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WHY THE **FED'S U-TURN** MATTERS TO INVESTORS AROUND THE WORLD

MINING DAM DISASTER TRIGGERS **IRON ORE PRICE RALLY**

THE FUND **EARNING MONEY** WHEN CERTAIN SONGS ARE PLAYED

Why the Fed's U-turn matters to investors around the world

A potential rethink on quantitative tightening sends investors back into riskier assets

There have been numerous interesting events in the US over the past week which matter to investors around the world.

The latest economic data implies the US economy is doing very well with soaring job creation a key stand-out. Yet the US Federal Reserve has chosen to follow a more cautious path by putting interest rate growth on hold and being more flexible on running down its balance sheet.

Central banks normally increase rates to cool an economy that is racing ahead. In the Fed's case, it is taking into account other metrics with its interest rate decision including global growth numbers. While the US economy is doing very well, the Fed clearly has concerns about a slowdown in China and Europe.

IMPORTANT FOR INVESTORS

The Fed's new rate strategy is music to the ears of investors, as evident by the US markets rallying off the back of the news, the 10-year Treasury yield falling to 2.68%, the yield curve steepening and the US dollar falling in value.

This matters for investors in other parts of the world on various levels. Firstly, US interest rates are seen as a reference point for the largest economy in the world. Rising rates are often considered negative for stock markets, so a pause by the Fed has been well-received by investors.

The US dollar is the world's 'de facto' reserve currency and primary currency of international finance. And the interest rate at which the US government can borrow – measured by the Treasury yield – ultimately acts as the level at which other financial assets are set.

Equally as important, Davy analyst Colin Grant says the Fed's latest actions have opened the door to abandoning quantitative tightening and to restarting quantitative easing.

Since the financial crisis in 2008 the Fed has seen its balance sheet swell by engaging in quantitative easing and buying large amounts of Treasuries and other bonds. As bonds matured it reinvested the money back in the market.

More recently it started to let as much as $50bn of bond holdings mature every month without replacing them, thereby winding down its balance sheet in a process known as quantitative tightening.

QE VS QT

Quantitative easing gave support to the stock market and so quantitative tightening was seen as doing the reverse, arguably a key contributor to last year's horrible performance among equities although that was also caused by other factors such as fears over slowing global growth and the US/China trade war.

Market commentators suggest we may now see the quantitative tightening programme decelerate and possibly stopped by the end of 2019. On a similar note, last month European Central Bank president Mario Draghi said the ECB was open to resuming quantitative easing in Europe to support its softening economy.

Against this backdrop it is not surprising to see investors regain appetite for risk by bidding up shares and putting money into commodities and emerging markets.

RECENT US ECONOMIC SURPRISES

- Nonfarm payroll growth of 304,000 in January vs 170,000 expected
- ISM manufacturing 56.6% in January vs 54.3% expected

By **Daniel Coatsworth** Editor

Contents

VIEWING SHARES AS A PDF?
CLICK ON PAGE NUMBERS TO JUMP TO THE START OF THE RELEVANT SECTION

Dam disaster triggers spike in iron ore prices

Vale's decision to cut production could leave the market short of supply

Iron ore prices have risen by 15% since a dam collapsed at one of Vale's iron ore mines in Brazil on 25 January.

The Brazilian company will halt 40m tonnes of production, equal to 10% of its annual production, in order to decommission dams similar to the one that burst.

That has prompted some analysts to say the market now needs extra supply from the seaborne market in order to meet anticipated demand, in turn driving up the iron ore price.

'Iron ore remains an efficient market and higher prices should come this to market quickly,' says BMO analyst Colin Hamilton.

London-listed beneficiaries of higher iron ore prices include **BHP (BHP)**, **Rio Tinto (RIO)** and **Anglo American (AAL)**.

Shares in Brazil-listed Vale have fallen by nearly 19% since the accident happened even though the subsequent rise in iron ore prices should boost its earnings.

'Despite the production cuts and after applying

high level estimates of restitution costs, Vale shows the greatest improvement in earnings amongst the peers,' says BMO analyst Edward Sterck.

'However, we think investors will largely look past this, with many applying an environmental, social and governance rather than financial overlay given the horrendous human cost of the disaster.'

By **Daniel Coatsworth** Editor

Funds to be forced to improve the quality of information for consumers

New push to cut out jargon

THE FINANCIAL CONDUCT Authority (FCA), a regulator, has published its second set of rules for asset managers to improve the quality of information they give to consumers and cut out the jargon.

The new rules set out how fund managers should describe clearly the objectives and investment policies of each fund they offer.

In particular they should explain whether a fund uses a certain benchmark and why, and if it doesn't use a benchmark how investors are meant to measure the fund's performance.

Managers also have to clarify that where a performance fee applies, it is calculated based on the fund's performance after all other fees have been deducted.

The FCA's market study has already shown that fund managers don't compete enough when it

comes to pricing their funds.

Now it wants to make sure investors know exactly what they are buying and that they get what they are paying for.

By **Ian Conway** Senior Reporter

DWF set to be the largest UK-quoted law firm

The business could be worth £700m when it floats on London's Main Market

Legal services firm DWF has confirmed plans to join the London stock market in what could be the largest legal services flotation. The firm first announced last June that it was interested in an IPO (initial public offering).

Media reports speculate DWF will be valued at around £700m or 15 times 2018 profits but some observers expect it to push for a higher rating.

While its quoted rivals can be found on AIM, DWF is planning to list on London's Main Market and could qualify for the FTSE 250 index in time.

Turnover in the 12 months to 30 April 2018 was £236.5m, an increase of 18.6%, driven equally by acquisitions and organic growth.

By comparison **Gateley (GTLY:AIM)** reported turnover of £86m in its 2018 financial year while **Gordon Dadds (GOR:AIM)** reported £31m and **Keystone Law (KEYS:AIM)** is forecast by analysts to show c£40m revenue when it reports full year earnings in May.

DWF has a global presence with 27 offices in 14 jurisdictions employing over 3,000 staff. Its blue-chip client list includes 23 FTSE 100 companies and over half of its clients have been with the firm for 10 years or more.

The business is split between commercial services, which includes litigation, insurance, international, and connected services with a focus on technology.

DWF estimates that the annual global legal services market reached over £650bn in 2017 and could grow to as much as £775bn by the end of 2021.

It sees this growth being driven by increased corporate activity at home and abroad, continued regulatory change and more outsourcing of in-house legal services to third party firms.

DWF is looking to grow and its stock market flotation document specifically refers to the 'large consolidation opportunity' in the legal market. It certainly has form as a consolidator having acquired 14 rival firms in the last 12 years.

Both the connected services and international divisions are singled out as areas where DWF is looking to grow through acquisitions.

As of last October the firm had fewer than 75 partners outside the UK and in the US it relies on a single office in Chicago and an association with a US law firm.

Interestingly, Nigel Knowles, the man who led DLA Piper's stellar rise to prominence, was appointed chairman in September 2017 which speaks volumes about the firm's ambitions.

By **Ian Conway** Senior Reporter

Impressive decade of returns from Computacenter

IT services business tops technology total returns list over the past 10 years

Computacenter (CCC) has the best total return track record of any UK-listed technology company from the past decade, according to investment bank Stifel.

While the share price has been no slouch over the last decade it is the FTSE 250 company's consistent dividends, both ordinary and special payouts, that add extra sheen to the returns of shareholders. Total return refers to the combined performance of share price and income.

Computacenter's annual average return of 52.5% over that decade tops the list of seven companies within the Stifel technology universe to have been listed on the UK stock market for at least 10 years.

IT infrastructure firm **Micro Focus (MCRO)** and engineering design software supplier **AVEVA (AVV)** come second and third, generating average annual total return of 31.3% and 25.9% respectively over the decade.

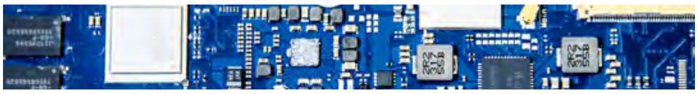
Investors often forget the value of income on their investment portfolios over the long-term, gauging performance largely by the share price alone. Yet 'Boring' award winner Computacenter is a fine illustration of why that way of thinking is a mistake.

The 'Boring' awards are the tongue-in-cheek gongs handed out by *TechMarketViews* analyst Richard Holway to IT services businesses listed on the London stock market with an unbroken 10 year track record of earnings growth.

While that title may sound detrimental, implying reliable if a bit dull, that was certainly not the case in 2018 for Computacenter.

Last year the company racked up a 91.8% total return for shareholders, according to Stifel, thanks to ordinary dividends worth 27.4p per share paid out during the 12 months, plus a £100m value return by way of a tender offer actioned in February 2018.

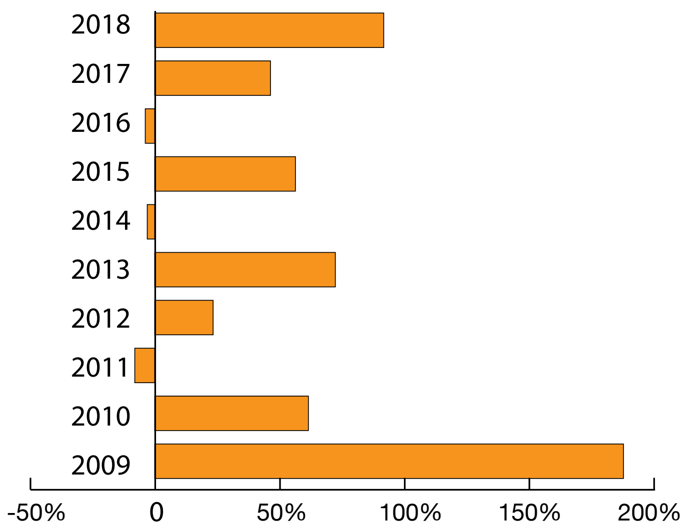
Despite this impressive investment performance



Computacenter: A decade of strong returns from capital gains, dividends and a tender offer

Average total return 52.5%

Source: Reuters, Stifel



over the longer-term Computacenter is not immune from the vagaries of economic investment and investor sentiment. This has been clearly illustrated in recent months, with a soggy third quarter in October 2018 followed up by softness in the services business in a further update on 23 January. Computacenter's share price has stabilised recently at £10.70.

By **Steven Frazer** News Editor

Metro Bank, Indivior, TalkTalk and other news

We look at some of the past week's share price movers

Shareholders in **Metro Bank (MTRO)** could be forgiven for thinking they had unwittingly booked tickets on the *Oblivion* vertical-drop ride at Alton Towers.

On 23 January the shares collapsed 39% to £13.45 as the company missed its profit target and chief executive Craig Donaldson confessed it had wrongly accounted for some of its loans. The next day they rallied to £14.81 and the storm looked to have passed.

