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## SHARES

WE MAKE INVESTING EASIER

Everything you need to know about markets, economics, commodities and politics for the year ahead

## Tightened governance should benefit investors in the long-term

New principles will be introduced in January for both private and listed companies

reater efforts to make companies good corporate citizens should prove to be in the best interests of investors.

The latest development is a new code of practice for large private companies called the Wates Principles and developed by a coalition led by the Financial Reporting Council, a body which regulates auditors, accountants and actuaries, and chaired by construction expert James Wates.

They are designed to help improve corporate governance standards and to ensure businesses are not simply run to make a profit.

These principles are relevant to investors for several reasons. First, large private companies could eventually list on the stock market and so adopting good practice now would mean they start life as listed companies with the high standards of corporate governance desired by shareholders.

Second, investment funds are increasingly putting money into private companies and so high governance standards have an impact on investors in these funds.

Third, it could encourage private companies to raise standards and potentially encourage listed companies to also raise their game.

Chris Cummings, chief executive of the Investment Association, says: 'Private companies are essential players in the UK economy; contributing to productivity, employing millions of individuals and having a positive impact on wider society and economic growth.'

He says the new Wates Principles could ultimately help to build trust and confidence in the UK business community and wider society.

Many of the principles are similar to those adopted by listed companies, namely how to construct a board and define their responsibilities, and make sure pay structures are aligned to the long-term sustainable success of a company.

Perhaps the most important principle covers the area of stakeholder relationships and engagement. It says the board is responsible for overseeing 'meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions'.

One of the key criticisms for private companies is that they are run to sole benefit of the founders/directors. This can often cause a cultural problem should a company list on a stock market where it must be run in the best interest of all shareholders, of whom there could be hundreds or thousands of individuals.

The Financial Reporting Council will introduce the Wates Principles in January alongside an updated code for companies which have a premium listing on the London Stock Exchange aimed at stamping out short-termism in business culture.

The updated rules will encourage greater board engagement with the workforce to understand their views, plus the need to refresh the board of directors and undertake succession planning, among other areas.

Investors will also get more disclosure on important issues. For example, when 20% or more of votes have been cast against the board recommendation for a resolution, the company will be encouraged to explain what actions it intends to take to consult shareholders in order to understand the reasons behind the result.

Updated views from shareholders and actions taken will then be published no more than six months after the original meeting. In our view all of these steps should be applauded.



By **Daniel Coatsworth** Editor



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PAST PERFORMANCE						
	Oct 13 - Oct 14	Oct 14 - Oct 15	Oct 15 - Oct 16	Oct 16 - Oct 17	Oct 17 - Oct 18	
Fidelity European Values PLC Net Asset Value	2.1%	6.9%	21.3%	18.9%	0.8%	
Fidelity European Values PLC Share Price	1.8%	10.7%	11.5%	26.4%	-0.8%	
FTSE World Europe ex-UK Index	-0.8%	5.2%	19.7%	20.0%	-5.6%	

Past performance is not a reliable indicator of future returns.

Source: Morningstar as at 31.10.2018, bid-bid, net income reinvested. ©2018

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#### **IMPORTANT**

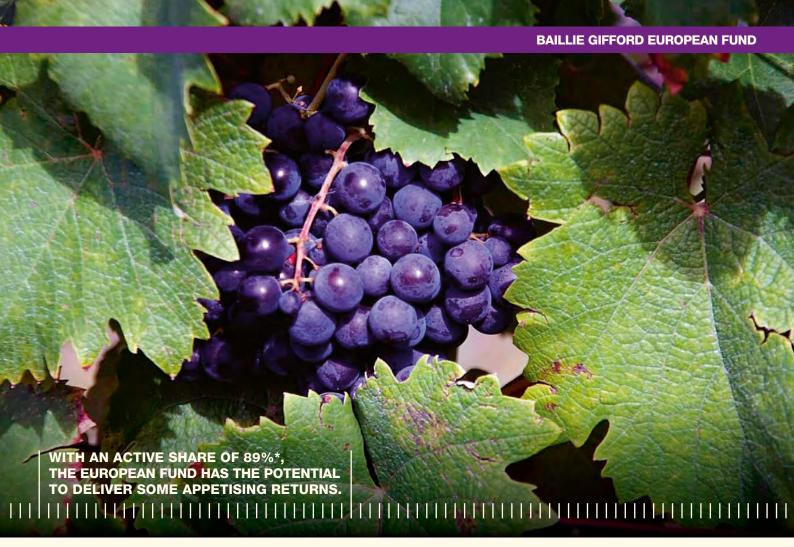
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	2014	2015	2016	2017	2018
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Average of IA Europe Sector Excluding UK	4.0	3.6	18.4	21.9	1.9

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### Renewed Brexit chaos leaves investors fuming

Sterling sinks to 20-month low and domestic stocks slump after vote postponement

he decision by Theresa May to postpone a vote on her Brexit deal in the face of an inevitable defeat (10 Dec) has added to a sense of chaos around both her Government and the UK's exit from the European Union.

Business and financial markets hate uncertainty and UK assets have suffered a renewed sell-off with sterling falling to its lowest level in 20 months in the wake of May's statement to the House of Commons.

Suggestions that any vote could be put off until at least January may force businesses into ramping up their no-deal preparations.

Predictably those businesses with most exposure to the domestic economy are among those to suffer the biggest hit (see table). This includes banks, supermarkets and housebuilders.

Investors also appear to be pricing in the enhanced possibility of a Labour government – hence the weak showing from utilities and Royal Mail (RMG) in recent days with the party previously suggesting these assets could be renationalised.

The airlines, whose ability to keep planes in the air could be affected by a disorderly no-deal Brexit, were also among the stocks to fall in the wake of the vote's postponement.

Investors should note we are heading into the Christmas period when volumes are typically thinner anyway and this could exacerbate volatility.

#### FTSE 100 worst performers in the wake of postponed Brexit vote

Company	Performance since close 7 December (%)
Standard Life Aberdeen	-6.8
EasyJet	-5.9
Centrica	-5.2
Melrose Industries	-5.2
Associated British Foods	-4.6
Barratt Developments	-4.5
GVC	-4.1
SSE	-3.8
Morrison	-3.7
ITV	-3.6
Smurfit Kappa	-3.6
Persimmon	-3.6
Johnson Matthey	-3.6
Schroders	-3.4
Royal Mail	-3.3
Royal Bank of Scotland	-3.3
Taylor Wimpey	-3.2
International Consolidated Airlines	-3.1
Evraz	-3.0
United Utilities	-2.9

Source: SharePad, 11 December 2018

#### **Downgrades for housebuilders**

Ahead of the drama in Westminster stockbroker Peel Hunt had already downgraded earnings forecasts for the housebuilders partly in response to the impact of Brexit.

Noting that some consumers were deferring house purchases

ahead of clarity on the outcome of the UK's departure from the EU, the broker now expects house prices to be flat in the next two years against a previous forecast of 2% growth, with volumes across the sector down between 2% and 3%.

Housebuilders' operating profit margins, previously seen as unchanged, are expected to fall 1.1% to an average of 18.4% between 2018 and 2020. This adds up to profit downgrades of 7% for 2019 and 10% for 2020 for the sector on average.

## The reasons behind Kier's shock rights issue

The chief executive of the well-known construction firm explains why money is being raised now

onstruction and infrastructure play **Kier (KIE)** had several key reasons for launching its heavily discounted £264m rights issue on 30 November.

Chief executive Haydn Mursell tells *Shares* the company acted in the face of discussions with lenders, which have become increasingly wary of the construction and contracting sectors following the collapse of Carillion, as well as pressure to pay suppliers faster.

'The rights issue structure was the right one for us as it enables us to have funds at the end of December with customers' pre-qualification metrics becoming more stringent and based around a year-end cash balance,' he adds.

Shareholders have up until 19 December to take up their rights on the fully underwritten issue. Mursell reassures on trading despite Brexit-related uncertainty, noting a focus on smaller contracts of



around £70m to £80m in the health and education sectors where he says money has to be spent to meet needs created by demographic trends.

Mursell defends the use of supply chain finance. He says it was 'abused by Carillion' but is seen as 'useful' by suppliers and the Government. These arrangements see the company provide facilities which effectively enable suppliers to be paid immediately by a third-party bank at a discounted rate.

The CEO says that, as this an uncommitted facility and could be withdrawn by the banks, it is kept under close control.

## Energy supply market in disarray as another firm fails

OneSelect is the eighth company in the sector to stop trading this year

THE ENERGY SECTOR is undergoing considerable change at the lower end of the market. Earlier this month OneSelect, a small domestic electricity supplier, became the eighth firm in the sector to stop trading this year.

OneSelect's 36,000 customers were told to 'keep calm and carry on' while Ofgem appoints a new supplier to take them on.

Ofgem admits there have been 'a number of supplier failures this year' and is trying to reassure customers that their energy supply will be secure and credit balances protected.

However new suppliers typically charge a higher tariff when taking on customers from bust rivals.

OneSelect is the third supplier to fail in as many weeks and already

had a reputation for poor service. Meanwhile its sister firm Energieflex had its licence revoked in the Netherlands in October.

Two other suppliers, Spark Energy and Extra Energy, ceased trading within days of each other last month. Ofgem had announced it was investigating Spark Energy two days before it shut up shop.

The number of suppliers has ballooned to nearly 70 in the last decade. Customers who have chosen small suppliers on the basis of price may find that the bigger firms are the safest option in the long run.

### Interserve, Ted Baker, **Berkeley and more news**

We examine some of the key announcements and the market reaction to them

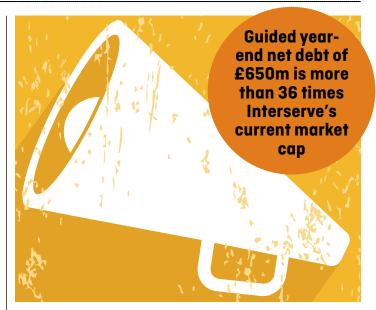
utsourcer Interserve's (IRV) deleveraging proposal (10 Dec) saw more than 70% wiped off its market value at one stage. Plans to launch a debt-for-equity swap are likely to leave little on the table for existing shareholders. The company hopes to get its debt-to-earnings ratio down to a more manageable 1.5-times from somewhere around five-times.

There was more bad news for the high street as Associated British Foods (ABF) reported (7 Dec) that its Primark budget clothing chain had endured a 'challenging' November. A struggling Primark with its value-led proposition raises big questions over how higher-priced retailers are faring.

Against this backdrop British fashion brand **Ted Baker (TED)** faces unwelcome distractions from a probe into the conduct of founder and chief executive Ray Kelvin, who is taking a leave of absence. It also reported lower third quarter revenue in a 6 December trading update.

Advertising giant WPP (WPP) is an example of what can happen when a powerful founder leaves a business in acrimonious circumstances as its shares have fallen nearly 30% since Martin Sorrell resigned in April.

His successor Mark Read, who formally took over as CEO in September, outlined his plans for the business on 11 December. The company is spending £300m to achieve annualised cost savings



of £275m from 2021 onwards and has pledged to maintain full year dividends at 60p per share.

Housebuilder Berkeley (BKG) provided reassurance on its dividend alongside first half results (7 Dec) with £280m a year to be returned to shareholders out to

2025. This is underpinned by a strengthening balance sheet as Berkeley reins in spending. On the flip side the company confirmed that profit will tail off in the coming years.

Berkeley's net cash of £859.7m is nearly three times the level from 18 months ago

#### Shareholder activism on the rise

A report by Deloitte suggests nearly \$300bn worth of shareholdings are being used to achieve the demands of 'activist' investors.

