

SHARES

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PLUS

TESCO'S SHARES
RACE AHEAD
WHILE PEERS
ARE DISTRACTED

ARE TWO HEADS
EVER BETTER
THAN ONE AT
THE TOP OF A PLC?

MANY GLOBAL
EQUITY FUNDS
FAIL TO ADD
VALUE

Many global equity funds fail to add value

One manager says something has to be done to separate the winners and losers

Three quarters of actively-managed funds with a global equity mandate have underperformed the MSCI World index since 11 November 2010, according to data from Trustnet.

Put another way, buying a passive exchange-traded fund tracking this index, which covers mid and large cap stocks from 23 countries, would have been one of the most rewarding ways of playing this market.

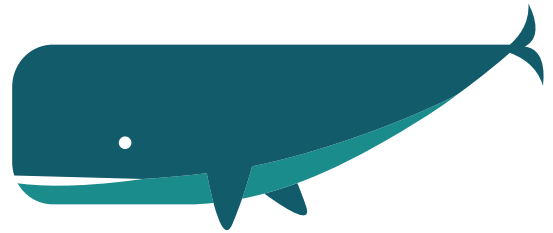
The IA sector average total return over this period was 105.2% versus 146.1% from the MSCI index. This outcome may surprise readers who are used to tapping into the services of fund managers to play global markets.

It goes to show that passive products shouldn't be dismissed and it also acts as a reminder to check whether any actively-managed fund in your portfolio is really adding value.

The starting point for this research exercise is important as 11 November 2010 was when **Fundsmith Equity (B41YBW7)** was launched. This fund has become very popular for good reason: it is the best performing fund in the IA Global category since that date with a 311.7% total return.

If you re-run the data from 11 September 2017 you will find that two thirds of funds in the IA Global category underperformed the MSCI World index – the latter delivering an 8.3% total return versus the 6.5% average from IA Global category. That date marks the launch of **Blue Whale Growth Fund (BD6PG56)** which has subsequently become one of the best performing funds in its category.

Blue Whale fund manager Stephen Yiu argues there are too many underperforming funds on the market and something has to be done about it such as relegating the worst to a lower league. He boldly claims that Fundsmith and **Lindsell Train Global Equity Fund (B3NS4D2)** are the only true competitors to Blue Whale in the IA Global category.



'We've all got highly concentrated portfolios, all with high conviction. Investors who don't want a passive product really have two choices – they either buy a global fund with a 75 stock portfolio or split their investment across Fundsmith, Lindsell Train and Blue Whale. I think you would do better with the latter approach,' says Yiu.

Interestingly its ascent comes at a time when Fundsmith is growing to become a gigantic monster worth £17.5bn. Its concentrated portfolio approach means that the bigger it gets, the higher up the market cap spectrum it has to go to invest if the money is spread out fairly equally. One could suggest it may soon reach a point where it doesn't want any more money to manage and could soft close its fund. Yet that seems unlikely.

A spokesperson says Fundsmith has 27 stocks with an average market capitalisation approaching £100bn, adding: 'If we owned 1% of each company – not a particularly illiquid position – the fund would be some £27bn, so much bigger than it is now.'

Blue Whale is tiny compared to these two other funds although it is now running £100m of assets versus £25m at launch, achieved through a mixture of new inflows and market gains. It has achieved 24.2% total return since launch 18 months ago. This top quartile performance has certainly helped it to grab the market's attention although investors will need to wait for another few years to assess whether its gains were down to luck or skill.



By **Daniel Coatsworth** Editor

Avoid distracting headlines



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SHARES AS
A PDF?**

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securities, derivatives or positions with spread betting organisations that they have an interest in should first clear their writing with the editor. If the editor agrees that the reporter can write about the interest, it should be disclosed to readers at the end of the story. Holdings by third parties including families, trusts, self-select pension funds, self select ISAs and PEPs and nominee accounts are included in such interests.

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**To know local
companies,
keep local
company.**

LET'S TALK HOW.



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

PAST PERFORMANCE

	Jan 14 – Jan 15	Jan 15 – Jan 16	Jan 16 – Jan 17	Jan 17 – Jan 18	Jan 18 – Jan 19
Fidelity China Special Situations Net Asset Value	41.2%	-2.9%	45.4%	42.3%	-19.2%
Fidelity China Special Situations Share Price	33.9%	-7.8%	52.5%	46.9%	-20.6%
MSCI China	29.5%	-16.7%	39.2%	43.6%	-13.4%

Past performance is not a reliable indicator of future returns. Source: Morningstar as at 31.01.2019, bid-bid, net income reinvested. ©2019 Morningstar Inc. All Rights Reserved. The comparative index of the Investment Trust is MSCI China.



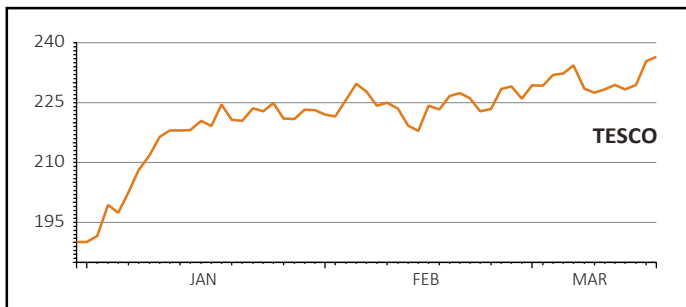
Fidelity
INTERNATIONAL

Tesco's shares race ahead while peers are distracted

The supermarket group has concentrated on the day job and the effort is paying off

Full year results from grocery giant **Tesco (TSCO)** on 10 April will reveal if the supermarket titan has extended an impressive run of quarterly sales growth.

With rivals **Sainsbury's (SBRY)** and **Marks & Spencer (MKS)** both distracted by strategic activity, Tesco has been quietly focusing on improving the core business, an approach that has helped the shares rise 24% to 235.6p so far this year.



In a trading update on 10 January, Dave Lewis-led Tesco reported a twelfth consecutive quarter of growth for the core Tesco UK business, a strong Christmas showing benefiting from an increasingly competitive offer for shoppers.

Tesco also flagged ongoing improvements in the quality of its business in Central Europe, not to mention a stronger underlying performance in Asia.

Investors will be looking for news of fourth quarter progress in the core chain, as well as confirmation Tesco is working towards Lewis' 3.5%-to-4% medium term operating margin target.

Bulls also expect Tesco to benefit from synergies and free cash flow following the 2017 takeover of Booker.

Shore Capital believes there is scope for pleasant surprises from the group for investors, particularly around free cash flow, that could increase dividend cover and set out a course for special dividends and/or a share buyback.

According to the latest Kantar Worldpanel grocery market share figures (5 Mar) for the 12 weeks ending 24 February, year-on-year sales growth in the ultra-competitive supermarkets



industry held steady at 1.9%.

While Tesco's market share fell by 0.2 percentage points to 27.7% amid further market share incursions by Aldi and Lidl, it achieved 1.3% sales growth in the period as customers bought 2% more items on each visit.

In contrast, Sainsbury's sales fell 1% and its market share waned 0.5 percentage points to 15.7%.

Last month a report from the Competition and Markets Authority cast doubt over whether Sainsbury's would be allowed to merge with Asda. However, Sainsbury's continues to fight back and argues there are benefits to consumers from combining the companies.

Without a boost from Asda, Sainsbury's is looking weak as a standalone business which has positive implications for Tesco.

Investors should note that Tesco will soon start to use a new accounting rule called IFRS 16. Although earnings downgrades are expected to filter through following the change, Tesco says the new accounting rule has no economic impact on its business, nor does it change the way the business is run.

However, it does have a significant impact on the way assets and liabilities are classified and the classification of cash flows. Further details on how IFRS 16 impacts companies can be found in this [feature](#).

Worldpay swoop takes value of 2019 global mega-deals above \$300bn

We examine the global M&A situation following the \$43bn bid

A recommended \$43bn takeover offer for **WorldPay (WPY)** from US financial technology firm FIS shows the value placed on payment processing assets amid structural growth in digital payments.

It also emphasises the need for scale in this space and highlights the M&A surge seen so far in the first quarter of 2019.

Worldpay, which was taken over by US peer Vantiv only two years ago, processes upwards of 40bn payment transactions a year across hundreds of countries and currencies.

Its leading position in e-commerce payments should position it to benefit from the ongoing increase in the amount of shopping done online across the globe. This clearly appealed to FIS which provides software for payment processing and other services to the banking industry.

Under the terms of the deal Worldpay shareholders are principally being paid in FIS stock (listed on the New York Stock Exchange) with a relatively modest cash element.

Interestingly, it is second largest mega-deal of the year worldwide according to financial data group Refinitiv, with mega-deals defined as \$5bn and upwards. The year-to-date total value of such transactions has hit \$354.3bn.

At the same point last year, the total value of global mega-transactions was more than \$500bn but as the chart demonstrates that was an exceptional period and transactions tailed off amid market turbulence in the second half of 2018.

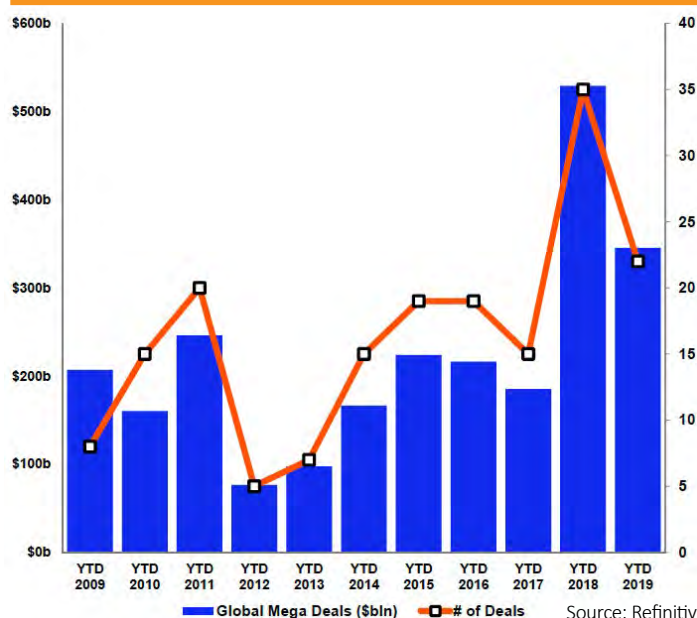
Many of the conditions to stimulate deal-making remain in place. Debt is still cheap and freely available with the US Federal Reserve seemingly

DID YOU KNOW?

