STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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SHARES

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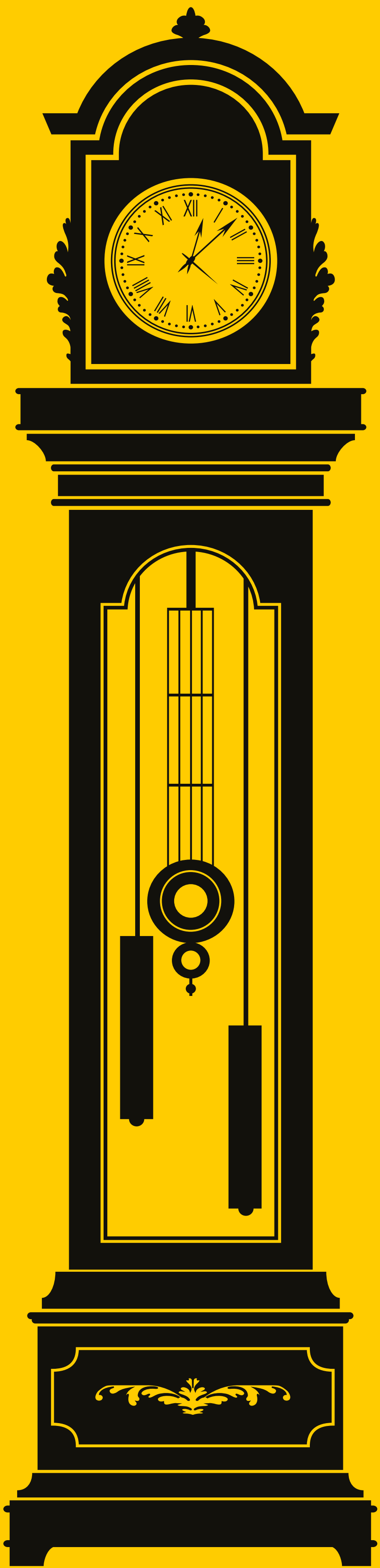


TURN PATIENCE INTO PROFIT

How reinvested dividends unlock the benefits of a buy and hold approach

PLUS

BREXIT STOCKPILING: COULD LOGISTICS FIRMS BENEFIT?

PENSION TAX RELIEF: UNDERSTANDING HOW IT WORKS

TOP OF THE CHARTS: BLUE WHALE FUND SOARS

Are we entering a bear market and does it matter?

We look at a new piece of research from Morgan Stanley as supplier warnings take a bite out of Apple

US stocks are experiencing renewed volatility after several of Apple's suppliers warned on profit (12 Nov). This has raised concerns over the growth rate at the consumer electronics giant and several of its big technology peers, sending shares in Apple and other tech companies into reverse.

Worries over Apple's growth prospects are nothing new and arguably it is already making the transition from growth stock to a mature cash generating machine.

This has been reflected in its valuation for some time, with an earnings multiple of 15-times much lower than those enjoyed by the likes of Amazon or Google's owner Alphabet.

So why is the tech sell-off relevant? The stock market ructions add some fuel to the debate over whether shares are entering a bear market. It is often the sector driving shares in a bull market (technology) which drags stocks lower in a bear market.

Investment bank Morgan Stanley has examined more than 900 big sell-offs across 28 markets to determine if we are indeed in a bear market, characterised as when equities fall by 20% or more from their peak.

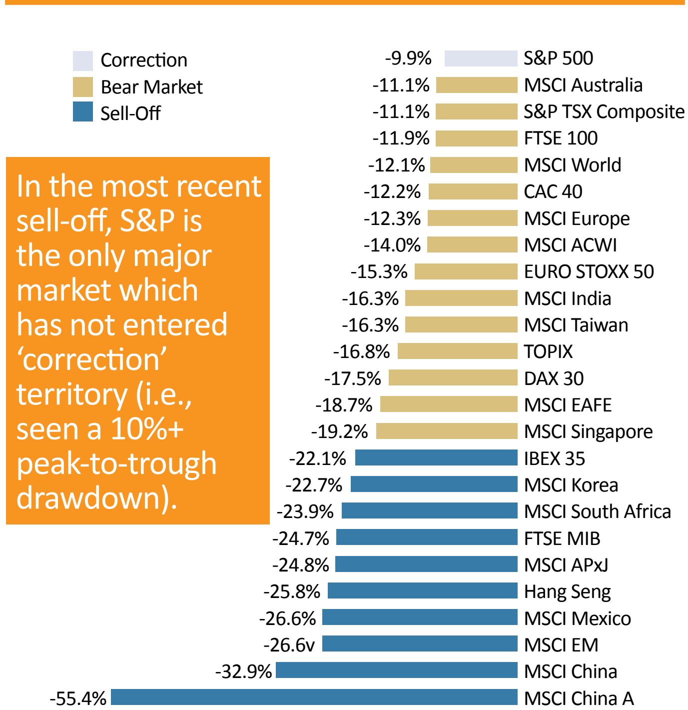
A bull market is a rising market characterised by optimism, investor confidence and expectations that strong results will continue. A bear market is the opposite with prices falling, a generally pessimistic outlook and increased fear of losses.

Morgan Stanley says that while the US might be experiencing a correction within an ongoing bull market, the rest of the developed world is heading for a bear market, with 'the degree to which valuations have repriced' leaning 'more towards the latest sell-off being a bear market'. Emerging markets are already in bear market territory in its view.

Investors should be interested in these trends. You must not ignore what is happening in the wider market and if you plan to dip into your investment pot sooner rather than later, reducing your equity exposure might be a sensible consideration.

Hasty action is definitely to be avoided for someone who is looking to stay invested for the long-term. Our main feature this week examines the power of compounding and how staying invested in a stock, particularly if it pays dividends, can be really lucrative, even if the share price is moving up *and* down. (TS)

LATEST SELL-OFF PEAK TO TROUGH



Source: Bloomberg, Morgan Stanley Research; Note: Showing markets which have troughed within the last month only. Markets not shown include MSCI Brazil, MSCI Russia and MSCI Switzerland

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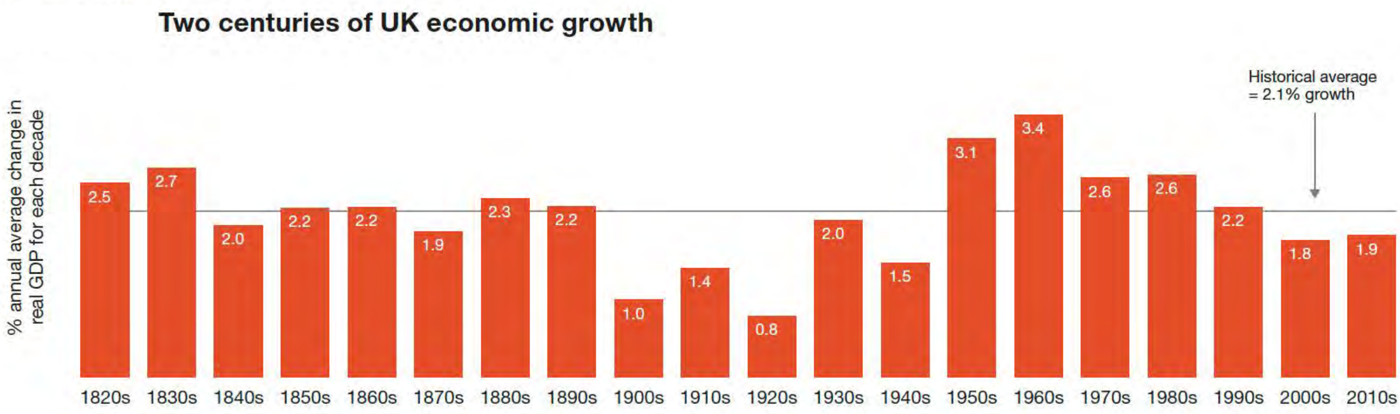
UK economic outlook flags risks for banks and consumer-facing businesses

Consultant PwC takes the country's economic temperature



Source: Bank of England (1830-1949), ONS (1950-2017) and PwC main scenario (2018-19)

A new report from consultant PwC suggests the UK economy could remain on a modest growth path in the years ahead but highlights some key pressure points including rising levels of debt.

While a reduction in government borrowings is expected, households and companies are expected to borrow at faster rate than economic growth. As a result, an increase in the overall ratio of debt-to-GDP from 252% in 2017 to 260% in 2020 is forecast.

Despite the mounting borrowings, the researchers expect the Bank of England to boost interest rates from 0.75% to 1% in mid-2019. Under the assumption that the Bank of England gradually increases rates back to 2% by 2023, total debt servicing costs could rise from 7.7% of GDP in 2017 to around 9.6% in 2023.

This could have implications for banks, if the situation results in a higher proportion of bad debt, as well as consumer-facing businesses if households are forced to rein in spending to get on top of their finances. Investors in these sectors should therefore be watching these trends closely.

PwC notes that its projections mean average levels of growth will be comfortably below 2% in each of the first two decades of this century.

MIND THE DEBT

	Debt as % of GDP	
	2017	**2023**
Households	94	100
General government	75	69
Non-financial companies	83	91
Total	**252**	**259**

Source: ONS, PwC main scenario projections for 2023

This represents the weakest performance in any decade since the Second World War and longer-term into the 2020s the consultant expects UK growth to remain at around 1.75% thanks to the effects of an older population.

PwC believes growth could be pushed back up towards the historical average of 2.1% through supporting the application of artificial intelligence, more efficient tax and regulatory systems, encouraging older people to remain in the workforce and maintaining 'open trading relations with the EU and the rest of the world'.

This final point could be crucial as these estimates all have the caveat that they depend on the outcome for Brexit which still remains uncertain. (TS)

Dividend relief lifts Vodafone

Mobile telecoms giant lifts guidance while maintaining first-half payout

First-half year results from **Vodafone (VOD)**, which helped the share price to strong gains on 13 November, tell us one thing loud and clear. This is a story where little else matters outside the dividend.

A typical sea of adjustments and footnotes, new chief executive Nick Read's ambition is to clean up and simplify the company and how it presents its performance but Vodafone is evidently still a work in progress.

It may be one of the world's largest mobile network companies but to be a shareholder through 2018 has been a thoroughly miserable experience. In January the share price changed hands at 238p, so at the price they traded at before the interims – 144.36p – it had lost 40% of its value in 2018.

By contrast, the FTSE 100 was down just 7% over the same period making Vodafone's shabby performance abundantly clear.

Even at the current 155p, it's still an ugly year-to-date performance and arguably even more staggering given that this is a FTSE 100 mega-cap valued at more than £41bn even at today's depressed levels.

> It may be one of the world's largest mobile network companies but to be a shareholder through 2018 has been a thoroughly miserable experience

Vodafone trades on a dividend yield of 8.7% based on current consensus forecasts

MODEST ENCOURAGEMENT

Vodafone was able to hand investors some cheer by nudging up full year guidance, even if that relies on a new swathe of cost cuts and efficiencies rather than any real improvement to how the business is trading.

Yet the only thing that really matters to investors in Vodafone is that it can keep spewing out hefty dividends. Fears of a cut to that payout have weighed heavily on the minds of investors with many presuming, so far incorrectly, that with a new man at the top a re-basing of expectations was coming.

That it hasn't so far is a sop for the optimists. But given the current debt pile of €31bn and costly new 5G spectrum licences to be funded, we wonder for how long.

A forward yield of nearly 9% suggests the market remains sceptical on the sustainability of the dividend. (SF)

Are investors overreacting to talk of a possible US ban on menthol cigarettes?

Analysts stress a ban could take years to enforce and may not even happen

Investors may be overreacting to chatter about a potential ban on menthol cigarettes from the US Food and Drug Administration (FDA) as part of its drive to crack down on smoking among young people.

