ones to drop from the list, leaving the fund manager with a more manageable final 50 names, on average.


Gooch & Housego is likely to appear in the fund’s portfolio

WHEN WILL INVESTMENTS BE SOLD?

New investments are given about six months to prove their worth otherwise they are thrown out of the portfolio. Marriage sells on the first profit warning and also starts trimming once a position has made at least a three-times return.

A lesson was learned in 2014 when the fund manager held on to his winners too long and was caught out when some of them fell back sharply. ‘I needed this experience to let me learn the importance of getting out.’

LOOKING FOR BARGAINS

This autumn’s stock market sell-off has seen a lot of high-flying AIM stocks rapidly lose value. Many investors will have been disappointed with this movement, but not Marriage.

‘It gives me great joy to see these highly-rated stocks come back down. It was a long overdue reality check. The fact the top end of AIM is trading on 38 times earnings is nuts.

‘For example, **ASOS (ASC:AIM)** – while not in the small cap space – is trading on 47 times earnings despite not having any earnings upgrades since 2014. It amazes me why some investors would pay that rating now.’

The manager argues the sell-off is good for the launch of his new small cap fund as he can pick up some stocks at favourable prices. Marriage says he’s got his eye on some good quality companies which he’d be happy to buy at 15 times earnings and which are now trading on 12-times.

He says diversified hire business **VP (VP.)** particularly stands out in the current sell-off. Its shares have fallen by 15% since August and now trade on a mere 10.2 times forecast earnings for the current financial year.

‘They do lots of different things and have a strong family ownership in the firm which I like, as families take a long-term view.’

Retailer **TheWorks.co.uk (WRKS)** has also caught his eye, saying it is a good quality business with a decent opportunity. It just needs to meet earnings expectations set at its IPO in order to fully convince Marriage.

He reckons The Works – as it is better known – is taking advantage of **WH Smith’s (SMWH)** strategic shift to focus on travel outlets, as that leaves a gap on the high street to offer stationery, school stuff, gifts, books and the latest playground craze.

MAIDEN HOLDINGS FOR THE FUND

Electronics group **Gooch & Housego (GHH:AIM)** has been flagged as a likely portfolio holding, boasting a market leading position in its chosen niche, management as long-standing shareholders, and potential for margin growth. Industrials group **Renold (RNO)** is also likely to join the portfolio, says the fund manager.

He concludes: ‘One reason we were fairly successful in the past is being consistent with our approach and not being dragged into mini bubbles or stuck in junk.’ (DC)

The investment trusts borrowing money to buy on share price weakness

We reveal trusts with the capacity and appetite to increase gearing in the wake of the recent market sell-off

Market corrections are often seen by retail and professional investors as an opportunity to acquire quality stocks at a bargain price.

Investment trusts have considerable flexibility to take advantage of these situations because they can borrow money to invest, creating a larger pool from which to earn dividends or generate capital gains.

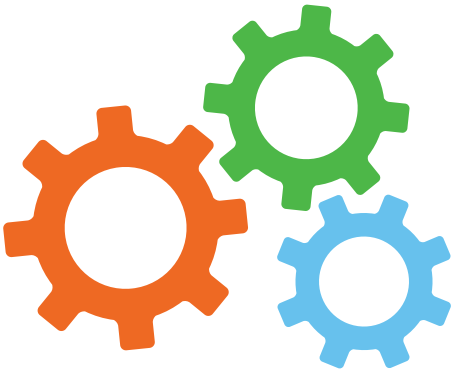
THE IMPACT OF GEARING

Borrowing to invest is also known as gearing up (or in other words increasing the proportion of debt to equity) and in a rising market it can help to boost returns. Equally it can work against investors when markets fall by adding to the short-term volatility.

It also means fund managers do not have to sell holdings they still like if they have other investment ideas they want to action.

There are different ways in which a fund manager can gear up a portfolio including bank debt, loan stock, debentures, foreign currency loans or preference shares.

Many trusts set strict in-house limits on how much gearing they can employ, typically a percentage of their net asset value and often pitched at



between 25% or 30%. In reality, many trusts will borrow a much smaller amount and some none at all.

DIFFERENT VIEWS ON GEARING

Some fund managers will reduce gearing when they believe we're heading towards more difficult market conditions.