Worldpay was once owned by Royal Bank of Scotland but it was forced to sell in the wake of the financial crisis



KEEPING TRACK OF LARGE M&A DEALS



hitting pause on rate rises. Most estimates put corporate cash piles in the US alone at more than \$2trn. Analysis by US publication *Business Journals* put the total at \$2.7trn in December 2018.

Weaker market sentiment amid signs global growth is beginning to wane may affect corporate appetite to spend large amounts of money.

Fund managers with 20+ years at the helm significantly beat the market

New figures illustrate the extent to which long-standing managers have shone

Approximately 50 funds have a 20-year track record of being run by the same fund manager. These managers will have invested through all market cycles. They will know their investment markets inside out, they will have been burnt by their past investment errors and will hopefully be wise to these traps in the future.

The table shows a selection of managers from the bigger-sized funds that qualify for the list. All the fund managers highlighted have beaten their peer group over the same period of time, and some by dramatic amounts.

John Chatfeild-Roberts and Algy Smith-Maxwell have more than doubled the returns of their peer

group on the Jupiter Merlin Worldwide and Growth portfolios, while Harry Nimmo has delivered almost double his peer group average on the **Standard Life Investments UK Smaller Companies Fund (B7FBH94)**.

The figures show how well funds focused on small companies have done – over the past 20 years the average UK small companies fund has delivered more than 550% return, but the long-serving managers in the list have handed investors nearer 1,000% return. Giles Hargreave at **Marlborough Special Situations (B907GH2)** has rewarded investors with an impressive 2,470% return over that time.

A SELECTION OF FUND MANAGERS WHO HAVE RUN THEIR FUNDS FOR MORE THAN 20 YEARS

Fund	Manager tenure	Fund manager	20-year performance (%)	Peer group 20-year performance
Aberdeen New Dawn Investment Trust, Asia Pacific Equity, & Asia Pacific & Japan Equity	29, 31 & 33	Hugh Young	1,311.2% 885.9% 583.1%	174.7% 579.0% 400.3%
Aberforth Smaller Companies Trust	28	Alistair Whyte & Richard Newbery	928.9%	194.5%
BlackRock World Mining	21	Evy Hambro	668.4%	260.4%
City of London Investment Trust	27	Job Curtis	248.8%	78.1%
Herald Investment Trust	25	Katie Potts	545.20%	300.3%
JPM Emerging Markets & Emerging Markets Investment Trust	21 & 25	Austin Forey	721.1% 1,034.1%	541% 1,015.8%
Jupiter Merlin Income Portfolio, Worldwide Portfolio & Growth Portfolio	21	John Chatfeild-Roberts and Algy Smith-Maxwell	217.2% 361.9% 388.5%"	114.8% 188.4% 163.9%
Lazard Emerging Markets	21	James Donald	621.9%	541.0%
Legg Mason IF Japan Equity	22	Hideo Shiozumi	614.5%	148.7%
Liontrust UK Smaller Companies	21	Anthony Cross	954.6%	555.3%
Marlborough Special Situations	20	Giles Hargreave	2470.3%	555.3%
Mercantile Investment Trust	25	Martin Hudson	961.4%	92.6%
Standard Life UK Smaller Companies	22	Harry Nimmo	995.8%	555.3%
Worldwide Healthcare Trust	23	Sven H Borho	1691.4%	481.7%

Source: AJ Bell. Data to 08/03/19.

News on ASOS, JD Sports, Restaurant Group and more over the past week

We explain the reasons behind some of the biggest share price movements

After a big profit warning in December 2018, online fashion retailer **ASOS (ASC:AIM)** disappointed again on 19 March with its first half update, leading the shares to sink more than 8% to £29.43.

Although previously-reduced full year sales growth guidance was reiterated at 15%, margin pressure linked to discounting was reported.

Hitting the 15% target will also require a material improvement in trading in the second half given sales only increased by 11% in constant currency terms in the first half.

The company also reported capacity problems in the US which resulted in a short-term hit from delayed shipments and a backlog of orders amid strong demand. While frustrating, this does at least hint at some promise for its North American operation.

Edison Investment Research analyst Paul Hickman says: 'ASOS's first half trading statement isn't as reassuring as might have been hoped following its shock downgrade in December.'

TAKEOVER TIME

On 18 March retailer **JD Sports Fashion (JD.)** announced the £90.1m takeover of its troubled rival **Footasylum (FOOT:AIM)**. JD had previously increased its stake in the company to 18.7% in February but at the time ruled out making a bid.

The 82.5p per share offer looks quite generous in the context of Footasylum's previous market closing price of 46.5p but is only around half the 164p price at which it joined the stock market in October 2017.

ASOS is targeting 15% sales growth for the full year but only achieved 11% growth in the first half

COMEBACK TIME?

On 15 March Wagamama-owner **Restaurant Group (RTN)** saw its shares marked sharply higher to nearly 140p as it reported full year results.

The market reaction was surprising given the group flagged a decline in profit, cash flow and like-for-like sales but investors focused on a recent improvement in performance. Like-for-like sales were up 2.8% in the 10 weeks to 10 March 2019.

Wagamama's sales increased by 9.1% in the 12 weeks to 3 February. And the company has also outlined plans to potentially cut the number of Frankie & Benny's sites by a third, and flagged good growth from its travel outlet sites and pubs.

Elsewhere, on 14 March diversified global property play **Savills (SVS)** saw its shares experience selling pressure as 2018 numbers were accompanied by a downbeat outlook.

Despite a 'solid start', the company expects to see transactions fall in 2019 as global economic and political uncertainties hit demand.

JD SPORTS' BID FOR FOOTASYLUM VALUES THE COMPANY AT LESS THAN 50% ITS MARKET CAP AT IPO

Law Debenture is cheap and could bounce once Brexit is sorted

This unique investment trust trades on a wide discount despite dividend growth and defensive attractions

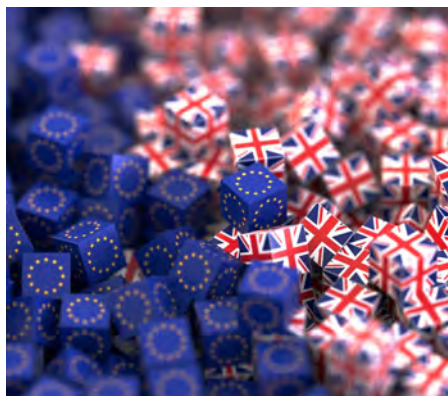
There is a rare chance to pick up an unusual but very attractive investment trust trading on a wider than normal discount to its net asset value (NAV) at 13.2% versus a 12-month average of 11.8%. You also get a dividend currently yielding 3.3%.

Law Debenture (LWDB) is an investment trust with a twist – in addition to a portfolio of stocks it also provides services to corporate trust and pension trustees. This provides an added element of diversification for investors that ensures the performance of the trust isn't solely reliant on the direction of the stock market.

A period of lacklustre performance, partly explained by a high UK weighting relative to global peers, has impacted sentiment towards Law Debenture, but that could change as Brexit uncertainty recedes and the performance of the professional services business improves. A low ongoing charges figure of 0.43% only adds to the trust's competitive allure.

Law Debenture seeks to achieve long term capital growth in real terms and steadily increasing income – aiming to generate a higher rate of

LAW DEBENTURE BUY
(LWDB) 578p
Stop loss: 462.4p



total return than the FTSE All-Share – via a diverse portfolio of investments spread both geographically and by sector.

Its portfolio is managed by James Henderson and Laura Foll at asset manager Janus Henderson. The professional services arm provides an important revenue stream that supports the payment of a higher dividend without constraining the manager to focus exclusively on higher-yielding stocks.

Encouragingly, the professional services arm performed strongly in its first full year under the new management team of Denis Jackson (CEO) and Katie Thorpe (CFO), a pair seeking to increase the growth of the business.

Law Debenture's 2018

NAV total return was -5.8%, negative in absolute terms, but comfortably ahead of the FTSE All-Share's total return of -9.5% as the low beta, defensive nature of the portfolio protected investors from the worst of the market decline.

Crucially, the trust has performed well in absolute terms over the three, five and 10 years to January 2019 and the total dividend was increased 9.2% to 18.9p in 2018, meaning the trust has a 44-year record of maintaining or increasing the shareholder reward.

While Law Debenture invests globally, the main focus is on quality UK companies trading at depressed valuations. As such, *Shares* sees scope for the portfolio to produce strong returns once Brexit uncertainty dissipates.

Towards the end of 2018, Henderson and Foll took advantage of market weakness to add to existing holdings including life insurance giant **Prudential (PRU)**, cruise operator **Carnival (CCL)** and homewares retailer **Dunelm (DNLM)**.



By James Crux
Funds and Investment
Trusts Editor



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Jersey Oil & Gas is about to quantify its North Sea discovery

The small cap has several other catalysts lined up in 2019

Oil exploration is a notoriously risky enterprise. It is often seen as an activity with a binary outcome for listed companies – either they find oil and the share price gushes higher, or they don't and the shares crash.

However, we've spotted a small cap oil play which is drilling a well that could provide a significant catalyst for the stock but with the potential for much more limited downside if the news disappoints.

AIM-quoted **Jersey Oil & Gas (JOG:AIM)** two years ago made a large discovery in the North Sea. Verbier is located on the P2170 licence in which Jersey has an 18% stake and is partnered by Norway multinational Equinor and a subsidiary of Japanese conglomerate Itochu Corporation in CIECO UK.

The partners are currently drilling an appraisal well to determine just how much oil it has found. The results are expected by the middle of the second quarter this year.

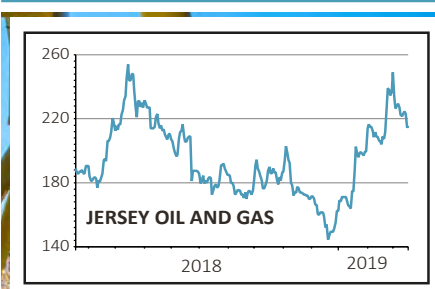
Current estimates put the size of the discovery at between 25m and 130m barrels of oil equivalent. And, according to analysis from broker FinnCap, the shares are currently pricing in something towards the lower end of that spectrum.