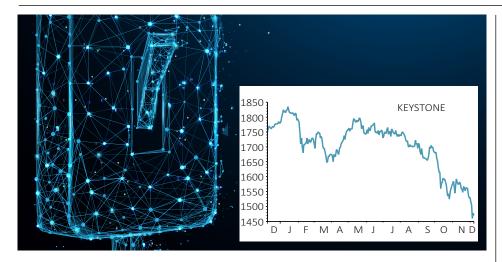
The research, covering the period from 2014 onwards,

suggests the value of newly deployed funds has more than doubled in the last 12 months compared with 2014.

In the UK, activists' interests have surpassed previous peak levels seen in 2016. The majority of demands are centred on board representation, M&A, business strategy and operations, though Deloitte found that only board and governance-related changes were successful more often than not.

## Use Keystone Investment Trust to make the switch to value investing

The easy money from growth stocks could be coming to an end



xperts increasingly believe value investing will come back into fashion and **Keystone Investment Trust** (KIT) looks an excellent product to buy ahead of the anticipated trend switch.

Don't put be off by its past performance – the trust has fallen in value in the past year – as buying Keystone is a bet on the market looking for different things in 2019.

Investing in growth companies, even some on very high valuations, has been the winning strategy for a considerable number of years.

This year we've seen many of these growth stories start to de-rate which means they trade on lower price-to-earnings multiples. This is partly down to rising bond yields which tend to depress the multiple investors are willing to prescribe to

corporate earnings.

It therefore seems logical that value investing could start to become more fashionable. This is buying companies that trade below their intrinsic value.

Analysts at Morgan Stanley, in particular, say they have a strong preference for value over growth going into the New Year 'as we think that we are only at the start of a long-term style trend reversal'.

#### A DOUBLE HIT OF CHEAPNESS

Invesco-run Keystone is currently trading 11.3% below its net asset value (NAV) which means you buy access to a portfolio for less than the value of its underlying holdings – many of which are also considered to be trading too cheaply.

Investors must appreciate there is no guarantee that value investing will be a

## KEYSTONE INVESTMENT TRUST BUY

(KIT) £14.77 Stop loss: £11.00

winning strategy in 2019 and therefore buying Keystone won't necessarily result in near-term gains. You also have to consider that parts of its portfolio are UK domestic earners which have been out of favour due to concerns on how Brexit will play out.

However, if we are right that value investing will win in 2019, you may see a rise in the share price driven by investors bidding up value strategies, plus a narrowing of the investment trust's discount to NAV.

There is also a potential extra kicker if there is a positive resolution to Brexit and investors around the world start to have renewed faith in UK equities, which is Keystone's focus.

#### WHAT IS KEYSTONE'S APPROACH?

James Goldstone took over the running of Keystone from highly-respected Invesco fund manager Mark Barnett in April 2017. The investment trust aims to maximise total return through a value-based strategy focused on cash flow and dividends, which results in a higher yield than a typical growth fund. At the moment it is yielding 3.8% according to Morningstar data.

Goldstone seeks to provide shareholders with long-term capital growth from a diversified portfolio of between 50 and 80 investments. Holdings include oil producer BP (BP.), information and analytics company RELX (REL), carpet manufacturer Victoria (VCP:AIM) and retailer JD Sports (JD.).

The fund manager favours companies with strong balance sheets, high barriers to entry and the ability to expand market share, traits he believes help to underpin long-term capital and income growth.

#### **HOW THE PORTFOLIO HAS CHANGED**

'I've made some significant changes (since inheriting the trust in 2017),' says Goldstone. 'The main things I've done are to reduce tobacco and healthcare and I've used that to fund a



Source: Invesco, as at 31 October 2018



move into financials including banks and more recently, some domestic cyclicals,' he informs Shares.

'The portfolio has moved further towards value and if I think about my approach to investment, it is very valuation focused. I try to be contrarian on the basis that if you are going against the flow, the chances are you are going to pick up something on a more attractive valuation than when everybody thinks this is great. And then beyond that it is really about risk/ reward,' he adds.

Goldstone will pay up for quality companies with strong track records, sustainable growth, cash generative business models and progressive dividends, and 'the right balance sheet' where the valuation is attractive.

#### **HOW KEYSTONE GETS AN EDGE**

Keystone investors benefit from the fund manager's regular interaction with the people running companies, spanning from small caps to FTSE 100 behemoths.

'The most interesting five minutes of a meeting are where you are getting into their capital allocation framework,' explains Goldstone.

'Retailer Next (NXT),

bought on a free cash flow yield of over 10% in early 2017, is the poster child for capital allocation in the FTSE 100. It has been extremely cash generative for the last 20 years and rather than waste that on vanity projects or M&A and not allocate capital properly, it has consistently returned that capital to shareholders over time both through dividends and share buybacks.'

Given myriad macro uncertainties, Goldstone hopes the modest average valuation of the bulk of the holdings and the defensive characteristics of gold -5.5% of the portfolio is exposed to the precious metal – will combine to produce a portfolio with compelling risk/reward characteristics in the years ahead.

The trust has positions in five profitable, cash-generative gold miners including Randgold Resources (RRS) – which is about to merge with Barrick and together will be the world's largest gold miner Newmont Mining, Endeavour Mining, Acacia Mining (ACA) and Agnico Eagle.

Investment bank UBS forecasts that gold will rise to an average of \$1,300 per ounce in 2019 (2018 forecast: \$1,270) before moving even higher to \$1,325 in 2020.



By James Crux **Funds and Investment Trusts Editor** 

**DISCLAIMER:** Keystone Investment Trust has a holding in AJ Bell which is the owner of Shares magazine. The author of this article also holds shares in AJ Bell.

## Oil play Amerisur is at a major turning point

The Colombian oil producer looks exciting after a \$93m agreement with a US firm and exploration success

e think a very active period for **Amerisur Resources** (AMER:AIM) could be the catalyst for the market to take another look at the stock.

A recently secured \$93m farm-out agreement with US firm Occidental Petroleum (23 Nov) and news of a potentially significant new oil discovery (10 Dec) has breathed some life into the share price. A forward price-to-earnings ratio of 10 times suggests the shares remain inexpensive and so we still believe the share price has much further to rise.

We expect momentum to be maintained in the coming months as the Occidental deal helps accelerate activity across the company's acreage in Colombia.

The political instability is one of the risks which must be weighed when assessing the stock, and this, plus some delays in fully tapping the potential of its Colombian assets, has been a factor in holding back the share price in the past.

However there are plenty of reasons to be positive. The company is underpinned by a strong and growing production base from its Platanillo field of around 5,500 barrels of oil equivalent per day. It has a low-cost export route through a pipeline into Ecuador. Amerisur





**AMERISUR** RESOURCES # BUY

(AMER:AIM) 13.5p Stop loss: 10.8p

Market cap: £164m

can fund activity from robust internal cash flow and it is sitting on plenty of cash.

Stockbroker Arden forecasts it will have \$49.3m cash at the end of 2018. This buffer also provides some insulation from short-term volatility in the oil price.

The recent successful result from the Indico-1 well, where Amerisur is partnered with Indian state oil firm ONGC, marks the start of a busy period of drilling activity with 12 more wells set to be drilled through to the end of 2019.

This has been augmented by the agreement with Occidental which will see Amerisur carried on a big seismic survey and five-well programme through to 2021.

The company's chief executive

John Wardle has plenty of incountry experience. He has been working in Colombia for the best part of two decades – initially for BP (BP.) and then Emerald Energy where he was responsible for the discovery of the Campo Rico and Vigia oil fields.

Emerald, which also had assets in Syria, was taken over by Chinese state firm Sinochem for £532m in October 2009.

And Wardle has backed his faith in Amerisur's forthcoming drilling effort with cold hard cash, investing nearly £1m of his own money in company shares in the wake of the Occidental deal.



By Tom Sieber **Deputy Editor** 

#### **DEVRO**

(DVO) 169p

**Loss to date: 11.7%** 

**Original entry point:** 

Buv at 191.5p, 6 Sep 2018



OUR 'BUY' call on sausage skins maker Devro (DVO) may be 11.7% in the red, yet we're sticking with our positive stance on the food producer.

A supplier of edible collagen casings for sausages, salamis and hams, Devro has disappointingly downgraded 2018 guidance to flat product volumes to reflect a weaker than expected Russian market, ongoing weakness in Japan and the slower than expected roll-out of its new Fine Ultra product.

However, the positive news is that volumes are growing in North America, Latin America and South East Asia, and new China and US plants are performing well.

We're also drawing confidence from the fact Devro is an initial holding in the Odyssean Investment Trust (OIT), managed by respected stockpicker Stuart Widdowson, one who invested in it at a material discount to Spanish-listed peer Viscofan.

Widdowson believes Devro is under-researched and under-owned and points out that private equity firms have been 'active in this niche', suggesting persistent price weakness could draw a bid from a predator.



#### SHARES SAYS: 7

Devro is an increasingly efficient manufacturer with global growth potential and Odyssean's presence on the shareholder roster is a positive. (JC)

#### **ASTRAZENECA**

(AZN)£60.80

Loss to date: 3.5%

**Original entry point:** 

Buv at £63, 15 Nov 2018

THE FAILURE of a Phase III clinical trial, reported on 7 December, has failed to knock

AstraZeneca (AZN) off track. Its shares are even trading



above the level at which it reported the setback with its Imfinzi drug (7 Dec) as there were low expectations given previous trial disappointments.

AstraZeneca says patients treated with Imfinzi monotherapy and the Imfinzi/tremelimumab combination were not significantly more likely to survive advanced head and neck cancer, compared to chemotherapy treatment.

When pharmaceutical companies fail Phase III trials, the response is generally harsher and in some cases can wipe off up to 75% of a firm's market cap if it is a single product firm. Fortunately AstraZeneca has a big portfolio of drugs in development, and approved for sale, and its fortunes are not tied to a single event.

Analysts point out that Imfinzi still has potential as the company is testing the treatment for other forms of cancer in additional Phase III trials.

In the first half of 2019, results from the Phase III Kestrel trial of Imfinzi/tremelimumab are expected for metastatic skin cancer around the head and neck.



#### SHARES SAYS: 7

We are not worried about the latest clinical trial setback as AstraZeneca has a big drug portfolio which should support earnings growth. (LMJ)

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## Aviva plans radical move with general insurance proposition

This has an impact on the entire industry and is relevant to a probe by the regulator on how insurers charge customers

n important development has occurred in the insurance sector which could have a major impact on the sector in the medium term.

Aviva (AV.) has announced that it will launch a new subscriptionbased insurance product called AvivaPlus with several novel features.

First the customer will be able to choose the level of cover and add or remove features during the policy life with no administration fees. They can also pay in monthly instalments without having to pay interest.

Most significant is the guarantee that when it comes to renewing a policy existing customers will get the same or an even better price than new customers.

One of the most common gripes among insurance customers is that loyalty isn't rewarded with renewal quotes routinely priced above the existing quote despite the cover being identical.

This issue prompted the **Financial Conduct Authority** (FCA), a regulator, to launch a study of the general insurance market in October looking at how firms charge their customers and the 'fairness' of pricing.



General insurance plays a key part in the UK economy generating close to £80bn in premium revenues each year. The FCA wants to make sure that insurers are providing competitive and fair prices to their customers.

It is particularly keen to look at renewal practices as it says it has identified 'potential noncompliance' by some firms when it comes to the transparency of renewal quotes.

The CEOs of the general insurers have been asked to submit their views to the FCA by the end of January and it will then publish a preliminary report next summer.

Aviva's move to guarantee prices is surprising given that UK general insurance isn't its core business. In the six months to the end of June UK car and home products generated just 20% of profit with life insurance generating almost all the rest.