For example, **JP Morgan American's (JAM)** Garrett Fish said in October 2018 that the current market conditions warranted a 'revision of the tactical gearing level to 0% plus or minus 2% from the previous level of 5%', effectively cutting the gearing level to zero.

It is worth pointing out that US stocks had performed particularly strongly in the run up to the recent volatility and many observers had suggested valuations had reached unsustainable levels.

In contrast many London-listed shares have lagged behind the US markets and so some fund managers are looking to take advantage of recent price weakness by deploying more money in this market.

In this article, we examine which domestic-focused UK trusts have the capacity to increase gearing, as well as talking to some managers about their investment plans.

CONSIDERABLE HEADROOM TO GEARING LIMITS

The accompanying table, based on data from stockbroker Numis, shows a collection of trusts with considerable headroom within their agreed gearing limits. It shows their 'effective' level of gearing which strips out any cash the trust is holding. It is worth pointing out that some trusts may have access to undrawn facilities which are not included in these numbers.

Charles Montanaro, who manages investment trust **Montanaro UK Smaller Companies (MTU)**, notes gearing in his trust was negligible at the end of the September. Yet he expects gearing on the trust to reach between 5% and 10% by the end of the year.

'October has been remarkable: the UK small cap sector fell 7.3%, the worst month in over six years; AIM had its worst month since October 2008; and UK small cap is now at the lowest valuation since November 2012.

'Fortunately, we were well-positioned. We are entering the seasonally strong period for stock market returns. Despite the gnashing of teeth over Brexit and the depressing geopolitical landscape, for most UK companies it is business as usual. With investor sentiment seemingly extremely cautious, we would not rule out a Santa Claus rally.'

Experienced manager James Henderson tells *Shares* he is planning to increase gearing on three of the trusts under his charge, seeing particular opportunities among smaller companies.

He says gearing could increase at **Law Debenture (LWDB)** from effectively zero to between 8% and 12%; on **Lowland (LWI)**, where he says, 'we don't move it around a great deal' potentially up to 20% 'on weakness'; and on **Henderson Opportunities (HOT)** up to 15% 'over time'.

GEARING TO SUPPORT INCOME

Lowland is an income-focused fund and, as Henderson explains, gearing can be a particularly helpful tool. He says: 'At the moment we would be borrowing with Lowland at about 1.25% and the stocks we would be buying would be yielding more than 3% and there would be things yielding 5%.'

The fund manager also notes that while gearing can increase volatility, income stocks tend at the outset to be lower beta or less volatile than the wider market.

While he concedes that you do need to be 'really careful' with gearing, he sees little chance of higher borrowing rates becoming an issue in the near term as they were for trusts which used relatively expensive debt to invest in the 1990s.

Other managers, with a remit which goes beyond the UK, are also looking to take advantage of the recent market weakness.

For example, the co-manager of **JP Morgan European Smaller Companies (JESC)** Francesco Conte notes his trust has the discretion to be 20% geared or 20% in cash.

It has operated at either ends of this extreme over the two decades he has been involved and until recently the trust had a small cash position after reducing gearing earlier this year.

Conte says: 'The sharpness and indiscriminate nature of the sell-off opened up attractively priced investment opportunities that we seized in the last few days of October so that by the end of the month we were 3.5% geared. Depending on opportunities we find we may raise this further over the coming months.' (TS)

UK-FOCUSED TRUSTS WITH BIG HEADROOM TO GEARING LIMITS

Investment trust	Effective level of gearing (%)	Gearing limit
Artemis Alpha	-3	25% of net assets
Aurora	-5	25% of net assets
Baillie Gifford UK Growth	-2	20% of net assets
Henderson Opportunities	9	25% of net assets
Independent IT	-3	50% of net assets
Invesco Income Growth	-1	20% of net assets
Invesco Perpetual UK Smaller Companies	-5	30% of net assets
Investment Company	-8	15% of net asset value
JPMorgan Claverhouse	7	20% of net assets
JPMorgan Mid Cap	11	Board limit of 25%, and max cash of 5% net assets
JPMorgan Smaller Companies	13	50% of net assets
Lowland	14	30% of net assets
Mercantile	2	20% of net assets
Miton UK Microcap	-5	15% of net asset value
Montanaro UK Smaller Companies	9	25% of net assets
Murray Income	7	25% of net assets
River & Mercantile UK Micro Cap	-5	20% of net asset value
Schroder Income Growth	8	25% of net assets (put options used to manage gearing)