JERSEY OIL & GAS  **BUY**

(JOG:AIM) 213.8p

Stop loss: 171p

Market cap: **£46.7m**



Proving up the mean estimate of resources at 69m barrels of oil equivalent could be worth 500p per share and the upper end would have a value of £10 per share, multiples of the current share price.

This is one of at least three prospective drivers for the shares in 2019. 3D seismic is currently being shot over P2170 and this could be a precursor to firming

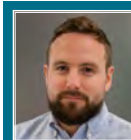
up a drilling plan for the Cortina prospect, possibly in 2020.

The other catalyst is the results of its participation in a North Sea licensing round. This encompasses acreage around Verbier which Canadian bank BMO believes could contain an undeveloped resource of up to 300m barrels of oil equivalent. News on this front is expected at some point in the second half of the year.

With more than £20m worth of cash on the balance sheet at the last count and zero debt, the company is well funded for its 2019 capex requirements of between £7m and £10m.

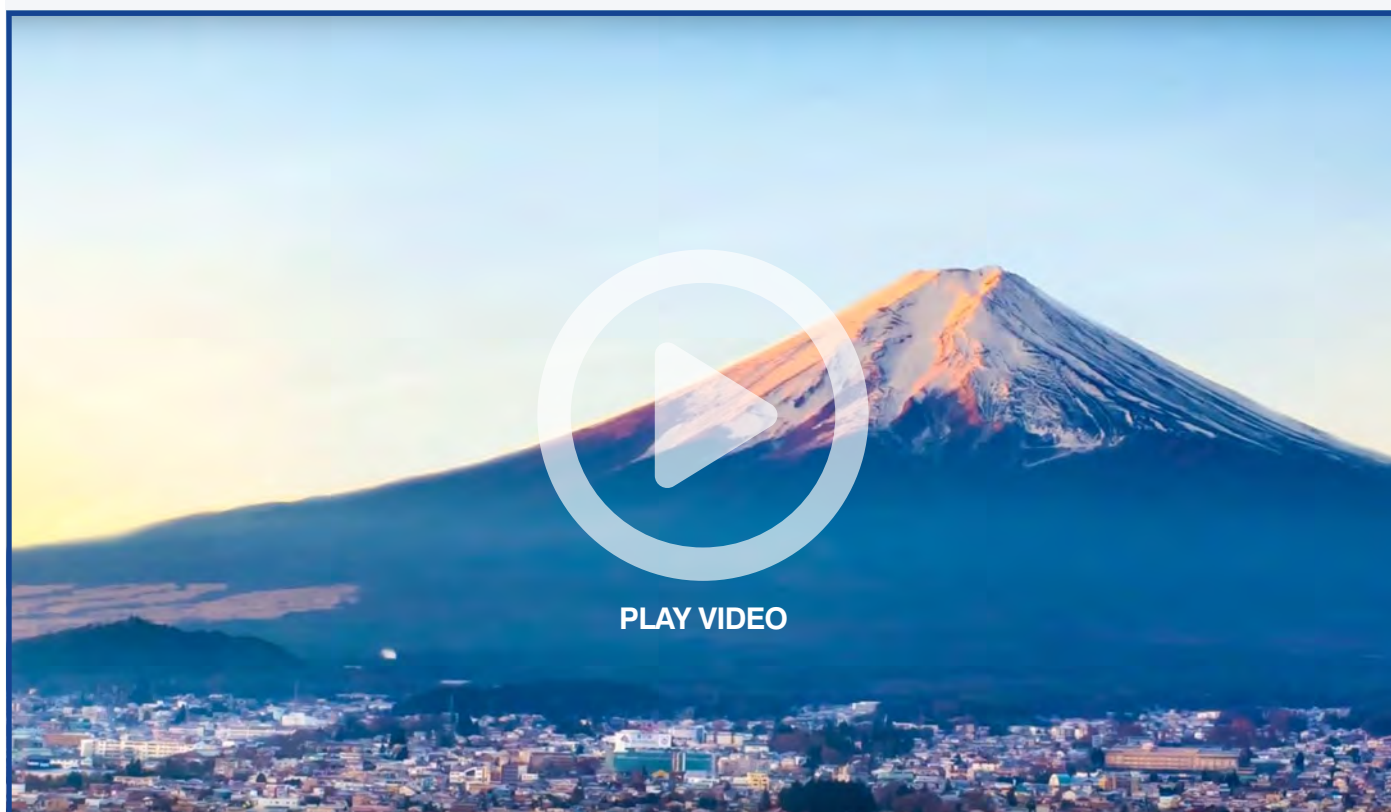
The company is also on the hunt for acquisition opportunities in the North Sea to add some producing assets to its portfolio. This would offer cash flow to help fund future activity and would also take advantage of the tax losses Jersey has racked up by investing in exploration as these can be offset against production revenue.

However, it is being picky having assessed and rejected somewhere around 50 deals. We find this patience reassuring.



By **Tom Sieber**
Deputy Editor

Introducing Witan Pacific Investment Trust



PLAY VIDEO

Witan Pacific is the only investment trust of its kind; with a strategic focus across the entire Asia Pacific region. The trust takes advantage of key opportunities across this region, such as Chinese growth and Japanese ingenuity by using a multi manager approach. This means we choose fund managers to run different parts of the portfolio based on their individual

strengths with the aim to smooth out the volatility that can arise from being dependant on a single manager.

This short video introduction to Witan Pacific Investment Trust explains the trust's key strategies and multi manager approach.

www.witanpacific.com

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CINEWORLD

(CINE) 298p

Gain to date: 12.7%

Original entry point:

Buy at 264.4p, 3 May 2018



Cineworld's (CINE) ownership of US cinema chain Regal Entertainment is going better than expected, helping to put the share price back on an upward trajectory.

It has increased anticipated synergies from the deal by 50% to \$150m, having achieved \$70m synergies in its 2018 financial year versus a planned \$40m to \$45m.

US operations have been very good with admissions up 4.9% and box office revenue rising by 7.2%. Encouragingly, US retail income which relates to food and drink sales increased by 8.2%.

Chief executive Mooky Greidinger says Cineworld will sign up a food and drink partner in the US as the business tries to emulate the success it has seen in the UK from having Starbucks cafés located inside cinemas.

UK admissions slipped by 2.6% in the year with the company blaming the World Cup and the hot summer weather. Greidinger says he isn't worried in the slightest.

Work is underway to refurbish various Regal sites with Cineworld confident that income will increase once the cinemas are spruced up, based on the way other refurbishment projects have turned out.

SHARES SAYS: ↗

Large debt is still the main negative with Cineworld's investment case, yet trading is good and strong cash generation should help to pay down borrowings to more comfortable levels in time. Keep buying.

MITON GROUP

(MGR:AIM) 58p

Gain to date: 38.9%

Original entry point:

Buy at 41.75p, 5 April 2018



FUND MANAGEMENT FIRM Miton Group

(MGR:AIM) put in an impressive score-card this week sending the shares up 12% to 58p.

Thanks to £1bn of net inflows last year, assets under management at the end of December were £4.38bn while pre-tax earnings were £8.9m, an increase of 43%.

Chief executive David Barron puts the record inflows down to Miton's 'genuinely active approach' to investing which allows fund managers the freedom to pick stocks outside of their benchmarks to generate above-average returns.

The strategy clearly works with over 80% of Miton's funds in the first or second quartile for the third year running and the European Opportunities Fund ranking first in its sector on its third anniversary.

Barron also hails the firm's success on the sales and marketing front and the scalable nature of the platform, supported by good financial management.

Even after buying back and cancelling 5.5m shares last year at a cost of £2.6m, the group still ended 2018 with net cash of £25.5m.

Analysts at Liberum point out that prior to the results the shares were trading on 10 times 2019 forecasts excluding the cash pile which is a low multiple for a growing business.

SHARES SAYS: ↗

Miton is clearly getting it right and we can see further upside.

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Aberdeen Standard
Investments



Are two heads ever better than one at the top of a PLC?

As Standard Life Aberdeen brings its experiment with two chief executives to a close, we discuss if such a structure can really work

Less than two years since Standard Life and Aberdeen Asset Management merged, the enlarged group is finally dispensing with its unpopular co-CEO structure as Martin Gilbert is relegated to a different role.

The boss of Aberdeen Asset Management before the tie-up, Gilbert will remain with **Standard Life Aberdeen (SLA)** as vice chairman for the time being with a focus on client relations, although some speculate his days are numbered with the firm.

The news raises the question of why companies use a co-CEO structure in the first place. In this article we discuss whether there are ever any benefits of having two people at the top and the main criticisms of such an approach.

We also look at the other end of the spectrum where some companies dispense with having a separate CEO altogether and just combine the roles of chairman and chief executive.

DOUBLE THE COST

Having more than one chief executive is unusual and an obvious argument against having two CEOs is the cost. The combined pay packet of Gilbert and his erstwhile counterpart



Alison Hall and Julie Lavington, co-CEOs of Sosandar

Keith Skeoch, including bonuses, came in a little under £2m in 2018. And this was after a tough year for the company which saw outflows of £41bn and flat profit.

In 2017 their combined pay totalled more than £4.3m. It's no wonder some people joked that the company was getting

two chief executives for the price of three.

For smaller companies this could be even more of a burden. For example, cosmetics seller **Warpaint London (WPL:AIM)** also has a joint chief executive structure. The combined remuneration of Samuel Bazini and Eoin Macleod in 2017 was significantly more modest than that of Skeoch and Gilbert at £400,000 but this was still a material outlay in the context of a pre-tax profit for that year of £6.9m.

POTENTIAL FOR CLASHES

A second possible problem is a lack of focus and the potential for clashes at the top over strategy.

In the US media and merchandising company Martha Stewart Living Omnimedia introduced a co-CEO structure in 2008 under Wenda Millard and Robin Marino. But within 12 months and after reporting a \$15.7m loss, Millard left with chairman Charles Koppelman acknowledging there had been tension between the two individuals.

The co-CEO leadership of Germany's Deutsche Bank was widely perceived as a failure before the announced exit of



Source: Legal & General

Anshu Jain and Jurgen Fitschen in 2015. The struggles of their successor John Cryan, who was himself pushed out in 2018, suggests the company's problems may have run deeper than just its management structure.