Cigarette seller **British American Tobacco (BATS)** took a near-10% hit to its share price on the speculation. It owns the Newport brand of menthol cigarettes following its acquisition of Reynolds American in 2017.

US menthol cigarettes generates around a quarter of the company's annual global profit.

Rival **Imperial Brands (IMB)** dipped 2.1% on the news as its exposure to US menthol is significantly lower.

Jefferies analyst Owen Bennett argues the reaction to the news, particularly for British American Tobacco, is 'extreme and overdone'.

Bennett says a ban is unlikely to happen anytime soon as evidence will be needed to enforce the ban, which would take time and may not be conclusive.

One of the effects of a ban could be a switch over to potentially reduced-risk products (RRPs), including tobacco heating and vapour products.

Up in smoke – BATS falls 10% on speculation menthol ban

WHY THE MARKET IS REACTING NEGATIVELY

Even if the ban happened, British American Tobacco is 'well placed' to gain market share thanks to its RRP portfolio, if people switch instead of quitting, according to Bennett.

US investment bank Piper Jaffray also believes the market reaction to be excessive, flagging that legal challenges can be made and could drag out any prospective legislation by at least eight years.

So ultimately any ban could take years to be enforce and potentially may not even happen if legal challenges are successful.

While it can be argued the speculation has not done much damage to the tobacco industry yet, uncertainty over regulatory action could continue to weigh on a sector traditionally known for high dividend yields.

The FDA has also noted that trendy flavoured vaping products such as mango and cucumber could entice teenagers and young people into the habit.

The FDA's focus on this part of the market could put a dent in the prospects of fast-growing rival Juul with 70% of the US e-cigarette market since its launch only three years ago.

This could be a benefit to the more mature firms in this market like Imperial Brands and British American Tobacco. (LMJ)

Tracsis rules out cash return as acquisition pipeline bulges

More than £22m is ready for deployment as company pursues M&A value strategy

Transport infrastructure technology company **Tracsis (TRCS:AIM)** is categorically ruling out returning any of its £22.3m cash pile to shareholders.

Instead, chief executive officer John McArthur has told *Shares* that he wants to put that money to better use by continuing its long-run policy of acquiring value-adding businesses with motivated management.

Tracsis provides a range of technology and services to the rail industry, including remote condition monitoring of tracks, power lines, points and other vital bits of equipment. The other half of the business is aimed at real-time traffic data and analysis tools used by organisations from road planners to large event organisers.

Over the past decade or so Tracsis has bought and integrated more than a dozen businesses, funded by cash generated internally by the business. This is popular with shareholders because

it has led to virtually dilution-free value creation over the years.

Since early 2012 the Tracsis share price has more increased more than 10-fold from 56p to the current 615p, and that's after selling off through much of October as most of the stock market did.

McArthur says there is a bulging pipeline of potential buyout targets although he admits that the exact timing of deals remains unpredictable, although he hopes to complete two by the end of the current financial year to 31 July 2019. (SF)

Supermarket sales slow after summer surprise

Groceries firms are struggling according to the latest round of sector data

AFTER FEASTING on better sales over the summer thanks to extraordinarily good weather and the FIFA World Cup, it seems the big supermarkets are back to lean times ahead of Christmas.

The latest Kantar Worldpanel data shows UK supermarket spending rose by 2.6% in the 12 weeks to 4 November compared with growth of 3.8% as recently as the 12-week period to mid-September.

Meanwhile data from Nielsen shows four-week spending to 3 November grew just 1.5% despite better sales of Halloween goods.

Both sets of data show hard discounters Aldi and Lidl continuing to eat into the Big Four's market share.

Five years ago less than half of British households visited Aldi or Lidl once or more in three months. Today almost two-thirds of us do and they account for 13% of supermarket sales.

By comparison **Morrison (MRW)**, recently (6 Nov) saw its shares slammed after flagging a slowdown in the market.

Sainsbury's (SBRY), which is aiming to merge with Asda, saw sales fall according to the latest data as did Waitrose which saw its first negative reading since February 2009, ending a remarkable run of positive growth.

Market leader **Tesco (TSCO)** reported its slowest sales growth for over a year. Despite the fanfare, we doubt that the new Jack's discount concept will cause the discounters to lose much beauty sleep. (IC)

Time to load up on AstraZeneca for capital gains and dividends

The FTSE 100 pharma giant is now looking more attractive after a long period in the doldrums

ASTRAZENECA ↗ BUY
(AZN) £63.00
Stop loss: £47.00

Market cap: £80bn

Pharmaceutical giant **AstraZeneca (AZN)** is looking more attractive as it enjoys momentum with drug developments and streamlines its business.

Its share price is starting to pick up after being sluggish for a long time. Analysts have also started to upgrade earnings forecasts which is important for sustaining upwards momentum in the stock.

Drug companies had been out of favour for several years amid concerns over political interference on pricing and blockbuster products losing patent protection.

Sentiment is now improving, helped by success with approving new drugs and the Congressional gridlock following the US midterm elections reducing the risk of disruptive, government-dictated price changes in that part of the world.

AstraZeneca is big in oncology which is the study of cancer. The company achieved a major breakthrough a few months ago with one of the most important drugs in its cancer portfolio, Imfinzi, which has shown to improve patient survival rates.

STRENGTH IN ONCOLOGY

In October AstraZeneca reported positive progress with trials involving its Lynparza ovarian cancer drug. This week the US Food and Drug Administration granted Lynparza priority review status – something given to medicines that, if approved, would offer a significant improvement in the treatment, diagnosis, or prevention of serious conditions.

Investors should appreciate that pharma companies are high risk, even ones worth billions of pounds. There is no guarantee that drug developments will be successful and the sector is at risk of disruption from regulatory and political interference.

AstraZeneca has set itself $40bn sales target in 2023. It stems back to when management fought off a takeover bid from Pfizer in 2014 and needed to be seen as having strong ambitions.

Big sales targets are always a risk as failure to hit them can be negative for a company's share price. Investment bank Credit Suisse forecasts AstraZeneca will achieve $31bn of sales in 2023, adding the full target would only be hit if its entire drug pipeline is successful.

While we're five years away from needing to measure this target, it is something for investors to watch closely.

The near-term focus is on continued success with its cancer drugs, as well as product news linked to treatments for anaemia, lupus and diabetes.

Finally, don't be shocked when AstraZeneca reports its 2018 financial results as pre-tax profit is forecast to fall by 14.8% to $5.84bn. The market is fully aware of the trend with earnings and the focus is on the future where profit is forecast to recover to $5.96bn in 2019 and then hit $6.37bn in 2020.

The dividend is forecast to stay flat at $2.80 (216.66p) for the foreseeable future, implying a decent 3.4% yield. (DC)

Why we think National Grid is a firm buy for the future

Inflation-benchmarked dividend is a powerful value creator for investors

The UK stock market has been beset with uncertainties all year with Brexit negotiations dragging on, the pound plunging and UK domestic growth stuck in a rut.

This could all change in 2019 but in the meantime there is one very compelling reason to own shares in **National Grid (NG.)** – inflation-protected dividends.

RPI inflation (retail price index) in September came in at 3.3%, according to figures from the Office of National Statistics (ONS) and forecasts suggest that figure to settle at around 3% out to 2023.

As the cost of living in Britain rises it makes income benchmarked to inflation or better increasingly attractive. National Grid, Britain's largest utility supplier, renewed its commitment to grow its dividend to match RPI inflation or better 'for the foreseeable future' earlier this year.

This is important for investors who rely on growing income to help pay their monthly bills but it also should act as a magnet for anyone looking to benefit from the powerful effect of compounding over time.

As fund manager Mark Barnett said recently, around 60% of the total return (share price gains and dividends combined) earned by the **Perpetual Income & Growth Trust (PLI)** that he runs came from reinvesting dividends.

NATIONAL GRID BUY
(NG.) 856.5p
Stop loss: 685p

Market cap: £29.1bn

INFRASTRUCTURE FOCUS

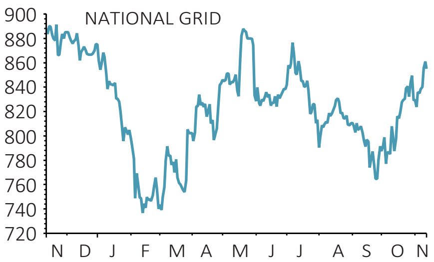
National Grid runs much of the UK's electricity and gas supply infrastructure, with similarly regulated operations in the US. It has a long track record of steadily increasing its annual payout to shareholders dating beyond the 2002 merger with Lattice, which formed an electricity and gas transmission national champion.

It has missed its dividend growth target just once in the past 10 years (2012), when RPI was coming down from a spell running at 5%-plus. This year's full year forecast payout of 47.45p implies a 5.5% income yield.

This sort of inflation-beating track record is matched by other utility stocks (electricity, gas, water suppliers, for example) but National Grid is the UK operator least threatened by tariff price caps being introduced across the industry.

This is not to say that the group is immune from its own challenges, not least a hawkish regulatory environment both sides of the Atlantic, strike action and one-off costs as it looks to realign its operating expenses for the future.

But we believe National Grid is pulling the right levers as it balances the demands of shareholders, workers, regulators and customers. A scheme to cut staff numbers through a programme of voluntary redundancies announced alongside recent half year results is a good example, even if that will mean some short-term one-off costs. (SF)



EXPERIAN

(EXPN) £19.06

Gain to date: 2%

Original entry point:

Buy at £18.69, 9 August 2018

WE FLAGGED **Experian (EXPN)** as a *Great Idea* in August at £18.69 on a combination of earnings growth and an appealing valuation.

Although the shares sold off with other growth stocks last quarter they quickly rebounded and thanks to a recent trading update (13 Nov) they are back above our initial entry point.

Demand for its products and services continues to grow with like-for-like sales increasing 8% in the first half leading the company to raise its guidance for full-year sales and earnings before interest and tax (EBIT).

Sales to clients in North America are particularly strong thanks to demand for its mortgage data. Also its Ascend 'big data' product has been adopted by all their big US clients and a version is being rolled out to mid-market clients.

EMEA/Asia-Pacific sales are also strong thanks to new business wins in the consumer-lending market.

SHARES SAYS:

We anticipate sales and earnings upgrades following these results and we stick with our positive view. (IC)

ON THE BEACH

(OTB) 446.5p

Loss to date: 11.6%

Original entry point:

Buy at 505p, 30 August 2018

ONLINE BEACH holidays retailer **On The Beach (OTB)** has been hit by troubles in the sector as the shares have reversed more than 11% to 446.5p since we flagged it as a compelling opportunity.

Shares in tour operators **Thomas Cook (TCG)** and **TUI (TUI)** are also in a downward spiral with the former serving up a big profit warning.

It appears the sector cannot shake off concerns over trading after the blistering summer weather deterred people from booking an overseas holiday.

Peel Hunt analyst Ivor Jones argues the absence of an October trading statement despite the unusual summer implies trading is on track.

'If there is to be disruption to the travel market [from Brexit] we do not expect On The Beach to be immune, but do expect it to fare better than competitors with high fixed costs and emerge with an enhanced market share,' comments Jones.

On The Beach's recent acquisition of Classic Collection, a business-to-business distribution network, which sells premium holidays, should offer a new growth opportunity.

SHARES SAYS:

We think the fall in the share price is due to negative sentiment in the sector rather than a poor operational performance. (LMJ)

Navigating Choppy Waters

SENECA INVESTMENT MANAGERS

Seneca Global Income & Growth Trust plc

- Investors have enjoyed calm seas for many years. With interest rates and inflation rising, there may be choppy waters ahead.
- As a genuinely multi-asset trust, Seneca Global Income & Growth Trust plc (SIGT) has the flexibility to trim its sails to the prevailing winds, by increasing or reducing exposure to a range of asset classes as investment markets change.
- Foreseeing more difficult conditions ahead, we began to trim our equity positions in the first half of last year. SIGT is now materially underweight* equities, and this process of de-risking will continue.
- As value investors we continue to find opportunity elsewhere in the investment seascape, which we believe will further enhance the defensive qualities of the Trust.
- We make significant use of specialist investment trusts which offer a combination of attractive starting yields, the prospect of income growth, and strong asset backing in the fields of property, aviation, copyright and infrastructure.
- In addition, we are extending our exposure to cash and managed liquidity**, to add a greater element of capital preservation to the Trust.
- Most importantly, as experienced navigators with a versatile craft, in addition to navigating choppy waters, we aim to be positioned to take advantage of smoother seas ahead, when the current squalls have abated.