However it has since emerged that the accounting blunder was uncovered by the Prudential Regulatory Authority (PRA), a regulator, rather than the bank.

In a statement Metro admitted that 'ongoing supervision by the PRA helped to identify potential inconsistencies in certain loans which were raised with the bank'.

Cue another gut-wrenching slump to £10.87 leaving shareholders nursing a 50% loss in just seven trading days. Hedge funds and lawyers smell blood, and the bank is now bracing itself for a law suit from disgruntled investors.

INDIVIOR SETBACK

Shares in pharmaceutical company **Indivior (INDV)** fell by as much as 25% on 5 February after a US court refused to rehear a case to stop rival Dr Reddy's Laboratories from launching a generic alternative to one of its opioid treatments.

Up to 80% of Indivior's market share for this treatment is now at risk, according to the company, as the ruling may allow Dr Reddy's and others to start selling generic versions of its Suboxone film.

TALKTALK WARNING

Lowering profit guidance is the charitable way to describe the thrust of **TalkTalk's (TALK)** third quarter trading update on 1 February, but a plain old profit warning is arguably more accurate.

The company trimmed between £10m and £15m off its guidance for full year earnings before

interest, tax, depreciation and amortisation (EBITDA). That news saw the share price decline 5% on the day and it has kept falling since to a year-low of 102.7p.

The company says it remains on track to beat its 150,000 target for new broadband customers but sceptics may wonder for how long it can continue to subsidise new subscribers and give them cheap deals.

YU GROUP RELIEF

Investors voiced a sigh of relief after business energy provider **Yu Group (YU.:AIM)** confirmed no further black holes had been found after October's shock accounting fiasco revelation.

The stock's near-100% gain since the update on 30 January suggests that investors are increasingly optimistic that there is a going concern to salvage, unlike the calamity at AIM peer **Patisserie (CAKE:AIM)**, where shareholders are facing complete wipe-out.

However, the fact that Yu's broker Shore Capital has yet to reinstate forecasts shows that little can be taken for granted.

By **Ian Conway, Lisa-Marie Janes, Steven Frazer**

Fantastic 4imprint is a master of promotion so buy its shares now

Snap up the stock while it is trading at a discount to its long-term average valuation

Investors should take advantage of an opportunity to buy promotional products firm **4imprint (FOUR)** while its valuation is towards the bottom of its historic range and as the benefits of a recent marketing push start to become apparent.

Full year results on 5 March could offer a near-term catalyst to drive the share price higher. We also see this as a growth stock to hold for the longer term with a credible target to hit $1bn in sales by 2022. For context, 2018 revenue was a little under $740m.

4IMPRINT BUY
(FOUR) £19.62
Stop loss: £15.70

Market cap: £552m

WHAT DOES THE COMPANY DO?

The firm sells items like branded mugs, dongles and pens to companies, almost entirely in the US, and has a nice habit of under-promising and over-delivering while generating plenty of cash.

The company has invested heavily in technology to build a proprietary processing platform which uses database analytics to drive efficient marketing to its client base.

Principally based in Wisconsin, 4imprint does not typically manufacture the products it sells itself but outsources this work to third parties which means it has limited capital requirements.

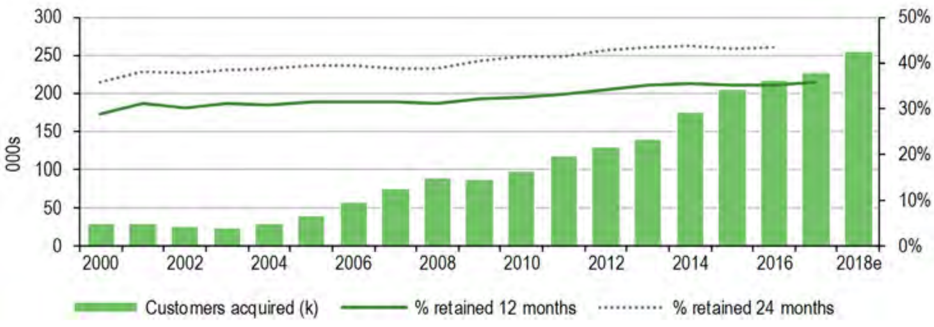
This underpins a modest but growing ordinary dividend and the company has paid special dividends in the past when cash has built up on the balance sheet.

It also only carries limited inventory with suppliers holding stock instead, printing the relevant product and often shipping direct to the client. However, 4imprint does have a large distribution centre with some manufacturing capability for higher specification items.

All told it has thousands of products which can be customised and shipped in 24 hours or less. Strong relationships with its suppliers are underpinned by good lines of communication and timely payments.

The idea of promoting a business through a branded pen or coffee cup might seem old-fashioned but in there is still strong demand from corporations for these items for

4IMPRINT CUSTOMER ACQUISITION AND RETENTION



Source: 4imprint

LONG-TERM GROWTH WITH MANAGED MARGIN

4imprint accounts, Edison Investment Research

both external marketing and to motivate staff.

SUCCESS WITH SELF-PROMOTION

Unsurprisingly given its area of expertise, 4imprint is good at promoting itself. A brand awareness programme, at a cost of $7m, was launched in 2018. This encompassed a TV-based campaign and was aimed at making the company synonymous with promotional goods.

The effort appears to have reaped early benefits, helping propel year-on-year organic revenue growth in the second half of 2018 to 18.7% from 16.5% in the first half according to a 17 January trading update which also guided for full year profit to be at least at the top end of the market range at around $45m. Management estimate that second half growth in its wider market was more like 5%.

Despite being the leading operator, 4imprint has a very large addressable market to exploit. Worth some $23bn in the US, the promotional products market is highly fragmented and 4imprint has less than a 3% share.

ORGANIC GROWTH FOCUS

4imprint is growing organically rather than looking for short-cuts through acquisitions, with all the risks of over-paying and integration that might entail.

It does something which in our view all the best businesses have in common – it really understands its customer base. It uses a mixture of technology and people skills to anticipate what clients want which reinforces its ability to retain and acquire new customers.

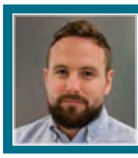
The shares currently trade on a price-to-earnings (PE) ratio of around 17.5-times based on Peel Hunt's earnings per share forecast for 2019. This compares with a five-year average PE of 19.7-times according to the broker, with the stock frequently trading at more than 20 times earnings. The well-supported forward dividend yield comes in at 2.9%.

WHAT ARE THE MAIN RISKS?

A key risk for investors to weigh is the company's historic tendency to track fluctuations in US GDP growth. However, while there are expectations for slowing growth across the Atlantic, recent releases suggest the economy remains in decent shape and a more patient approach from the US Federal Reserve on interest rates could help support business confidence.

Like many firms and industries, there has been speculation of a competitive threat from online retailer Amazon, however it would be difficult for an outfit like Amazon to replicate 4imprint's personalised approach and attention to detail.

The company also has pension liabilities associated with its small UK operation but a series of large contributions since 2012 have seen the level of payments into its pension scheme now become more modest and predictable.



By **Tom Sieber**
Deputy Editor

The fund management giants can't live without this small cap

Alpha Financial Markets provides essential services to BlackRock and Vanguard

Small cap stock **Alpha Financial Markets Consulting (AFM:AIM)** may not be a household name but it provides consultancy services to over three quarters of the world's top 20 wealth managers measured by assets under management.

For a firm founded just over 15 year ago, it has an enviable client list including fund management giants BlackRock, Fidelity and Vanguard.

Alpha has scope to keep growing this list as well as its earnings as it expands geographically and in terms of products.

According to consultant PWC, global assets under management were $85trn in 2016 and that number is expected to reach almost $150trn by 2025.

As the volume of assets grows, asset managers rely on Alpha to advise them on new trends and technologies.

At the same time, asset managers are under constant pressure from their customers to cut costs. This means more work for Alpha helping to automate processes, re-domicile funds, or in the case of mergers to rationalise products or markets.

As Alpha's reputation grows so does its work load. It already consults for the London offices of the biggest US asset managers and it is getting an increasing number of referrals for work in the US for these same firms.

ALPHA FINANCIAL MARKETS CONSULTING ↗ BUY

(AFM:AIM) 236p

Stop loss: 175p

Market cap: £239m

On top of selling services to existing clients in new markets, Alpha is adding new services to its roster in response to customer demand.

In 2018 the firm launched new technology solutions and chief executive Euan Fraser is confident that his team can add several more business lines to the dozen or so they currently offer.

At the half year stage to September 2018 revenue was up 35% to £39m while operating profit was up 47% to £8.4m and profit after tax grew by 57% to £6.3m.

In order to achieve this growth Alpha is continually adding to its headcount, particularly in the US where it was under-represented in the past.

Helpfully the behemoths of consulting regularly spotlight their top-performing staff making it easy for rivals like Alpha to cherry-pick the best talent.

If it decides to grow by acquisition instead of poaching consultants, Alpha's strong cash flow generation and net cash position mean that it has the leeway to do so.

By **Ian Conway**
Senior Reporter

DIAGEO
(DGE) £29.39

Gain to date: 4.9%

Original entry point:
Buy at £28.02, 2 August 2018

AFTER A PERIOD of languishing in the red, our August 2018 'buy' call on drinks maker **Diageo (DGE)** is refreshingly in the black.

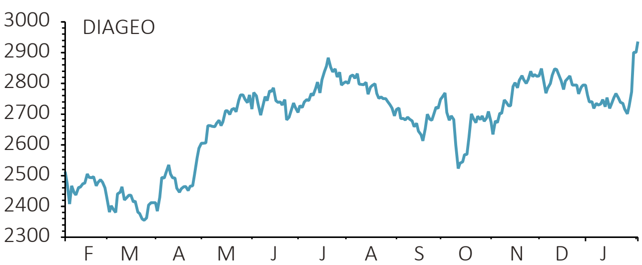
Our patience with the *Johnnie Walker* whisky-to-*Smirnoff* vodka maker has thus been rewarded.

Forecast-beating first half results (31 Jan) and an increase in the share buyback from £2.34bn to £3bn for the year ending 30 June 2019 provided catalysts for the latest upward share price movement.

Organic net sales growth of 7.5% and organic operating profit growth of 12.3% were both ahead of consensus estimates with the beat driven by the emerging market regions of Latin America, Africa and Asia.

Diageo also grew sales by 4.7% in the US, where management is optimistic the *Captain Morgan*-to-*Casamigos* brands owner can continue to serve up growth in line with or ahead of the market.

This is a high-quality company with global scale and brand power, defensive characteristics including strong free cash flow and long term growth potential in emerging markets including China and India.



SHARES SAYS:
We're sticking with Diageo for its globally-diversified earnings, cash generation and capital returns.