By being the first to act it obviously hopes to gain an advantage over its smaller rivals. Also by moving ahead of the regulator it is able to pitch it as a response to customer demand.

The smaller UK general insurers like Admiral (ADM), Direct Line (DLG), Esure (ESUR) and Hastings (HSTG) will have to respond in kind as they are almost entirely dependent on car and house insurance and they can't afford to lose customers.

However the issue for the smaller firms is that some of them already lose money on selling home insurance and they don't have the resources that Aviva has to absorb lower fees and premium income if they want to match its offer.



By lan Conway Senior Reporter









## Artemis US Select Fund: The land of opportunity ...





he US is the largest and most diverse market in the world. Its entrepreneurial spirit has seen it become home to some of the world's most innovative companies. Thanks to its large domestic consumer market, the US economy is less dependent on exports and more resilient to global downturns. Of course, like any market, it's not without its problems. What it has in its favour is a President who – like him or not – is very supportive of US companies ...

The impact of President Trump's tax cuts and incentives to increase companies' spending have only just begun to be recognised. The current (already long) economic cycle has been further prolonged and the expectation is that we should now see growth continuing into late 2020 or even into 2021. The longer the current economic recovery lasts, the more favourable it will be for US companies oriented to the domestic economy.

For investors looking to access the potential for growth that America has to offer, the Artemis US Select Fund may be of interest. It's an actively managed fund, which means the fund's manager, Cormac Weldon, carefully chooses which shares to buy, and how many. Crucially, he also considers which shares to avoid. For how long can companies' share prices continue to rise? These are decisions that Cormac and his team actively make.

The fund typically holds between 40 and 60 companies, small, medium and large. Cormac considers which stocks are appropriate for the current economic environment.

Collectively, the members have around 80 years' experience. Lead manager Cormac Weldon has over 20 years' experience and has successfully invested in many market cycles.

#### Fund profile:

- Invests in any North American company, no matter their size, wherever opportunities can be found.
- The distinctive research-driven process uses many sources of information to generate diverse and, where possible, uncorrelated investment ideas.
- The team consider not only by how much a share price could rise, but also how much it could fall. Only those where the potential reward significantly exceeds the potential loss make it into the fund.
- Cormac Weldon is a seasoned fund manager with a robust investment philosophy. As an investor in the fund himself, his interests are closely aligned with that of holders in the fund.

To ensure you understand whether this fund is suitable for you, please read the Key Investor Information Document and Costs and Charges Information document, which are available, along with the fund's Prospectus, from artemisfunds.com. The value of any investment, and any income from it, can rise and fall with movements in stockmarkets, currencies and interest rates. These can move irrationally and can be affected unpredictably by diverse factors, including political and economic events. This could mean that you won't get back the amount you originally invested.

The fund's past performance should not be considered a guide to future returns. The fund may have investments concentrated in a limited number of companies, industries or sectors. This can be more risky than holding a wider range of investments. The fund may invest in the shares of small and medium-sized companies. Shares in smaller companies carry more risk than larger, more established companies because they are often more volatile and, under some circumstances, harder to sell. In addition, information for reliably determining the value of smaller companies – and the risks that owning them entails – can be harder to come by. The fund may invest a portion of its assets in a currency other than the fund's accounting currency (sterling). The value of these assets, and the income from them, may decrease if the currency falls in relation to sterling, in which the fund is valued and priced. The costs and benefits of currency hedging transactions will apply to hedged shares. The historic yield reflects distribution payments declared by the fund over the previous year as a percentage of its mid-market unit/share price. It does not include any preliminary charge. Investors may be subject to tax on the distribution payments that they receive. Third party endorsements are not a recommendation to buy. Any research and analysis in this communication has been obtained by Artemis for its own use. Although this communication is based on sources of information that Artemis believes to be reliable, no guarantee is given as to its accuracy or completeness. Any forward-looking statements are based on Artemis' current expectations and projections and are subject to change without notice. Issued by Artemis Fund Managers Ltd which is authorised and regulated by the Financial Conduct Authority.

## HOTINVESTMENT TOPICS FOR 2019

**Everything you need to know about** markets, economics, commodities and politics for the year ahead

nvestor sentiment is fragile amid a very difficult period for stock markets around the world. The FTSE 100 has hit a two-year low and numerous market experts say we are at a major turning point for investments.

Against this backdrop it is no wonder that investors have so many questions about what's going on, and what could happen next.

We've distilled all the key issues into this article and attempted to make sense of the current state of affairs, as well as drawing upon the expertise of analysts and strategists from across the investment community for guidance.

The best advice we can give is not to panic. Long-term investors should take advantage of market weakness to buy high quality companies or funds run by best-in-class managers.

Investing on a monthly basis means you buy more shares or fund units when markets are down, and less when they are up. It's this steady drip-feeding which ensures you a) continue with a saving habit and do not attempt the devilishly tricky task of timing the market and b)













effectively pay the average price over a longer period which can help smooth out market volatility.

#### WHAT ARE THE **EXPERTS SAYING?**

Bank of America Merrill Lynch, an investment bank, predicts the long bull market for stocks and bonds will finally wind down in 2019 'but not before one last hurrah'.

Asset manager Unigestion believes expected returns from stocks and risky assets overall will remain positive, though at lower levels.

UBS, also an investment bank, says slower US growth is 'unlikely to bring equities down, but likely to drive volatility up'. It says history suggests equity returns can remain strong even if corporate earnings growth slows.

'For 2019 we expect solid but decelerating global earnings growth and potential challenges from higher oil prices, rising benchmark yields and a weaker dollar. Altogether, that implies single-digit returns for the MSCI All Country World Index,' adds UBS. This index includes large and mid-cap stocks across 23 developed markets and 24 emerging markets countries.

## YIELD CURVES, INTEREST RATES AND RECESSION FEARS

nvestors need to watch events in the US very closely as this country has a major influence on markets in other parts of the world. There is a phrase that says 'when America sneezes, the world catches a cold'.

The big story going into 2019 is whether the US economy has reached its peak and could be headed into recession over the next few years. Market experts are watching the US yield curve very closely, namely the difference between short and long-dated yields on US government bonds (also known as Treasuries).



Theoretically investors want a higher yield for longer-dated bonds because there is a risk for holding something for longer.
Therefore the yield curve should ordinarily show an upwards pattern if you were looking at a single graph covering the different maturities.

The difference between the 2-year and 10-year US



government bond yields was more than 290 basis points in 2010. It fell below 10 basis points at the start of December this year, causing investors to ponder what this signals.

History suggests an inverted yield curve happens in the run-up to a recession. Inversion means when the yield curve ceases to be upward sloping and shorter-dated yields are higher than longer-dated ones. This has now happened, with yields on five-year bonds (2.74%)

dropping below the two-year ones (2.754%).

Analysis by Deutsche Bank suggests the average time lag between the yield curve inverting and an economy falling into recession is nearly two years (21 months). Investors must remember that the stock market is forward-looking, and 21 months is too close for investors to ignore.

#### WHAT COULD HAPPEN TO INTEREST RATES?

The US economy grew at an annualised rate of 3.5% in the most recent quarter and the Federal Reserve has raised interest rates eight times since 2015, currently standing at a range of 2% to 2.25%. Arguably the central bank needs to have much higher rates to provide a cushion should the economy start to decline, requiring rates to be cut.

Fed Reserve chairman
Jerome Powell last month
hinted at fewer interest rate
rises which went down well
with investors, temporarily
acting as support for the
stock market. The general
consensus at present is for
three quarter point rate
hikes in 2019.

Investment bank
Morgan Stanley believes
US economic growth will
decelerate sharply in 2019
with the third quarter

potentially showing just 1% annualised growth.

#### WHAT COULD HAPPEN TO THE US DOLLAR?

Bank of America Merrill Lynch believes the US dollar will weaken in the coming year which is good for emerging markets and for commodity producers, in particular.

In fact, the bank's top sector pick for 2019 is metals and mining where it says the industry has attractive equity valuations and a greater emphasis on dividends and share buybacks. A weaker dollar makes it cheaper for foreign companies to

buy dollar-denominated commodities.

### WHAT COULD HAPPEN TO US GOVERNMENT BONDS?

The investment bank forecasts rising US government bond yields next year with the 10-year bond rising to 3.25% by the end of the year. At the time of writing they stood at 2.877%.

Higher bond yields are bad for equities because they tend to depress the multiple investors are willing to prescribe to earnings. In essence, companies which used to trade on high priceto-earnings (PE) ratios may de-rate, if they haven't already done so, to trade on much lower PEs.

Second, higher bond yields put pressure on companies with stretched balance sheets. We suggest investors be very wary of highly-indebted businesses, particularly if interest rates are expected to keep going up.

The cost of debt will be higher to service which would put pressure on profit margins. The market may be more averse to businesses with large borrowings, potentially resulting in widespread share price declines for debt-heavy stocks.

## WHERE NEXT WITH BREXIT AND HOW WILL MARKETS REACT?

e write in the immediate fall-out of Theresa May delaying the parliamentary Brexit vote. Sterling and the UK-focused FTSE 250 index both took a hit amid renewed uncertainty over how Brexit will play out.

#### WHAT COULD HAPPEN IN A NO-DEAL SCENARIO?

The situation likely to see the biggest devaluation in the pound is a disorderly nodeal Brexit which sees some flights grounded, provision of food and medicines put under threat and queues of



trucks at Dover and Calais.

There would likely be degrees of disruption from a no-deal situation with the possibility of a so-called 'negotiated no-deal' to prevent such issues.

Both the Treasury and the Bank of England would probably look to shore up the economy with financial stimulus and the continuation of low interest rates or even a cut, although a spike in inflation from weaker sterling could make this problematic.

#### THERESA MAY TRIES AGAIN?

At the time of writing Theresa May faced a vote of no confidence from Tory MPs. The result hadn't been released as this edition of Shares went to press.

Assuming no change at top, it is possible Theresa

May will return to MPs for the Brexit vote very soon, perhaps having secured some sort of concession from the EU (although most expect this to be cosmetic at best).

Her hope would be that the prospect of a no-deal Brexit is sufficiently scary to bring parliament in line. If she is successful you should expect a big recovery in UKfocused assets.

#### IS THERE A PLAN B (OR C)?

This could take several different forms. Either a parliamentary consensus forms around an alternative such as 'Norway-plus' which effectively means staying in the customs union and the single market. Assuming the EU was amenable this would likely boost UK assets.

Alternatively, a new government is formed, Brexit is delayed, and a fresh set of negotiations take place, or a second referendum is called with 'Remain' on the ballot paper.

These situations would likely lead to renewed pressure on domestic stocks and sterling as uncertainty is prolonged, with the possibility of a big recovery if a softer Brexit or even no Brexit emerged as the outcome.

Crucially, a European ruling on 10 December suggested the mechanism through which the UK is exiting the EU (Article 50) can be unilaterally revoked.



Company% of revenue<br/>from UKBarratt<br/>Developments100British Land100Greene King100Greggs100Halfords100J Sainsbury100Metro Bank100Moneysupermarket100Saga100

Source: Liberum Capital, 6 December

#### VALUE INVESTING TO COME BACK INTO FASHION?



Growth companies have been the best performers for numerous years on the market with value investing very much out of favour. There are suggestions that this situation could now change.

Analysts at Morgan Stanley say they have a strong preference for value over growth 'as we think that we are only at the start of a long-term style trend reversal'.

Geir Lode, head of global equities at asset manager Hermes, adds: 'After a long period of low real interest rates resulting in growth outperforming value stocks we believe value is inexpensive versus growth.