Source: Numis, 1 Nov 2018

We show you the most expensive ETFs on the market

Products targeting exotic markets and offering niche exposures can charge similar fees to active funds

Exchange-traded funds (ETFs) have fast gained popularity for their reputation as a low-cost investment option. Cost-conscious investors have been attracted to these tracker funds because of their ability to track global stock markets for an annual fee as low as 0.04%.

Investors should be sure to check the total costs when they choose a tracker fund as not all of them are as cheap as you might think. As ETFs have become more popular they have expanded the regions, assets and indices to which they offer exposure.

But niche investment themes and remote stock markets are not so easy to trade at a low cost, and the fees on some of these trackers are starting to look more like those charged by active funds.

Analysis by AJ Bell shows that some ETFs have fees of up to 1%. Indeed, at least 26 trackers charge 0.8% or more.

Adam Laird, head of ETF strategy at Lyxor, says: 'There are some serious differences in cost across the spectrum of ETFs and this is particularly evident on some of the niche funds, where demand just isn't as strong.'

THE MOST EXPENSIVE ETF

The most expensive tracker in our analysis is the **Expat Bulgaria Sofix ETF (BGX)**, which has a hefty fee of 1% and tracks the performance of the Sofix index. Investors may not be surprised that this is a concentrated market and the ETF only follows the 15 most liquid companies on the Bulgarian stock exchange.

> **Investors should check a fund's fees before they invest because there are still expensive pockets within the market**

A high exposure to a low number of stocks means performance is likely to be volatile. Pharmaceutical firm Sopharma, for example, accounts for 14.9% of the index while holding company Chimimport accounts for 12.3% of assets.

Far-flung regions make up a considerable proportion of the most expensive ETFs, including those which track stock markets in Bangladesh, Pakistan and Vietnam. Xtrackers has ETFs tracking these markets, each of which has a charge of 0.85% – similar to what you might expect to pay for a fund run by an active manager.

Also among the priciest products are those which take a thematic approach to investing. The **Ossiam ESG Low Carbon Shiller ETF (5HEP)** tracks companies with a reduced carbon footprint and good economic, social and governance (ESG) profile, screening out businesses involved in activities such as tobacco, coal and weapons. It has a fee of 0.85%.

Meanwhile, the **L&G Robo Global Robotics and Automation ETF (ROBG)** tracks global companies focused on the robotics and automation industries. Around half of its assets are in US equities and a further quarter in Japanese companies, with holdings including sensor manufacturer Keyence and Israeli medical device company Mazor Robotics. It charges 0.8%.

INVESTOR INTEREST IS A MAJOR FACTOR

One major factor which

determines the price of ETFs is investor interest. As funds build up their assets under management they are able to pass on the economies of scale and start to reduce their fees. This is particularly evident among some of the cheapest ETFs, which are usually simpler offerings tracking a well-known stock market index such as the FTSE 100 or S&P 500.

After all, the difference in cost to a provider of running £500m or £1bn of investors' money is minimal. Stronger demand for these products also means there is more competition in the market, which encourages providers to keep their costs as low as possible.

The Expat Bulgaria Sofix ETF, for example, has assets under management of around £12m, whereas the Invesco S&P 500 ETF, which has charges of just 0.05%, has assets of around £2.8bn.

Just because an ETF charges more than you had anticipated, it doesn't mean you should immediately write it off. Firstly, it is worth delving into the potential returns – one ETF might charge 0.05% but only deliver a return of 1%, while one charging 1% could grow your money by 10%.

If a fund is consistently justifying its fee then, just as with a skilled active manager who charges more than his or her rivals, it may be worth paying up. But factoring in the risk you are taking on for these potential returns is crucial.

COMPARING COSTS

Investors should also compare the costs of an active fund with a similar mandate; if there is little difference in the cost, some investors may prefer to pay a little extra to employ an active manager instead. It's worth remembering that tracker funds don't aim to outperform, only to mirror the index they are following, whereas a fund manager will aim to beat the market.