PPHE HOTEL
(PPH) £17.74

Gain to date: 25.8%

Original entry point:
Buy at £14.10, 28 June 2018

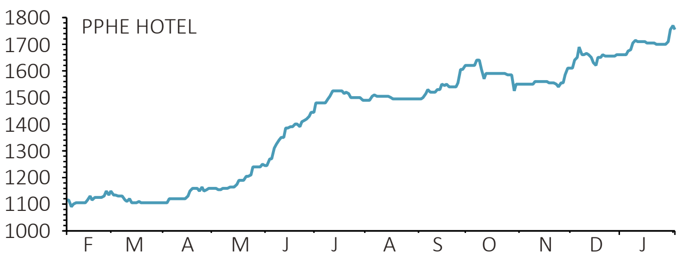
PPHE Hotel (PPH) has continued to enjoy strong share price gains, driven by positive trading updates and bullish broker comment.

It has reported 6.7% growth in like-for-like total room revenue for 2018, driven by improved trading across all its operating regions. The good performance also benefited from a site in Amsterdam being renovated and having its full room inventory available once more, plus the benefits of refurbishment at two London hotels which were completed in 2017.

FinnCap analyst Guy Hewett says there is potential to 'significantly enhance' asset values in Amsterdam and Croatia via investment, helping to attract more tourists and drive up room rates.

Berenberg analyst Ned Hammonds is also positive, saying: 'PPHE stated that its EPRA net asset value per share was £24.21 at the end of June. We think it will have increased slightly over the remainder of 2018, partly due to the extension of Park Plaza London Riverbank.

'In addition, we believe the current refurbishment projects and the development of art'otel London Hoxton have the potential to create further value over time. On top of this, PPHE continues to focus on acquisition opportunities that could drive additional growth and create value.'



SHARES SAYS:
We remain optimistic about PPHE's prospects thanks to its pipeline and strategy to boost the value of its assets by refurbishing existing properties.

ANGLO AMERICAN

(AAL) £19.66

Gain to date: 19%

Original entry point:

Buy at £16.52, 12 July 2018

SHARES IN **Anglo American (AAL)** have hit a six-year high off the back of a rally in iron ore prices and a deal involving one of its largest shareholders.

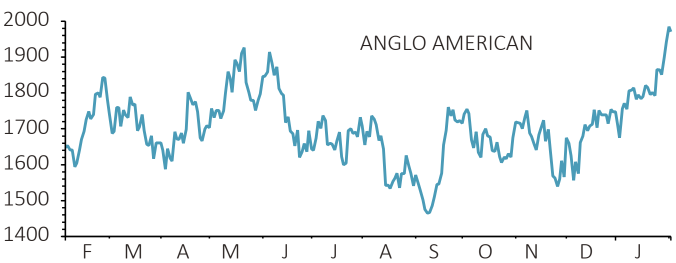
Vedanta has paid $200m for a stake in Anglo from its parent company Volcan, a vehicle linked to Indian billionaire Anil Agarwal.

Volcan bought a near-20% stake in Anglo two years ago, funded by issuing exchangeable bonds which mature in 2020. That led to speculation that Volcan would try and buy part of Anglo such as its South African operations.

Volcan would need to raise approximately $6bn to convert the bonds into equity at the current price, but it is already highly leveraged.

UBS analyst Myles Allsop says Agarwal's intentions remain unclear. 'It is possible the move is to alleviate Volcan's balance sheet pressures, rather to prepare for conversion,' he says.

'The Anglo share price is likely to be supported if Volcan converts the bond into equity (as the hedge funds that bought the exchangeable would have to buy 17% of the shares in the market); the share price may, however, be negatively impacted if Volcan allows the bond to mature and returns the shares to the hedge funds.'



SHARES SAYS:

Anglo's shares are worth owning with or without any corporate action from Volcan. Hold on to the stock.

RENISHAW

(RSW) £43.68

Gain to date: 14.8%

Original entry point:

Buy at £38.04, 20 December 2018

HALF YEAR RESULTS from precision engineer **Renishaw (RSW)** were well received by the market despite pre-tax profit dipping 6.9% to £61.6m.

The business is doing very well in all of its geographic territories apart from the Far East where revenue slipped 1% in the six-month period. It attributes this weakness to a slowdown in demand for encoder products and from large end-user manufacturers of consumer electronic products.

Fortunately Renishaw is a diverse business in terms of customers. Its metrology business has seen 'strong growth', so too its healthcare operations.

The company has a strong balance sheet with a £100.5m net cash balance at the end of 2018. Inventory balances rose by about 10% in the second half of last year amid increased trading levels, expected future demand and stockpiling in case of Brexit-related supply chain delays.

SHARES SAYS:

We're pleased with Renishaw's progress and aren't worried by the profit slip. The market should have already expected weakness in its consumer electronic products given negative news from that industry of late.

Renishaw is a strong, well-invested business which has a track record of delivering superior returns. We have upmost faith in it being able to navigate tougher market conditions. Keep buying.

Would the FTSE 100 be better equally weighted?

Historical performance suggests this could be better for investors

Year-on-year performance (total return)								
	2012	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**CAGR**
FTSE 100	10.0%	18.7%	0.7%	-1.3%	19.1%	11.9%	-8.7%	7.0%
FTSE 100 Equal-Weight	17.9%	19.8%	4.5%	3.0%	12.6%	13.2%	-9.0%	8.50%

As investors we're used to looking at the price of indices like the FTSE 100 fairly regularly but it probably never occurs to most of us how the index is constructed or how its value is calculated.

Like most indices, its value is calculated by taking the free float London adjusted market value of all the companies within the index and dividing it by a number to get an index value.

When it was launched in 1984 the base value for the FTSE 100 was 1,000 points.

Working out the right weighting for each stock within the index is highly complex as their market values are constantly changing.

On top of that, adjustments

FTSE 100 Top 5 constituents

Stock	Sector	Mkt Cap	Weight
HSBC	Banks	£130bn	7.7%
Royal Dutch Shell A	Oil & Gas Producers	£105bn	6.2%
BP	Oil & Gas Producers	£97bn	5.7%
Royal Dutch Shell B	Oil & Gas Producers	£88bn	5.2%
AstraZeneca	Health Care	£74bn	4.4%
Total		**£494bn**	**29.2%**

FTSE 100 Top sector weightings

Sector	Mkt Cap	Weight
Oil & Gas Producers	£292bn	17.2%
Banks	£219bn	12.9%
Personal & Household Goods	£188bn	11.1%
Health Care	£164bn	9.7%
Basic Resources	£140bn	8.2%
Total	**£1,003bn**	**59.1%**

Source: FTSE Russell 31 Dec 2018

have to be made to the index value for stocks going ex-dividend, corporate actions like rights issues, and takeovers such as last year's deal between **Melrose (MRO)** and GKN.

That said, the weighting of the top 10 stocks is about the same today as it was 10 years ago at around 45%.

OILS AND BANKS DOMINATE THE FTSE

The stocks with the biggest weightings are **Royal Dutch Shell (RDSB)** and **BP (BP.)** which together make up just under 20% of the index.

However this is a bit misleading as there are two classes of Royal Dutch Shell shares, A and B, and each is included in the index meaning there are actually 101 stocks in the FTSE 100.

For most investors the FTSE is the benchmark and no-one questions whether there might be a better way of calculating it.

For those who don't want all their eggs in one basket however, there is a FTSE 100 equally-weighted Index.

It includes all the same constituents as the FTSE 100 index but each company has a weighting of just 1%.

Launched in September 2011 with a base value of 100, it has out performed the standard FTSE 100 since inception with a compound annual growth rate of 8.5%.

On an equally-weighted basis oil producers are the major losers with their weighting falling to just 2.8%.

Banks are also big losers with their weighting falling to just 5%.

The big winners are industrial goods and services, travel and leisure, retail and media.

While mining stocks look as though they are winners, taking three of the top five spots, in fact the sector has a similar weighting to the standard FTSE 100.

REDUCING THE INFLUENCE OF MEGA-CAPS

Clearly what equally-weighting the index does is play down the impact of mega-cap stocks like BP, Royal Dutch Shell and **HSBC (HSBA)**, and play up the performance of smaller stocks.

It also increases diversification and reduces the risk profile of the index because mega-cap stocks can just as easily lose money as make money and by reducing their relative weight any damage can be limited.

There is a wealth of historical evidence to show that smaller stocks do better than larger stocks over the long term.

> **Naturally there are no guarantees with investing but for those interested in an equally-weighted approach there are tools and products out there**

In an article in the *Financial Times*, authors Robert Ferguson and David Schofield showed that from January 1966 to June 2010 an equally-weighted portfolio of S&P 500 stocks beat the market value-weighted S&P 500 by around 3% per year.

Even in the short time that the equally-weighted FTSE 100 has been in existence it has beaten the standard index by around 1.5% per year.

FTSE 100 equally weighted top sector weightings

Sector	Weight	FTSE 100 weight
Industrial Goods & Services	14.4%	6.9%
Personal & Household Goods	9.0%	11.1%
Travel & Leisure	9.0%	4.4%
Basic Resources	8.4%	8.2%
Insurance	7.9%	5.2%
Total	**48.7%**	**35.8%**

Source: FTSE Russell 31 Dec 2018

VOLATILITY IS LESS THAN YOU MIGHT EXPECT

In theory giving smaller stocks a bigger influence ought to make the equally-weighted index more volatile than the standard index but that's not the case.

As the table below shows, over one year, three years and five years the volatility figures are very similar.

Naturally as share prices move the weightings of each stock changes over time so the equally-weighted index is re-balanced every quarter.

This means taking money out of stocks which have outperformed and putting it into those which have underperformed so that they are equally weighted again at the start of the next quarter.

There is a cost to this but it is more than compensated by the better performance of the equally-weighted index over time.

In fact by taking small profits in stocks which have outperformed and reinvesting the gains in those which have underperformed the index is using a 'buy low/sell high' approach.

Naturally there are no guarantees with investing but for those interested in an equally-weighted approach there are tools and products out there. Among them exchange-traded fund **Xtrackers FTSE 100 Equal Weight (XFEW)** which has an ongoing charge of 0.25%.

By **Ian Conway**
Senior Reporter

Volatility

	1 Year	3 Years	5 Years
FTSE 100	12.6%	12.6%	10.3%
FTSE 100 equally weighted	12.4%	12.9%	10.0%

Source: FTSE Russell 31 Dec 2018

HOW YOUR ISA CAN PAY YOU £10,000 A YEAR

Wouldn't it be great if in your retirement you could pay for all the boring bills in your life with a tax-free income, and keep your pension savings for the fun stuff?

People who save into an ISA benefit not only from tax-free growth on their investments but they can also draw income off their investment pot tax free, meaning they can supplement their pension income.