The most long-standing co-CEO set-ups tend to be situations where the founders are heading up the company. For example, cousins and co-founders George Roberts and Henry Kravis have run private equity giant KKR together for years.

FOUNDERS IN FOCUS

Web-based women's fashion brand **Sosandar (SOS:AIM)** is run by co-founders and now joint chief executives Alison Hall and Julie Lavington and the company has enjoyed a decent start to life as a public company since listing in March 2018.

Online fast fashion play **Boohoo (BOO:AIM)** has also been a success story under joint CEOs who were also founders of the business. However, the company appears to have accepted that the next stage in its development requires a change of approach, with Mahmud Kamani and Carol

Kane recently agreeing to move into the role of executive chairman and executive director respectively and former Primark man John Lyttle taking sole charge.

CAN IT EVER WORK?

US software business Salesforce courted controversy by moving in the opposite direction and adding an extra CEO, with Keith Block stepping up from a chief operating officer role to join the company's founder Marc Benioff.

One of the key arguments for having two people at the top is that they might have different and complementary skill-sets. And the manager of global equity fund **Blue Whale Growth (BD6PG56)** Stephen Yiu, who holds Salesforce, observes that Benioff is best at 'culture, brand and vision' while Block excels at 'sales, operations and execution'.

Yiu adds: 'Ultimately, Block is a world-class executive. If his promotion to co-CEO keeps him at Salesforce as opposed to a competitor, then it's an excellent move on Benioff's part'.

CHAIRMAN AND CEO

So what about situations where rather than having two

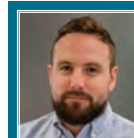
people operating as CEOs, there is just one person who combines the roles of both chairman and chief executive?

Legal & General Investment Management says separating the position of chair and CEO is generally advisable. It comments: 'The roles of chair and CEO are substantially different and therefore require distinct and complementary skills and experience.'

'While the CEO focuses on running the company's business, day-to-day operations, leading and executing the company's long-term strategy. The chair, along with the rest of the board, is responsible for overseeing the actions of management. They are expected to act as a counter-power and constructively challenge the executive directors.'

'In addition, the chair leads the evaluation of the board, including company management. They are also responsible for the running of the board, setting the agenda, board composition and succession planning matters, such as the recruitment of a new CEO.'

The chairman/CEO joint role has been more prevalent in the resources sector. For example, Randeep Grewal is chairman and CEO of Chinese coal bed methane play **G3 Exploration (G3E)** and Peter Levine has combined both roles at **President Energy (PPC:AIM)** since 2015 in a move explained at the time as a 'streamlining' exercise or, in other words, to save money.



By **Tom Sieber**
Deputy Editor

Brunner: the best of most worlds

LUCY MACDONALD

Portfolio Manager of The Brunner Investment Trust

Longevity and long-term conviction are two attributes that Investment Trusts have demonstrated over time. As Portfolio Manager of The Brunner Investment Trust (and an investor in Investment Trusts myself), I know that investors considering future investment decisions find it reassuring to look back in time, since these are amongst the very oldest forms of investment vehicle. Established in 1927, Brunner has demonstrated not only longevity over its 92 years but also an ability to deliver long-term income and growth returns in a sustained manner even when market conditions are uncertain, as they have been recently.

Our priority for Brunner is to build a global equity portfolio of around 70 strongly financed companies with good long-term growth prospects that are trading on sensible valuations. As Brunner's objective is to deliver growth in both capital value and dividends, the companies we choose need to meet certain criteria. We prefer companies in growing industries that can grow through their own innovation. We believe these are the sorts of companies that will allocate surplus capital well and invest wisely in both business and management. But, we also need companies that can provide a decent yield, to keep a core part of the dividend coming through.

Brunner has increased its dividend for 47 consecutive years, something that's very important to our investors and a source of pride for us. The Trust is high on the list of the Association of Investment Companies' dividend heroes, an elite list of companies that have increased dividends for 20 years or more.

For the stocks we choose, we aim to discover future winners before the crowd. The current market environment provides a challenging backdrop of tightening liquidity, slowing global economic growth and trade friction. But, as a 'bottom-up'-driven fund manager, we are confident that our stock selection process can cope with these challenges. It's helpful that, since we focus on companies, the Brunner portfolio is diversified across a wide range of sectors and geographies, without being overly exposed to any one theme or sector. We think of it as 'the best of most worlds'. Moreover, our bias for high quality companies with strong cash flows and low levels of debt should be a source of relative return and lower risk in the current climate.



**The Brunner
Investment
Trust PLC**

Right now, technology is a sector where we think we can find stocks with structural growth potential. Digitisation is having a massive impact on industry and commerce and we are all familiar with the digital heavyweights that have become part of our daily lives.

Cloud computing, social networking, online travel and gaming are all represented in the Brunner portfolio. And looking ahead, as many industries continue the shift online, we think it will be our ability to differentiate between those companies that are leading, and profiting from, the digitisation trends in their industries, while at the same time avoiding the losers. This holds the key to the Trust's future performance potential, but we are confident that our stock picking approach will continue to serve our valued investors well in the future.

To discover more about Lucy's investment approach, visit www.brunner.co.uk where you can register for regular updates.

Lucy Macdonald is CIO of Global Equities at Allianz Global Investors and is portfolio manager of The Brunner Investment Trust PLC. Brunner aims to provide its investors with growing dividends and capital growth by investing in a portfolio of global equities. Although past performance is no guide to the future, Brunner has paid a rising dividend to shareholders for 47 consecutive years.

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WAYS TO GET PAID IN RETIREMENT

We explain how to find suitable sources of income versus your risk appetite

Generating a steady income from the markets in retirement isn't as hard as you might think. Doing some basic research and understanding the risks involved with certain investment products are good starting points. In this article we'll discuss these topics and more in order to help you find that prized stream of cash.

Anyone deciding to stay in the markets instead of generating a fixed income through an annuity needs to think about where their money is invested. The goal is to earn a continuous stream of money through dividends as well as avoiding capital losses.

Investment funds can be a better route to take than individual shares as you should get instant diversification.

Actively-managed funds let you benefit from someone else doing all the hard work of picking stocks or other asset classes. Passive products such as exchange-traded funds typically come with

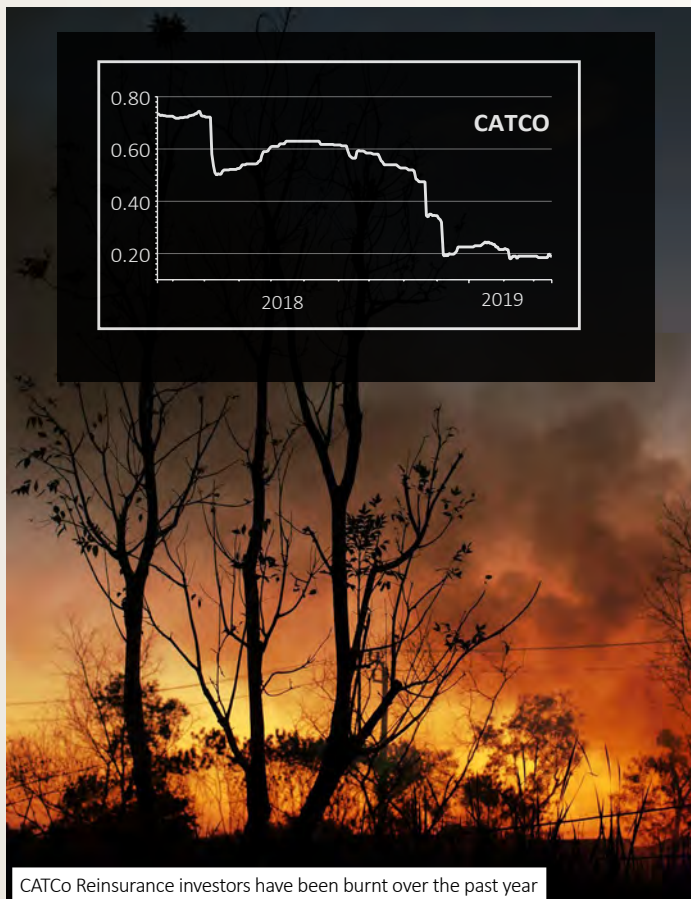
lower fees and let you track the performance of a wide range of markets, sectors or themes.

— DON'T JUST PICK THE HIGHEST YIELD —

There are plenty of options in the market but not all are good paths to follow. For example, some actively-managed funds may offer high yields because they are high risk products. You need to understand exactly what they are investing in.

Some passive products work off rules that track the highest yielding stocks. That sounds interesting but it is important to consider that many of the yields from the underlying portfolio are optically high because the market doesn't believe the earnings forecasts for the relevant companies and this has ultimately weakened their share price. A dividend cut could be just around the corner.

The key message is that knowing what to avoid is equally as important as knowing what to buy when it comes to investing.



ARE YOU BEING COMPENSATED ENOUGH FOR THE RISKS TAKEN?

The general rule in investing is that higher yields equate to higher risk. The yield is a way of compensating you for taking on extra risks.

Sources of higher yields include debt-related funds such as **Honeycomb (HONY)** which yields 7.1% and asset-backed investment trusts which include **TwentyFour Income Fund (TFIF)**, yielding 6.3%.

“ THE GENERAL RULE IN INVESTING IS THAT HIGHER YIELDS EQUATE TO HIGHER RISK ”

One of the highest yielding investment trusts is **CATCo Reinsurance Opportunities (CAT)** at 14.3%. On paper the yield is extremely attractive versus the typical sub-2% rates you would get on cash savings in the bank. However, look closer and you may think twice about wanting to get involved.

CATCo's strategy is to invest in insurance products linked to catastrophe reinsurance. The shares have lost three quarters of their value over the past 12 months as the managers got their risk models wrong and underestimated losses from US hurricanes and wildfires.

WHAT ABOUT INCOME FROM BONDS?

Bonds are often considered to be lower-risk products, particularly ones issued by governments or high-quality companies. The potential rewards are therefore lower because they are widely considered to be safer options when it comes to collecting the regular income they offer (known as coupons) and getting your capital back at the end of the bond term.

Someone in retirement may find the rates on bond funds are too low for their income needs. For example, **iShares Global Government Bond ETF (SGLO)** yields a mere 1.2%.

However, bond funds can still play an important role in a diversified portfolio, particularly if equity markets go through a rocky patch and you need to have at least some portion of your portfolio which isn't falling in value.