Laird adds: 'The price war in ETFs is not over yet and charges are still falling, but investors should check a fund's fees before they invest because there are still expensive pockets within the market.' (HB)

THE MOST EXPENSIVE LONDON-LISTED ETFS

NAME	TICKER	EXPENSE RATIO (%)
Expat Bulgaria SOFIX UCITS ETF	BGX	1.0
Xtrackers S&P Select Frontier GBP	XSFR	0.95
Xtrackers S&P Select Frontier USD	XSFD	0.95
L&G E Fund MSCI China A UCITS GBP	CASE	0.88
L&G E Fund MSCI China A UCITS USD	CASH	0.88
EMQQ Emerging Markets Internet & Ecommerce USD	EMQQ	0.86
EMQQ Emerging Markets Internet & Ecommerce GBP	EMQP	0.86
Xtrackers FTSE Vietnam Swap GBP	XFVT	0.85
Xtrackers FTSE Vietnam Swap USD	XVTD	0.85
iShares MSCI EM Islamic UCITS	ISDE	0.85
Lyxor MSCI India UCITS ETF GBP	INRL	0.85
Lyxor MSCI India UCITS ETF USD	INRU	0.85
Xtrackers Nifty 50 Swap UCITS GBP	XNIF	0.85
Xtrackers Nifty 50 Swap UCITS USD	XNID	0.85
Xtrackers MSCI Bangladesh Swap	XBAN	0.85
Xtrackers MSCI Pakistan Swap	XBAK	0.85
Ossiam ESG Low Carbon Shiller	5HED	0.85
Ossiam ESG Low Carbon Shiller GBP	5HEP	0.85
L&G ROBO Global Robotics and Automation EUR	ROBE	0.8
L&G ROBO Global Robotics and Automation GBP	ROBG	0.8
L&G ROBO Global Robotics and Automation USD	ROBO	0.8
First Trust Emerging Markets GBP	FEM	0.8
First Trust Emerging Markets USD	FEMU	0.8
Amundi MSCI India UCITS ETF GBP	CI2G	0.8
Amundi MSCI India UCITS ETF USD	CI2U	0.8
GF International-FTSE China A	PRCE	0.8

Source: AJ Bell

What would make the Federal Reserve change tack?

We revisit the topic of liquidity to see if central bank policy is influencing market volatility

Regular readers could be forgiven that this column is obsessed with the issue of liquidity, not least because that is the case.

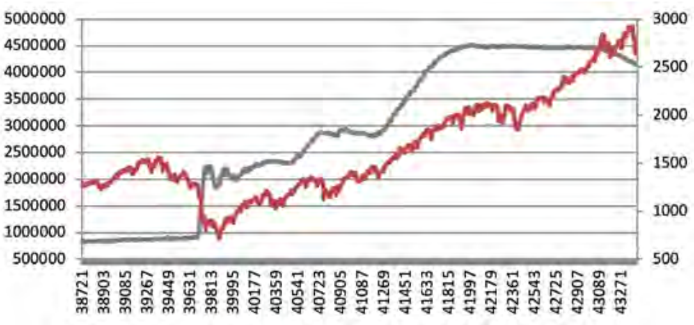
We have already looked at how central banks are draining it away and how issues such as capital controls could mean that investors must never assume that it will always be easy to buy or sell assets, owned directly or indirectly via funds, when, in the size and at the price they want.

Now we must return to the issue of central bank policy because our warning that higher rates and less quantitative easing (QE) could provoke increased volatility does not seem too far off the mark, given the autumn stock market wobble.

The Fed has now reduced its balance sheet by some $351bn, or 8%, while the S&P 500 is some 7% off its all-time high.

This may be just a coincidence but it is enough to prompt complaints from no less than US President Donald Trump, whose willingness to measure his administration's success by how high the US stock market goes may yet prove a poor choice of yardstick.

THE FED'S MOVE TO SHRINK ITS BALANCE SHEET AND REDUCE MONETARY STIMULUS MAY BE WEIGHING ON US STOCKS



Source: FRED – St. Louis Federal Reserve database, Refinitiv data

The President's colourful accusations that his country's central bankers are 'loco' and 'going crazy' articulate a deep-rooted fear in the markets that higher rates and less stimulus could mean lower share prices.