Growth, Income and Low Volatility

- Our multi-asset expertise and approach have delivered successful outcomes for investors over the last five years***.
- The Trust pays quarterly dividends, offering a current yield of circa 4.1%[1]. Over its last five financial years to April 2018 the Trust has grown its dividend at a compound rate of 4% per annum, ahead of CPI every year****.
- Over a typical investment cycle[2], we aim for the Trust to achieve a total return of at least CPI plus 6% after costs, with low volatility. In addition, we aim to grow aggregate dividends at least in line with inflation.
- Over the five years to end October 2018, the Trust delivered an NAV return of +35.4% with volatility circa two thirds that of the major equity indices[3]. Details of the Trust's returns can be found in the performance tables below.

Cumulative performance (%) to 31.10.2018	3 months	6 months	1 year	3 years	5 years
Trust share price	-6.4	-6.0	-6.4	26.4	49.3
Trust NAV	-4.7	-3.6	-4.0	24.4	35.4
Benchmark[4]	2.6	4.5	8.8	18.4	27.0

Discrete annual performance (%)	31 October 2018	31 October 2017	31 October 2016	31 October 2015	31 October 2014
Trust share price	-6.4	16.7	15.7	11.8	5.6
Trust NAV	-4.0	15.1	12.7	7.7	1.1
Benchmark[4]	8.8	5.1	3.6	3.6	3.6

Find out more about Seneca Investment Managers at senecaim.com or call us on 0151 906 2450

Things To Be Aware Of

[1]Current yield: the yield calculation is based on the latest quarterly dividend, annualised, compared against the month end share price.

[2]Seneca Investment Managers Ltd defines a typical investment cycle as one which spans 5-10 years, and in which returns from various asset classes are generally in line with their very long term averages. There is no guarantee that a positive return will be achieved over this or any other period.

[3]Annualised volatility of returns over five years versus FTSE World ex-UK and FTSE All Share.

[4] Benchmark: CPI plus 6% from 06.07.17. Previously LIBOR GBP 3 Months plus 3%, all after costs for the period ending 31.10.2018 a forecast CPI is used.

*In relation to strategic asset allocation

**Managed Liquidity is a term used to describe assets that can be quickly converted into cash. This category includes investments in open ended funds which invest in corporate bonds and covered bonds (these will have a minimum credit rating of AA-) and money market instruments (these will have a minimum rating of A). These funds offer very low risk exposure to interest rate, credit spread and currency risks.

***The Trust has outperformed its benchmark over the last five years and has grown its dividends in excess of inflation over each of the last five financial years. It has delivered these returns with materially lower volatility than equity markets over the last five years.

****There is no guarantee that dividends will continue to increase or grow ahead of CPI.

Performance and dividend data sources: Seneca Investment Managers Ltd, Bloomberg & Morningstar. Share prices calculated on a total return basis with net dividends reinvested. NAV returns based on NAVs excluding income and with debt valued at par. Returns do not include current year revenue.

Past performance should not be seen as an indication of future performance. The information in this article is as at 31.10.2018 unless otherwise stated. The value of investments and any income from them will fluctuate, and investors may not get back the full amount invested.

Could logistics firms benefit from stockpiling ahead of Brexit?

We discuss the impact on the food and drug supply chain

Food and beverage companies seem to be following in the footsteps of the drug firms in making preparations for a 'no-deal Brexit'.

Heineken recently announced plans to deal with supply chain issues and back in July pharmaceutical giant **AstraZeneca (AZN)** caused quite the stir when it announced that it would begin stockpiling medicines in preparation for a no-deal outcome.

The company said it would increase the amount of finished medicines available to pharmacies and hospitals by around 20% 'as a safety net'.

Less than a month later rival Sanofi announced that it would also stockpile medicines in the UK.

Sanofi is one of the world's leading producers of insulin and vaccines and imports its medicines into the UK.

CROSS-CHANNEL TRADE RISKS INCREASING

Every month some 37m packs of medicine come into the UK from Europe and 45m travel the other way, according to a BBC report.

All drugs are licensed, tested and certified according to strict national regulations, and for now tests in the UK and Europe are treated equally.

Under a 'no-deal Brexit' that would no longer be the case, potentially causing major delays in the UK getting drugs from Europe and vice versa.

Now it seems food companies are following suit. Cold storage firm Wild Water says it is running out of room because food producers and supermarkets are concerned that food will be held up at ports 'with or without a deal'.

> UK firms will stockpile close to £40bn of goods ahead of Brexit

Last week Heineken, the world's second-largest brewer, admitted that it had begun adding warehouse space in the UK to give it 'greater flexibility to meet customer demands'.

Its comments came after the chief executive officer of UK logistics firm **Wincanton (WIN)**, Adrian Colman, described the Dutch firm as stockpiling 'thousands of pallets worth of goods' ahead of the March deadline.

EARLY CHRISTMAS (AND EASTER) FOR LOGISTICS FIRMS

The Centre for Economics and Business Research estimates that

UK firms will stockpile close to £40bn of goods ahead of Brexit.

Among the goods being stored by Wild Water are 1.75m turkey crowns, 7,000 pallets of cakes, 4,000 pallets of supermarket deserts and 1,000 pallets of mozzarella sticks of all things.

Wild Water's chief executive Ken Rattenbury described the surge in demand as 'completely out of sync' with normal trading and says it is having to turn customers away on a daily basis.

As well as finished products, customers are worried about keeping access to supplies of raw ingredients post-Brexit including such basics as flour and fruit juices.

Besides brewers stockpiling beer, Wincanton has seen chocolate-makers producing and stockpiling Easter eggs months ahead of normal in order to ensure it can supply its customers.

Next year Easter falls in late-April so there is likely to be a big rush for all kinds of seasonal products before the March 31 Brexit deadline.

Other UK stocks which may be linked to stockpiling in coming months include transport firms **Eddie Stobart Logistics (ESL)** and **Xpediator (XPD:AIM)** and warehouse landlords like **Segro (SGRO)** and **Warehouse REIT (WHR:AIM)**. (IC)

TURN PATIENCE INTO PROFIT

Compounding is a fundamental force, a bit like gravity. In fact Einstein is said to have called it the most powerful force in the universe.

While gravity pulls a snowball downhill, it's compounding that makes it grow bigger.

As it rolls downhill the snowball collects more snow: the further it rolls the more snow it collects.

UNDERSTANDING THE COMPOUNDING EFFECT

In the same way, the longer you hold an investment the greater the power of compounding. So how does it work?

Say you invest £1,000 in a stock and the shares go up 10% in a year. At the end of that year you'll have £1,100, your original £1,000 plus £100 of gains — (see chart A).

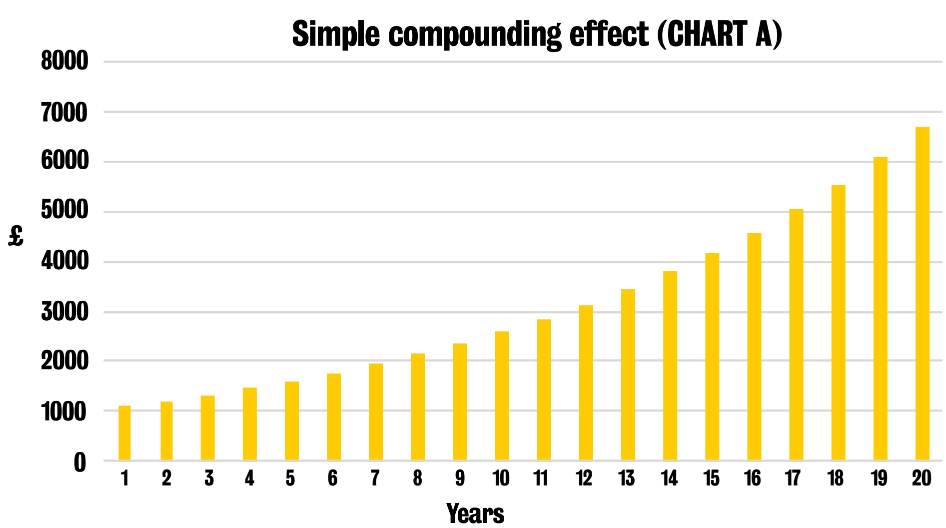
How reinvested dividends unlock the benefits of a buy and hold approach

If the shares go up 10% the next year you'll have £1,210 as you've generated a gain not just on your original investment of £1,000 but also on the £100 gains you made last year.

If the shares keep going up 10% a year for 10 years, you'll end up with £2,588 as you keep making gains on your previous year's gains. You actually double your money after just over seven years.

If you keep the same shares and they go up 10% a year for another 10 years you'll end up with £6,714 or more than six times your money.

Notice how steep the increase is in the last few years, which means most of the benefit comes from sticking with it.



THE POWER OF DIVIDEND REINVESTMENT

If as well as going up 10% a year your shares pay you an annual dividend of £50, re-investing these dividends rather than getting a cheque every three or six months could substantially improve your returns — (see chart B).

In this case, at the end of the first year you have £1,150 – your original £1,000 plus £100 of capital gains plus £50 of dividends.

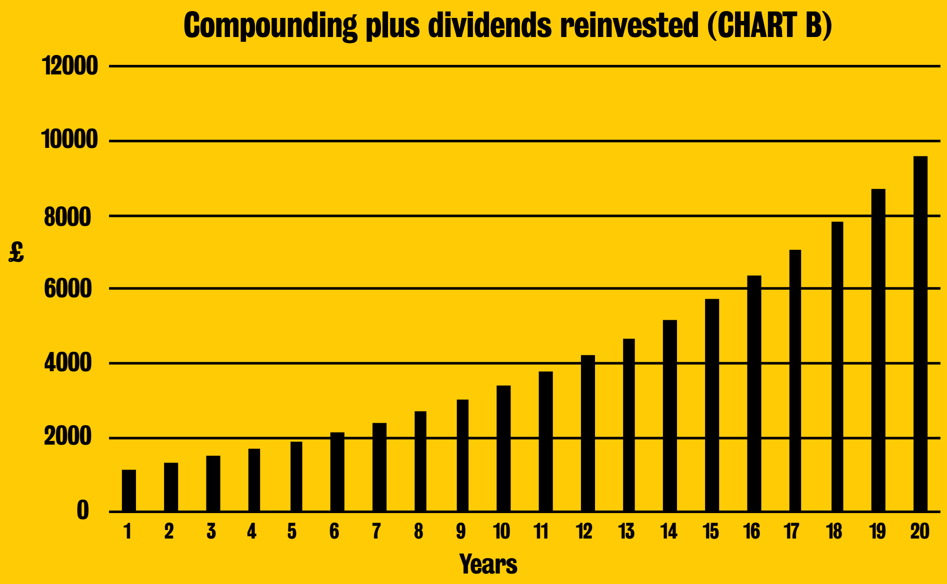
If you keep reinvesting the dividends then instead of doubling your £1,000 in just over seven years, it doubles in less than six years. In 10 years it turns into £3,390 rather than £2,588, almost a third more.