'For example, we are seeing attractive investment opportunities in the oil services sector and US regional banks. In Japan we are also finding stocks with strong fundamentals at attractive prices.'

#### **WILL TRADE WARS ESCALATE IN 2019?**

K investors may find it difficult not to view everything through the prism of Brexit yet trade tensions between the US and China have the scope to exert significant influence on financial markets around the world, including the UK.

This was beautifully illustrated when a short-term truce was struck between Donald Trump and China's President Xi Jinping during talks in Argentina at the recent G20 summit. That sparked a widespread rally in global equities, only for financial markets to fall sharply again as economic growth, inflation and recession fears came back to haunt investors, plus Trump reminding the world that he is 'Tariff Man'. The furore over the arrest of Huawei executive Meng Wanzhou in a spying row hiked the pressure further.

So far the US has slapped tariffs on \$250bn worth of Chinese imports with the threat of more to come if the current truce fails to hold, while China has responded in kind with \$160bn of its own taxes on US products.

These are trade tensions that extend far beyond the simple cross-border exchange of goods and services. 'It is primarily a national security dispute



#### So far the US has slapped tariffs on \$250bn worth of Chinese imports with the threat of more to come

where the key ingredients are technology leadership; laws, regulations, and behaviours; an overarching accusation of state interference; and ideological differences,' says Jay Roberts of RBC Wealth Management.

Accusations of intellectual property theft by Chinese agencies remains one of the US's chief bugbears.

Ramping up hostilities in 2019 would undoubtedly have significant ramifications for economic growth in a year when inflation and interest rate pressures are already building.

The re-emergence of a strain between the US and European Union would add to financial market risk.

The hope is that diplomacy, and common sense, will prevail on all sides during 2019 but as we have seen with his frequent loose cannon Twitter tirades. President Trump remains an unpredictable powder keg for financial markets.

## WHERE NEXT FOR THE US STOCK MARKET?

o quote the chairman of the US Federal Reserve, 2018 has been an 'extraordinary time' for the US economy.

The combination of a boost to corporate profits from Trump's tax cuts, steady growth in consumer spending and an almost 50-year low in unemployment means that economic growth will surpass 3% this year.

Even with interest rates rising and more increases to come growth should remain healthy into the middle of 2019 before slowing.

The US stock market has had a much bumpier ride with the S&P 500 index twice making all-time highs this year only to suffer sudden reversals, the most recent of which wiped over 10% off stock prices leaving the index flat for the year.

Looking ahead, although tax rates will remain favourable, companies won't see a repeat of the 'bump' in profits which they enjoyed this year.

According to data provider FactSet, aggregate earnings per share for the S&P 500 index have grown by 25% each quarter so far this year with every sector showing an increase. The outlook for 2019 is a much more measured 8% increase.



Meanwhile the tightness of the labour market is slowly pushing up wage costs and while the trade war with China hasn't yet had a notable effect on US companies if it escalates it could begin to impact sales and profits.

The combination of higher interest rates and slower earnings growth isn't great for the stock market and investors are going to have to be more selective if they want to make money next year.

Mike Thompson, who as managing director of S&P Investment Advisory Services oversees and advises on the allocation of over \$37bn of assets, remains bullish on the US over Europe and emerging markets but cautions that investors need to look beyond the so-called FAANG stocks.

'People have bought stocks like Facebook, Apple and Netflix because they engage with them on a personal level and because the media is constantly hyping them,' says Thompson.

'There's now a huge "goodwill premium" between the book value of these businesses and their market value,' he adds.

#### PREDICTIONS FOR THE S&P 500

S&P Investment Advisory Services forecasts that the S&P 500 index will hit 3,100 points by the end of July 2019, 13% above its current level.

In contrast analysts are erring on the side of caution with strategists at investment bank Goldman Sachs seeing a 1-in-2 chance that stocks will gain 5% next year and a 1-in-3 chance that they will lose 7%.

Goldman is advising clients to sell some of their stocks and increase their allocations to cash. With interest rates rising, short-term dollar deposits and Treasury bills now look more attractive than they have done for many years.

#### WHAT IS THE ECONOMIC OUTLOOK **FOR KEY GLOBAL REGIONS?**

he global economy is likely to slow back to trend in 2019 after two years of above-trend growth, according to Bank of America Merrill Lynch.

It says the divergence between the Federal Reserve and other major central banks is likely to surprise markets. 'Risks are skewed to the downside', argues the bank. 'The US-China trade war, Brexit and "Quitaly" loom large with a wide range of possible outcomes.' Quitaly is the fear that Italy might withdraw from the eurozone.



US – America's economy is going gangbusters, no doubt boosted by President Trump's late 2017 tax cuts, although whether the globe's biggest economy can keep growing so rapidly when its trading partners are not remains to be seen.

Trade could become an even more acute issue in 2019 as the White House steps up the pressure on China, Canada. Mexico and the EU.

Bank of America Merrill Lynch's 2019 GDP growth forecast of 2.7% appears



strong, although it masks a predicted second half slowdown.

Invesco's chief economist John Greenwood argues that despite low unemployment and Trump's fiscal stimulus, the course of the US economy will remain broadly consistent with the Fed's mandate to achieve full employment with 2% inflation.

'This, in turn, should limit the upside risk for interest rates and inflation. By the same token, it should limit the downside risk for the stock market and the bond market,' he explains.

**Greenwood** points out tariffs are potentially damaging to trade volumes and will raise the cost of imports for US businesses and consumers. 'But the important thing to remember is that if domestic spending on consumption and investment is maintained, the damage

from these trade measures should be minor.'



**JAPAN** – Japan continues to experience sub-par growth and below-target inflation. Next year sees it welcome both a G20 summit and the Rugby World Cup, but investors will be watching the Shinzo Abe government and the Bank of Japan to see if they can boost growth on a sustainable basis and prove the country's punchy public-debt-to-GDP ratio is manageable.

Despite five years of aggressive quantitative and qualitative easing, scant progress has been made in restoring growth and inflation to normality, with Japan hamstrung by an ageing population.



**CHINA & SMALLER EAST ASIAN ECONOMIES** – A trade war and deleveraging are taking their toll on China, which is confronting the challenge of deleveraging while attempting to maintain growth by intermittent easing of monetary policy.

Real GDP has slowed and is likely to slow further in 2019 as tariffs impact export growth. Next year, Invesco's Greenwood expects only single-digit growth of exports in US dollar terms.

Elsewhere in East Asia. domestic spending has been subdued while export growth has slowed. In 2019, smaller, low-cost economies such as Thailand and Vietnam may benefit from some re-allocation of Chinese manufacturing, but the overall outlook will be subject to trade tensions.

**EUROPE** – America's tough stance on tariffs and trade, Brexit and Italy's fractious new coalition government were all pressure points for Western

The US-China trade war. Brexit and 'Quitaly' loom large with a wide range of possible outcomes



Europe in 2018, and are likely to have a huge influence in 2019.

Facing the demographic challenge of a receding working age population in most EU member states, unemployment remains higher than ideal at 8.2% across the eurozone, albeit this is the best figure since the summer of 2008.



#### AFRICA & THE MIDDLE

**EAST** – Population growth, strong demographic trends driving private consumption and increased urbanisation are potential catalysts for positive economic progress, although 2018 proved a damp squib amid the region's political and economic challenges.

In the New Year, a weaker dollar and stronger commodity prices could help sentiment, while the economic outlook could be affected by elections in Nigeria, South Africa and also Israel.

#### WHAT ARE THE IMPLICATIONS OF UNDER-**INVESTMENT IN THE RESOURCES SECTOR?**

he commodities crash which took place four-to-five years ago forced a rethink in the mining, oil and gas industries as companies were faced with dwindling cash flow.

On the mining side some of the pain was endured directly by shareholders as dividends were cut and capital losses were incurred.

However, for the most part and particularly in the oil and gas space, capital

spending took the brunt of firms' straitened financial circumstances.

If companies are not spending cash on developing new assets then output will eventually fall. Next vear could be when this impact becomes apparent given the multi-year timelines associated with bringing a new mine or oil field into production.

And if output falls faster than demand then prices will go up, leading to increased

energy and raw material costs for the corporate world and, among other things, a higher price at the pump for consumers.

#### **BAD TIMING FOR BUDGET SETTING**

The longer-term picture could also be affected by the recent renewed correction in commodities markets with management teams currently in the process of finalising budgets for the coming 12 months.

It will therefore be worth watching first quarter updates from the likes of BHP (BHP), BP (BP.) and **Royal Dutch Shell (RDSB)** for guidance on capital expenditure.

On oil, Canadian investment bank BMO says: 'The drop in crude oil prices comes as oil companies are setting capital budgets for 2019. This could translate to lower spending assuming that most companies will incorporate a conservative oil price outlook of roughly \$50 per barrel into their

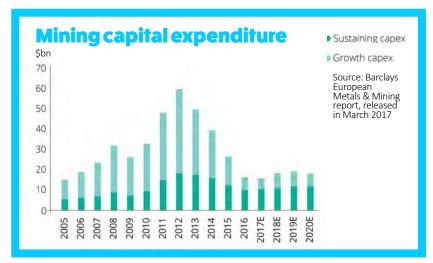
COMMODITY PRICE FORECASTS 2019					
COMMODITY	2018E	2019E	2020E		
Copper (USc/lb)	297	289	323		
Aluminium (USc/lb)	96	92	99		
Nickel (US\$/lb)	5.96	5.80	7.51		
Zinc (USc/lb)	133	108	110		
Gold (US\$/oz)	1270	1300	1325		
Brent crude oil (US\$/bbl)	72	74	72		

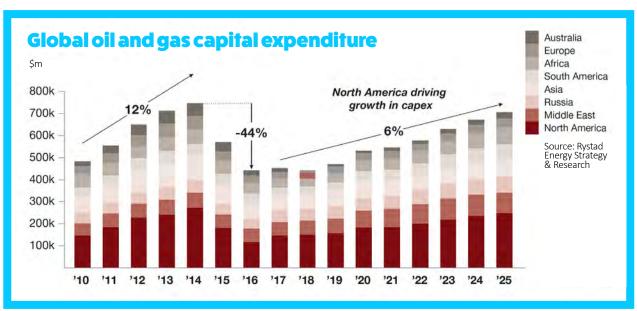
Source: UBS

capital spending plans. More worrisome, this could exacerbate the possible

supply shortfall after 2020.'

On mining, in a report published earlier this year Deloitte noted: 'Still burdened with high debt loads and rising price-toearnings (PE) multiples, mining companies are struggling to free up the exploration and development budgets required to exploit new resources. At the same time, they remain extremely hesitant to engage in acquisitions to feed the exploration pipeline.'





#### **MAJOR POLITICAL DEVELOPMENTS IN 2019**



South Africa recently emerged from its recession but faces high unemployment and low investment. The country also struggled with corruption in the upper ranks under Jacob Zuma.

Successor Cyril Ramaphosa wants to get rid of corruption and is targeting \$100bn in investment, although he will have to face off against the Democratic Alliance and Economic Freedom Fighters in the 2019 election to maintain power. The election could happen in May.



Since the UK voted to leave the EU there have been questions over whether others will follow. The outcome of Greece's general election, which will be held by 20 October, will shed light on whether the public are satisfied with its leadership and the EU.

Greece was hit hard by the 2008 financial crash, resulting in a bailout to the tune of nearly €300bn and drastic austerity measures.



India has a general election in April/May where Prime Minister Narendra Modi hopes to stay in power. The election may be a tough battleground as Modi has already been forced to fight off a no-confidence motion.

There have been protests from farmers amid a backtrack on planned reforms and concerns about increasing inequality.