HOW MUCH DO I NEED AND HOW CAN I SAVE IT?

The average household needs around £10,000 a year to pay their basic bills and run a car. We have taken rent or mortgage costs out of monthly costs, as we assume most people in retirement will have paid off their mortgage and own their property outright.

Based on average UK-wide estimates, around £1,560 a year is needed for gas, electricity and water bills, another £1,671 for council tax and around £203 a year for internet. Car costs – MOT, tax and insurance – come to £861, while home insurance costs £150 on average. We've allowed £4,000 for food, although this may be higher depending on where you shop and what you eat, and we've added just over £1,500 a year for unforeseen costs, such as car repair or needing to replace a broken appliance, for example.

So if you need to generate a £10,000 a year income, you'll need an ISA pot of around £200,000, assuming you can generate income of 5%. These figures can be scaled up, so a couple wanting £20,000 income would need £400,000 between them, or someone with some housing costs may want £15,000 a year, so will need a £300,000 pot.

We'll stick with the £10,000 example, but how do you get to £200,000? The current annual ISA allowance is £20,000 per year, per person. If someone saved this full allowance every year, and we assume 4% investment growth each year after charges, they would reach £191,656 after eight years, or £220,122 after nine years.

If you had longer until retirement, and a smaller disposable income, you could instead save £10,000 a year and end up with the crucial £200,000 pot after 15 years – when you'd have £208,245.

Starting saving early pays off, as someone starting in their mid-30s for example, would only need to save £4,650 per year to reach £200,000 after 25 years, assuming the same 4% annual growth as before.

HOW DO I GET MY INCOME?

Once you've built up your pot, you can invest in income-generating investments and draw off the 'natural income' to cover your boring annual expenses and not touch the capital, meaning that your £200,000 shouldn't be reduced.

This means you'll have a healthy pot in the future if you want to make a big purchase, or if you want to pass on money to future generations after you die.

The big question is what to invest in. Targeting an income of 5% is fairly realistic but by no means easy. You'll have to hunt around to find investments that pay this income now and aren't likely to cut payouts in the future.

Nothing is guaranteed, but you can look at the fund or stock's past track record to get an idea of how highly they value the income stream. In particular, you'll want to look for investments that have a track record of increasing payouts.

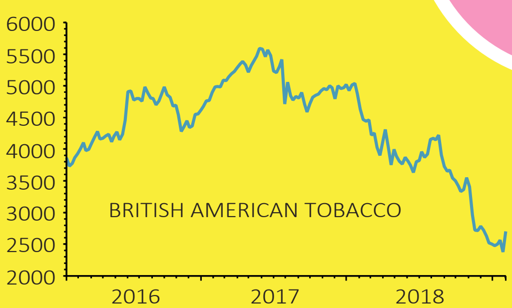
We've based the £10,000 on the current average costs of bills and expenses, but these will go up with inflation, meaning your income needs to keep rising too, or you'll end up eating into your capital.

We've selected five investments currently yielding approximately 5% or more, that are showing promising signs up keeping up those payouts and increasing them.

5%

BRITISH AMERICAN TOBACCO (BATS)

British America Tobacco (BATS) has an expected yield of 8% this year, way above our target. The tobacco giant has been a regular income payer, and is also the best performing stock of the 30 companies remaining in the FTSE 100 from the original index 35 years ago. Russ Mould, investment director at AJ Bell, says: 'A yield up near 8% can be a sign that there is lots of risk here and the dividend is under threat. Regulatory pressures and a big debt pile are both genuine dangers. But cash flow is still strong and management seems poised to start tidying up the balance sheet so British American Tobacco's dividend may be safer than it seems.'

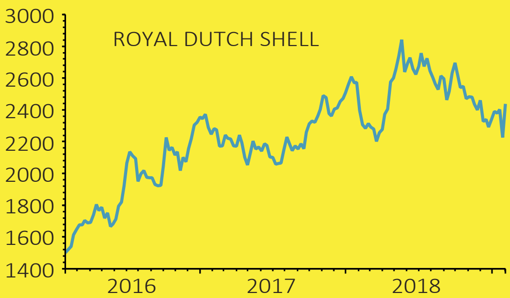


BRITISH AMERICAN TOBACCO YIELDS 8%

ROYAL DUTCH SHELL (RDSB)

Oil giant **Royal Dutch Shell (RDSB)** is another firm that has proven its dividend paying ability – it hasn't cut its payout since 1945. It is currently yielding 6.3% and has 'dividend cover' of 1.7 times, meaning it could pay out its dividend 1.7 times from current earnings alone. Mould says: 'The company proved it could weather an oil collapse in 2016/17, while cost cuts and tighter capital discipline mean the oil major can now maximise the benefits of $60-plus oil and it is paying down debt for good measure.'

ROYAL DUTCH SHELL HAS NOT CUT ITS DIVIDEND SINCE WW2

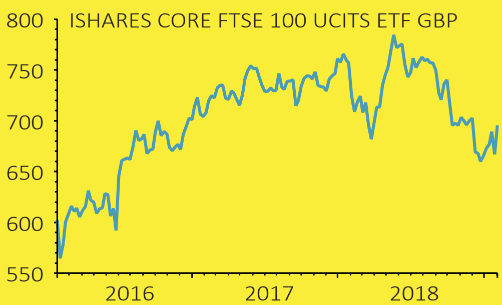


ISHARES CORE FTSE 100 ETF (ISF)

Another option is to spread your risk and invest in the FTSE 100 index. Based on analyst forecasts the FTSE 100 index of leading UK companies is expected to yield 4.9% this year – slightly below our target, but this can be counteracted by higher-yielding options elsewhere. The **iShares Core FTSE 100 ETF (ISF)** is a low-fee option, costing just 0.07%.

iShares Core FTSE 100 ETF's largest holdings include HSBC

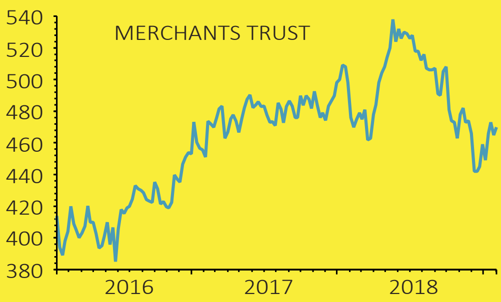
YOU CAN GET LOW-COST ACCESS TO THE FTSE 100'S YIELD THROUGH ETFS



MERCHANTS TRUST (MRCH)

The Association of Investment Companies has come up with a 'dividend hero' list, namely investment trusts that have consistently increased their payouts for 20 consecutive years or more. It proves a great hunting ground for reliable dividend-paying trusts, although a number don't meet our 5% yield mark. One that does is **Merchants Trust (MRCH)**, which is currently yielding 5.5% and has increased its dividend every year for 36 years. It invests in UK, income-producing companies, and the current roster of holdings includes blue chip companies such as Shell, **GlaxoSmithKline (GSK), BAE Systems (BA.)** and **Imperial Brands (IMB)**.

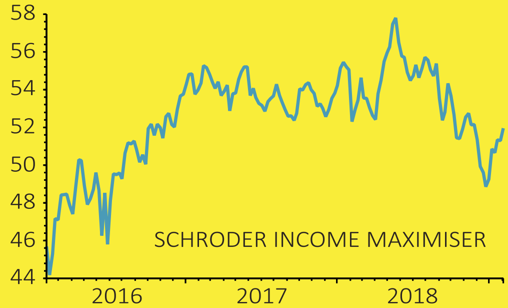
MERCHANTS IS AN AIC DIVIDEND HERO



GlaxoSmithKline features in Merchant's portfolio

SCHRODER INCOME MAXIMISER (B53FRD8)

Investors who want to squeeze maximum income out of their pot and don't mind about getting minimal or no capital growth can invest in so-called 'income maximiser' funds. They generate income by selling complicated derivatives called options on some of their holdings, which have the effect of limiting capital growth. **Schroder Income Maximiser (B53FRD8)** is one option; it yields 7% and has been one of the highest paying income funds over the past 10 years. It is worth remembering these funds are higher risk and if they erode some of your capital then you will need a more substantial yield than 5% to generate your £10,000 figure.



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

At the end of 2018, Pearson was Schroder Income Maximiser's top holding

AJBell Youinvest

Low-cost pension

The savvy saver

Whether you like to save a little or a lot, there's an investor inside us all. Discover yours with our flexible, low-cost SIPP.

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We don't offer advice about the suitability of our products or any investments held within them, if you require financial advice you should consult a suitably qualified financial adviser. Tax treatment depends on your individual circumstances and rules may change. The value of investments can go down as well as up and you may get back less than you originally invested.

Greencoat UK Wind regales market with news of material acquisition

£452m

Greencoat UK Wind (UKW) plans to buy stakes in two wind farms from **SSE (SSE)** for £452m. It also plans to issue new shares at a 5.1% discount to its closing price on the night before the announcement to raise up to £131m.

'These are significant acquisitions for Greencoat UK Wind with the acquisition price of £452m representing 32% of net assets (or c.30% assuming the completion of the fundraising),' says the investment trust team at stockbroker Numis.

'SSE has announced that the acquisition price implies an average valuation of £4m/MW. We understand that the manager is comfortable with a relatively expensive headline valuation due to the quality of the assets, which are new, have a high load factor, and have renewables obligation certificates running to 2036/2037.'

PHOENIX SPREE BOOSTS RENTS AND VALUES

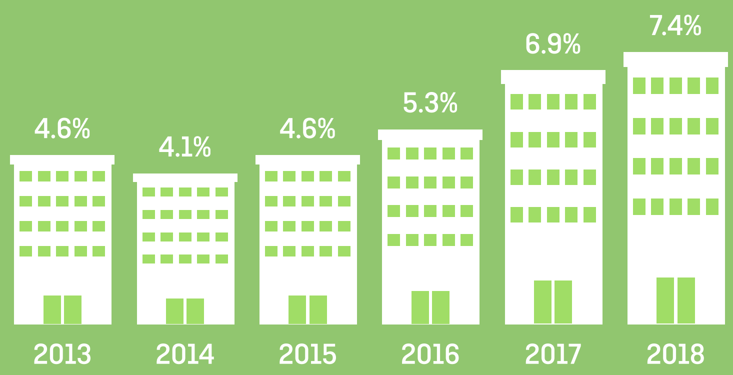
GERMAN RESIDENTIAL property investor **Phoenix Spree Deutschland (PSDL)** seems able to brush off the country's economic struggles after it reported a 14% increase in the value of its portfolio during 2018.

Its focus on a relatively buoyant Berlin property market also delivered strong rental growth of 7.4%. The investment trust benefits from its exposure to a city with falling unemployment, an undersupply of rental properties and population growth.