The Fed does not seem moved by such talk as yet, but this does beg the question of what might have to happen for the US central bank to stop tightening and start loosening policy once more.

DIFFERENT SCRIPT

Fed chairman Jay Powell's predecessors Ben Bernanke and Janet Yellen oversaw the launch of all three phases of the Fed's QE scheme in November 2008, November 2010 and September 2012.

All three of those programmes came in the wake of a combination of stock market weakness, a sell-off in high yield (junk) bonds and a flattening in the yield curve (a decline in the premium yield offered by US 10-year Treasuries relative to two-year ones).

Powell seems to have a different outlook, given his 2017 quote that 'it's not the Fed's job to stop people losing money' and the US central bank's recent suggestions that the yield curve is not as reliable an indicator as it once was.

If financial market indicators will not sway Powell and colleagues, then perhaps we have to look to real-world, economic ones.

THREE INDICATORS

This column has looked at US data to see which items may have influenced Fed thinking under Bernanke and Yellen.

Of the real-world ones, three areas seem to have tempted the US central bank to pull the monetary stimulus trigger in the past (the rings show when QE1, QE2 and QE3 were launched):

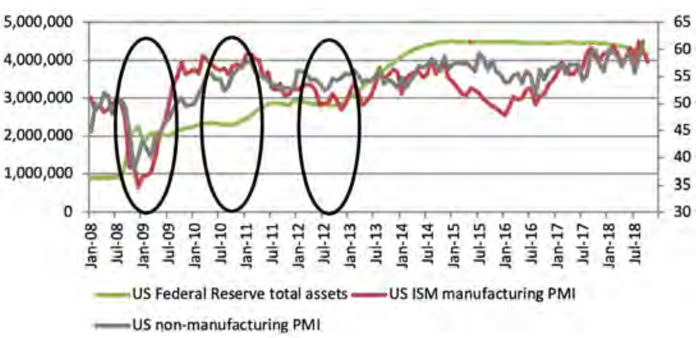
- Weakness in the Institute for Supply Management's (ISM) manufacturing purchasing managers' index (PMI)
- Weakness in the non-farm payroll data and a loss of momentum in job creation
- A slackening in the rate of inflation

The following charts illustrate these points, with the rings highlighting when each phase of QE came into effect.

The Fed has a twin mandate of employment and inflation. The latter has ebbed a little and the PMI has pulled back slightly from its peak but neither really has done so to the degree seen ahead of QE2 or QE3.

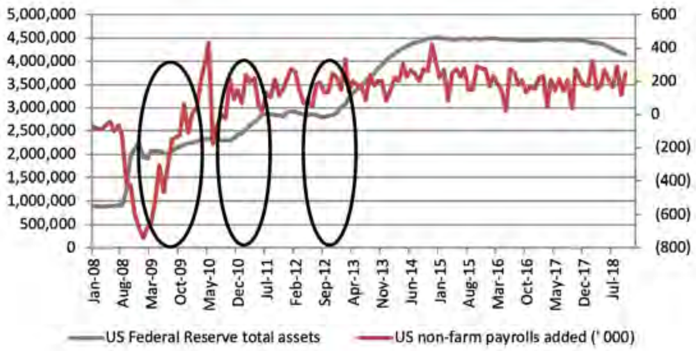
Moreover, US job creation is still strong, judging by the 250,000 new non-farm payrolls added in

MARKED SOFTNESS IN MANUFACTURERS' CONFIDENCE COULD PERSUADE THE FED TO STOP TIGHTENING (OR EVEN EASE) POLICY ….



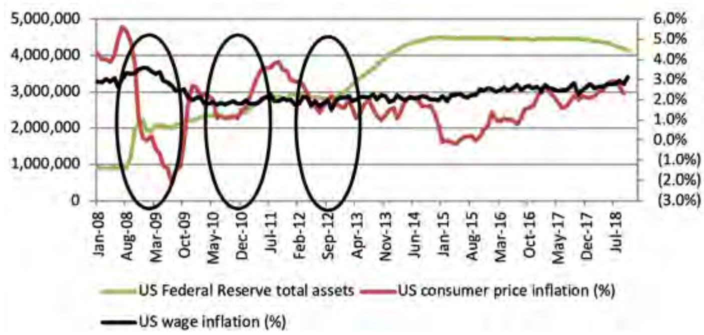
Source: FRED – St. Louis Federal Reserve database, Refinitiv data

…. AS COULD A SLOWDOWN IN JOB CREATION ….