Back in 2014, Modi's party was able to form a government despite gaining 31% of overall votes, the lowest figure for a party in power since 1947.

#### PICTET'S PREDICTIONS FOR 2019:

- Slowing economic growth and a squeeze on corporate profit margins would be bad for equities.
- Growing wages are feeding through to inflation which is bad for bonds. Investment and speculative-grade credit look vulnerable to a correction.
- A weaker US economy could be good for long-dated and index-linked US Treasuries and gold

By Daniel Coatsworth, Tom Sieber, Steven Frazer, James Crux, Ian Conway and Lisa-Marie Janes



## How to achieve consistent income growth



Job Curtis, Fund Manager of The City of London Investment Trust, explains the strategy behind the Trust's 52-year dividend growth record and how the portfolio is currently positioned with the aim of achieving income and capital growth.

The City of London Investment Trust has grown its dividend every year since 1966, which is the longest record of any investment trust. How has this 52-year record been achieved? How is the portfolio positioned for dividend growth going forward?

City of London seeks to have at the core of its portfolio quality companies which are able to grow their profits and dividends consistently. The aim is to find companies that cover their dividends with cash flow and profits and retain enough to invest for the long-term growth of their business. Different industries and companies have varying investment needs. Those in a high growth phase may need to retain a lot of cash for investment. On the other hand, more mature companies may be able to hand back a greater proportion of their retained profits to shareholders as dividends. It is important to check what is being accounted for as profits equates to the cash actually earned by a business. A company needs to generate cash to be able pay its dividend on a sustained basis.

Another important feature to consider is the level of a company's indebtedness. Companies with high debts are more likely to cut their dividends in a downturn because they have to prioritise interest payments. Companies that are in stable sectors are more suitable for leverage which can enhance returns for equity holders. Leverage is less appropriate for companies in sectors that are susceptible to sharp drops in activity.

#### **DISCIPLINE, DIVERSIFICATION AND DIVIDENDS**

In general, we believe that paying and growing a dividend provides a helpful discipline for corporate management against which to judge acquisitions and capital expenditure projects. During the downturn of the oil price in 2015 and 2016, BP and Royal Dutch Shell were able to maintain their dividends by cutting capital expenditure and operating more efficiently.

In terms of portfolio construction, diversification across sectors and stocks is, in our view, helpful for providing consistent dividend growth as well as capital gains. This goes back to the principle of not having 'all one's eggs in one basket.' While a portfolio manager will want to have definite biases within a portfolio, too extreme a position can lead to volatile performance. For example, a portfolio purely of defensive stocks will significantly lag the market during a cyclical upswing of the economy.

The investment trust structure is a definite advantage in delivering consistent dividend growth. While open ended trusts have to distribute all of their income once a year, investment trusts can retain up to 15% which is added to the revenue reserve. The revenue reserve can be drawn down during difficult years for dividends in the equity market enabling an investment trust's dividend to continue growing. In the 27 years since I became City of London's fund manager, we have used the revenue reserves seven times to keep the dividend growing.

#### **PORTFOLIO BREAKDOWN**

Looking at City of London's portfolio, we have a balance of key areas with the aim of generating income and capital growth. First, the consumer staples sectors, where the companies are global and have a record of consistent profitability. They sell basic, everyday items and in the



long run should benefit from secular growth in emerging markets as vast populations become more affluent. Among City of London's largest ten holding are three consumer staples companies: Diageo, the world leading alcoholic beverages company with brands such as Johnnie Walker Scotch Whisky and Guinness; British American Tobacco and Unilever.

A second key area is the oil sector with Royal Dutch Shell — City of London's largest holding — and BP, the third-largest. While the oil price has recently fallen, we believe that the outlook is positive over the next few years given growing demand for oil and natural gas, especially from emerging markets. More importantly, both Royal Dutch Shell and BP have significantly improved the efficiency of their operations in recent years bringing down the oil price needed to cover their dividends.

A third key sector is banks where there are two holdings in City of London's top ten: HSBC and Lloyds. HSBC is a global bank but with the majority of its profits coming from the Asia Pacific region. On the other hand, Lloyds is completely focused on the UK. In our view, both banks have strong capital ratios (reserves versus risky assets) and offer an attractive combination of dividend yield and growth for a relativity modest share price valuation. Banks tend to benefit from rising interest rates, as they achieve better pricing on their deposits. HSBC has already seen some benefit from the rise in US rates and if UK interest rates were to continue to go up, it would, in our opinion, be a positive trend for Lloyds.

#### **BRICKS AND MORTAR**

A fourth important area for City of London is property related being Real Estate Investment Trusts (REITs) and homebuilders. REITs own properties and are able to pass through the rental income to dividends without paying tax, which is an attractive structure for an income fund to own. REITs owned by City of London, such as Land Securities and British Land, own prime UK office and retail property. Their share prices are currently standing at significant discounts to the valuation of the properties they own which reflects nervousness about the outlook for London offices, which are a major part of their portfolios, ahead of Brexit. In addition, there are specific concerns over structural issues for retail property but we believe the prime shopping centres owned by Land Securities and British Land are destinations and have a prosperous future. The discount ratings appear to offer an opportunity



for investors and the REIT sector should be a beneficiary if there is a satisfactory Brexit outcome.

Sentiment towards housebuilders has also been affected by the vicissitudes of Brexit. However, we believe that there is latent demand for home ownership across the UK. The housebuilders owned in the portfolio, which are Taylor Wimpey, Persimmon and Berkeley, are well placed to meet this demand with their strong balance sheets and extensive land ownership available for new homes to be built upon.

All in all, the UK equity market, in our view, offers an attractive opportunity for dividend income from a variety of different sectors. The investment trust structure is well placed to aim for consistent annual dividend growth as demonstrated by City of London's fifty-two year record. It is important to select companies that are both able to cover their dividend and invest enough to grow their profits on a sustained basis.

Before investing in an investment trust referred to in this article, you should satisfy yourself as to its suitability and the risks involved, you may wish to consult a financial adviser. Past performance is not a guide to future performance. The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested. Nothing in this article is intended to or should be construed as advice. This article is not a recommendation to sell or purchase any investment. It does not form part of any contract for the sale or purchase of any investment.

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## LISTEN TO OUR NEW PODCAST



### WELCOME TO OUR NEW PODCAST

## **MONEY & MARKETS**

A good investor keeps their ear to the ground. That's why *Shares* and AJ Bell have launched a new weekly podcast – so you can stay up to speed with everything investing.

Whether you listen on your commute or at your computer, 'AJ Bell Money & Markets' is a handy way to find out what's been happening in the financial world, so you can stay one step ahead.

In each episode you'll get our thoughts on topical financial issues – from pensions to pocket money, from stock markets to savings.

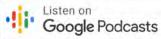
The podcast is presented by *Shares'* editor Daniel Coatsworth and AJ Bell's personal finance analyst Laura Suter. They are joined each week by special guests including various *Shares* journalists and other investment experts.

#### HOW TO LISTEN

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Or you can listen to each episode on our website by clicking **here**.











## What changes will your finances face next year?

We discuss some of the big issues to keep tabs on in 2019

s the new year fast approaches, savers and investors should be aware of the key dates and events happening for their finances in 2019.

Here we look at the big things to look out for – and whether they will make you wealthier or poorer.

#### **END OF HELP-TO-BUY ISA**

From 30 November 2019 noone can open a new Help to Buy ISA account. However, if you already have one you can keep the account open and carry on paying into it for another decade, and you have until 1 December 2030 to claim your 25% Government bonus.

Alternatively you can transfer the account into a Lifetime ISA.

The Lifetime ISA has a number of benefits, including a higher limit of £450,000 on the value of the property you can buy, a bigger potential Government bonus each year of £1,000 and the ability to save lump sums rather than just monthly.

#### <u>Click here for more on Lifetime</u> <u>ISAs</u>

#### INCREASE IN RESIDENCE NIL-RATE BAND

While the tax-free amount for inheritance tax purposes has been stuck at £325,000 since 2009, the new residence nil-rate band gives a boost to anyone



passing on their home.

From April 2017 those with a residential property were given an extra £100,000 inheritance-tax-free allowance, increasing to £125,000 this year and from 2019 this will increase again to £150,000. However, there is tricky small print with this allowance, as the property must be left to direct descendants, so a child, grandchild, or their spouse.

Anyone with an estate valued at more than £2m will also start to lose the allowance by £1 for every £2 they are over this limit.

#### Click here for more on inheritance tax

#### INCREASE IN INCOME TAX ALLOWANCES

The Government says that 32m people will effectively get a pay rise in April, when the amount everyone can earn before paying

income tax is increased from £11,850 to £12,500, while the amount you earn before hitting the higher-rate tax band will rise from £46,350 to £50,000.

The devil is in the detail as those benefiting from the higherrate band increase will be hit by a higher National Insurance bill.

Employees pay 12% National Insurance up to an upper earnings limit, after which it is reduced to 2%.

This upper earnings limit is linked to the higher-rate tax band, meaning employees will now pay the 12% rate on their earnings between £46,350 to £50,000 – rather than the 2% previously. This move wipes out a big chunk of the tax gain from the income tax breaks.

The main ISA annual allowance will stay at £20,000 this year, but from April the amount people can put into a Junior ISA will increase to £4,368.



#### **MORTGAGE INTEREST RELIEF CUT FOR LANDLORDS**

April will see the continuation of the tax crackdown on landlords, when the tax breaks available for buy-to-let investors are reduced again.

Since last year the Government has been gradually removing the amount of mortgage interest landlords can use to offset against their profit.

Instead landlords will get a basic rate tax relief reduction, at 20%. From April next year landlords can only offset 25% of their mortgage costs against their profit.

#### Click here for more on buy-to-let

#### **NS&I SLASHES RATE** ON INDEX-LINKED SAVINGS **CERTIFICATES**

From May next year NS&I will cut the rate paid to the more than 500,000 customers who have Index-linked Savings Certificates.

NS&I is switching its benchmark index from the retail prices index to the consumer prices index – which is around 1 percentage point lower.

At current inflation, someone with a five-year Index-linked Savings Certificate will miss

out on about £50 on a £1,000 investment, and someone who had £50,000 invested over five years will lose out on £450.

The savings accounts aren't on sale anymore, but existing holders can renew their certificates for two, three or five years when they come up for renewal.

#### **PENSION CHANGES:**

#### **Automatic enrolment** contributions hike

The Government's flagship autoenrolment reform programme will hit another milestone next year, with the total minimum contributions into the pension set to rise from 5% to 8% of qualifying earnings in April.

The minimum contribution will be 3% from employers and 5% from staff. This means someone earning around £27,000 and paying in the minimum will see their pension contribution rise from around £500 this year to more than £850 in the 2019/20 tax year.

#### Flat-rate state pension rising to £168.60 a week...

Anyone in receipt of the state pension continues to benefit from the triple-lock, which pegs the payment to the highest of average earnings, CPI inflation or 2.5%.

With average earnings being the highest figure in the calculations used for next year, pensioners will enjoy a 2.6% increase in their state pension income from April 2019.

That will bring the basic state pension up to £129.20 per week, while the flat-rate state pension introduced for those retiring from April 2016 onwards - will rise to £168.20.

#### ...but state pension age increasing to 66

While the Government gives to older people through the state pension triple-lock, it takes away via increases in the state pension age. From December this year and running through 2019 the state pension age will gradually increase from 65, eventually hitting 66 by October 2020. The state pension age is then set to increase to 67 in 2028 and 68 bv 2037.

#### Lifetime allowance increase to £1,055,000

The pension lifetime allowance is set for a small uplift next year too, rising from £1,030,000 to £1,055,000 from April 2019 in line with CPI inflation. After another year when it appeared retirement saving incentives were under threat from the Treasury, savers will be relieved this is the only notable pension tax relief change they have to navigate.