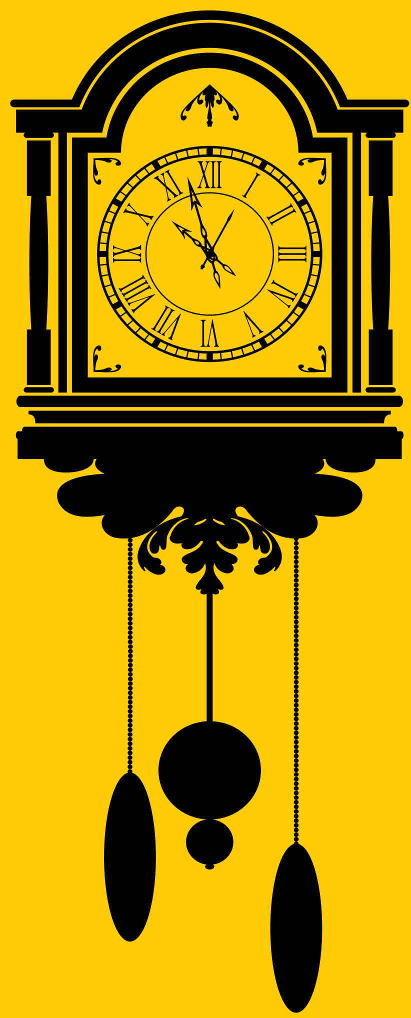
If you stick with it for the whole 20 years, rather than £6,714 you end up with £9,591 or over 40% more than the return from not re-investing the dividends.

Again, as the chart shows, your returns accelerate towards the end.

Most investment platforms, including AJ Bell Youinvest, allow you to opt for dividends to be reinvested automatically.

For those wanting to let someone else re-invest dividends for them, many investment trust

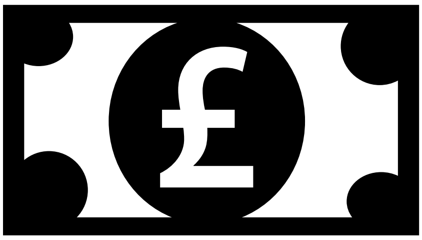




and funds have ‘accumulation’ units which will automatically do this without your having to tell them.

BANKING THE DIVIDEND

On the other hand you could have just banked the £50 of dividends every year instead of re-investing it, in which case you would have £7,714 consisting of £6,714 from your original investment plus £1,000 in dividend cheques.



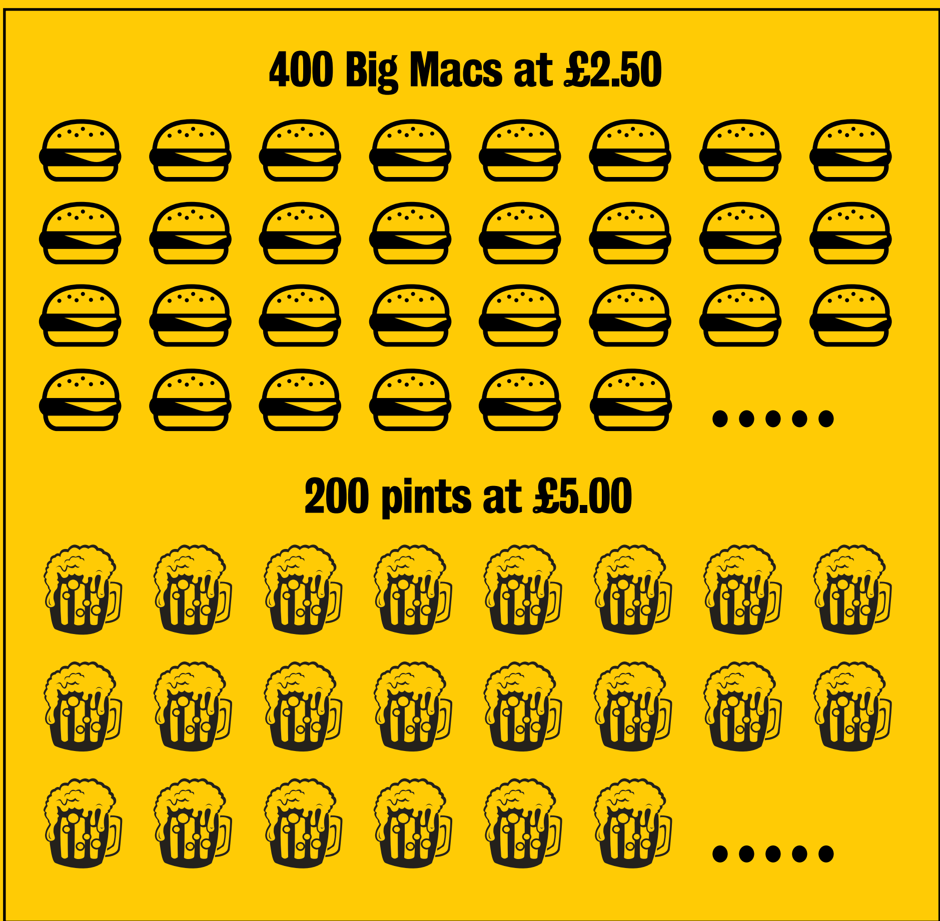
Or you could have spent the £50 in which case over 20 years you could have bought 400 Big Macs at £2.50 each or 200 pints of strong lager at £5.00 each.

Now imagine that as well as re-investing your dividends you invest another £1,000 at the start of the year, so you start the second year with £2,150 instead of £1,100 — (see chart c).

After five years you’ve invested £5,250 – five lots of £1,000 and five dividend payments of £50 – and with the same 10% increase a year you will have £7,021 or a third more.

After seven years and an investment of £7,350, you amass £10,106, and after 10 years and an investment of £10,500 you end up with a whopping £18,328 or almost 75% more than you’ve invested.

If you keep this exercise going and invest £1,000 of capital plus



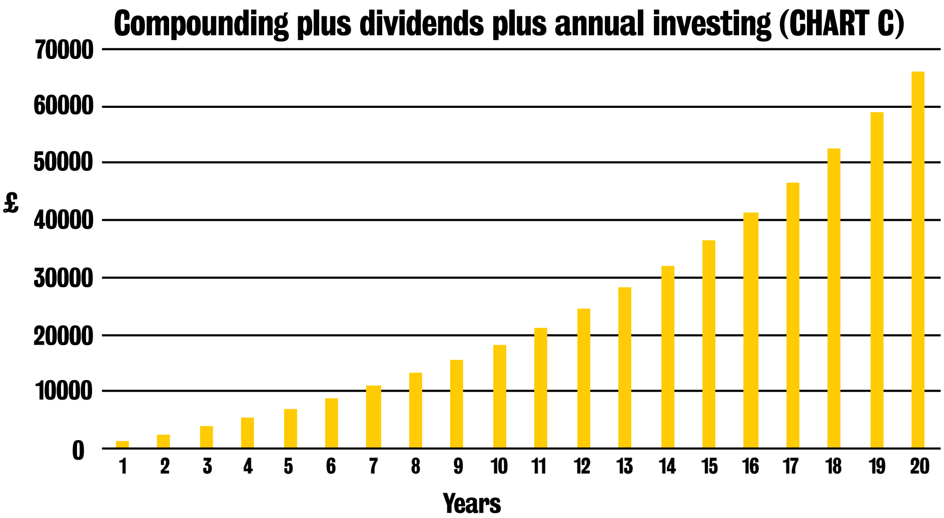
the £50 of dividends each year for another 10 years, you'll have turned £21,000 into £65,866 or more than three times your money, assuming a constant 10% annual return.

THE IMPORTANCE OF STAYING THE COURSE

Again note how sharply the curve rises in the last few years. In fact your returns double in the last six years which is why it's so important to stay the course.

As well as staying the course to allow the power of compounding to work, another crucial rule is to start early.

The chart, shows the difference that investing early



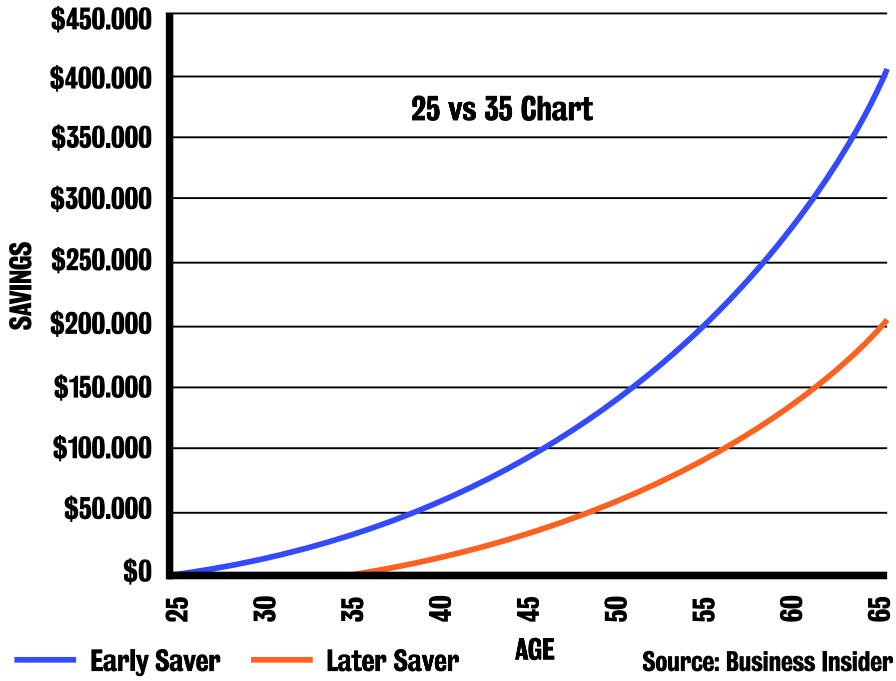
can make to your retirement pot.

If two people want to retire at 65, with one investing regularly from age 25 and the other investing the same regular amount from age 35, the difference those early years make is staggering.

The early saver (blue line) invests a third more than the later saver (red line) but their retirement pot is almost double as the scale of the gains accelerates in the latter stages.

STARTING EARLY

In fact if you start putting money aside early enough and let it



Compounding in action: JPMorgan Chase

US investment bank JPMorgan Chase has a tool on its website which allows you to calculate your return on an investment in its shares from 1972 to the present day.