By renovating its properties, many of which are upwards of 70 years old, Phoenix can push through rent increases in a tightly regulated market.

At 351p the shares trade at a 4.7% discount to net asset value and yield 1.9%.

PHOENIX'S LIKE-FOR-LIKE PROPERTY PORTFOLIO RENT GROWTH (%)



Source: Company reports

MURRAY INTERNATIONAL SHARES NEAR A TWO-YEAR HIGH PREMIUM

GLOBAL EQUITY INCOME trust **Murray International (MYI)** is trading at close to a two-year premium to net asset value.

The trust holds total assets worth more than £1.4bn, or approximately £11.05 per share, and trades on a stock price of £11.72 for a premium of around 6%.

This compares with an average premium of 2% over the past 12 months, say analysts at broker Stifel.

Murray International remains one of the global equity income sector's most cost efficient for investors to consider, with an ongoing charge of 0.64%, the second lowest according to Morningstar data.

The stock also offers the sector's highest income yield, currently at 4.42%.

This fund makes money every time the songs it owns are played

Hipgnosis Songs Fund owns the rights to various bits of music which earn it regular royalty cheques

Investments uncorrelated to the market are increasingly sought by individuals looking to diversify their portfolio during volatile times.

That might explain why investment trust **Hipgnosis Songs Fund (SONG)** is currently trading at a premium to the value of its assets.

It owns the rights to certain pieces of music and receives a royalty payment each time they are played on the radio, streamed online, feature in adverts, films, TV programmes or computer games, or are bought on CDs or vinyl. It is confident this income should help to fund a steady stream of quarterly dividend payments for shareholders.

Merck Mercuriadis, former manager of artists Elton John and Iron Maiden and founder of the investment trust's adviser The Family (Music), argues that music is consumed regardless of the economic backdrop, meaning that Hipgnosis' income stream should be predictable and reliable.

'People consume music in both good and bad times. In difficult periods people want entertainment to get away from the negativity in real life,' he says.

IPO DELAYED THREE TIMES

Hipgnosis had a few false starts joining the stock market as potential investors took a long time to fully understand the music rights market, says Mercuriadis. 'The IPO took longer than I expected; it was naivety on my part. It took time for investors to understand why the asset class was predictable and reliable.'

Seneca Investment Managers was among the institutions to have backed the trust, saying it was attracted to its bond-like characteristics and low correlation to other asset classes.

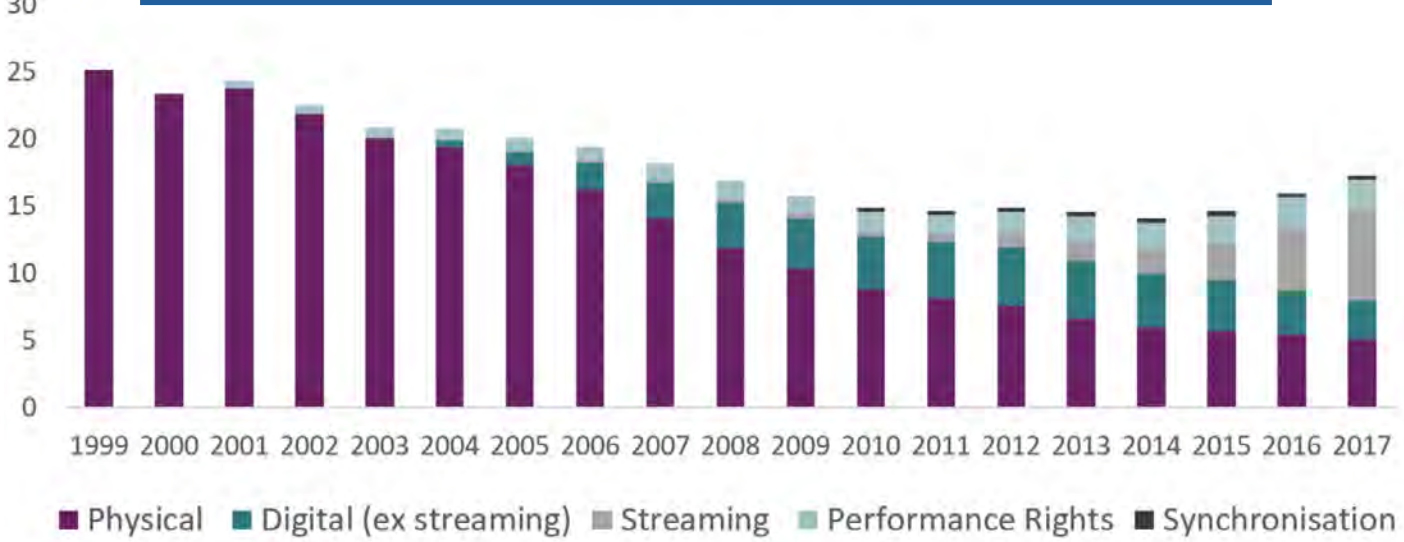
'We understand Hipgnosis' broad cash flows and pricing models,' says Gary Moglione, a fund manager at Seneca. 'The Hipgnosis team is comprised of industry veterans, including songwriters and chief executives-to-chief financial officers from the music industry.

'We feel they can identify the best catalogues, complete the purchase at the right price and manage those assets by enhancing revenue from other areas such as advertising and video games to give us that extra upside potential.'

ACQUISITION COSTS

Having finally floated in July 2018, Hipgnosis has now deployed at least £73m of the £200m raised at its stock market listing, with a £600m pipeline of future deals under negotiation. The trust is bound by confidentiality agreements concerning deal pricing and can only reveal that investments to date have been made on an average of 12.2 times historic annual net income.

GLOBAL RECORDED MUSIC INDUSTRY REVENUES 1999-2017 ($BN)



Source: IFPI 2018

'The valuation process is difficult as this is a fairly opaque market,' says Moglione. 'A little over a year ago Round Hill Music purchased one of the industry's prized assets in the form of the Carlin music catalogue. This contained songs from James Brown, AC/DC, Meatloaf and Billie Holliday and Christmas classics such as *Santa Baby* and *Jingle Bell Rock*'.

'The reported price paid was 16 times the catalogue's earnings generating yields of around 6%. An "evergreen" catalogue may trade at 11 to 13-times (yielding 7% to 9%). The more speculative "unproven" catalogues will trade on lower multiples,' adds the fund manager.

Spotify had 87m subscribers as of 30 September 2018, representing 30% growth year-on-year

EXAMPLES OF SONGS HIPGNOSIS OWNS

The goal is to obtain the rights to music that has long-lasting appeal. So far Hipgnosis' investments include a mixture of new and old songs including the rights to songs performed by Sister Sledge and Diana Ross such as *We Are Family* and *I'm Coming Out*, respectively.

It recently acquired a music catalogue from songwriter Itaal Shur which includes the song *Smooth*, recorded by Santana and ranked as the second most successful song of all time, according to *Billboard*. The media outlet last year said *Smooth* generates approximately 1m on-demand streams per week, citing Nielsen Music data.

Hipgnosis focuses on striking deals with producers and songwriters rather than artists because it believes they are more likely to want to take a cash lump sum upfront instead of having a longer-term stream of income from royalties.

'If you're an artist like Neil Young and we approach you to buy the rights to your songs, you have several options. One is to sell to us, but the others include going on tour and selling tickets and merchandise to get more money.

'Neil Young has the brand to do that; a songwriter doesn't have the same ability which is why many are happy to take our money upfront,' says Mercuriadis.

FIGHTING OFF COMPETITION

While there is competition to buy song royalties, Mercuriadis claims his team is the only one to come from the artistic community, giving them an advantage during the negotiating process.

'I've made my success with artists rather than at the expense of them and producers. Other people buying royalties are just bankers. I will take someone's output and make sure it is nurtured, loved and appreciated and that their legacy will grow.'

The investment adviser says

many companies who own the rights to tens of thousands of songs only have a limited number of staff, meaning they struggle to deal with licencing requests and they miss revenue opportunities.

'We have fewer songs but a good team who come up with ideas and go looking for ways to implement them with the right partners. For example, it might be saying this song would be great for this movie, or that song would work in that game,' he comments.

London-listed stocks **One Media IP (OMIP:AIM)** and **Entertainment One (ETO)** are also active in the royalty market. The former has rights to various songs and TV content, while the latter is a significantly larger company with rights to TV, film and music content.

THE PROS AND CONS OF STREAMING

The public is increasingly streaming music via sites such as Spotify or YouTube rather than buying CDs or digital downloads. Artists continue to complain about the extremely small royalty cheques they receive from these services. Could this not pose a risk to Hipgnosis in terms of future income?

Mercuriadis admits that rates are low but insists it is just an evolutionary process. He gives the example of The Beatles signing to EMI in 1962 and the advent of the long-player (LP) format.

'In the early days The Beatles were getting less than 1% royalty. More people then started consuming music via LPs and by the time The Beatles broke up eight years later they were on 25% royalties. The same thing will happen to streaming services.

'The idea of streaming payments currently being anaemic is not something you can argue with. Instead, you should focus on the explosion in music consumption.'

He draws attention to various telecom companies bundling streaming subscriptions as part of new phone contracts as an example of how even greater numbers of people are accessing these services.

POTENTIAL EARNINGS UPLIFT

Last year the Copyright Royalty Board announced that songwriters' share of royalties would increase from 10.5% to 15.1% in the US streaming market over the next five years.

'To date the music streaming market has been dominated by YouTube with a 46% share,' says Moglione at Seneca. 'However, YouTube pays a much smaller percentage of revenue on royalties compared to companies such as Spotify. It uses outdated safe harbour laws from 1998 that were intended to protect passive online intermediaries.

'If the legislation were updated to ensure YouTube had to move toward Spotify's level of royalty payments this would provide a sizeable revenue uplift.'

OUR VIEW ON THE INVESTMENT CASE

Hipgnosis was priced at 100p when it floated last summer and said it would target an initial 3.5% dividend yield based on the listing price.

Once fully invested it expects the yield to rise to 5%. It hopes to generate 10% or more annual total net asset value returns over the medium term, net of fees.

The shares currently trade at 108p which is a 10.6% premium to the 97.68p net asset value as at 30 September 2018, the last published information.

In general, investors should only consider buying a trust at a premium if there is something special on offer, such as a high quality fund manager or superior assets.

In Hipgnosis' case, we think the shares are worth buying at the current price as the investment adviser has already shown expertise in buying good assets and it looks like there is a lot more to come.

By **Daniel Coatsworth**
Editor

The benefits of highly-diversified investment trusts

The space includes Alliance Trust, F&C Investment Trust, Herald and Witan

Given the return of equity market volatility, the threat to global growth from trade wars as well as political uncertainties, portfolio diversification should be front of mind for the savvy investor and there is plenty on offer in the investment trust space.