Source: FRED – St. Louis Federal Reserve database, Refinitiv data

…. AND A MARKED DECELERATION IN THE RATE OF INFLATION



Source: FRED – St. Louis Federal Reserve database, Refinitiv data

October and 3.1% wage growth.

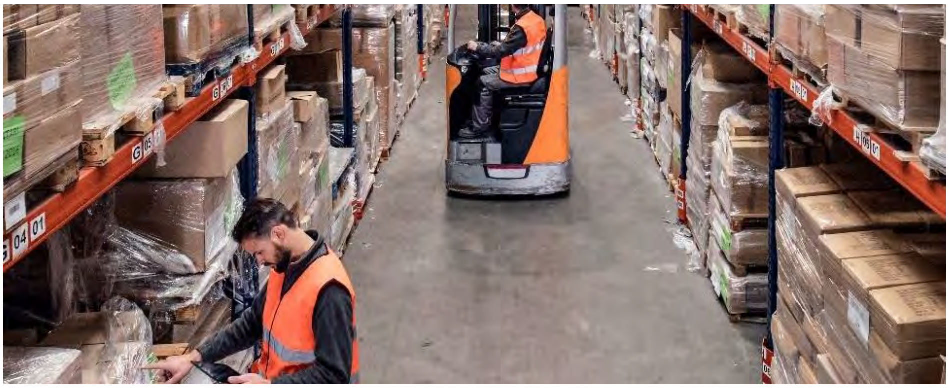
Under such circumstances, the Fed seems unlikely to be deflected off course by increased asset price volatility. Financial markets are on their own.

Investors must decide whether momentum in earnings, cash flow and dividends are sufficient to justify prevailing valuations and compensate them for the specific risks that come with individual asset classes and geographic regions, because there is no longer enough cheap money around to lift all prices on a tide of liquidity.

By Russ Mould, investment director, AJ Bell

Staffline is ambitious but can it survive any Brexit fallout?

The company has historically been very reliant on Eastern Europeans to fill UK jobs



Nottingham-based **Staffline (STAF:AIM)** is one of the biggest recruiters in the UK, supplying over 60,000 contract staff a day to more than 1,500 customers, yet it is probably one of the least well-known to investors.

The company is the leading outsourced provider of blue-collar workers to the private sector and the Government, although it tries to avoid the tag of outsourcer given the negative connotations and low earnings multiples that UK outsourcing stocks attract.

Its recruitment arm, which accounts for 90% of revenue and 60% of pre-tax profit, is focused on food production and distribution, logistics and online retail.

Staffline claims to account for 10% of the blue-collar UK recruitment market.

Its size and its embedded relationships mean its business should theoretically be resilient in economic downturns as well as providing growth during expansions.

BUSINESS MODEL SUITED TO THE CHANGING ECONOMY

Staffline operates a very asset-light model with managers working from their customers' premises for the most part, connected to Staffline's systems via a laptop.

It also operates from a small number of regional recruitment hubs using social media and the internet to attract candidates rather than having a nationwide network of offices.

Most of the staff it contracts out work in food production and distribution, including supermarkets. However as consumers switch to buying more goods online it is winning a growing share of business from delivery firms such as DHL, Hermes and Parcelforce, and retailers such as Argos, **ASOS (ASC:AIM)** and **Ocado (OCDO)**.

The majority of people who find jobs via Staffline secure permanent contracts, with a fifth on temporary contracts to cater for companies needing to increase or decrease head-count at short notice.

INCREASING ITS 'TRUSTED SUPPLIER' ROLE

In order to make its customers 'stickier' the company introduced a digital engagement platform last year to allow companies and workers to share their experiences.

The platform has been a huge success, improving both employer insight and worker productivity and retention, boosting Staffline's reputation as a trusted supplier.