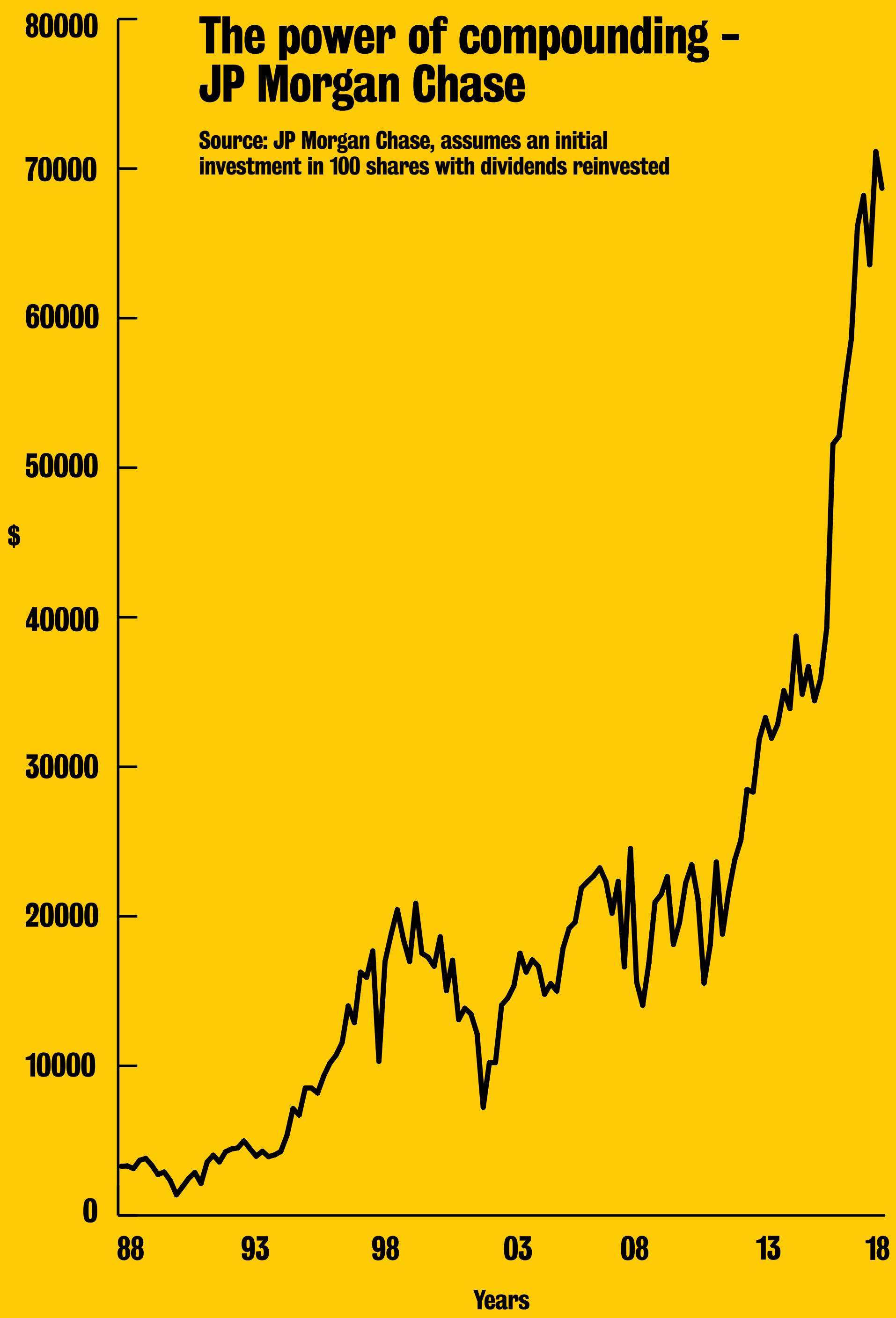
To create a more realistic timeframe, let's take a shorter 30-year period which means looking at data from November 1988.

If you'd bought 100 shares 30 years ago at $32.87, your initial investment would have been worth $3,287.

The share price traded below this entry level during several periods including the early 1990s and again around the financial crisis in 2008.

But by staying invested through the entirety of this period your initial $3,287 investment would be worth $33,387 today.

And if you'd reinvested dividends your investment would be worth $68,681.74. The chart shows that a significant chunk of this value has been achieved in recent years, underscoring the importance of patience in your investing. **(TS)**



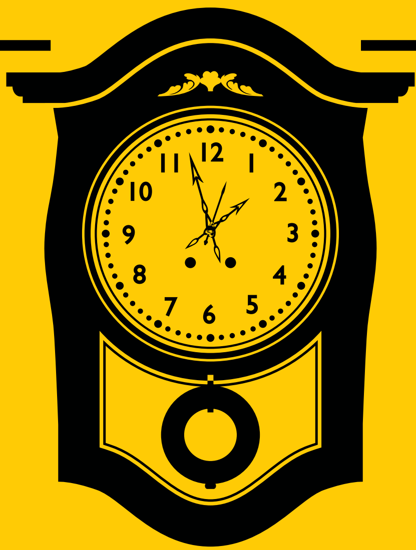
compound you could stop paying in at some point and just let the funds compound themselves.

Research firm CLSA looked at savers who each invested £2,500 a year in a pension growing at 7% per year.

One started at 21 and stopped at 30, while the other started at 31 and didn't stop until they hit 70.

Remarkably the first saver ended up with the bigger pension pot by age 70 — £533,000 against £534,000 — even though they made no contributions for 40 years.

The early saver pays in £25,000 but the power of compounding means returns are greater than the later saver who pays in £100,000. **(IC)**



How to save money when you're investing

We reveal ways to keep your costs down and help bolster your returns

Whether it's a buy one get one free offer in the supermarket or getting an early deal on a getaway, most people love bagging a bargain.

But it's a bit more difficult when it comes to investing – shares don't have three for two offers, and the only way to buy at a discount is if you do so when a stock is out of favour.

But savvy investors can still keep costs down through a few simple tricks:

REGULAR INVESTING

Setting up a regular investment account with your fund supermarket has a number of benefits. First and foremost is the fact that experts say drip-feeding is often the most effective way to invest your money. Putting a set monthly amount into your holdings each month means you are not tempted to try and time the market with a lump-sum investment, running the risk of it falling immediately after your have invested.

Instead, regular investors benefit from so-called pound-cost averaging whereby, over time, you get a better deal because you are buying fewer shares or units in a fund when they are expensive and more when they are cheaper.

Pat Connolly, chartered financial planner at Chase de Vere, says: 'It's incredibly difficult to call markets, so investors need to decide whether they are happy to take that risk and invest a lump sum, which can potentially generate higher returns, or reduce risk by investing through regular payments. It is often the best way for novice or cautious investors and should allow them to sleep easier at night.'

> **You shouldn't choose a platform just on the basis of free trades, as it will likely end up costing you in the long-term**

ECONOMIES OF SCALE

Regular investing has another major benefit too in that most platforms will allow you to trade at a lower cost if you have an investment plan set up.

With AJ Bell Youinvest, for example, the standard dealing fee is £9.95 each time you buy or sell shares, but this falls to just £1.50 for those using the regular investment service.

Hargreaves Lansdown charges £11.95 as a standard dealing fee but also charges £1.50 for regular investment.

The reason for the lower regular investment charge is that platforms group trades together, so that trades are cheaper to transact and they pass this saving on so that investors benefit from the economies of scale. Investment plans are easily set up online and allow you to set a monthly amount to be invested on a particular day each month.

AJ Bell estimates that regular investors can save more than £100 a year compared to those who trade each month but have not set up an investment plan.

FREQUENT TRADING

Many platforms will reduce the fee for trading if you buy and sell regularly. Investors who make ten or more share deals a month can see their fees half. That might sound that a lot of buying and selling but bear in mind that share dealing incorporates not just company shares but bonds, exchange-traded funds and investment trusts.

At Interactive Investor you pay £10 per trade but that falls to £6 if you have traded 10 times or more a month for the preceding three months.

As discussed, investors using the AJ Bell Youinvest platform typically pay £9.95 per trade but see this fee fall to £4.95 per trade if they make 10 or more deals in a month.

However, while a discount on trading sounds appealing, investors should not be tempted to buy and sell for the sake of it. Patrick Thomas, investment manager at Canaccord Genuity, warns: 'Trading regularly is not necessarily helpful if there is not much of a strategy behind it. If you are buying the same fund every month and getting a discount for the privilege then that might be advantageous, but not if you are choosing a different one every week depending on what you've read or how you are feeling.'

He adds: 'You shouldn't choose a platform just on the basis of free trades, as it will likely end up costing you in the long-term. More important is what you are trying to achieve, what you are investing in and what the costs of that investment are.'

LARGE TRADES

In other instances, platforms may charge less based on how much you invest. They might, for example, cap their charges at a certain amount or they could be staircased so that those who invest more pay a lower percentage.

At AJ Bell Youinvest, for example, the typical platform fee is 0.25% a year but this is capped at £30 a year for an ISA and at £100 a year for a SIPP. The effect of this is to reduce the overall percentage that you are paying. For example, £100 as a percentage of a £50,000 portfolio is 0.2% and on a £100,000 portfolio is just 0.1%.

Foreign exchange fees are another area where charges may be tapered depending on the size of your order. Fees start at 1% for trades up to £10,000 with AJ Bell, falling to 0.25% for deals worth more than £30,000. (HB)

Vietnam is thriving.

While other frontier and emerging markets have had a tough go in 2018, Vietnam continues to grow. In 2018, its GDP is expected to rise 7%, coming off 6.8% growth in 2017. Foreign direct investment continues to reach new highs, mostly from companies looking to establish or expand manufacturing operations – Vietnam has quickly become the manufacturing hub of Southeast Asia. These companies are driving export growth, and for the first nine months of 2018 export value rose 15% to reach US$179 billion, much of that consisting of high-tech items such as mobile phones and microchips going to the EU and UK, the US, and China. Vietnam's aggressive efforts to integrate into the global economy via free trade pacts, including the recently signed CPTPP and the EU-Vietnam Free Trade Agreement, are reaping dividends.

Investment is also creating more and better paying jobs for Vietnam's 95 million people, more than half of whom are under the age of 35. Many are moving from rural areas to cities – Vietnam boasts Asia's highest urbanisation rate – to seek better incomes and opportunities for themselves and their families. This in turn has created solid demand for new homes, better education, healthcare, and financial services, and discretionary spending, as the rapidly growing middle class, expected to reach 33 million people by 2030, looks to spend increased disposable income.

Spurred on by strong international investor interest, private sector IPOs and a newly aggressive push by the Vietnamese government to privatise state-owned enterprises, Vietnam's stock markets have expanded dramatically. The total market cap for the more than 1,500 companies listed on Vietnam's three exchanges is approximately US$193 billion, making the frontier market much larger than some emerging markets such as Pakistan (US$59 billion). FTSE Russell included Vietnam on its watchlist for upgrade to emerging market status in September.

Add in controlled inflation, a relatively steady currency and a stable government committed to further reforming the economy for continued sustainable growth and it is easy to see why Vietnam is far better positioned to weather global uncertainty than many other frontier and emerging markets, and why growing numbers of international investors have been attracted to Vietnam.

How to invest in Vietnam? The VinaCapital Vietnam Opportunity Fund

Launched in 2003, the VinaCapital Vietnam Opportunity Fund (VOF) is one of the largest and most successful investment vehicles focused on Vietnam. VOF is unique from other funds in that it can invest across asset classes, such as listed equities, private equity, and government privatisations, enabling it to participate in all segments of Vietnam's vibrant economy.

VOF believes that the most compelling investment opportunities are in companies participating in Vietnam's domestic consumption growth story, sectors such as consumer discretionary, education, financial services, construction and materials, and infrastructure. Examples of some of our key investments include Vinamilk, the country's largest food and beverage company, with a US$13 billion market capitalisation; VietJet Air, Asia's fastest growing low-cost airline; Hoa Phat Group, the leading steel manufacturer; and most recently, Tam Tri Medical, a new private healthcare network that is expanding to meet the growing medical needs of Vietnamese people.

With extensive investment experience in Vietnam and internationally, VOF's senior leaders have developed an expansive network that gives the fund exposure to opportunities not available to others, contributing to the fund's strong results. VOF's one-year net asset value/share increased 18%. VOF is also the only Vietnam-focused fund to pay dividends. VOF was included in the FTSE 250 Index earlier this year, a testament to both the strength of our model and the tremendous opportunities available in Vietnam today.

Andy Ho
VinaCapital
Vietnam Opportunity Fund

‘How does pension tax relief work?’

AJ Bell expert Tom Selby helps explain the money you get on pension contributions

Alan** from **Wimbledon
Can you explain exactly how pension tax relief works? I’ve seen some stories saying people in ‘net pay’ schemes might not get anything, but others say you get it at your marginal rate – but I’m not really sure what this means! Any help appreciated!

Tom Selby, AJ Bell senior analyst, replies:

Firstly, don’t worry – you’re not alone in getting in a bit of a tangle about the mechanics of pension tax relief. But once you get your head round it the system is actually fairly simple for most people.

Receiving tax relief at your ‘marginal rate’ just means getting back whatever income tax you paid.

It’s probably easiest to illustrate this with an example. Let’s imagine someone has total taxable earnings of £46,400 in 2018/19. The basic-rate tax band is currently £46,350, meaning this person is only just a higher-rate taxpayer (with £50 of their earnings taxed at 40%).

If they make a £40 contribution into a SIPP, that contribution will automatically be increased to £50 when basic-rate tax relief (20%) is added automatically by their provider.