By **Laura Suter** AJ Bell, Personal Finance Analyst







29 January 2019 – Business Design Centre, London

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**SHARES** 

## What fund managers learned in 2018

We look at the lessons investment experts have taken from a turbulent year

his year has been one full of surprises for investors. From a trade war between the US and China to a stock market sell-off in October, many people will have been caught off guard by some of the curve balls which have been thrown up in recent months.

With so much uncertainty in the air, we asked the professionals what they have learned this year.

lain Wells, manager of the Kames UK Equity Income (B4ZMVX8) fund says: 'It may be my imagination, but the volatility of stocks seems to be increasing. This year has been difficult for active UK fund managers.'

Wells says one of the hardest things to navigate in recent months has been that there is often no rational expectation for short-term stock market and share price movements.

#### STAYING DISCIPLINED AMID VOLATILITY

He says: 'The lesson is to resist the temptation to act in haste in the face of large but irrational moves in prices, even though this will feel very difficult at the time.'

At times of volatility he says sticking to an investment process becomes even more important.

In 2018 Ian Lance, manager of the RWC UK Equity Income (B4QKMZ0) fund, has learned that 'this time it isn't

The lesson is to resist the temptation to act in haste in the face of large but irrational moves in prices, even though this will feel very difficult at the time

different'. Technology stocks have been at the forefront of this lesson, with many enthusiasts claiming the sector would continue to climb even after it had made stellar gains.

But as tech behemoths Apple and Amazon each reached the landmark market capitalisation of \$1 trillion, the market seemed to have doubts.

Facebook has since fallen 40% from its high while Nvidia's shares halved in a six-week period. Another group which have disappointed are consumer staple stocks.

Lance says: 'We were told that any price could be justified for these so-called "quality compounders" but that has also turned out to be untrue.'

#### IT IS NEVER DIFFERENT THIS TIME

He points to stocks such as **British American Tobacco** (**BATS**), Kraft Heinz and Anheuser Busch, whose share prices have halved from their peaks.

Lance adds: 'The four most expensive words in investing are still "this time is different" and 2018 has demonstrated that once more.'

Will Lough, manager of the River & Mercantile UK Dynamic Equity (B7H1R58) fund, thinks 2018 has been a good reminder in the importance of 'process, patience and position size'.

He says: 'Macro-dominated markets are often driven by headlines and a news cycle that favours conjecture over facts.'

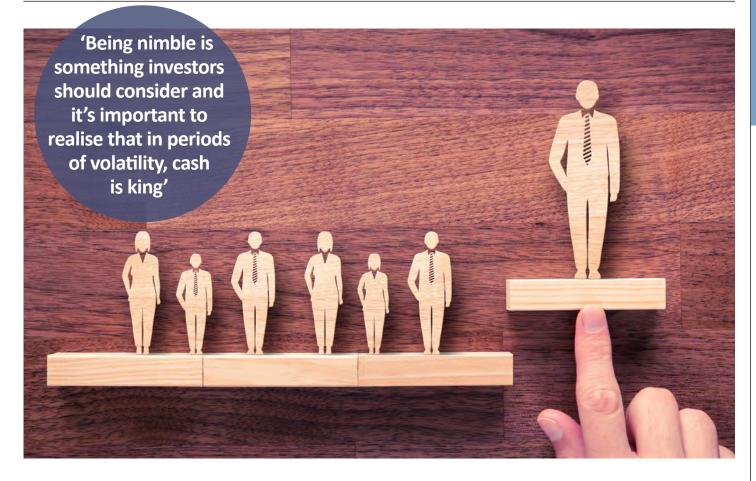
#### **BREXIT BRUISES MARKETS**

Lough says keeping a focus on the long-term has been especially important amid shortterm volatility.

In tough times he tries to remember the investment adage that the stock market is, in the short term, a sentiment-driven voting machine, but over the long term it is a weighing machine driven by whether companies are delivering growth.

He adds: '(Veteran investor) Anthony Bolton once wrote: don't be too stubborn with your views but don't lose all conviction.'

Mark Swain, co-manager



of the Smith & Williamson Enterprise (B5NY4X4) fund, has been mindful of how Brexit has affected the market this year.

He says: 'One lesson we have learnt is that the market's logic on Brexit remains extremely fuzzy, despite the fact that we are now much closer to exit day.'

He believes 2018 has been a lesson to investors in not trying to pick the winners and losers from an event when it is not yet clear how it will play out.

He adds: 'This makes no sense and we don't think there is any mileage in trying to make heroic assumptions about Brexit, currencies or any of the broader macro risks.'

#### THE IMPORTANCE **OF DIVERSIFICATION**

James Mee, manager of the **Waverton Multi Asset Income** (BQ1KPQ1) fund, says 2018 has been a lesson in the importance of diversification.

He has been increasing his allocation to alternative assets such as infrastructure, property, specialist lending and commodities to try and mitigate some of the effects of market volatility.

He says: 'Achieving positive returns from a traditional portfolio of equities and bonds will be challenging going forward and many of these alternative assets are attractively priced and have lower correlation to the stock market volatility, which we expect to continue.'

Nathan Sweeney, manager of the Architas Active Growth (B88MN82) fund, says this has been a year when many investors will likely have learned about the importance of being nimble and investing tactically.

He says: 'For the past 10 years,

investors have been able to simply buy the index and watch it go up but that will not have happened this year.'

#### **CASH IS KING**

He has been adjusting his cash holdings in recent months amid the market volatility, holding as much as 10% of assets in cash in September when he was concerned about a market selloff and reducing that position down to around 2% after the volatility in October when there were more buying opportunities.

Sweeney says: 'Being nimble is something investors should consider and it's important to realise that in periods of volatility, cash is king.'



By **Holly Black** 

## 'What are the advantages of pension consolidation?'

AJ Bell expert Tom Selby explains the pension dashboard initiative

#### Roy from London

I'm a 50 year-old council worker who has had a variety of different jobs (and pensions) in the public and private sector. I reckon I've got about £140,000 in pension savings altogether.

Are there any benefits to me combining these in one place? Or will the pension dashboard do this for me? And what is the best way to maximise my benefits in retirement?



By Tom Selby Tom Selby, AJ Bell Senior Analyst

The pension dashboard project is designed to allow people to see all of their retirement pots in one place online.

A limited version is expected to be up and running in 2019, although it's worth noting the introduction will be phased, meaning you will unlikely be able to see everything - including old defined benefit (DB) pensions in the first version.

In fact the pensions minister says it could take 'three or four years' for pension dashboards to be fully live.

Dashboards won't allow you to transact or cut your charges, however. If you want to combine your defined contribution (DC) pensions in one place you'll need to take action yourself.

Doing this can make sense for a number of reasons.



Overpaying in charges can have a devastating impact on the value of your fund over the long-term, so if you can get all your pots with a single, good value provider that meets your needs you'll have made a decent start.

It will also make it much easier for you to keep track of the performance of your portfolio. While you should avoid over-trading (as this costs money and eats into your returns), it's good to keep on top of your investments and review regularly – at least once a year.

DB pensions are trickier to combine because they are a promise to pay an income through retirement rather than an individual pot of money. You should speak to each scheme to find out how much income they will provide and from what age – it might be more valuable than you think.

As you work in the public sector the best way to maximise your retirement benefits is likely to involve staying in your DB scheme.

If you have any extra spare cash it might be worth paying into a personal pension scheme such as a SIPP, where you benefit from tax relief on the money you pay in and 25% of withdrawals from age 55 are tax-free. This would also potentially be a good place to consolidate your DC pensions.

This can be a complex process, so consider speaking to a regulated financial adviser who can give impartial advice based on your personal circumstances.

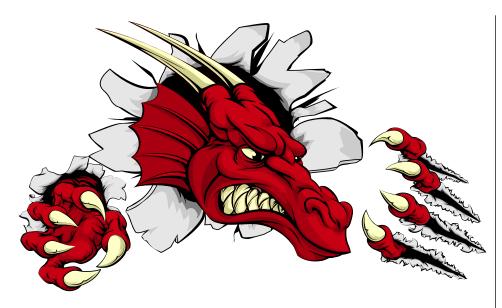
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## Edinburgh Dragon looks to find its roar despite market volatility

Manager of Asian-focused trust is putting his faith in a long-term approach



s its name hints at,
Aberdeen Standard
Investment's Edinburgh
Dragon Trust (EFM) invests in
Asian stocks. This has meant that
over the past year it has suffered
various ups and downs as trade
war fears have buffeted the
region's markets.

Despite an increase in volatility however, shares in the trust are more or less flat year-to-date in sterling terms at 368p while the MSCI Asia ex-Japan index is down 13% for the year.

As of the end of October shares in the trust were trading at an 11% discount to the underlying net asset value (NAV) of its investments of 413p per share.

Performance has been mixed and on a cumulative basis the trust is up 30.6% in share price

terms over five years, against a 50.2% advance for its MSCI AC Asia ex Japan index. This is largely because the trust has avoided some of the growth stories in the Asian technology space.

It should be noted that as well as avoiding Japan, the trust (like its benchmark) steers clear of stocks in Australia, New Zealand and Sri Lanka.

#### FOCUSED ON QUALITY, ESTABLISHED COMPANIES

When selecting stocks, manager Adrian Lim puts a great deal of emphasis on the strength of a company's business model, the quality of its accounts and its corporate governance record.

This means that he tends to buy stakes in established names rather than 'the latest thing' which may or may not prove to be a sustainable business.

It also means that if a company meets the trust's quality criteria he is happy to pay a fair price rather than try to time the investment and buy more cheaply because in doing so he risks missing out if the stock rallies instead.

#### LESS POSITIVE ON TECHNOLOGY STOCKS

The two biggest sectors in the Asia ex-Japan index are technology (30%) and financials (24%) but Lim favours the latter over the former.

While the trust counts chipmaker Taiwan Semiconductor and tech giant Samsung Electronics among its top holdings, it has a larger spread of financial stocks ranging from Hong Kong insurance firm AIA Group to India's Housing Development Finance Corp (HDFC) and Indonesia's Bank Central Asia.

Asia's middle class is currently estimated at 525m people or less than a third of the world's total but over the next decade more than a billion more people are expected to join their ranks.

One school of thought is that catering for the financial needs of a rapidly-expanding and increasingly wealthy middle class will result in plenty of potential upside for local banks and insurers.

#### STILL OPTIMISTIC ON **DOMESTIC CHINESE STOCKS**

Lim, who is based in Singapore and has jointly run the fund since 2007, is positive on Chinese stocks but avoids those which might be impacted by US tariffs.

The fund's second-biggest holding is Tencent which operates online and mobile games, online messaging and apps for the Chinese market.

The fund also owns local hotel chain Huazhu which is benefiting from a strong and steady increase in tourism within China, and Kweichow Moutai which makes a premium version of the distilled Chinese liquor baijiu.

#### THE IMPORTANCE OF TAKING A LONG-TERM VIEW

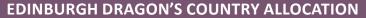
Having run the fund for more than a decade Lim has seen Asian stocks come in and out of favour with investors and he takes a longterm 'through the cycle' view.

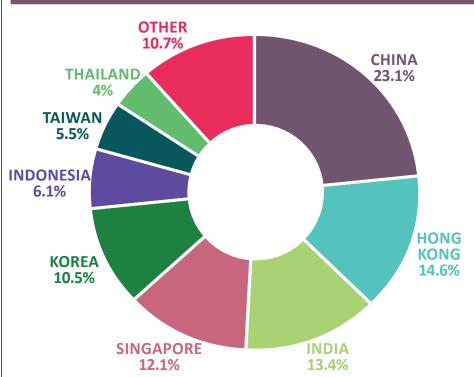
Stocks such as Samsung Electronics, Tencent and HDFC have been in the portfolio for many years and all have experienced large sell-offs this year.