You can still make capital losses from bonds and there is no guarantee you will get your money back at the end so don't think of them as completely risk-free.

Going for equity income funds should get you a better rate of income but the returns are not always significantly better than cash or bonds. For example, **Neptune Global Income (B91RFZ2)** yields 2.29% compared to SmartSave which is paying 2% on a one-year fixed rate savings account.

You have to ask yourself whether such an equity income fund is worth the extra risk for a mere 0.29% additional income rate in this example.

ARE INFRASTRUCTURE FUNDS A GOOD OPTION?

Infrastructure funds have been popular among investors – both those accumulating wealth and those already in retirement – because many offer good yields, typically in the range of 4% to 6%. For example, **HICL Infrastructure (HICL)** yields 4.9% and

INFRASTRUCTURE TRUSTS TRADING AT A PREMIUM

INVESTMENT TRUST	PREMIUM TO NET ASSET VALUE
3i Infrastructure	29.1%
BBGI	24.8%
Bluefield Solar Income Fund	15.6%
Greencoat UK Wind	13.7%
GCP Infrastructure	13.2%
International Public Partnerships	10.0%
Greencoat Renewables - Euro	10.0%
Next Energy Solar Fund	9.7%
Sequoia Economic Infrastructure	8.0%
John Laing Environmental Assets	7.3%
HICL Infrastructure	6.0%
Foresight Solar Fund	5.5%
Gresham House Energy Storage	5.4%
Renewables Infrastructure Group	5.1%
SDCL Energy Efficiency Income	3.6%
Gore Street Energy Storage	0.3%

Source: Winterflood. Data as at 18 March 2019

Foresight Solar Fund (FSFL) yields 5.7%.

Infrastructure can be a good source of income because you get exposure to assets which generally have predictable cash flows and are often in highly regulated markets. However, infrastructure projects can encounter unforeseen delays, something which was the case with Foresight Solar in 2018.

Many infrastructure investment trusts trade at significant premiums to net asset value (often 10% or more) so you are paying much more than the value of the assets are worth. There is a risk the market goes off this sector and the shares de-rate back towards fair value. In this scenario you could be hit with a capital loss.

You may be better off looking at open-ended funds (unit trusts and Oeics) for exposure to infrastructure where you wouldn't pay a premium to net asset value. We've picked one later in this article.

Read on to discover its identity and five other funds which we believe to be good investment ideas for someone in retirement who is happy to take on some element of proportionate risk.

We suggest you consider most or all of them to act as a blended source of income. All the yield information refers to dividends paid in the past 12 months and none of the income payments are guaranteed. Any reference to the term 'OCF' stands for ongoing charges figure.

TWO NEW AJ BELL INCOME FUNDS BOTH TARGET 4% YIELD

AJ Bell has launched two new income funds which may suit someone who wants to obtain a better income than cash in a bank or building society account. They both aim to pay 4% yield although this is not a guaranteed return. The ongoing charges figure is capped at 1%.

The funds blend a mixture of passive products and actively-managed funds. **AJ Bell Income Fund (BH3W755)** is a multi-asset fund with investments in equities, bonds and property. **AJ Bell Income and Growth Fund (BH3W799)** is similar with the addition of alternative investments like infrastructure but no exposure to bonds.

'Our starting point is finding decent income for decent cost. For example, you can get passive infrastructure funds yielding 2% and costing 0.65%, yet there are also actively-managed funds yielding 4% for not much more cost,' says Matt Brennan, head of passive portfolios at AJ Bell.

He explains that some of the funds' income will be generated by passive products which follow specific rules to find dividend-paying assets.

'You can get ETFs that rank FTSE 350 stocks by yield. We don't like these products because you are chasing income at any cost. The ones we've selected have a quality income tilt. For example, one range we use is iShares Quality Dividend products which only includes companies which have strong fundamentals as well as a higher yield. This ensures the yield is not just high, but more importantly sustainable.'

The AJ Bell Income Fund may appeal to someone in the latter stages of retirement because the product has been designed to keep the capital fairly flat over time, although that isn't guaranteed to happen.

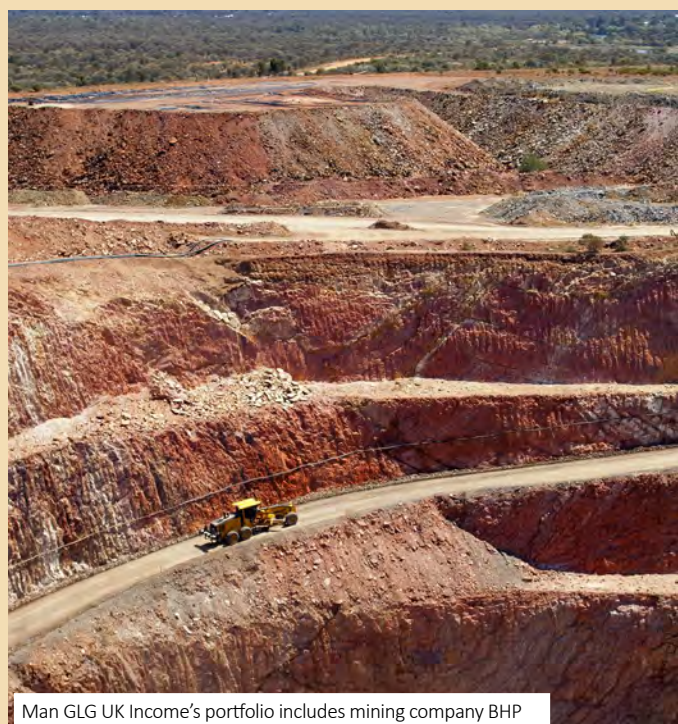
The AJ Bell Income and Growth Fund could suit someone either in the early stages of retirement who want their investments to keep growing, or even someone younger who likes the benefits of income or wants to enjoy compounding benefits by reinvesting all dividends.

SIX OF OUR FAVOURITE INCOME FUNDS FOR INDIVIDUALS IN RETIREMENT



TB EVENLODE INCOME (BD0B7D5)

YIELD: 3.30% – OCF: 0.90%



Man GLG UK Income's portfolio includes mining company BHP

Man GLG UK Income has minimal overlap with the aforementioned product from Evenlode as fund manager Henry Dixon takes a value rather than quality approach. He buys stocks that are much cheaper than you'd typically find in Evenlode's fund and the yield is greater at 4.29%.

He avoids value traps by focusing on cash, cash flow and assets. Value investing ultimately means buying something when it is cheap and selling when it becomes fair value. As such, the Man GLG fund can have high levels of turnover and so transaction costs can be elevated.

Dixon's track record is good: the fund has delivered 8% annualised return over five years, twice that of the market. Miner **BHP (BHP)**, housebuilder **Bellway (BWY)** and banking group **Lloyds (LLOY)** currently feature in the portfolio of approximately 70 stocks. Dixon also invests in some corporate debt and convertible bonds.

This should be a core holding for income investors wanting exposure to high quality companies. The fund managers look for companies with high returns on capital and strong free cash flow. They believe these attributes can help identify companies capable of sustainable dividend growth above the rate of inflation.

You'll get exposure to names like consumer goods giant **Unilever (ULVR)**, drinks group **Pepsico** and comparison website **Moneysupermarket (MONY)**.

A 3.3% yield is decent in the current environment and you should also expect some level of capital gains. Over the past five years it has delivered 9.7% annualised returns versus 4.1% from the FTSE All-Share total return index.

What's really interesting is the lack of exposure in the top holdings to some obvious names which crop up in many income funds such as **Royal Dutch Shell (RDSB)** and **Vodafone (VOD)**. That's because Evenlode prefers to put money into companies that don't need to spend a lot of money to keep their business ticking over and it also prefers to avoid firms with high debt levels.

It is worth noting that Evenlode's website displays a message saying the fund is soft closed. This means it has put up restrictions such as a 5% initial charge to put off new investors as it doesn't want its fund to get too big in size. Some investment platforms such as AJ Bell Youinvest can still accept new investment into this fund without the 5% initial charge.



TB Evenlode Income has a stake in Moneysupermarket

MAN GLG UK INCOME (B0117D3)

YIELD: 4.29% – OCF: 0.90%





MONTANARO UK INCOME (BYSRYZ3)

YIELD: 3.67% – OCF: 0.86%



Sweden is one of the global markets to which Henderson International Investment Trust provides exposure

Henderson International Income will give you access to global markets excluding the UK. The latest factsheet shows exposure to a wide range of geographies including the US, Switzerland, France, Netherlands, China and Sweden.

The investment trust's objective is to provide a high and rising level of dividends as well as capital appreciation over the long-term.

The current portfolio includes some really big names in the world of business including Microsoft and Coca-Cola. It tends to hold between 60 and 80 positions and has a strong value focus. It holds stocks until a cheap valuation re-rates to a fair valuation.

Henderson says most of the companies in its portfolio increased or maintained their dividends in its financial year to 31 August 2018. It also says dividend growth in this period was driven by both earnings growth and an increase in the proportion of earnings paid out as dividends.

This fund is more suited to someone in the very early stages of retirement who wants to obtain some capital growth from their portfolio as well as income.

While you may think it is odd suggesting a small cap fund as a source of income in retirement, there is a slight twist to this product in that you won't find lots of high-risk AIM stocks in its portfolio. Instead you get exposure to more established businesses, some of which are really mid-caps in size.

The companies in its portfolio are cash generative, well-managed businesses, often with founding management still owning large stakes. Example names include self-storage group **Big Yellow (BYG)**, piping manufacturer **Polypipe (PLP)** and leisure group **Cineworld (CINE)**.

The fund had a tough year in 2018 with 14% loss versus 24% positive return in the previous year. That was predominantly down to 2018 being a tough year for smaller companies including the worst fourth quarter since the global financial crisis.

Don't let that put you off. Montanaro has a big research team and is very good at finding opportunities in the small and mid-cap space.