Investors can put money to work with funds that not only produce growth and income, but also provide a less rocky ride during times of market strife. The diversity of their underlying portfolios means that if one investment hurts, the wider portfolio doesn't take a big performance hit.

Highly-diversified trusts include **Witan (WTAN)**, offering investors broad exposure to global equities via a multi-manager strategy and whose 2018 results should confirm a 44th consecutive annual dividend hike.

Witan's funds are allocated to 10 external managers and up to 12.5% is directly invested in specialist funds and smaller, niche managers. Top holdings range from consumer goods powerhouse **Unilever (ULVR)** and **Lloyds Banking (LLOY)** to listed life sciences fund **Syncona (SYNC)**.

In combining different investment approaches and geographical mandates, Witan recognises that no manager will excel in all market conditions and regions. It is hoped the Witan way should reduce performance variability relative to using a single manager.

HIGHLY DIVERSIFIED TRUSTS

COMPANY	SHARE PRICE	NAV	DISCOUNT / PREMIUM TO NAV
Alliance Trust	721p	764.59p	-5.7%
Bankers	816p	838.65p	-2.7%
F&C Investment Trust	667p	667.65p	0.1%
Herald Investment Trust	1210p	1388p	-12.8%

Source: AIC/Morningstar

MORE EXAMPLES OF DIVERSIFIED TRUSTS

Bankers Investment Trust (BNKR) has a diversified portfolio of 196 stocks as at 31 December, whose top 10 investments speak for a mere 16% of the total portfolio.

Besides geographical diversification, Bankers is highly diversified at the sector level. Managed by Alex Crooke, who takes responsibility for the allocation to seven regional portfolio managers, Bankers, like Witan, boasts 52 years of consecutive dividend increases under its belt.

Other trusts with diversified portfolios include multi-manager collective **Alliance Trust (ATST)** and **Herald Investment Trust (HRI)**, the tech, communications and multi-media investor flush with 285 holdings at last count.

But the big daddy when it comes to diversification is **F&C Investment Trust (FCIT)**. Having been through over a century and a half of market ups and downs – 2018 marked the trust's 150 year anniversary and it has flourished despite two world wars, the great depression and 2008's global financial crisis – the world's oldest collective investment fund knows how to navigate current choppy market conditions.

UNDER THE BONNET OF F&C

F&C Investment Trust's diversified portfolio provides exposure to most of the world markets. Like Witan and Alliance Trust, it is a multi-manager fund – for example, the US

HERALD INVESTMENT TRUST'S PHILOSOPHY

We are evangelists for the technology, media and telecommunications sector, and firmly believe investors are missing an opportunity if they are not represented in it.

'We endeavour to offer a relatively low risk way of investing in stocks with high risk on a sufficiently diversified basis that the risk is greatly diminished, whilst still aspiring to premium returns

fund component is managed by external managers T Rowe Price and Barrow Hanley – offering diversified, low cost exposure to more than 500 companies in 35 countries.

This staggering diversity should theoretically help it smooth out the ups and downs of the market and also makes it a suitable building block for a beginner's portfolio.

As of 31 December 2018, the 20 largest holdings included Amazon, Microsoft, Boeing, JPMorgan Chase and Facebook.

Crucially, the investment trust boasts a stellar track record, having generated 10 year annualised total price and net asset value returns of 14.5% and 13.08% respectively, according to Morningstar.

Manager Paul Niven is tasked with finding the right blend between different strategies. He ensures the portfolio offers broad-brush exposure to a combination of global stock market giants, rising star companies in developing economies and private equity opportunities too.

FIT FOR THE FUTURE

Niven explains the trust's long-term objective is to grow capital and income. 'The trust has adapted through time to make sure we are fit for purpose,' he informs *Shares*.

He says the trust's original objective was to provide the man or woman of moderate means access to the same opportunities as large capitalists.

'We started out in 1868 investing in emerging market bonds. We invested in private equity in 1942 and really went wholesale into equities in the 1960s. That is probably the biggest decision the trust has made over the last 150 years. If they hadn't made that move, obviously the 1970s and inflation came along and bond markets got killed.'

The trust has paid a dividend every year for 150 years and paid a rising dividend in every one of the last 47 years.

He hammers home the point that F&C Investment Trust sees 'growth assets' as the place to put money to work in today's world. 'We've grown our capital returns and total returns for shareholders materially. Because we're focused on capital and income, we don't chase income for its own sake.'

Niven adds: 'We seek to provide a one-stop shop for investors that are looking for a global growth solution. We think it is appropriate to be diversified. I think focused portfolios make a lot of sense, but for the end investor, there needs to be a bunch of focused portfolios which combine in an appropriate way to deliver performance. I wouldn't bet the ranch on one particular style or approach.'

His approach is to blend a range of different strategies in its portfolio. 'If you look at our return against risk, we score very favourably against the competition. We give quite a smooth performance journey with less surprises than you might get if you buy a single, focused portfolio.'

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

How to judge funds without a track record

Many investors will want to see returns over more than a three year period before committing to a fund, so what about new launches?

Investors are often told they should wait until a fund has a track record of at least three years before they trust their money to it.

This is, it is said, long enough for the manager to prove that their strategy works and that the fund will perform as promised. But a fund needs money to invest in order to produce that track record. It is something of a catch 22 for fund houses and a dilemma for investors.

Ryan Hughes, head of active funds at AJ Bell, explains: 'Many investors like the comfort of a three year track record because it essentially provides a proof of concept to show that the fund manager has the ability to deliver good performance.'

Yet investors are clearly not always following this advice. When Fundsmith last year launched investment trust **Smithson (SSON)**, investors piled an incredible £822m into the vehicle – the biggest trust launch on record. Renowned emerging markets investor Mark Mobius raised £100m for the launch of his new fund firm's first investment trust, **Mobius Investment Trust (MMIT)**.

Elsewhere, it's been slower going. Richard Penny's newly launched **FP CRUX UK Special Situations (BG5Q5V0)** fund currently has just £11m of assets under management and the

Octopus UK Multi Cap Income Fund (BG47Q44), which launched in November, is running just £4m of investors' money.

BIG NAMES STRUGGLING TO ATTRACT BIG BUCKS

What seems quite clear is that big name managers can attract big bucks without proving a track record. Smithson, for example, is Fundsmith's first foray into investing in smaller companies and the trust will not actually be run by veteran investor and founder Terry Smith himself, another first for the group. Yet the stellar track record of Smith's flagship vehicle **Fundsmith Equity (B41YBW7)** appears to be proof enough for investors.

Ben Yearsley, director at Shore Financial Planning, says: 'If I'm convinced by a manager then I'm happy to back a newer fund. However, the manager will need to have a decent history elsewhere.'

Hughes agrees: 'I prefer to look at the track record of the manager, particularly if they were running a similar fund for a different company. I can get comfort that the new fund will operate in a similar manner and then I am comfortable investing long before the three-year track record is reached.'

THE CHALLENGES OF LAUNCHING A NEW FUND

Merian Global Investors has just undergone a major rebrand (it was formerly Old Mutual Global Investors) as well as launching its first ever investment trust. **Merian Chrysalis (MERI)** trust focuses on private equity

Mark Mobius raised £100m on the strength of his team's proven experience in emerging markets

investments and is managing just under £100m.

Warren Tonkinson, managing director of distribution at Merian Global Investors, explains: 'Launching new funds can be a tricky business so it's imperative to consider the market conditions and appetite for a product before you go ahead.

'There has to be investor demand and a gap in to the market – there is no point launching a fund into a crowded space where investors can buy an existing product they already know and trust.'

As well as that investors need confidence in the trust. This can be bolstered if the manager is putting their own cash into the fund.

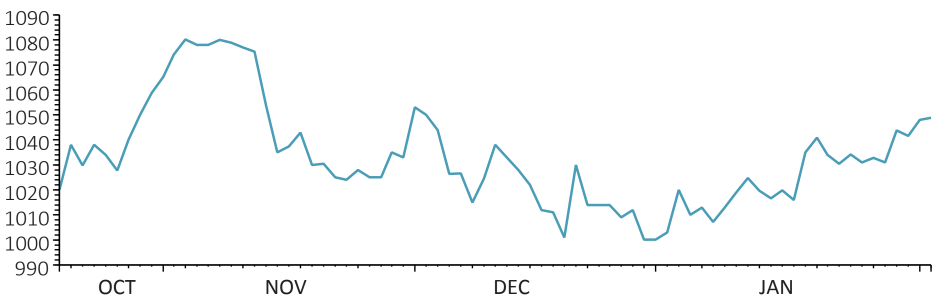
For example, Terry Smith committed around £250m of his own money to the Smithson trust while the entire team at Mobius has invested in their own trust.

Carlos Hardenberg, partner at Mobius Capital, thinks having a strong track record and a fund that investors understand is key. In today's price-conscious world, he believes that getting the fees of a fund at the right level is important too.

The consequences of not getting these factors right can be brutal – funds are often scrapped or merged into other similar mandates if they cannot attract enough capital to make them viable for the group to operate.

Hardenberg adds: 'Raising money is always a challenge; people need to trust you as a stable team and have confidence that your process can deliver robust results. We have proven to the market that we have a track record in different strategies over the long term as individuals.'

SMITHSON INVESTMENT TRUST



STICKING TO WHAT THEY KNOW

For this reason, many managers tend to stick to areas they know when it comes to new fund launches.

Mark Mobius has invested in emerging markets for decades, Merian's Richard Watts has already proven himself in the smaller companies investment space, and Richard Penny has previously managed the very successful **L&G UK Special Situations (B3DMY12)**.

Yearsley adds: 'I think three years was seen as a decent length of time to see how a manager performs in different market conditions, but that hasn't been true of recent years. You want to know how they react in different scenarios – that's more important than an arbitrary length of time.'

DISCLAIMER:
Daniel Coatsworth, who edited this article, has a personal investment in Smithson and Fundsmith Equity

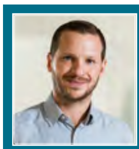
By **Holly Black**

‘I’m confused about DB pension transfers’

AJ Bell pensions expert helps with a popular question among *Shares* readers

Bill from Devon
‘I’m thinking about transferring out of my defined benefit pension scheme but struggling to decide if it’s the right thing to do. I’ve been offered a £230,000 transfer value and have a meeting with an adviser to discuss it.

‘I understand there are risks involved but I’m confident I can get better value by investing the money myself. Are there any other things I should be thinking about?’



Tom Selby
AJ Bell
Senior Analyst says:

Swapping the security of a guaranteed defined benefit (DB) income for the flexibility of defined contribution (DC) plans such as SIPPs has become increasingly common in recent years.