Tencent owns some of the biggest video game franchises in the world and its shares more than doubled last year as investors chased growth stocks.

However a less favourable







attitude towards gaming by the Chinese authorities this year saw the shares fall from a high of HK\$470 in April to a low of HK\$260 last month.

Lim notes the upcoming listing of its music subsidiary as evidence of its ability to create value.

**Tencent Music Entertainment** runs the four leading mobile music apps in China with 800m monthly active users and reported a 240% increase in profit for the first nine months of the year. The listing is expected to value the company at over \$1bn.

Another long-term holding to have suffered a setback recently is Indian mortgage lender HDFC, which is a core shareholder in infrastructure group IL&FS.

Over the summer IL&FS failed to make payments on some of its loans sparking panic that it was in financial difficulty.

#### **UNANTICIPATED RISKS**

According to India's *Economic* 

Times, IL&FS's debts amount to an astonishing 18 times its market value and after it defaulted the company's credit rating was cut making it more expensive to roll over its loans.

This means that shareholders including HDFC and the Indian government face pumping more money into the company or selling their stakes at a big loss.

Lim admits that until the default no-one had IL&FS on their radar as a risk but he is confident that HDFC can weather the storm and in fact its shares have already recovered most of the ground they lost this summer.

These episodes show that even with a portfolio of rigorouslychosen, high-quality stocks, investing in Asia needs steady nerves and a long-term view.



By lan Conway Senior Reporter

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## Are UK stocks a value trap or a screaming buy?

We look at what can be drawn from the charts and fundamentals



ecember's failure (so far) to deliver a Santa rally means the FTSE 100 is trading at a two-year low and now also stands below the 6,930 level at which it peaked on 31 December 1999, just before the technology, media and telecoms bubble burst.

This means investors are now left to decide whether this is a chance to buy on what is now becoming a big dip in the UK's premier index, which topped out for the year, on a closing basis, at 7,877 on 22 May.

#### **TOPS AND BOTTOMS**

Technical analysts, who look for signals from charts and market price action, may well be sceptical, especially if they are adherents to the old saying that 'market tops are a process, while market bottoms are an event'.

This can be seen from the FTSE 100 chart going back to the start of 1999.

The three tops that are clearly visible, in 1999, 2007 and 2015, were all preceded by a series of minor peaks, with each upward move less convincing before the last, as dip-buyers were lured to what proved to be their doom.

Chartists may see worrying echoes of that pattern now. By contrast, the second half of the adage rests upon how the bottoms of 2003, 2009 and 2016 were sudden as the FTSE 100 moved into recovery mode very quickly.

#### PREVIOUS CYCLICAL TOPS IN THE FTSE 100 HAVE TAKEN TIME TO DEVELOP (IN CONTRAST TO MARKET BOTTOMS)



#### **PRICES AND PESSIMISM**

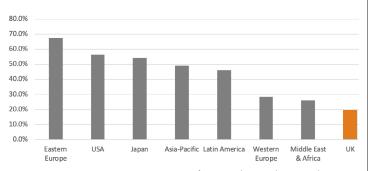
Investors who prefer to focus on fundamentals such as profit, cash flow, dividend yield and valuation may take a different view, especially if they have a long-term time horizon and are able (and willing) to sit out what could prove to be further Brexit-related volatility in UK equities.

They may argue that UK stocks are cheap, because of the gloom which currently surrounds the Brexit process, Sino-US trade relations and the prospect of yet more interest rate increases in the US.

As master investor Warren Buffett once put it: 'The most common cause of low prices is pessimism – sometimes pervasive, sometimes specific to a company or industry. We want to do business in such an environment, not because we like pessimism but because we like the prices it produces. It is optimism that is the enemy of the rational investor.'

There does not look to be too much optimism surrounding the UK economy at the moment, or its stock market, which has been the worst performer (in sterling, total-return terms) among the eight major geographic options available to investors since 23 June 2016, when the British electorate voted to leave the European Union.

#### **UK STOCK MARKET HAS LAGGED ITS GLOBAL** PEERS SINCE THE EU REFERENDUM VOTE



Source: Refinitiv. Total return data in sterling terms from 23 June 2016 to 5 December 2018

That begs the question of whether value is emerging from the UK stock market – and some investors may be tempted to think so. Thirty one FTSE 100 firms are trading on a forward price-toearnings ratio for 2019 of less than 10-times, and 38 of the index's members offer a dividend yield of more than 5% for next year, according to analysts' consensus forecasts.

That leaves two issues for value-seeking investors to address, whether they are selecting their own stocks or paying a fund manager to do the donkey work for them.

The first is whether analysts' forecasts are reliable. Estimates of 8% growth in earnings and 4% in dividends across the whole of the FTSE 100

#### TEN CHEAPEST FTSE 100 STOCKS, BASED ON 2019 PRICE/EARNINGS RATIO (PE)

2013 1 11102/271111111103 1111110 (1 2)			
	2019 Price/ earnings ratio	2019E Earnings per share growth (%)	
International Cons. Airlines	6.0	-1%	
Aviva	6.3	7%	
Taylor Wimpey	6.4	1%	
3i	6.6	-4%	
Barclays	6.8	11%	
Barratt Developments	6.9	2%	
Persimmon	7.1	2%	
Glencore	7.2	0%	
Lloyds	7.3	0%	
Legal & General	7.6	4%	

FTSE 100	11.3	8%
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Source: Digital Look, Refinitiv, consensus analysts' forecasts

#### TEN HIGHEST FORECAST 2019 DIVIDEND **YIELDS FROM FTSE 100 STOCKS**

	2019E Dividend yield	2019E Dividend growth (%)	2019E Dividend cover (%)	
Evraz	13.7%	-12%	1.09	
Persimmon	11.8%	0%	1.20	
Taylor Wimpey	11.1%	18%	1.19	
Barratt Developments	9.3%	3%	1.51	
Standard Life Aberdeen	9.2%	4%	1.01	
SSE	8.9%	-16%	1.24	
Centrica	8.7%	-3%	1.09	
Direct Line	8.5%	5%	1.10	
Vodafone	8.3%	0%	0.75	
Imperial Brands	7.9%	10%	1.36	

FTSE 100	4.9%	4%	1.79
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Source: Digital Look, Refinitiv, consensus analysts' forecasts

might not sound like much, but if the UK economy slips into an unexpected recession, and is joined there by say the US, then such figures are likely to prove wildly optimistic.

Equally, the numbers could prove to be too low if the British and global economies prove more resilient than the current consensus amongst analysts and economists would have us believe.

The second is what could be the catalyst to persuade money, be it from domestic or overseas sources, to revisit UK stocks once more. Even if they are unloved, have underperformed and could be undervalued, you could have said the same a year ago, to no particular effect, as it turned out.

Any visibility on what Brexit will look like and what it may mean could be one possible answer.

Once investors know what they are dealing with, whatever it may be, then they have a chance to rationally assess earnings and dividend forecasts and thus valuations.

Any would-be dip-buyers may have to be brave and patient – but then the darkest hour always comes before the dawn.



**By Russ Mould** AJ Bell Investment Director

### THEBESTPERFORMIN **SHARES OF 2018:**









### **QUANTIFYING THE REASONS EIR SUCCESS**

We look at four different sized groups to find out why certain stocks had such a good year

#### MARKET CAP: £1BN & ABOVE

#### OCADO +101%

SHARES IN Ocado (OCDO) have doubled in value in 2018 as the company made progress with signing international contracts where it sets up large distribution centres to enable online grocery services.

Building on a 2017 tie-up with France's Groupe Casino, Ocado has this year signed deals with Canada's Sobeys, Sweden's ICA and most significant of all, with US groceries giant Kroger, which could transform the US food retail market.

Bulls believe Ocado's end-to-end solution for operating online grocery businesses has the potential to become the standard platform for international retail logistics.

For all the hype, Ocado remains in a growth phase requiring heavy investment spend and it still doesn't generate material earnings. Shore Capital says: 'Ocado's stock has been a bit of a rollercoaster to date with risible capital returns. We know that the capital continues to be expended; as for the returns, well who knows.'

BEST PERFORMING STOCKS: £1BN+  do.com				
Name	EPIC	Price	Year to date change	
Ocado	OCDO	798.5p	101%	
Plus500	PLUS	£13.82	52%	
Hikma Pharmaceuticals	HIK	£17.22	52%	
Evraz	EVR	466.65p	37%	
Jardine Lloyd Thompson	JLT	£18.91	36%	
Drax	DRX	362.8p	34%	
Pearson	PSON	919.6p	25%	
J Sainsbury	SBRY	300.15p	24%	
Qinetiq	QQ.	287.05p	24%	
Auto Trader	AUTO	422.75p	20%	
Source: SharePad, data 1 Jan to 6 December 2018				

#### PLUS500 +52%

IT WOULD HAVE been a bold move to buy shares in Plus500 (PLUS) at the start of this year considering that UK and European regulators at the end of 2017 vowed to crack down on derivative platforms marketing to retail investors.

The fact that the shares had already gained 160% last year, ranking second in our 'Best Performers of 2017', makes this year's returns even more surprising.

Yet just as last year, the company has raised guidance with each earnings update helped by an increase in higher lifetime-value customers and a backdrop of heightened market volatility which encourages them to trade more.

The firm even cautioned at the half year stage that it wouldn't be able to sustain its run of form to the end of the year, but in mid-October it admitted it would probably beat expectations.

It seems unlikely that Plus500 can repeat the trick for a third year given that the new rules are clearly impacting revenue growth so despite its high operational gearing profit growth will inevitably slow in 2019.

#### **HIKMA PHARMACEUTICALS +52%**

PHARMACEUTICAL COMPANY Hikma (HIK) saw its shares rise in 2018 as its strategy to boost sales paid off.

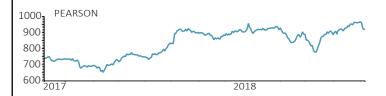
It is fair to say that 2017 was a disappointing year for the drug developer after it was forced to cut sales guidance three times amid challenging conditions in the US.

Hikma subsequently revived trading in 2018 thanks to strong product demand and its extensive pipeline, prompting it to hike earnings guidance for its generic and injectables businesses in August.

Cantor Fitzgerald analyst Brian White notes that pressure in the generics business has persisted, but pricing in the US is stabilising. 'We expect Hikma to focus on margin delivery and the potential for bolstering the pipeline through acquisition and collaboration', he adds.



#### **PEARSON +25%**



THE RECOVERY IN 2018 from publishing firm Pearson (PSON) followed a tricky run for the share price which fell from highs of around £15 in 2015 to a trough a little over 550p a year ago.

The company has faced structural headwinds as demand for the expensive academic textbooks it sells has fallen away in a more digital world, contributing to a string of profit alerts.

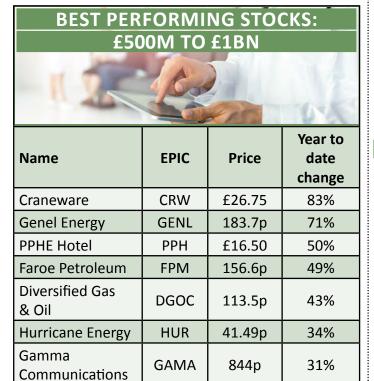
Signs that the company is beginning to face up to this transition while keeping a tight control on costs excited the market this year.