Cineworld features in Montanaro UK Income's portfolio

HENDERSON INTERNATIONAL INCOME (HINT)

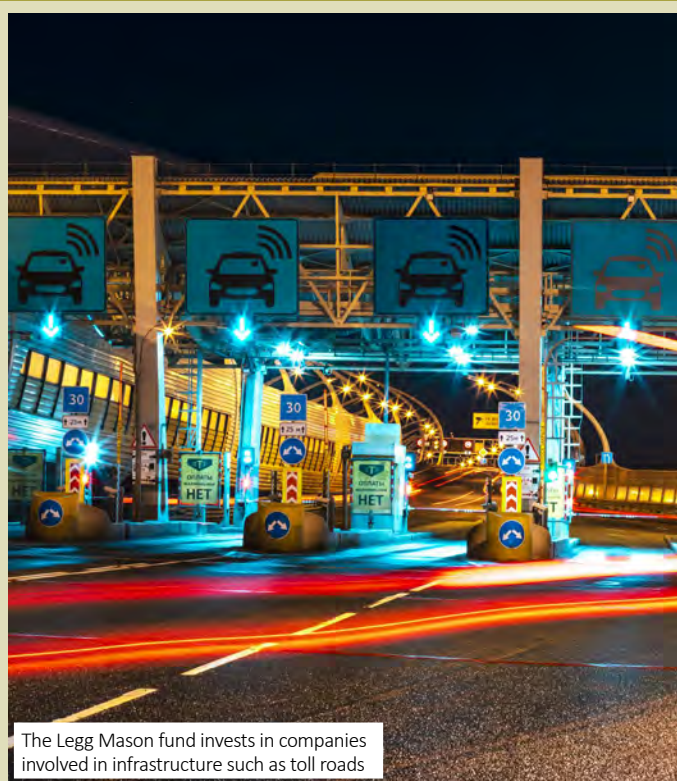
YIELD: 3.50% – OCF: 0.83%





JUPITER ASIAN INCOME (BZ2YMT7)

YIELD: 3.88% – OCF: 0.98%



The Legg Mason fund invests in companies involved in infrastructure such as toll roads

Earlier in this article we talked about the risks of paying a premium if you accessed infrastructure through investment trusts. The Legg Mason product avoids this situation because it is an open-ended fund.

Investors in the income fund are benefiting from the expertise of a true specialist in the field of infrastructure, namely Rare Infrastructure which was founded in 2006 and acquired by Legg Mason in 2015.

The fund's model is to invest in a range of different companies involved in gas, electricity and water utilities, toll roads, airports, rail and communication infrastructure.

This is the sort of fund you want to hold for at least five years and you shouldn't expect capital gains every year.

This fund has a fairly concentrated portfolio of 40 to 50 stocks and follows a strict investment criteria. It invests in companies listed or located in Asia Pacific, including Australia and New Zealand, but not Japan.

Fund manager Jason Pidcock will only consider a company that is well-managed and well-positioned in its own industry. Companies need to have a scalable business model and must be committed to paying dividends. The shares also have to be good value for money rather than paying any price for quality names.

The portfolio includes stakes in investment bank Macquarie, Samsung Electronics and Ping An Insurance.



Jupiter Asian Income will invest in companies located in New Zealand among other places

LEGG MASON IF RARE GLOBAL INFRASTRUCTURE INCOME (BZ01WT0)

YIELD: 5.17% – OCF: 0.93%



By **Daniel Coatsworth** Editor

DISCLAIMER:

AJ Bell is the owner and publisher of *Shares*. This article is not a recommendation to buy AJ Bell's new income funds referenced in the feature – it is for information only. The author owns shares in AJ Bell.



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Witan investment trust

Here are five people who should definitely use an ISA

We spell out the benefits of using the tax-efficient savings wrapper

There were 300,000 fewer ISA account subscriptions in 2017/18 versus the previous year, according to Government figures.

The introduction of the personal savings allowance, which gives a £1,000 tax break to basic-rate taxpayers on savings income and a £500 tax break for higher-rate payers, is largely thought to be the cause behind fewer people using ISAs.

But at the same time over the past few years there has been a massive increase in the amount you can put into an ISA each year. This means that the 'use-it-or-lose-it' pressure has diminished, as not many people can afford to max out their £20,000 annual limit. Read our article about this [here](#).

Despite this backdrop, ISAs still offer considerable benefits to savers and investors. We've looked at five groups of people who should definitely use an ISA for their savings to avoid being hit with a tax charge in the future or missing out on free Government cash.



If you move from the basic-rate tax band to the higher-rate your personal savings allowance will



be cut by £500, meaning only your first £500 of savings income will be tax free.

If you move from the higher rate to the additional rate you will lose the allowance entirely, meaning all your non-ISA savings interest will be taxed at 45%.

For example, if you move from the basic to higher-rate tax band you'll face a £200 tax bill on that £500 of savings interest. If you're close to these tax band limits and think you might get a pay rise that tips you over in the next tax year it could be a good idea to move some of your money into an ISA.



Investors have been hit in recent years by successive changes to the dividend tax allowance, first increasing the tax rate and then slashing the tax-free dividend

allowance. Read more [here](#).

For the current tax year you can earn just £2,000 in dividends before you start to pay tax, at 7.5% for basic-rate taxpayers, 32.5% for higher-rate taxpayers or 38.1% for additional-rate taxpayers.

The £2,000 limit means that someone with a £50,000 pot earning a 4% yield will hit the limit. If you moved this money into an ISA then it will be free of income tax.

It's also important for people who plan to take an income from their ISA savings in future years.

Any withdrawals from ISAs are free of tax, meaning you can draw an entirely tax-free income off the investment pot.

So someone with £200,000 in an ISA and earning a 4% yield can take an £8,000 income tax free each year, while someone with a £600,000 ISA will be able to take £24,000 income tax free – at this level you'll save £2,430 each year in tax. If you take this same income over 20 years, for

example, that's a total of £48,600 saved in income tax.

3

THE BIG SAVERS

The larger your non-ISA savings the longer it will take to move it into an ISA. You have a £20,000 allowance each year, so if your pot is larger than this it could take a long time to move it into the tax-efficient ISA.

Savers with large non-ISA funds are at the mercy of future Governments changing the tax rules on savings, scrapping the personal savings allowance or even reducing the annual amount you can save into an ISA.

People were caught out by this before with the cut to the dividend tax allowance and many were hit with a large tax bill. If it will take several years' worth of allowances to move your money into an ISA, think about starting before the end of this tax year.

4

THE SUPER-SIZE GAINS INVESTOR

Someone who has held investments outside an ISA for a long time or has seen their investments perform well may have large capital gains on their investments.

Any investments outside of an ISA face 10% or 20% tax on any gains above their tax-free allowance. You can make use of your capital gains tax allowance each year to bank some gains



5

THE FIRST-TIME HOUSE BUYER

and move them inside an ISA.

So-called 'Bed and ISA' means you can sell assets with gains of up to £11,700 (rising to £12,000 from 6 April) and then buy them back within an ISA, without facing any tax.

Your future gains will then be protected from capital gains tax too. You can do a similar move but transfer the asset to your spouse instead, who can then put it in their ISA.

If you're planning to buy your first property in the future then you should use an ISA to get free Government money to help boost your savings pot. With a Lifetime ISA or Help to Buy ISA you get a 25% Government bonus on the money you pay into the accounts, which will then go towards your first home – a rate of return that's hard to beat.

Each ISA has pros and cons, you can read more about them [here](#). The Lifetime ISA has a higher annual limit of £4,000, and so a higher Government bonus of £1,000 each year, but only works if you have at least 12 months until you plan to buy a house.

If you plan to buy in the next 12 months you'll need to use the Help to Buy ISA, into which you can pay £200 a month, as well as £1,200 in your first month – getting your 25% Government bonus on top.



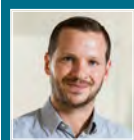
By **Laura Suter**
AJ Bell Personal
Finance Analyst

‘Have we got enough pension savings for £25,000 annual income?’

AJ Bell pensions expert Tom Selby looks at different income scenarios

Anonymous

My wife and I have just turned 65 and are about to start taking an income from our pensions. I have a private pot worth just over £300,000 and we also have a bit of state pension each (worth about £10,000 a year combined). We have paid off our mortgage and need a bit of help managing our withdrawals as I know taking too much too fast could be a problem. Ideally we'd like to have £25,000 a year between us to live on.



Tom Selby

AJ Bell

Senior Analyst says:

There are two broad retirement income avenues you could go down – handing your private pension pot to an insurance company in exchange for an annuity providing a guaranteed income for the rest of your life, or keeping your money invested and drawing flexible income and staying invested.

At today's rates a healthy 65-year-old with a £300,000 fund could buy a single-life, inflation-protected annuity worth about £850 a month, or just over £10,000 a year*. If you took your 25% tax-free cash (£75,000) the remaining pot (£225,000) would buy a similar income worth about £7,500 a year.

If you wanted to add 50%

spouse's protection – meaning your partner would get 50% of the annuity income if you died first – the same £300,000 buys you an income worth £8,363 a year (or £6,272 if you took your 25% tax-free cash first).

In short you'll fall short of your annual income target in all scenarios. However, because an annuity is guaranteed you won't need to worry about running out of money if you live to a ripe old age.

Alternatively, you could keep your fund invested and draw an income through drawdown. This route will require you to manage both your investments and withdrawal strategy, taking into account things like rising prices ('inflation risk') and how long you might live for ('longevity risk').

If we assume you achieve investment returns after charges of 5% and withdraw £15,000 a year, rising in line with 2% inflation, your fund should last until your 95th birthday.

This is only a guide and your actual investment returns will have a significant impact on the sustainability of your strategy – so you might need to reduce your income if markets turn sour.

You should also bear in mind that while average male life expectancy at 65 stands at 86, you will have about a one in 10 chance of reaching 97 and a 4.7% chance of celebrating your 100th birthday. For a female, the chances at age 65 of reaching 100 are 7.4%**.

Another option is to take ad-hoc lump sums from your pot, with 25% of each withdrawal tax-free. For many, a mix-and-match approach – combining some guaranteed income through an annuity with some flexibility through drawdown – will provide the right balance.

**Annuity quotes estimated on 15 March 2019 using the Money Advice Service annuity comparison tool*

***Based on Office for National Statistics projections (May 2018)*

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.



LIVE LONG AND PROSPER!

Have you thought about the type of lifestyle you would like in retirement? For many of those currently in work, retirement feels a long way off – but to be comfortable in our golden years, it's important to start saving early.

A longer life

Long-term demographic trends are favourable. We are in general living longer and, as long as we remain healthy, later life can be enjoyed to the full. However, finances are a factor. Whether we spend our later years in comfort is largely dependent on us and our actions in advance.