You are right to think carefully before making the leap because this could be one of the biggest financial decisions you ever make. In most cases, it’s likely you’ll be better off sticking with the scheme you already have.

That said, there are a number of perfectly legitimate reasons to consider transferring. One of the most common is to increase the amount of money you can pass on after you die.

In most DB schemes you will get two valuable guarantees: inflation protection and a guaranteed spouse’s pension worth at least 50% of your pension income.

Although transferring to a DC scheme will mean you lose both of those benefits, you have the potential to pass on any funds you haven’t yet withdrawn. What’s more, you can usually pass them on to anyone you want to, not just your spouse.

It’s worth noting that DC funds can also be passed on tax-free if you die before age 75. If you die after 75 income tax will be payable at your beneficiaries’ marginal rate.

You can read more about pension death benefits rules here.

Another major factor influencing DB transfers has been fears over the solvency of the employer ultimately responsible for paying the pension.

If this is your primary concern, remember that the Pension Protection Fund (PPF) provides a valuable insurance policy so that, even in the worst circumstances, you should get at least 90% of your promised retirement income.

You can read more about how the PPF works in this article from 2017.

When it comes to investing your fund, the ‘critical yield’ shows the returns you’ll need to achieve (after charges) to match what you would have received from your DB scheme. If your critical yield is higher, your investments will have to work harder to equal your previous benefits.

You’ll also need to think about all sorts of other potential risks, primarily managing your income withdrawals in a sustainable way.

Your financial adviser should be able to talk you through this, although as a very rough rule of thumb if a 65 year old makes annual withdrawals of more than 4% of the initial value of their fund they are at serious risk of exhausting their retirement pot early.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

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

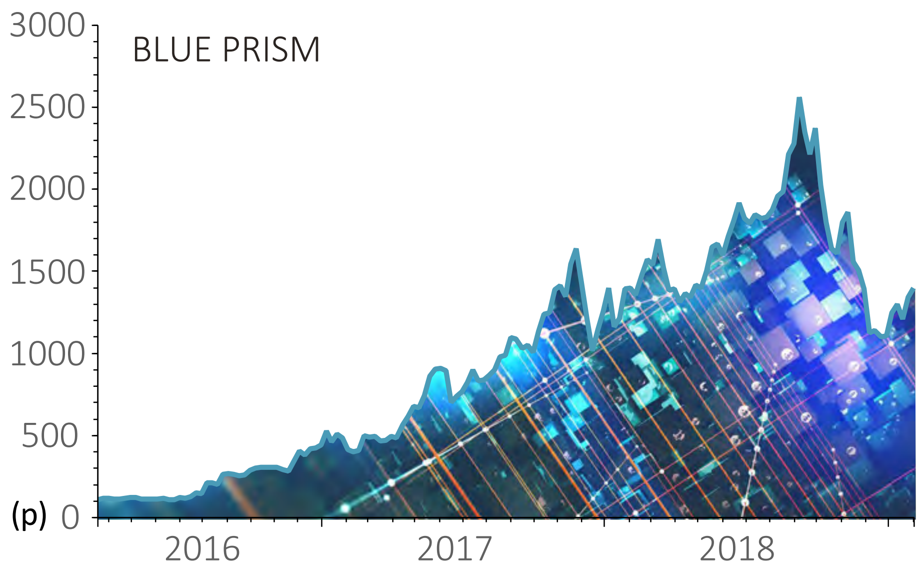
Please note, we only provide guidance and we do not provide financial advice. If you’re unsure please consult a suitably qualified financial adviser. We cannot comment on individual investment portfolios.

Is Blue Prism the best growth stock on the UK market?

Digital workforce designer raises £100m to capitalise on significant growth opportunities

This is one of the most 'marmite' equity stories on the UK stock market right now. Sceptics argue that **Blue Prism (PRSM:AIM)** has unproven technology, a business model that is yet to make a profit, and the shares trade on an eye-watering valuation.

Fans believe the Warrington-based business is embracing a new, digital way of automating labour-intensive and mundane administrative tasks. They consider it to be a rare made-in-Britain growth opportunity that can match anything Nasdaq-listed companies have to offer.



WHAT'S ALL THE FUSS ABOUT?

Blue Prism is a virtual workforce disruptor which uses robotic process automation (RPA) technology to automate manual back-office administration. This cuts costs for clients, frees the human workforce to do more value-adding stuff, improves customer service and speed, and reduces the need to invest in new IT systems, all via a compliance-friendly platform.

It is an area that is attracting serious money from investors around the globe, with more than $1bn of growth funding raised in the last two years by two of the industry's three poster kids – UiPath and Automation Anywhere.

Blue Prism, the third of that trio, has tapped investors for more than £120m since its IPO in March 2016, including a £100m fundraise announced two weeks ago.

This is a nascent, fast moving digital industry whose scope to benefit businesses is capturing the imagination of top management teams everywhere. Blue Prism alone is helping more than 1,100 clients tap into the operational improvement scope of its RPA digital workforce tools, and many are industry heavy-hitters such as Coca-Cola, Walgreens, Xchanging and 02.

Shop Direct (which owns the Littlewoods brand) is one of Blue Prism's longest standing customers of more than 10 years, and it recently doubled its licence with the company. Importantly, nearly all of the company's revenues are on a multi-year recurring basis with very limited churn to date.

UNWRITTEN FUTURE

Chief executive Alastair Bathgate admits that the future potential of RPA is impossible to predict, outside of stating that the 'market is growing very fast'.

There is a clear land grab going on right now but Bathgate believes that RPA is a 'genuine utility product' and its applications have the scope to support multiple specialist players, and it's his job to ensure that Blue Prism is one of them.

That's why the company has just raised fresh funding. The opportunity is there for bigger sales teams, more marketing expertise, and product development to widen and deepen Blue Prism's RPA toolkit applications.

For example, there is inherently a level of self-learning in the technology but Bathgate thinks that as artificial intelligence gets better, faster and more user-friendly, his company will be able to embed more capabilities into the Blue Prism product set and do clever things for clients.

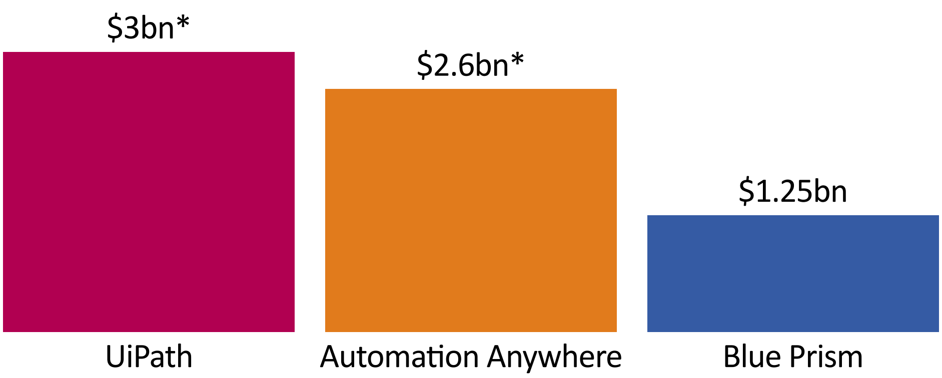
In the meantime, Blue Prism isn't doing too badly at winning new business; it secured 538 new licences in the year to 31 October 2018. The company is also winning more work with existing clients. An extra 723 licences were upsold into 300-odd existing customers, demonstrating the common sense of integrating itself far deeper into its large client base.

Such achievements have helped Blue Prism post astonishing growth since floating on AIM in March 2016. Analysts forecast £93.8m revenue this year, roughly 10 times the £9.64m reported for 2016, and approximately £140m for 2020. 'A year from now we could be really profitable,' Bathgate tells *Shares*, although it is worth noting that analyst forecasts out to 2020 imply no change to Blue Prism's loss-making status.

HOW BIG IS THE OPPORTUNITY?

At this stage it remains tricky for retail investors to gauge the

VALUATION OF RPA'S GOLDEN THREE



*Based on latest funding rounds

real scope of opportunity for a business like Blue Prism.

With the company still firmly investing for future growth, there are no profit metrics to lean on for valuation assistance, while near-term plans will likely mean negative cash flow for the foreseeable future.

One way analysts get round this situation is to look at revenue multiples or enterprise value-to-sales, which is basically market cap less net cash. Blue Prism currently trades on 9.9 times this year's expected £93.8m revenue.

That is bound to look punchy compared to more mature businesses, yet balancing against its main peers UiPath and Automation Anywhere provides useful perspective.

Detailed data is hard to obtain for these privately-owned, venture capital-backed rivals. Yet based on revenue estimates from market intelligence website Owler, we estimate peer sales multiples of 25 to 30-times, a massive premium to Blue Prism.

Analysts at Shore Capital have done similar calculations and have come to an even bolder conclusion: 'Taking the average of the recent private equity valuations for UiPath and Automation Anywhere implies a short-term fair value for Blue Prism of $2.4bn (or £27 per share).' That is nearly double its current share price of £13.98.

GROWTH ASSUMPTIONS

If we assume revenue grows at 50% a year on average for the five years beyond the current forecast range (which stretches to 2020) then 2025 revenue could be in the region of £1bn.

Let's assume sales and marketing costs come down as a percentage of revenue from the 80%-odd expected in 2020, and other operating expenses expand at a slower rate than sales, given the recurring revenue nature of most of Blue Prism's income.

You could then see how the company might become very profitable on a reasonable, mid-range time frame.

We believe that is by and large what will happen, and believe Blue Prism's shares are still attractive for investors willing to play a longer game.

By **Steven Frazer**
News Editor

Is Shanghai's stock market ready to surprise?

We explain why the market is down and what it might take to trigger a recovery

China's latest lunar year started on 5 February and investors will be delighted to welcome the Year of the Pig and say goodbye to the Year of the Dog.

China ranks dead last in capital, local-currency returns from Asian markets over the past 12 months so its stock market has, frankly, been a dog.

CHINESE EQUITIES HAVE BEEN TERRIBLE PERFORMERS OVER THE PAST 12 MONTHS

Source: Refinitiv. Local currency, capital returns.

It remains to be seen whether the Year of the Pig can bring some portfolio cheer but the downbeat Year of the Dog still brings three valuable lessons:

1. **Economic growth does not guarantee positive stock market performance, at least in the short term.**

Chinese GDP grew by 6.4% year-on-year in the fourth quarter of 2018, a number that any nation in the West would kill for, but this was still disappointing.

It represented the slowest growth rate for a decade and doubts lingered over the quality of the growth, too, given its apparent reliance on government stimulus and debt.

2. **Fund flows are never enough on their own to take a market higher.**

In 2018, index constructors such as MSCI and FTSE Russell began to include onshore Chinese

A-class shares, and not just Hong Kong-traded H shares, in their benchmarks.