Contrarian investor Alex Wright, who steers Fidelity **Special Values (FSV)**, has previously said that in time Pearson will be viewed as a tech company, not a text book company.

A third quarter trading update (17 Oct) confirmed the company was on track to deliver £300m of annualised cost savings, with the full benefit felt from the end of 2019 onwards, and full year profit guidance was reaffirmed.



#### **MARKET CAP: £500M TO £1BN**



Source: SharePad, data 1 Jan to 6 December 2018

37.65p

179.6p

425.5p

28%

27%

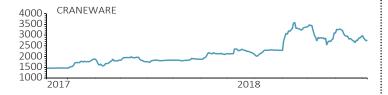
25%

#### **CRANEWARE +83%**

SolGold

El Group

Kainos



**SOLG** 

EIG

**KNOS** 

IF YOU BELIEVED the mass media you might think California's Silicon Valley and the FAANG stocks had the exclusive right to technology growth excellence. You would be wrong.

Craneware (CRW:AIM) is a made-in-Britain company that dominates its niche, earns only recurring revenues, on average five-year contracts, and enjoys an entrenched competitive position at the top of its industry.

It provides billing and healthcare analytics software to almost a third of the hospitals in the US. The company estimates it can help an average 350-bed hospital tap an extra \$22m a year of revenue currently missed out on.

It uses automation to identify new income opportunities to healthcare management as well has highlight operational and financial risks.

There is no single reason behind the shares' 2018 performance, but Berenberg analysts say about

Craneware: 'Few companies can combine software which generates significant value for its customers, an addressable market in the hundreds of billions, excellent revenue visibility and a growing annuity base of high margin, cash-generative software-as-aservice contracts.

#### **GENEL ENERGY +71%**

IN RECENT YEARS oil play Genel Energy (GENL) has been beset by reserve downgrades, geopolitical issues and management changes. Life was more stable in 2018 as the company focused on delivering cash flow from its fields in Kurdistan, a semi-autonomous region of northern Iraq.

The company achieved free cash flow of \$119m in the first nine months of 2018 and has moved from a substantial net debt to a positive net cash position.

A better-than-expected contribution from its Peshkabir field has been a significant factor. The company is also advancing plans to develop its other assets in Kurdistan, including the Miran natural gas field, while making tentative moves with its exploration portfolio in Africa.

The company has displayed good discipline with operating expenditure guidance recently trimmed from \$30m to \$25m and capital expenditure at the lower end of the expected range in 2018.

At 181.8p its shares are still a long way from the highs above £11 seen in early 2014.

#### **HURRICANE ENERGY +34%**

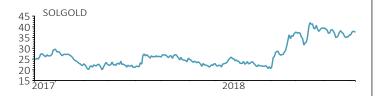
**EVERYBODY WAS excited when Hurricane** Energy (HUR:AIM) made one of the largest recent discoveries in the North Sea with its Lancaster find in 2014, particularly after its potential was proved up by follow-on drilling.

The subsequent questions were all centred on how the development of this prized asset and the drilling of other targets in the group's portfolio would be funded.

These questions are now some way to being addressed with the company moving closer to first cash flow from an early production system on the Lancaster field. This milestone is expected in the first half of 2019.

Hurricane Energy's plans to advance the Greater Warwick Area were aided by a \$387m farm-out agreement with Spirit Energy with drilling expected to commence in the first quarter of 2019.

#### SOLGOLD +28%



Shares in copper explorer **SolGold (SOLG)** were looking a bit sleepy for the first nine months of the year as it ploughed on with drilling at its Alpala prospect in Northern Ecuador. The share price burst to life in September when FTSE 100 miner **BHP (BHP)** acquired a 6.1% stake in the business, picking up the shares from Guyana Goldfields which sold out completely. A month later BHP invested £45m for more shares, taking its stake to 11.18%.

In 2017 BHP tried to cosy up to SolGold by proposing to invest money to earn up to a 70% stake at the project level and on its own terms. SolGold rejected the proposal as it didn't want to give away that sort of upside.

The two companies are now getting on famously as BHP has invested at the plc level, at a premium to the market price, and on agreed preferable terms to SolGold.

While the miner is years away from thinking about developing the project into a commercial entity, there is ongoing speculation that BHP will ultimately be the owner and operator, assuming SolGold continues to prove up large amounts of copper.

#### **EI GROUP +27%**

THE UK'S largest pub company **EI Group (EIG)** has ramped up progress with its transformational strategy and its share price has done very well given a challenging backdrop for consumer-facing companies.

EI has been reaping the benefits of people opting to drink rather than dine out as its pubs are generally wet-led.

The company is finally finding its feet again after struggling with huge amounts of debt during and after the global financial crisis.

A possible catalyst in 2019 is the potential sale of its Commercial Properties portfolio for an estimated £300m, which may leave the company in healthier shape by further cutting debt.

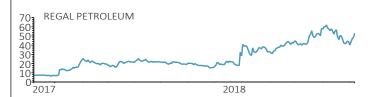
Canaccord Genuity analyst Nigel Parson says the sale could lead to a special dividend for shareholders.

#### MARKET CAP: £100M TO £500M

BEST PERFORMING STOCKS: £100M TO £500M					
Name	EPIC	Price	Year to date change		
Regal Petroleum	RPT	48.1p	587%		
Bushveld Minerals	BMN	42p	394%		
Sopheon	SPE	£12.30	242%		
Anglo Asian Mining	AAZ	91.5p	186%		
Creo Medical	CREO	196p	182%		
lenergizer	IBPO	127.5p	180%		
Bioquell	BQE	580p	117%		
Keystone Law	KEYS	380p	100%		
Versarien	VRS	117.5p	93%		
BATM Advanced Communications	BVC	46.2p	79%		

Source: SharePad, data 1 Jan to 6 December 2018

#### **REGAL PETROLEUM +587%**



UKRAINIAN NATURAL gas producer **Regal Petroleum (RPT:AIM)** surged higher in 2018
after a period of stasis with new and supportive
legislation in the country relating to the oil and gas
sector providing a catalyst.

The company's financial performance improved with first half revenue doubling and the business swinging from a loss to a net profit year-on-year.

This was underpinned by increasing production and the company says it is now in a position to fund its development plans from cash flow and existing cash resources which totalled \$40m at the last count.

The shares have also been supported by speculation over corporate activity with a vehicle apparently owned by Ukrainian billionaire Victor

Pinchuk buying 24% of the company.

Pinchuk was behind a failed bid in 2011 when he lost out to Regal's current shareholders Vadim Novinsky and Andrei Klyamko who gained control of the business and still hold a 52% stake.

As a natural gas focused producer, the company has been largely insulated from the recent volatility in the oil price which has seen a fall from \$85 per barrel to less than \$60 per barrel in a matter of weeks.

#### **BUSHVELD MINERALS +394%**

TALK ABOUT A radical transformation. For years Bushveld Minerals (BMN:AIM) was a bewildered multi-commodity business dabbling in vanadium, titanium, tin and coal. Investors weren't really interested as many of the relevant commodity prices were in the doldrums and exploration projects were completely out of fashion.

Fast forward to the end of 2017 and everything changed. Bushveld went from being a minority shareholder in the Vametco vanadium mining operation to a 59.1% owner (since increased to 74%). That meant Bushveld was seen as a proper operating business rather than an explorer and investor.

All this happened against a backdrop of soaring vanadium prices, helping to explain why its share price has done so well.

Bushveld believes it can improve productivity to further enhance earmings.

#### **SOPHEON +242%**

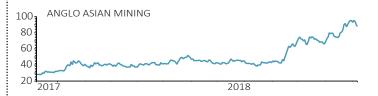
COMPANIES THAT develop a habit of beating expectations will sooner or later start seeing that reflected in a rising share price, and this trend certainly applies to research, development and product lifecycle tools designer Sopheon (SPE:AIM).

This is the second time Sopheon stock has put up eye-popping performance, having shot from 63p to 352p in 2016.

Success in 2018 really stems from the broader industry segment appeal for its Accolade platform, plus the way it has improved visibility despite still largely selling licences.

This was topped off with a strong third quarter to 30 September that 'normally involves a pause for breath before a busy fourth quarter, a trend which has been bucked this year with two material contracts booked during the final days of the quarter,' explain analysts at stockbroker FinnCap.

#### ANGLO ASIAN MINING +186%



AZERBAIJAN-BASED Anglo Asian Mining (AAZ:AIM) saw its share price perk up in September when it reported drill results indicating its Gedabek project contained a lot more gold and copper, thereby extending its mine life.

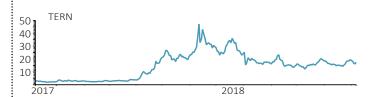
It then treated shareholders with news of a maiden dividend, having moved into a net cash position earlier in the year.

The shares kept on rising as more effort was made by the company into studying the wider Gedabek area, plus the head of geology buying shares which sent a vote of confidence in the business.

Analysts expect the company's gold and copper production to grow in 2019 and they note all-in costs are among the lowest in the mining sector.

#### **MARKET CAP: LESS THAN £100M**

#### **TERN +633%**



Tern (TERN:AIM) is little-known technology investment firm whose focus on connectivityrelated internet of things (IoT) really started to pay off in 2018.

The balance sheet has been cleaned up of convertible loan notes while fresh growth funding was successfully raised, but the real kicker for the stock was success for Device Authority, a specialist in secure IoT authentication in which Tern owns a 56.8% stake.

Strategic alliances with Intel, Dell, Amazon Web Services and others have put the promise of rapid growth on the horizon, while those sort of industry names do wonders in validating Device Authority's password management tool KeyScaler.



Name	EPIC	Price	Year to date change
Tern	TERN	16.5p	633%
Rockrose Energy	RRE	617.5p	386%
JKX Oil & Gas	JXK	37.1p	237%
SalvaRx	SALV	63.25p	220%
Pebble Beach Systems	PEB	5.25p	213%
Eurasia Mining	EUA	0.655p	191%
Biome Technologies	вюм	545p	153%
Beeks Financial Cloud	BKS	109p	151%
Elektron Technology	EKT	42.5p	139%
Ultimate Sports	USG	20p	135%

Source: SharePad, data 1 Jan to 6 December 2018

#### **ROCKROSE ENERGY +386%**

Rockrose Energy (RRE) has enjoyed something of a break-out year in 2018. It is a buy-and-build effort in the oil and gas sector which floated in 2016 with a plan to capitalise on the oil price crash.

The company has been generating significant amounts of cash flow from its acquired portfolio of assets in the UK and the Netherlands. It was even in a position to launch a £16.4m tender offer to clear out any potential sellers of the stock.



Rockrose enjoyed significant advances in May when it announced the acquisition of Dutch assets which effectively doubled its output. October saw the Arran project in the North Sea, acquired from Korean-owned Dana Petroleum in August, green-lit for development by operator Royal Dutch Shell (RDSB).

By Daniel Coatsworth, Tom Sieber, Steven Frazer,
Ian Conway, Lisa-Marie Janes



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**UK Individual Shareholders Society** 

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#### WHO WE ARE

EDITOR: Daniel Coatsworth @SharesMagDan

**FUNDS AND** INVESTMENT TRUSTS

EDITOR: James Crux @SharesMagJames

DEPUTY EDITOR: Tom Sieber @SharesMagTom

SENIOR REPORTER Ian Conway

REPORTER: Lisa-Marie Janes @SharesMagLisaMJ

NEWS EDITOR: Steven Frazer @SharesMagSteve

CONTRIBUTORS Holly Black Russ Mould Tom Selby

Laura Suter

#### ADVERTISING

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

**CONTACT US:** 

support@sharesmagazine.co.uk

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**Head of Design** Designer Darren Rapley Matt Elv

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