We should all think about preparing for a longer retirement. Although we are inevitably working later in life, current UK 'pension freedoms' mean that some pensions can be accessed from the age of 55, whether one continues working or not. Pension income could supplement a wage or be a major source of income in retirement. Whichever, its importance in later life is likely to be considerable.

A longer income

The downside of living longer is that the money, which we save up from our working career, needs to last longer. Gone are the days of gold-plated, defined benefit schemes and annuity rates of over 10%. With interest rates so low, bond yields and, in turn, annuity rates are also low. In this environment, your pension fund in retirement needs to be bigger than ever.

The logical imperative is to save more. Most of us would like to maintain the standard of living that we have grown accustomed to. But still, some are sleepwalking into a lower standard of living by not putting enough aside. Those who come to realise this often do so too late to do much about it. The key is to start to save at a young age and to put sufficient sums away. Easier said than done, of course, when there are so many competing claims on our money.

Invest long-term and prosper slowly

The good news for the young is that the longer one is invested, the greater chance one has to build up a substantial sum of money to fund retirement. The upward bias of markets over the long-term, the benefit of reinvested dividends and the magic of compounding – are key factors required to drive returns. Historically, equities have been one of the best assets for maximising returns over the long run, although they can be more volatile than bonds. Investing over the long-term can smooth out the corrections in equity prices that will occur during the period you are building up funds for retirement.

Contrariwise

A fund with a contrarian approach could be a useful component of a diversified pension portfolio. This style does not chase the investment fads of the moment or become swayed by current themes but aims to provide investors with above-average returns over the longer term. It demands patience, recognising that some stocks, while representing good value, can stay 'unloved' or shunned by the market for some time. Good companies can go out of fashion, but they often remain good companies with the potential for share prices to recover.

“A fund with a contrarian approach could be a useful component of a diversified pension portfolio.”

Being an independent, closed-ended fund allows the investment managers at The Scottish to select companies where they have a high conviction and a view to long-term payback – appropriate for long-term investors. The Scottish has one of the lowest ongoing charges figures within the AIC Global sector which is important as seemingly small differences can have a surprising impact on investors' returns over the long-term.

Similarly, dividends have historically accounted for a significant portion of total returns. According to the Association of Investment Companies (AIC) figures, The Scottish has one of the highest dividend yields in its peer group. The AIC have also named the trust a 'Dividend Hero' as it has grown the regular dividend for the past 35 years. However, it should be remembered that dividends are not guaranteed and can fall as well as rise.

By consistently investing from a young age – and taking a long-term approach – you are more likely to build your pension fund to a substantial level, helping to ensure a happy and fulfilling retirement. ■

As at 18 March 2019

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Why do share prices change overnight?

We examine the role of market makers in enabling investors to buy and sell

Relative newcomers to investing may be confused by the fact share prices can move between days, apparently without any trading taking place.

Even more experienced investors often grumble darkly about these moves and in some cases the difficulty in buying as much as they want of a stock when it is moving higher.

For example, a small cap healthcare firm could announce a breakthrough with clinical trials of a new drug at 7am and at 8am, when trading resumes, you might find the shares are materially higher before you've even had a chance to participate in the rally.

An opening auction starts at 7.50am where certain individuals can place bids to buy and sell shares during a 10-minute period in order to help determine the opening price at 8am. Only people with access to the London Stock Exchange's order book can participate and in general retail investors using an investment platform won't have access to this service.

Also behind these out-of-hours movements in share prices are market makers. These are banks or stockbrokers who commit to trading shares, investment trusts, exchange-traded funds and bonds to ensure you are always able to buy or sell on an exchange in normal market



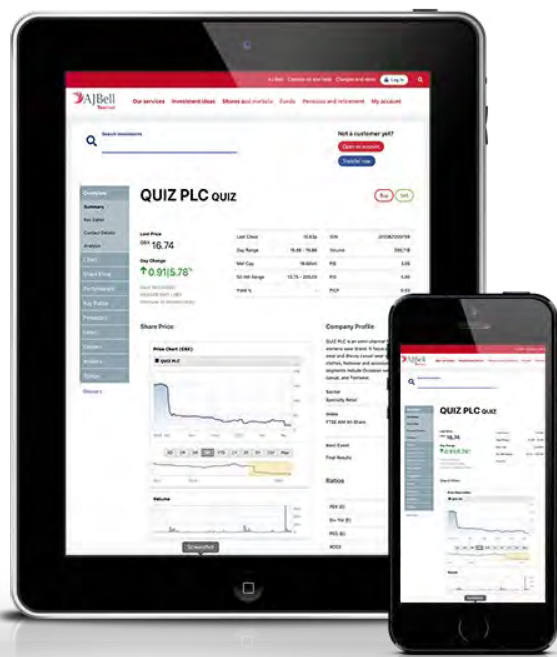
Big stocks, such as Cif-owner Unilever, have plenty of investors who are willing to trade without the intervention of market makers

hours. There are more than 20 registered market makers with the London Stock Exchange.

Market makers are obviously involved in this activity to make money and they do so through the spread – the difference between the price at which you

buy and sell a share. But it is not just this commercial element which dictates the gap.

The 'bid' is the price at which the holder can sell shares and the 'offer' is the price at which you can buy shares. Almost 100% of the time the bid price will be



below the offer price. The size of the difference or spread is largely a function of how liquid a stock is or in other words how easy it is to buy or sell.

Market makers have more impact on companies at the smaller end of the spectrum as big stocks, such as consumer goods giant **Unilever (ULVR)**, have plenty of investors who are willing to trade without the intervention of these professionals. Here buy and sell orders are typically matched through the SETS electronic trading system.

MORE RELEVANT TO SMALL CAP STOCKS

Smaller firms might only have one or two market makers and here the difference between the bid and offer price can be significantly higher.

To take a real-world example, on 14 March biological products firm **Plant Health Care (PHC:AIM)** traded at a bid price of 5.55p and an offer price of 6.45p.

These figures imply you would pay 6.45p to buy the shares and get 5.55p if you tried to sell them – so in effect you would be sitting on a paper loss as soon as your initial buy order is placed.

You would need the bid price to increase by 16% to 6.45p just to stand a chance of breaking even on your trade if you looked to sell.

Dictated by Supply and Demand

The regulatory set-up for market makers, as for other parts of the financial markets, is stricter than it was historically but there is certainly no rule which says a

stock has to open at the level it closed at the previous day.

Market makers, which usually only keep a relatively small number of the relevant shares on

hand, will set their price at a level which they know they will be able to both buy and sell stock.

To take our hypothetical example of the small cap healthcare play, if the market maker took no account of the clinical trials breakthrough, and just set their price at the level it closed the night before, they would not be able to persuade any shareholders to sell and therefore wouldn't have any stock available for people to buy.

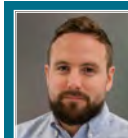
This is further complicated by the fact that some small cap stocks have a very limited 'free float'. This refers to the portion of a company's shares which are freely bought or sold, rather than being held by directors or large institutional investors.

After all, market makers have to provide 'two-way continuous pricing'. In simple terms this means that for the shares they are registered to make a market in, the firms must, throughout the trading day, provide prices at which the shares can be bought and sold. They are mandated to do this up to a certain size of trade known as the normal market size (NMS).

If you are looking to buy shares which are rising sharply, you may find it difficult to buy large quantities but again this is likely because the market maker is struggling to find sellers from whom to buy stock. Remember, they are only obliged to trade at the NMS and this can be quite a modest amount for small cap stocks.



Plant Health Care's spread is typically 14%



By **Tom Sieber**
Deputy Editor

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BLACKROCK SMALLER COMPANIES TRUST PLC

Roland Arnold

Co-portfolio Manager,
BlackRock Smaller
Companies Trust plc



When it comes to investing in the UK, the first thing that comes to the mind of most investors will be the FTSE 100. When you hear comments on the radio or on the news in the evening relating to the “stock market”, the comments will almost always be in relation to the FTSE 100 being up/down x number of points. However, while the £2 trillion+ FTSE 100, a collection of the largest 100 companies listed in the UK, is an important component, it certainly isn't the entire UK market. The high levels of accounting and legal standards in the UK, but few barriers to corporate activity, means that the UK market is an attractive place that many leading global businesses choose to call home. As a result, there are a further 1500+ companies that are listed on the UK market beyond the largest few that everyone has heard of, that are well diversified across a broad range of sectors and geographies. It is in this space, particularly the smaller companies, that we believe presents us with the most attractive hunting ground as active managers, and therefore the greatest opportunity to generate returns for our clients over the long term.

Please remember that your capital may be at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. You may not get back the amount originally invested.



Why do you believe UK smaller companies present the greatest opportunity?

We believe that the UK small-cap market is home to some of the most exciting companies listed on the London market, businesses which may offer the prospect of a long runway of growth as they develop new products or markets or can enter into corporate activity and fundamentally shift their operations to capitalise on market opportunities. It

is important to highlight though that smaller company investments are often associated with greater investment risk than those of larger company shares. The small-cap sector has consistently demonstrated greater earnings growth than larger peers¹, which has in turn manifested itself in greater long-term returns for shareholders. We therefore believe that UK smaller companies are a great asset class for investors, and as a result of the above, this is an area of the market that has historically outperformed large caps by +4% per annum².

However, this is an area of the market where the dispersion of returns can be very high. For those companies that get it right, they can see their market caps multiply several times over, but those businesses that get it wrong can go bust. Therefore, this is really an area of the market where active management is crucial, and as a team we are looking to find the ‘hidden gems’ within the under-researched small cap universe. When selecting companies for inclusion in our portfolios our focus is, and has always been, dedicated towards finding high quality, cash generative companies, with strong management teams, that are able to manufacture their own growth regardless of the wider economic environment.

Are investors currently avoiding UK equities?

Yes this is true, however one common misconception is that investors often assume that exposure to UK companies, particularly smaller companies, is exposure to the UK economy. This is simply not the case. Companies in the mid-cap FTSE 250 universe generate around half of their revenues from overseas, and even the small-cap universe generates around 30% of revenues from overseas. Therefore, active managers can quite easily build very globally diverse portfolios, which is exactly what we have done in our portfolios, with only around 50% of our portfolios revenues being generated in the UK. This is not a recent change to portfolio positioning in response to the increased uncertainty and political turmoil facing the UK economy right now. We held a preference for international businesses over domestic for a number of years and have been using market volatility and the pessimism towards UK shares

Do you invest in IPOs (Initial Public Offerings)?