Note here it’s 20% of the total amount that goes into the pension or ‘gross’ contribution, rather than 20% of the amount they put in initially. They can also claim back an extra 20% (£10) through their tax return, meaning the £50 SIPP contribution has only cost them £30.

If they had paid £100 gross into their SIPP rather than £50, only half of that contribution would have received higher-rate tax relief, with the other half getting basic-rate relief.

In practical terms, that means the £100 contribution would have cost them £70 in total. If the entire contribution had been granted tax relief at the higher rate, they’d have been able to claim back an extra £10 – meaning it would have cost them just £60.

On your second point, you are right that there is an issue for some members of so-called ‘net pay’ pension schemes. These work differently to ‘relief at source’ pensions (such as the SIPP example described above) because contributions are taken automatically from salary, meaning you don’t have to claim anything back from HMRC.

The issue you highlight mainly affects people who are automatically enrolled into net pay schemes. Under government rules anyone earning £10,000 or more should be auto-enrolled into a pension scheme by their employer.

However, because the basic-rate tax band doesn’t start until you earn over £11,850 anyone in a net pay scheme earning between £10,000 and £11,850 won’t get tax relief added to their fund automatically (although they can make a claim to HMRC).

This is not the case in relief at source schemes, where tax relief is added automatically.

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.

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. ■

RISK WARNING

Please remember that past performance may not be repeated and is not a guide for future performance. The value of shares and the income from them can go down as well as up as a result of market and currency fluctuations. You may not get back the amount you invest. The Scottish Investment Trust PLC has a long-term policy of borrowing money to invest in equities in the expectation that this will improve returns for shareholders. However, should markets fall these borrowings would magnify any losses on these investments. This may mean you get back nothing at all. Investment trusts are listed on the London Stock Exchange and are not authorised or regulated by the Financial Conduct Authority. Please note that SIT Savings Ltd is not authorised to provide advice to individual investors and nothing in this article should be considered to be or relied upon as constituting investment advice. If you are unsure about the suitability of an investment, you should contact your financial advisor. Issued and approved by SIT Savings Ltd, registered in Scotland No: SC91859, registered office: 6 Albyn Place, Edinburgh, EH2 4NL. Authorised and regulated by the Financial Conduct Authority.
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Blue Whale goes straight to the top end of the fund chart

We reveal how a hugely successful new fund approaches stock picking and differentiates itself from the crowd

The team behind **LF Blue Whale Growth Fund (BD6PG78)** have set the bar very high with their debut performance. The product launched in September 2017 and went to the top end of the funds chart.

In its first year, the fund outperformed the MSCI World index by 13.1% and the FTSE 100 index by 22.3%, meaning it ranked in the top 1% in the IA Global Sector.

Delivering such impressive results means that some investors may expect superior returns going forward. That puts a lot of pressure on the five-strong investment team (two fund managers, three analysts) who are not only battling a difficult market backdrop at present, but also trying to live up to investors' heightened expectations.

THE INVESTMENT PROCESS

The fund's goal is to deliver outperformance of least 5% per year versus the MSCI World index. Fund manager Stephen Yiu says that is only possible if you run a concentrated portfolio, namely you've got to take big bets on specific stocks rather than spread yourself too thinly with countless holdings.

The Blue Whale fund aims to hold 25 to 35 stocks in its portfolio. 'We are truly active, not buy and hold,' explains Yiu.

Many people think of Amazon solely as a retailer but its AWS web server business is growing at 50% a year

He says the investment process is very different to many other global funds because his team do their own research and do not speak to brokers or read third party analyst notes.

Yiu also claims his team spend more time per company than many other funds, excluding ones run by very large asset managers like Schroders who have considerable resources.

'There are five of us in the team. We work 10 hours a day, so 250 hours a week combined, or 1,000 hours a month. For a 25-stock portfolio that means we spend 40 hours on research per stock per month. We think our competitors only spend five hours per month per stock.'

LONG-TERM GROWTH FORECASTING

Yiu believes Blue Whale has an edge through its own modelling, in particular taking a strong view on long-term earnings potential.

He says the market is very inefficient with forecasting earnings beyond 18 months to three years. He believes analysts are merely following the pattern of believing what a company's management predict near-term and then assuming that earnings growth will slow down over time.

'The market underappreciates long-term growth potential and longevity of growth,' says the fund manager. Essentially he is saying that while a company may look expensive on current valuation metrics, it could look far more attractive if you look further out.

He gives the example of Amazon. 'Before the market sell-off it was trading on 50 times earnings with a 7% operating margin forecast in two years' time. That's the margin the business said 20 years ago it would achieve over the long-term. But the business has since evolved.

'Its AWS web server business is growing at 50% a year with 30% operating margin. The advertising side of its business is growing at over 50% a year with 60% to 65% operating margin.

> **Many analysts are lazy and just put down numbers between 1% above and below those guided by company management in their earnings models**

'If you put everything together our long-term operating margin for Amazon is up to 20%. The timing of hitting those numbers depends on its expansion plans.'

Yiu says that Amazon's shares are cheap even on a 50-times price-to-earnings multiple.

BLUE WHALE GROWTH FUND PERFORMANCE

	Blue Whale fund	MSCI World	FTSE 100	Rank (IA Global Sector)
2018*	+15.5%	+3.7%	-3.6%	#3 of 294
Since launch**	+18.8%	+7.8%	+0.7%	#5 of 287

*Source: Blue Whale. *1 Jan to 8 Nov 2018. **Launched 11 Sep 2017*

'You've never had a business like Amazon where anything it does is margin accretive; that's because it started from such a low base.'

The Blue Whale Fund has a global remit; while 60% of its holdings are listed in the US, many of these businesses are global in nature. Some of the names are stable holdings in other global funds like the aforementioned Amazon and Google-owner Alphabet. Other popular names with global funds are noticeably absent from Blue Whale such as Apple which Yiu criticises for not growing or innovating.

'We don't do anything special in terms of investment philosophy,' says the fund manager, somewhat candidly. 'There is no magic formula'. This modesty clearly understates the expertise of the team.

PORTFOLIO POSITIONING

Blue Whale sees the biggest short-term risk to markets as the US Federal Reserve raising interest rates too quickly.

The fund says it wouldn't typically invest in companies with high levels of direct exposure to interest rates, commodity prices or industrial cycles, which explains why the portfolio mainly features technology, consumer and healthcare stocks as it believes they are less impacted by macroeconomic factors. Current names in the portfolios include payments group PayPal, computer software business Adobe and healthcare-focused cloud computing firm Veeva.

A key ingredient behind the team's success, along with taking a longer-term view with earnings potential, is its awareness of issues that could affect a company and knowing companies inside out.

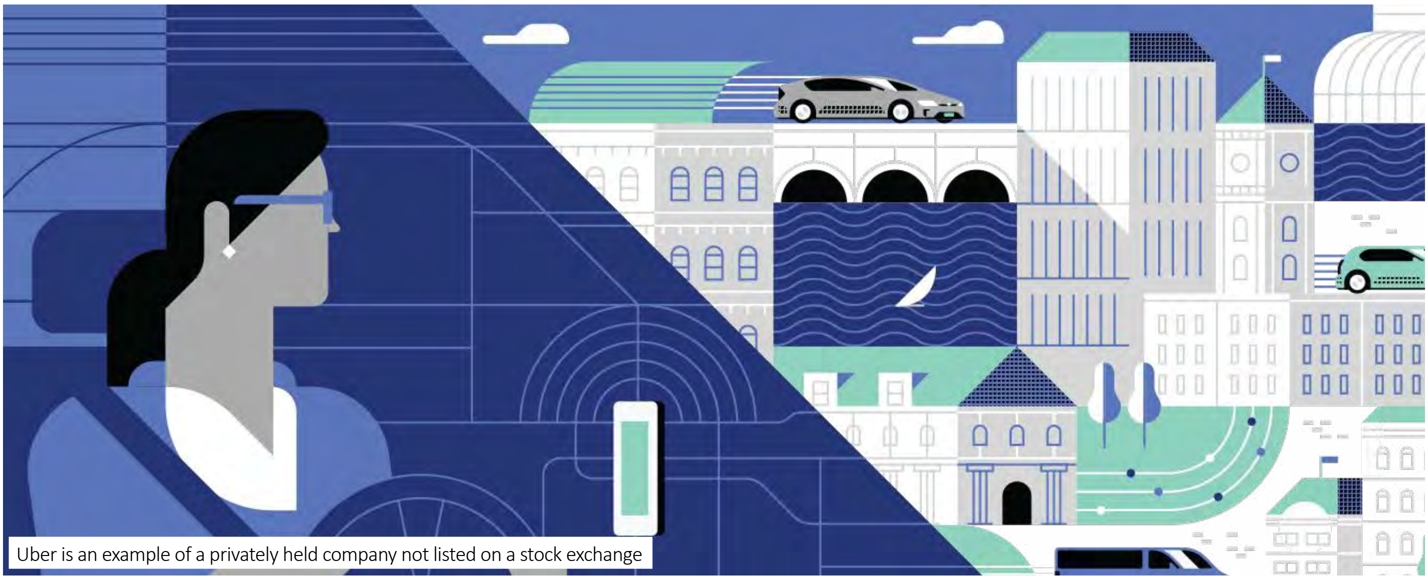
'Many analysts are lazy and just put down numbers between 1% above and below those guided by company management in their earnings models.

'As fund managers we try and understand how the last three years' earnings for a company were delivered and whether something has changed, plus how macro factors could impact,' says Yiu. 'We look at what's already known in the market and recognise how these issues are relevant to various companies.'

He says many fund managers in the near future will blame disappointing performance on areas such as tariffs, Brexit and currencies. His view is that they should have already factored this issues into their research and stock picking, as that's their job. (DC)

Can retail investors bag a unicorn?

How you can use investment trusts to invest in private growth companies



Uber is an example of a privately held company not listed on a stock exchange

Investors often hear about high growth private companies, but can't access a piece of the investment. So-called Unicorns, start-up companies that have reached a valuation of $1bn or more, have become more commonplace in recent years.

Big names such as taxi-app Uber, accommodation website Airbnb and delivery company Deliveroo are still held privately and aren't listed on the stock exchange.

While many large institutional investors, such as pension funds and insurance companies, can invest in private companies, individual investors struggle to buy them directly. However, they can access a slice of the action through certain funds.

Ryan Hughes, head of active portfolios at AJ Bell, said: 'While gaining a stock market listing has always been seen as a badge of honour, many companies choose to stay private for a variety of reasons. Many of these companies can be quite large with a notional market capitalisation of hundreds of millions of pounds.'

Here we look at the different options.

PRIVATE EQUITY TRUSTS

There is a grouping of investment trusts that invest solely in 'private equity' – so companies not listed on the stock exchange. These trusts look to invest in early-stage, high growth companies, which are often riskier than most.

Some trusts invest directly in these start-up companies, while others have a 'fund of fund' structure and invest in other funds and trusts that are focused on private equity. Some split their money between the two approaches.

One issue with these trusts is that they typically trade at a constant discount – meaning you can buy each share for less than the value of the underlying assets. Some investors see this as a buying opportunity, but not if the discount remains and doesn't narrow.

For example, **Standard Life Private Equity (SLPE)** currently trades at a 17.3% discount, ahead of its 14% 12-month average, while **Apax Global Alpha (APAX)** is on a 20% discount, compared to its 12-month average of 14%. However, this is far lower than in the financial crisis, when the sector averaged discounts of 60% or more at some points.

But there is a potential double-discount on offer. Due to the unlisted nature of these trusts' holdings, they are not valued daily like those with shares on the stock market. This means the net asset value figures of the trust can be out of date, and the actual discount will be much larger.