As well as leading to increased business from existing customers, word has spread to non-customers with one firm trialling the system across its 35,000-strong workforce meaning potentially another big win.

LEADING POSITION IN SKILLS AND TRAINING

As well as being the leading provider of flexible workers, Staffline is the leading adult skills and training provider in the UK.

Its PeoplePlus business, which accounts for 10% of turnover and 40% of pre-tax profit, has been transformed from a contractor to the Government's Work Programme into an education and training provider.

With the Work Programme ending next March the transformation of PeoplePlus is almost complete with non-Work Programme revenue up 28% in the first half of the year.

The total apprenticeship market is seen growing to £3bn by 2022 and the Chancellor's decision in the latest Budget to halve the contribution from small businesses to the levy is seen as a positive.

After the acquisition of LearnDirect Apprenticeships in July, PeoplePlus is now the market leader in apprenticeships both levy-funded and non-levy with a 10% market share in the latter and blue-chip clients such as **Lloyds Bank (LLOY)**, **Marks & Spencer (MKS)** and **J Sainsbury (SBRY)**.

Its leadership position has been bolstered by the failure of its nearest rival 3aaa, which has been investigated twice by the Government and is currently barred from taking on new learners.

Staffline also runs training programmes in 10% of the country's prisons helping to teach prisoners valuable skills such as plumbing and car mechanics to help them find subsequent employment.

Getting a job is a key step to offenders being able to find accommodation which in turn reduces the risk of their re-offending.

AGGRESSIVE NEW 5-YEAR EARNINGS TARGET

While apprenticeship and adult learning revenues build, revenues from the Work Programme continue to wind down creating a short-term drag on Staffline's accounts.

To counter this situation the company is making strategic acquisitions with the hope that earnings per share will hit a new target of 200p in 2022.

To put this target in perspective the current consensus forecast for 2020 earnings is just 107p, i.e. below last year's level, so the new target is ambitious.

The blue-collar recruitment market and the skills training market are still quite fragmented with the potential to buy assets at four times operating profit.

Therefore the company is investing its cash flow and taking on debt to acquire assets. While debt has doubled since the end of 2017, the net debt position (debt minus cash) is still less than 1x last year's operating profit.

With more companies needing to contract staff on a long- and short-term basis and the company adding billings by buying up smaller competitors, one can understand why management are confident about a solid growth trajectory for Staffline.

The £336m business has raised its dividend every year for the past decade and profits are forecast by analysts to keep growing for the foreseeable future.

That's encouraging although there are several negative issues to consider as well.

For example, investors should watch to see how Brexit affects the pool of workers happy to do lower-paid jobs. Historically Staffline has been very reliant on Eastern Europeans living in the UK to do such work.

It is also worth noting that earnings forecasts have been downgraded several times over the past 12 months. (IC)

STAFFLINE ESTIMATES

	FY 2017	H1 2018	H1 YEAR-ON-YEAR CHANGE	FY 2018E	CHANGE
Group Sales	£958m	£481m	12%	£1,080m	13%
Group EBIT	£36.3m	£15m	-7%	£39.6m	9%
Recruitment Sales	£843m	£430m	16%	£975m	16%
Recruitment EBIT	£20.2m	£7.9m	18%	£23.6m	17%
PeoplePlus Sales	£115M	£51.4M	-11%	£105M	-9%
PeoplePlus EBIT	£18.9M	£7.1M	-25%	£16M	-15%

Source of consensus FY 2018 estimates: Refinitiv

KEY

- **Main Market**
- **AIM**
- **Investment Trust**
- **Fund**
- **Exchange-Traded Fund**

KEY ANNOUNCEMENTS OVER THE NEXT SEVEN DAYS

Finals

12 Nov: Carr's. **13 Nov:** McCarthy & Stone.

Interims

13 Nov: BTG, Carclo, FirstGroup, Premier Foods, Vodafone. **14 Nov:** British Land, Jackpotjoy, SSE, Flybe, Workspace. **15 Nov:** Dart Group, Mediclinic, Royal Mail.

Trading Statements

12 Nov: Dignity. **13 Nov:** Aggreko, BBA Aviation, Taylor Wimpey.

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