This prompted much chatter about a wall of money piling into Chinese stocks, not least because passive trackers, such as exchange-traded funds (ETFs), could have to buy to reflect the new, increased weighting given to China.

The money may have flowed but it did not help the performance of Chinese stocks as technical buyers were clearly accommodated by plenty of willing sellers.

3. **You can have good news and cheap stocks, just not both at the same time.**

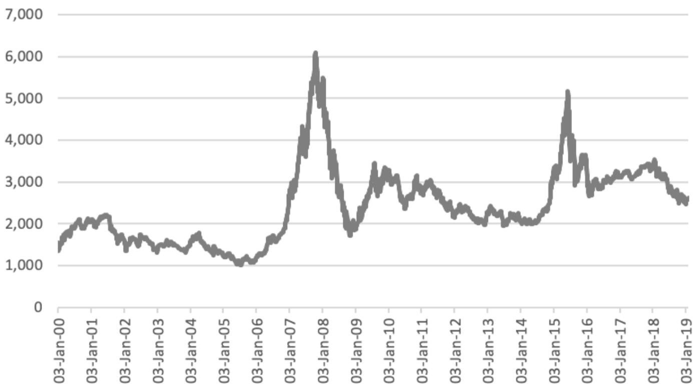
Buying Chinese or China-related stocks when the country's economy was booming could have led investors astray, as they would have been buying when those valuations and expectations were highest, downside protection was at its thinnest and the asset class at its most dangerous.

By contrast there seems to be precious little good news around, at least if the Shanghai Composite index is any guide.

STEEP DE-RATING

The benchmark is no higher now than it was in January 2007 – and that may be good news. Depending upon whose estimates and which index you use, analysts' forecasts put Chinese stocks on around 10.5 times forward earnings for 2019, down from 14 to 15-times a year ago.

THE SHANGHAI COMPOSITE IS TRADING AT BARELY HALF OF ITS ALL-TIME HIGH



Source: Refinitiv

Such a steep de-rating points to a major loss of faith in Chinese stocks. It also suggests that it may not take too much to go right to persuade money to return, since expectations are now lower and thus easier to beat.

It is therefore a worthwhile exercise to look at why Chinese stocks disappointed, to see if any of these headwinds from 2018 can become a tailwind in 2019. Three key issues seem to have clouded the outlook:

- **Oil.** China is a net buyer of crude so oil's rise to $80 a barrel in early 2018 increased costs for corporations and squeezed profit margins. But oil has since settled back to $60 which is potentially helpful.

- **The dollar.** This column regularly notes the apparent negative correlation between emerging market assets and the dollar. If the buck rises, emerging markets seem to struggle and vice-versa, not least because so much emerging market debt is dollar-denominated.

A strong US currency makes it more expensive to service this borrowing, sucking cash out of emerging market economies and hampering growth.

The dollar was strong in 2018 and China's renminbi was weak. But the US Federal Reserve's possible U-turn on further interest rate increases in 2019 and hints it could slow or stop its programme to shrink its balance sheet and withdraw quantitative easing are hugely important. The dollar is softening and the renminbi is rallying.

CHINA'S CURRENCY SEEMS TO BE STABILISING

Source: Refinitiv

- **Trade**. This remains the most unpredictable element, given the ongoing negotiations between Washington and Beijing.

If no deal is reached by the 2 March deadline and US President Donald Trump slaps 25% tariffs on all $500bn+ of China's exports to the US that will hurt China (and quite possible America, too, not that the White House sees it that way).

But Beijing is looking to support its economy, via tax cuts for consumers and lower pension contributions for corporations.

These changes are more subtle than 2016's debt-funded spending spree on fixed assets and property. They may bring longer-term benefits in the form of rising consumption and more productive investment, even if those benefits are less immediate.

Debt and growth remain huge long-term issues and the trade talks remain a key near-term catalyst. But at least Chinese stocks are discounting a negative outcome so any trade deal with the US could be the first step on the road to recovery for the downtrodden Shanghai stock market and firms who sell into China.

By **Russ Mould**
AJ Bell Investment Director

Which companies are potential takeover targets in the healthcare sector?

We explain why the broader sector is seeing increased M&A activity

Corporate activity in the healthcare sector is heating up. **GlaxoSmithKline (GSK)** and US rival Pfizer plan to marry their consumer health businesses in a £10bn joint venture. Bristol-Myers Squibb has made a $74bn takeover offer for Celgene and Eli Lily is to pay $8bn for Loxo Oncology.

Analysts are confident the mergers and acquisitions (M&A) trend still has legs in the sector and many believe there are numerous potential takeover targets among London-listed stocks including **Indivior (INDV)**, **CareTech (CTH:AIM)** and **Consort Medical (CSRT)**.

While buying a stock purely for takeover potential is risky, in case it doesn't happen, it is worth understanding what's driving the latest bout of M&A and to spot any shared characteristics among the targets.

WHY ARE THE DEALS HAPPENING?

There are various reasons why takeovers and mergers have happened of late. Principally, large drug companies have struggled to create enough replacements for old blockbuster drugs which have lost patent protection so they are buying rival companies to access new products and treatments.

Pharmaceutical firms have also been seeking complementary drugs and treatments as many try to refine their focus and concentrate on certain niches.

Others have simply decided that buying new developments is easier, faster and potentially cheaper in the long run than ploughing large amounts of money into research and development.

And some are making strategic moves to reposition their portfolio with a view to strengthening certain segments and then selling them off or separating them.

That is certainly the case with GlaxoSmithKline which will have a 68% controlling stake in its new consumer healthcare venture with Pfizer. It will demerge and float the business within three years, thereby splitting GlaxoSmithKline into two distinct businesses: one focused on consumers, the other on pharmaceuticals and vaccines.

In the broader field, many medical device makers and healthcare service providers are also seen to be takeover candidates.

TAKEOVER TARGETS OF VARYING QUALITIES

Some takeover targets are companies with promising drugs or treatments, or established firms making good profit. Others are struggling firms who may benefit from being owned by a larger company with deep pockets and widespread expertise.

Healthcare companies which have suffered a delay or product failure, but which still have something to offer to a third party, may be vulnerable to a low-ball bid if they are strapped for cash.

Clinical trials are extremely

expensive and could spiral to millions of pounds, so investors may be less willing to back a drug company with more money if a major setback occurs during the trial process.

Peel Hunt analyst Amy Walker argues companies with multiple Phase III assets (either in the middle of Phase III trials or successfully completed them) are likely to be at the top of any M&A list as most of the hard work will be done bar approval and commercialisation.

Companies that have overcome problems could also be bid targets. For example, last November Boston Scientific offered £3.3bn for global healthcare company **BTG (BTG)**. The target had previously suffered setbacks including a £53.5m payout for damages for breaching a distribution deal and a £150m impairment charge for severe emphysema treatment PneumRx Coil.

In the run up to the takeover, BTG upgraded its pharmaceutical sales guidance twice, illustrating it was on the road to recovery.

WHY IS INDIVIOR A POTENTIAL TARGET?

Investment bank Stifel suggests addiction specialist Indivior could be snapped up by someone else.

'With a low valuation, strong balance sheet, steady growth of Sublocade, as well as Perseris awaiting launch, we believe Indivior is now an attractive acquisition target,' says Stifel analyst Max Herrmann.

Herrmann believes global biopharma firm Alkermes could be an ideal partner for Indivior as taking over the business would make the suitor immediately

profitable and diversify the company's treatment range.

Indivior had a torrid time last year after tussling with rival Dr Reddy's Laboratories over its attempts to sell a generic version of Indivior's sublingual film product Suboxone to treat opioid addiction.

Panmure Gordon analyst Julie Simmonds doesn't see Indivior as a takeover target, flagging ongoing legal battles and reimbursement issues for Sublocade as possible deterrents – although one could argue some or all of these risks are already priced into its low valuation.

It is trading on 11.3 times current year earnings and an EV/EBITDA (enterprise value-to-earnings before interest, tax, depreciation and amortisation) ratio of 1.5-times, according to Refinitiv data.

CARETECH'S ROUTE TO THE UK MARKET

Simmonds says residential care home specialist CareTech is a potential target. The healthcare business has historically enjoyed strong growth and is cheap compared to its peers.

CareTech trades on a 7.8 times forecast earnings per share for the year to 30 September 2020 compared to an average of 13.5 times for its peers, according to Refinitiv data.

Simmonds believes CareTech is potentially attractive to overseas companies looking for a strategic entry into the UK residential care market where it has a 5% market share.

The company last year bought Cambian for £372m, expanding its presence in services for children and specialist education.

CONSORT MEDICAL'S COMEBACK

Consort Medical is another potential takeover target, says Simmonds. Its share were struggling between 2017 and late 2018 but have started to pick up more recently.

In 2017, Consort's partner Mylan had its launch of generic asthma treatment Wixela blocked by US authorities. Consort manufactures the device used in Wixela which is Myland's version of GlaxoSmithKline's Advair treatment.

The setbacks triggered a series of events including a £3m pre-tax profit hit for Consort as Mylan had a lot of inhalers that were yet to be sold before approval, suppressing demand for more stock.

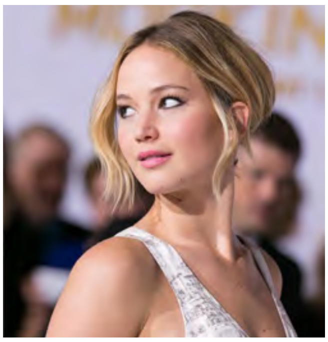
The US authorities have now approved Mylan's Wixela product which has helped to renew market interest in Consort's shares.

By **Lisa-Marie Janes**
Reporter

INDEX

KEY

- Main Market
- AIM
- Investment Trust
- Fund
- Exchange-Traded Fund
- IPO Coming Soon



KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

11 Feb: Acacia Mining. **13 Feb:** Smurfit Kappa, Tullow Oil. **12 Feb:** Plus500. **14 Feb:** AstraZeneca, Coca-Cola HBC, ConvaTec, Indivior, Micro Focus, Moneysupermarket.com.

Half year results

13 Feb: Dunelm, Galliford Try. **14 Feb:** Ashmore, MJ Gleeson.

Trading updates

8 Feb: SSE. **12 Feb:** AA. **14 Feb:** Safestore.

WHO WE ARE

EDITOR: Daniel Coatsworth @SharesMagDan

DEPUTY EDITOR: Tom Sieber @SharesMagTom

NEWS EDITOR: Steven Frazer @SharesMagSteve

FUNDS AND INVESTMENT TRUSTS EDITOR: James Crux @SharesMagJames

SENIOR REPORTER Ian Conway @SharesMagIan

REPORTER: Lisa-Marie Janes @SharesMagLisaMJ

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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Designer: Matt Ely

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