Adding to this list recently is Old Mutual Global Investors, now rebranded as Merian Global Investors, which has just launched a new investment trust focused on unquoted companies called **Merian Chrysalis (MERI)**. The trust raised £100m at launch, and originally aimed to invest in between seven and 15 unquoted companies. The team's existing unlisted holdings in other funds they run include The Hut Group, TransferWise and Secret Escapes, which will likely make it into the new trust.

Hughes adds: 'Merian's new investment trust launch is interesting as it gives private investors a method of gaining exposure to a dedicated investment focused on this area. The small cap team at Merian is one of the strongest in the market and therefore their expertise in this area is important.'

OTHER FUND OPTIONS

Another option is to invest in funds that have a slice of their money in private companies, but still have a large portion in the public markets. Investment trusts are an ideal vehicle for these kind of investments – because they are closed-ended they are not going to be forced sellers of the private companies as a result of investor withdrawals.

Hughes comments: 'Accessing private companies for retail investors is typically very difficult but some funds do have exposure to this area.

While investing in this area isn't without risk, with potential for liquidity issues, investment trusts in this area may be a useful diversifier to a portfolio of existing UK equities.'

The £8bn **Scottish Mortgage (SMT)** investment trust has recently expanded its private allocation – in 2016 it increased the amount it could have in unquoted companies from 15% to 25%. It currently has 37 unlisted companies, which accounts for 15% of the portfolio. Earlier this year, its unlisted holdings included music streaming website Spotify, Airbnb and ride-sharing app (and Uber rival) Lyft.

Another globally-focused example is the £2bn **Caledonia Investment Trust (CLDN)**, which has a 36% allocation to unlisted companies but also invests in private equity funds, giving it further exposure to private businesses.

Investors who feel particularly enthusiastic about the growth of start-ups in particular countries or regions also have options. For example, the Asia-focused **Fidelity China Special Situations (FCSS)** has 5% in unlisted investments at the moment, including ride sharing app Didi Chuxing and Chinese app developer Jiguang.

Laura Suter, personal finance analyst, AJ Bell

SELECTED TRUSTS WITH UNQUOTED ALLOCATIONS

Trust	Unquoted allocation
RIT Capital	220.0%
Woodford	69.0%
Lindsell Train	44.8%
Caledonia	36.0%
Scottish Mortgage	15.0%
Artemis Alpha	12.0%
Miton Global	12.0%
Fidelity China	5.0%
Edinburgh Worldwide	2.8%

Source: AIC

Do capital preservation funds perform as planned?

These funds aim to protect investors' capital come rain or shine

Volatility returned to equity markets during October and this recent market setback provides an opportunity to reappraise the merits of trusts that prioritise the avoidance of capital loss.

Capital preservation funds are collectives with a strong track record of helping investors avoid large losses whilst growing their wealth too, albeit more slowly than adventurous, more risk-tolerant collectives.

These trusts can suffer losses during widespread sell offs and there is no guarantee they will always make you money, yet their whole ethos is to fall by less than the market during a downturn, limiting your losses and protecting your hard-earned capital.

Many consider capital preservation funds to be simply defensive portfolios, but at least some of these collectives have good track records of delivering decent annual returns.

> Ruffer's principal objective is to protect its investors' capital

It is important you understand that when equity markets rip-roar ahead, they are unlikely to keep pace, as they tend to have a lower exposure to shares than a standard income or growth fund.

AIMING TO DELIVER POSITIVE RETURNS, COME RAIN OR SHINE

This article will help investors familiarise themselves with capital preservation trusts and their performance. They include **RIT Capital Partners (RCP)**, which has a strategy to preserve shareholders' capital and deliver long-term capital growth through a multi-asset approach.

One of its peers is **Ruffer Investment Company (RICA)**, whose 'near obsessive principal objective is to protect our investors' capital', according to investment director Hamish Baillie.

Specifically, Ruffer aims to achieve a positive total annual return, after all expenses, of at least twice the Bank of England bank rate, by allocating assets towards bonds, cash, gold and equities.

According to the Association of Investment Companies (AIC) & Morningstar, Ruffer has delivered robust 10 year share price capital returns and NAV capital returns of 75.7% and 65.9% respectively.

Albeit generated during a bull market, Morningstar data shows annual returns on an NAV basis rising in nine of the last 10 years, save for 2015.

Ruffer seeks to be genuinely uncorrelated with equity markets and the trust would sit rather snugly alongside an equity-focused portfolio, where it could be called upon when other assets fall in value.

Elsewhere, **Capital Gearing's**

(CGT) dual objectives are to preserve shareholders' real wealth and achieve absolute total return over the medium to longer term.

During periods of market exuberance this means sacrificing short term returns for the sake of protecting capital, but over the longer term, the cumulative effect of positive compound returns drives outperformance.

Morningstar data show positive annual price and annual NAV returns dating back to 2008, except for an 8.99% price decline in 2013. In the year ended 5 April 2014, covering the bulk of the period, Capital Gearing's net asset value per share fell 2.5% to £31.20 and the trust failed to meet its objective of achieving growth in absolute terms for the first time in over thirty years.

This disappointment was due to a relatively high exposure to underperforming defensive asset classes and unfavourable currency movements.

STALLIONS OUT OF THE TROY STABLE

When it comes to capital preservation strategies, investors cannot ignore Troy Asset Management, founded by the late Lord Weinstock and Sebastian Lyon in 2000, whose investment approach aims to avoid permanent capital loss. Its managers put money to work in sustainable business franchises and run concentrated, low turnover portfolios.

Troy manages **Personal Assets Trust (PNL)**, offering an exposure to a defensive combination of high quality equities as well as government bonds, gold and cash.

Also in the Troy stable is **Troy Income & Growth Trust (TIGT)**. Co-manager Hugo Ure seeks outstanding franchises, quality companies that generate high levels of free cash flow, steadily and sustainably grow their dividends and also return excess capital through special dividends and buybacks.

Such companies could help shield his shareholders 'from the worst of capital drawdowns and markets'. He and colleague Francis Brooke tend to cut holdings when valuations become too high for their comfort.

When it comes to avoiding permanent capital loss, Ure says 'the underpinning tool that we have to do that is the investment in sustainable business franchises' and 'a group of assets that have steadily and sustainably grown long term dividends'.

Troy Income & Growth has delivered a more robust return when markets have been softer, although Ure concedes it struggles to keep up when markets are 'more ebullient'.

Top 10 holdings as at 30 Sep included **Unilever (ULVR)**, Nestle, **Reckitt Benckiser (RB.)** and **Experian (EXPN)**.

Other stocks in the portfolio include high retailers **Next (NXT)** and **WH Smith (SMWH)**, whose management teams are internally allocating capital to growing bits of their businesses, as well as Coca Cola and Procter & Gamble.

Significantly, there has been no meaningful discount on the trust since the discount control mechanism (DCM) was put in place in January 2010, providing shareholders with liquidity and avoiding wild swings between discounts and premiums.

'Right from the outset, we wanted to address some of the big issues that investment trusts have, whilst keeping some of the benefits,' explains Ure.

'We felt we could create a vehicle that removed some of the downsides that people get concerned about. The DCM we put in place effectively addresses two big issues – discount volatility and liquidity.' (JC)

Find out how ETFs are getting active

We take a look at this growing space, how to define it and the challenges it faces

Robo Global Robotics and Automation Index ETF is an example of an ETFs with 'active' characteristics

The global exchange-traded fund (ETF) industry is estimated to soar in value from $5tn to $30tn by 2030 according to JP Morgan as more people seek out low-cost investments.

ETFs are used by investors to match the performance of an index of assets, usually for a cheaper price than actively managed funds.

As well as growing rapidly this industry is also innovating so while historically ETFs have been almost entirely passive investments, there are an increasing number of 'active' products which have a fund manager in charge aiming to beat the benchmark.

One of the companies hoping to tap into the growing active ETF space is JPMorgan which three new London-listed products in October 2018.

AIMING TO BEAT THE INDEX

With these products the fund manager looks at the index it wants to beat and decides what companies it wants to go overweight or underweight on using research and future cash flow insights from its analysts.

Typically, you would expect to pay for the extra work which goes into building such a portfolio so you would expect truly active ETFs to have higher charges than their passive counterparts.

Of these new products, **JPM Global Research Enhanced Index Equity (JREG)** aims for a long-term return in excess of the MSCI World Index by investing in global companies.

> As well as growing rapidly this industry is also innovating

JPM US Research Enhanced Index Enhanced Index Equity (JREU) uses a US portfolio of companies to try and beat the S&P 500.

Both ETFs have top positions in Apple, Microsoft, Amazon, Google-owner Alphabet and Johnson & Johnson. These are some of the largest companies in the world and already have a significant weighting in US and global indices, so there have to be questions on the extent to which investors are benefiting from the active management approach.

Among the top holdings for **JPM Europe Research Enhanced Index Equity (JREE)** are Novartis, Nestle and **Unilever (ULVR)** in a bid to beat the MSCI Europe Index.

This ETF tracks an index of 716 stocks, far more than most traditional active funds and considerably more than the 122 and 210 holdings in the two other aforementioned JPMorgan ETFs. You have to question whether a fund manager is really on top of everything affecting 716 companies.

In these products' favour is their ongoing charge of 0.25%, higher than the cheapest passive ETFs which sometimes have fees as low as a few basis points but lower than most traditional active funds.

WHAT MAKES AN ETF ACTIVE?

There is significant debate over what makes an ETF 'active' in terms of how the investment strategy is decided and implemented.

Legal and General's ETF head Howie Li argues for an ETF to be truly active it should be led by a fund manager and an investment team who undertake research to decide what to invest in.

The benefits of having someone take control of an ETF is that they can keep an eye on the investment universe and remove any companies if, for example, they become overvalued.

For investors considering an active ETF, Li says it is essential they understand the investment, who is involved and whether the portfolio is actually unique and if it has delivered to expectations in the past.

Active ETFs are not always as straightforward as a fund manager picking stocks. The criteria for the investment strategy may be set by the manager and implemented in an automated way.

Investors may be curious about how active ETFs are different from other investment methods such as smart beta and there is something of a grey area here.

How can an investment manager in this scenario expect to be as effective? It's the equivalent of starting a hand of poker by showing your opponents your cards.

HOW DOES SMART BETA DIFFER?

Smart beta features a 'rules-based' approach to investing, effectively applying a screen to the market but not making a qualitative judgement on individual stocks.

In this sense smart beta ETFs are something of a hybrid – using aspects of both active and index investing. These funds focus on incorporating assets that have certain characteristics attractive to investors, such as low volatility, good dividend yield or strong company performance.

Other examples of ETFs with 'active' characteristics include **Robo Global Robotics and Automation Index ETF (ROBO)**. It tracks an index created by Robo Global made up of firms with a high sales association with robotics, automation and AI.

Robo Global EMEA & ASIA chief executive officer Richard Lightbound says experts from its advisory board, including robotics and AI academics, help identify companies for the index. They have to demonstrate growth in robotics, automation and AI with a potential product or technological advantage. (LMJ)

THE TRANSPARENCY CHALLENGE

Writing in January 2018 Robert Malone, client management, HSBC Securities Services, noted that active ETFs were a 'challenging proposition'. Firstly, he raised the point of costs as ETF issuers will have to balance the expectation for low costs on exchange-traded funds.

In Malone's words: 'Managers are going to have to find a pricing point which is attractive to ETF investors but which keeps the lights on.'

His second concern relates to transparency. Whereas a traditional active fund only publishes a full list of its portfolio periodically (if at all), ETFs traditionally publish the full list of underlying investments daily.

Malone adds: 'How can an investment manager in this scenario expect to be as effective? It's the equivalent of starting a hand of poker by showing your opponents your cards.'

It is not yet clear if solutions such as introducing a timing lag to publication of the composition of a portfolio will meet with the requirements of global regulators, although that approach is being adopted by the likes of Robo Global.

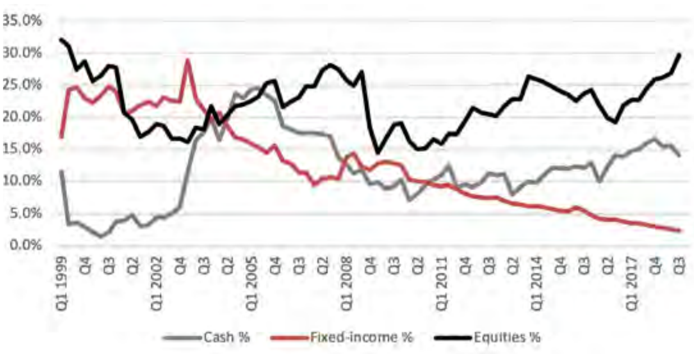
Why Warren Buffett seems to be running scared of bonds

The conclusions to draw as the legendary investor turns away from fixed income

The decision by Warren Buffett to spend some of his Berkshire Hathaway investment vehicle's enormous cash pile on a share buyback is grabbing the headlines, as it suggests the legendary investor is struggling to find a company that he wants to acquire at a price he wants to pay.

But a deeper look at how Berkshire's balance sheet breaks down by asset mix, rather than in just absolute dollars, suggests that the Sage of Omaha is a lot more concerned about fixed income than he is about stock markets. At $18.7bn, US Government bonds represent just 2.5% of Berkshire's assets, continuing a downward trend that has been in evidence since 2003.

BERKSHIRE HATHAWAY'S FIXED-INCOME ALLOCATION STANDS AT MULTI-YEAR LOWS



Source: Company accounts

It is not Buffett's style to make macroeconomic calls. He instead prefers to focus on company fundamentals and particularly valuation, so perhaps the gradual decline in the fixed income allocation reflects a view that bonds represent relatively poor value.

US wages grew 3.1% in October, a figure which suggests a summer drop in the headline overall inflation rate to 2.3% may not last long, a trend which could mean that even a 3.2% yield on the US 10-year Treasury, for example, may not offer as much wealth protection as investors would like.

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In such an environment it is easy to understand why the US Federal Reserve seems intent on pushing through further interest rate increases, with one more planned for December and possibly for 2019. If it executes that plan, the American central bank will have overseen a dozen interest rate hikes of a quarter-point apiece by next Christmas, to 3.25%

Such a trend could well drag US 10-year bond yields higher still and, as we all know, bond prices move inversely to their yield.

SEISMIC SHIFT

It does seem that Mr Buffett is taking evasive action on the fixed-income front and this chart of the US 10-year Treasury bond yield suggests he may be right. It can be argued that a long bull run is ending.

A 30-YEAR DOWNWARD TREND IN US TREASURY YIELDS IS BEING TESTED

Source: Refinitiv data

Whether that is down to the end of QE, higher US Budget deficits (which would mean America needs to issue more bonds to fund itself just as the Fed stops buying) or inflation remains to be seen. But if Treasury yields do go higher that would leave investors with an environment we have not seen since the 1970s, especially if inflation does start to motor.

The logical conclusion of this is that the investment strategies that have served advisers and clients well since the early 1980s may not work so well going forward. This could beg a reassessment of fixed-income exposure, especially at the very long end where yields are traditionally the highest and a cold look at growth and momentum strategies, as cash flow would become more highly valued than profitless revenue growth or customer land-grabs.

In the 1970s, the best performers were gold and, from an equity perspective, consumer staples firms and the providers of life essentials - anything you could eat or and drink or pour down the sink to keep your house clean. A return to inflation could therefore mean it might be time to reassess precious metals and also stocks with pricing power. Firms with it will be able to defend their margins, profits, cash flow and thus dividends. Those without it will be poor selections indeed an in inflationary world.

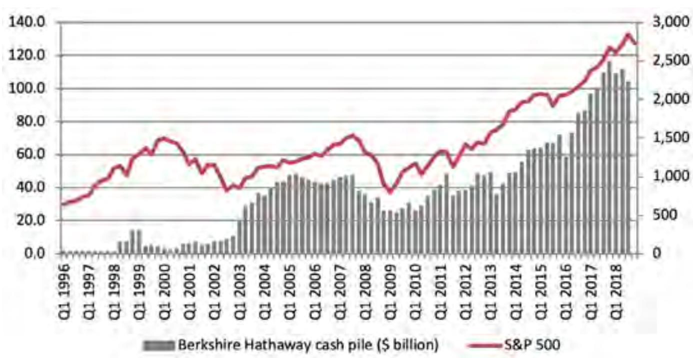
FEEL THE POWER

Pricing power is a key requirement for Buffett before he invests in any stock, which takes us back to where we started. He seems to be shunning bonds but may also be having difficulties in finding companies that he likes at a valuation he likes.

Remember that he railed against the latest wave of merger and acquisition activity in this year's Letter to Shareholders (not that chief executives have listened, judging by this year's bumper takeover activity around the globe).

Berkshire's cash pile, including short-term Treasury bills, stands at a near-record high $103.6bn. That represents 14.1% of Berkshire's assets although that figure is way down, from the 24.5% high of 2005, when Buffett had clearly begun to develop doubts about the bull market that began in 2003, ran out of puff in 2007 and cratered in 2008-09.

BERKSHIRE'S CASH PILE STANDS AT NEAR ALL-TIME HIGHS



Source: Company accounts, Refinitiv data

It is also noticeable how equities, including a $17.5bn stake in Kraft-Heinz, now represent 29.7% of Berkshire's assets, up toward the levels seen at the last two US stock market peaks.

It will therefore be interesting to see how Buffett and business partner Charlie Munger husband their cash from here, given their patient, long-term approach.

By Russ Mould, investment director, AJ Bell

Which small cap pharma firms make a profit?

We explore the profitable companies in this notoriously high risk part of the market

Typically people invest in small cap biotechnology and pharmaceutical stocks in the hope they can enjoy returns of many times their initial investment as the share price reacts to the discovery of the next wonder drug.

However, stories like these are actually few and far between and lots of companies in this space instead burn through their cash quickly and end up going bust.

Profitable businesses are a rarity in the small cap pharma space. We calculate only seven out of 60 London-listed pharma firms with a market cap of up to £500m are profitable, amounting to a little over 10% of this investment universe.

The fact they are making money provides some comfort on the sustainability of their business model, but does a lower risk approach mean surrendering the prospect of mega-returns?

We calculate the average total return from investing in five of the seven profitable small cap pharmaceutical companies over the last five years is 222.3%, but this is heavily skewed by the exceptional performance of **Bioventix (BVXP:AIM)**. Excluding Bioventix, the average total return would be 84.6%.

Two currently profitable companies have been excluded as these are forecast to tip into a loss.

Redx Pharma (REDX:AIM) is expected to be loss making over the next few years after delivering a £1.6m pre-tax profit in the year to 30 September 2017.

Last year, trading was suspended at Redx after flirted with financial collapse over an unpaid debt and after temporarily stopping a clinical trial after the first patient suffered 'significant adverse events'.

Drug discovery company **Synairgen (SNG:AIM)** is also expected to fall into a loss as pre-tax profit is anticipated to fall from £1.6m to a loss of £5.5m in the year to 31 December 2018.

In October, Synairgen's partner **AstraZeneca (AZN)** abandoned a Phase IIa asthma clinical trial.

This leaves five companies that are expected to continue being profitable: **Alliance Pharma (APH:AIM)**, **Eco Animal Health (EAH:AIM)**, **Bioventix (BVXP:AIM)**, **Anpario (ANP:AIM)** and **Animalcare (ANCR:AIM)**. All of this quintet also pay dividends.

BIOVENTIX'S SHARES HAVE RALLIED

Shares in antibodies developer Bioventix have soared from 595p to £29.25 in only five years.

Bioventix manufactures high

PRE-TAX PROFIT FORECASTS

	2018	2019	2020
Alliance Pharma	£28.1m	£33.3m	£36.6m
Animalcare	£7m	£8.2m	N/A
Anpario	£4.4m	£5m	£5.6m
Bioventix *	£6.9m	£7.1m	£7.9m
Eco Animal Health **	£13.9m	£18.5m	£20.6m

Results for year to 31 December unless otherwise specified. * Year end is 30 June. ** Year end is 21 March. Source: Refinitiv affinity sheep monoclonal antibodies for use in blood testing machines in hospitals and laboratories worldwide.

One of its biggest sellers is vitamin D antibody called vitD3 .5H10, which is used for vitamin D deficiency testing.

Over the last few years, Bioventix has enjoyed consistently rising sales and profits.

In the year to 30 June, earnings per share beat expectations thanks to higher sales across the majority of its products, prompting broker FinnCap to upgrade its forecasts.

For 2019, sales are expected to be 11% higher at £9m and adjusted operating profit is anticipated to rise 12% to £7.1m.

TOTAL RETURN OVER FIVE YEARS

Company	Total return	Current market cap
Alliance Pharma	111.0%	£353.4m
Animalcare	10.8%	£101.2m
Anpario	85.7%	£93.8m
Bioventix	773%	£161.5m
Eco Animal Health	131.0%	£305.4m

Average return:	**222.3%**
Average return: (without Bioventix)	**84.6%**

Source: SharePad, 12 November 2018

OUR TOP PICK

Alliance Pharma offers exposure to the pharma sector without taking on drug development risks.

Alliance Pharma acquires and licenses pharmaceutical and healthcare products and delivers these to patients. Approximately half of all sales are generated in the UK with the remaining sales generated equally from Europe and elsewhere in the world.

Concerns over one-off costs from stricter regulations and Brexit preparations have seen the shares give back the strong advance they enjoyed in the first half of the year.

While Alliance Pharma's cash flow may be negatively impacted by stockpiling to mitigate Brexit, we consider this a short-term set back and still like the business.

ANIMAL MAGIC

Eco Animal Health develops and markets medicines to control disease in livestock such as chickens and pigs, as well as companion animals.

Its antibiotic Aivlosin treats various gut and respiratory diseases in pigs and poultry. This market is worth $1.5bn according to Eco Animal Health, whose product is already licensed in Europe and Asia.

Eco Animal Health wants to take advantage of consolidation in the global animal health industry by looking for drugs to acquire that fit into its portfolio and specialised markets.

ANIMALCARE IN THE DOG HOUSE

Rival Animalcare supplies animal health products such as bandages, dressings, treatments and microchipping for various animals, including cats, dogs, horses and cows.

It has been a tough year for the company following a profit warning in April as a changing sales mix and competitive pressures hit earnings.

The company is trying to create a pan-European animal health business through the acquisition of Ecuphar, helping Animalcare expand its direct sales operations to seven countries.

POTENTIAL BREXIT HEADWIND FOR ANPARIO

Anpario produces high performance natural feed additives, which are food supplements for farm animals that cannot get enough nutrients from traditional meals.

In the year to 31 December 2017, sales climbed 20% to £29.2m and profit before income tax jumped 27% to £3.4m thanks to strong trading in South East Asia, China, Middle East and the US.

Looking ahead, Anpario plans to invest in growth and potentially seek earnings enhancing acquisitions.

Peel Hunt's Charles Hall warns of a potential Brexit-related issue for Anpario as half of its goods are purchased from Europe. (LMJ)

KEY

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

KEY ANNOUNCEMENTS OVER THE NEXT SEVEN DAYS

Finals

19 Nov: Diploma. **20 Nov:** Compass, CYBG, EI Group, EasyJet. **21 Nov:** Marston's, Sage Group.

Interims

20 Nov: AO World, Aveva, Big Yellow Group, Electrocomponents, Halma, Homeserve, Telecom Plus. **21 Nov:** Babcock, Biffa, Johnson Matthey, TalkTalk, United Utilities. **22 Nov:** Mitchells & Butlers, Assura, CMC Markets, Mitie, Severn Trent, Majestic Wine.

Trading Statements

20 Nov: Coats Group, Spectris. **21 Nov:** Kingfisher. **22 Nov:** Centrica, Keller Group.

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