Yes. One of the benefits of managing the BlackRock Smaller Companies Trust plc is often having more opportunities in the IPO space than those available to funds that invest in larger companies. Companies that we are able to purchase at IPO have been extremely strong contributors to performance for more than a decade. When it comes to purchasing IPOs we are as selective as we are with investing in businesses that are already listed. We like to identify businesses that demonstrate strong organic growth, with strong management teams, a protected market position and sound financials. Historically companies that we have purchased at IPO have often been able to demonstrate some of the strongest organic growth; these can be the purest examples of the type of companies that we look to invest in.

Investing in small-caps

To invest in this type of investment, it may also be worth holding it in an ISA, making the most of your tax-free ISA allowance and sheltering it from income and capital gains tax. You can also use an ISA as a regular way to save rather than putting a lump sum in the market in one go. ISAs allow up to £20,000 to be sheltered from income and capital gains tax. Much like an open-ended fund, you can also buy shares in the Trust through most online platforms or through a stockbroker.

Capital at risk: All financial investments involve an element of risk. Therefore, the value of your investment and the income from it will vary and your initial investment amount cannot be guaranteed.

For more information on BlackRock Smaller Companies Trust, and how to access the potential opportunities presented by smaller companies, please visit www.blackrock.com/uk/brsc

BlackRock have not considered the suitability of this investment against your individual needs and risk tolerance. To ensure you understand whether our products are suitable,

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Trust specific risks

Smaller companies are high risk. The Trust's investments may have low liquidity which often causes the value of these investments to be less predictable. In extreme cases, the Trust may not be able to realise the investment at the latest market price or at a price considered fair. Investment strategies, such as borrowing, used by the Trust can result in even larger losses suffered when the value of the underlying investments fall.

¹ The case for SMID, Bloomberg, Fact Set, September 2018

² Source: BlackRock, 28 February 2019

to add to many global businesses at attractive valuations. Our largest holding for example is a marketer of promotional products which despite being listed in the UK, generates all of its revenues in the US and has been a strong contributor to portfolio returns in recent years.

Use investment trusts to cash in on historic low valuations and high yields

The UK stock market is going cheap as investors worry about the impact of Brexit

For decades UK stocks were prized by global asset managers but in the last two to three years they have been roundly shunned due to uncertainty over Brexit.

The result is that on some measures the UK stock market is now the cheapest it has been for nearly 30 years.

With valuations so low, investment trusts are a great way to get broad exposure to the UK market and some well-known trusts are also trading at a discount to net asset value (NAV) meaning that canny buyers can get a double discount.

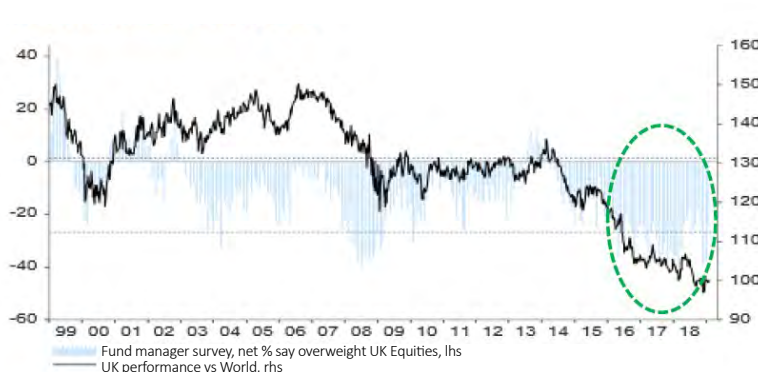
BEST OF BRITISH

Historically many global investors had a large weighting to UK stocks in their portfolios based on the quality of their earnings, their professional management teams, the business-friendly regulatory regime, high levels of corporate governance and reliable dividend streams.

Also buying a basket of FTSE 100 stocks meant diversification as more than 70% of the index's sales and earnings are generated overseas meaning investors can tap into global growth, often at a discount.

However the last two to three years have seen international investors desert the market in

FUND MANAGERS AROUND THE WORLD HAVE GONE OFF UK EQUITIES



- UK Equities remain a consensus underweight and has been so since February 2016
- Latest reading February 2019 showed underweight reduced by 13% points to 25% underweight

their droves and the overall asset allocation to UK equities has tumbled to decade lows according to research by Bank of America Merrill Lynch.

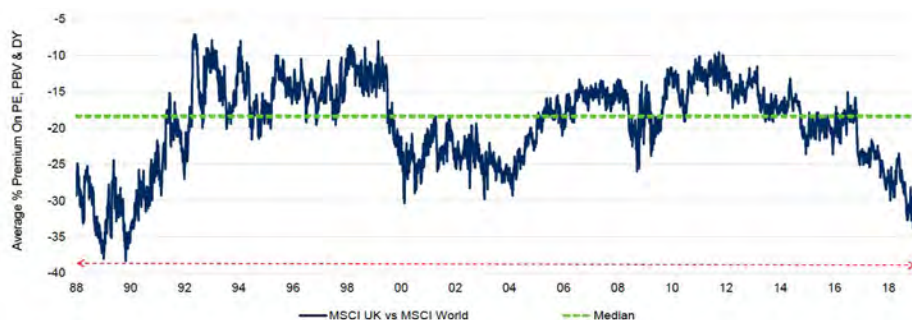
As the right-hand side of the first chart shows, fund managers are as underweight UK stocks

today as they were at the height of the global financial crisis, if not more so (blue bars).

At the same time the UK stock market has underperformed global equity markets sharply over the last two to three years.

Looked at another way,

UK EQUITIES UNLOVED WITH RELATIVE VALUATIONS EXTREMELY LOW IN A HISTORICAL CONTEXT



Valuation ratios: PE = price to earnings, PBV = price to book value, DY = dividend yield

A SELECTION OF INVESTMENT TRUSTS TRADING BELOW THE VALUE OF THEIR ASSETS

Investment trust	Current discount to net asset value	12m total return
All cap		
Keystone	11%	-7%
Baillie Gifford UK Growth	5%	8%
Mid cap		
Schroder UK Mid Cap	11%	4%
Mercantile	8%	-1%
JPMorgan Mid Cap	7%	-11%
Small cap		
Montanaro UK Smaller Companies	17%	-2%
JPMorgan Smaller Companies	16%	-9%
Henderson Smaller Companies	9%	0%
Standard Life UK Smaller Companies	7%	-10%
Aberforth	5%	-1%
Throgmorton Trust	5%	4%
BlackRock Smaller Companies	2%	4%
Equity Income		
Invesco Income Growth	14%	0%
Perpetual Income Growth	10%	-3%
Dunedin Income Growth	8%	7%
Lowland	7%	-8%
Edinburgh Investment Trust	6%	3%
Murray Income	6%	7%
Schroder Income Growth	5%	5%
Temple Bar	3%	10%

Source: Winterflood Securities

UK stocks are at their lowest valuation in almost 30 years on a combination of price-to-earnings, price-to-book and dividend yield.

Over 30 years the average discount between global markets and the UK has been in the region of 18% although that figure is somewhat skewed by the last five years: excluding the most recent past the average discount would likely be between 15% and 18%.

Today the discount is almost 35%, roughly double the average, taking it back to the levels of the early 1990s. Yet one could argue that UK companies today are in far better shape than they were in the early 1990s so buyers now are getting better management and a higher-quality earnings stream.

Investors looking for income are really being spoilt at the moment with UK dividend yields

at a level which has only been seen twice before in the last three decades – during the tech bubble and before that in the 1991 recession.

A RICH HUNTING GROUND FOR INCOME

Schroder Income Growth (SCF) fund manager Sue Noffke says for

dividend payouts would have to be cut by a quarter for yields to 'normalise' from the current 4.7% to the 30-year average of 3.5%.

Even during the global crisis, the peak-to-trough fall in dividend yields was only 15% so a 25% fall looks unrealistic.

Alex Wright, manager of **Fidelity Special Values (FSV)**,

says he is 'struck by the sheer number of stocks across different sectors whose valuations suggest significant asymmetry of risk and reward over the next two to three years'.

Among the sectors where he is finding opportunities is financials. 'The assets held by UK life insurers are significantly higher quality and more internationally diversified than the market is discounting,' he adds.

Alastair Mundy, manager of **Temple Bar Investment Trust (TMPL)**, is also finding opportunities in UK financials. He says: 'The UK banks have become something of a pariah sector but we have seen significant changes and improvements over the past decade and yet they remain on undemanding valuations.'

New management, strengthened balance sheets, closer regulation and the winding down of provisions for past misconduct mean banks are much more profitable than they were.

Mundy is also finding opportunities among retailers and housebuilders



UK DIVIDEND YIELD RELATIVE TO THE REST OF THE WORLD



Past performance is not a guide to future performance and may not be repeated.
Source: Schroders, Refinitiv as at 30 November 2018. MSCI UK relative to MSCI World.

and he expects the builders' merchants to be big beneficiaries once housing transactions pick up again.

Schroders' Noffke agrees that 'some of the most attractive opportunities are among companies whose businesses are

most exposed to the domestic consumer, such as housebuilders and hotel and leisure companies'.



By **Ian Conway**
Senior Reporter



THE INVESTMENT TRUSTS HANDBOOK COMPETITION

Last week we asked for the biggest holding in Scottish Mortgage's portfolio. The answer is **Amazon**

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- Thomas Stendall from Southwell, Nottinghamshire

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Specialist fund TB Amati can help with growth companies

The fund has a small cap focus but still invests in some fairly big firms

Many retail investors avoid small cap companies as there is a perception that the space is littered with too many inexperienced management teams, unproven business models and threadbare balance sheets.

Then there's the extra volatility and difficulties in even buying and selling these types of shares.

This is perhaps why tapping into the expert help of a specialist fund manager is often seen as a solution. Yet even the experts struggle sometimes.

Judging stock markets is about as difficult as for some time, David Stevenson tells *Shares*. He calls the fourth quarter of 2018 for the AIM market 'a nightmare'.

Stevenson is co-manager of the **TB Amati Smaller Companies (B2NG4R3)** fund. Illustrating the point, the fund's cash position is about twice its typical 5% of assets while it waits for clear investment opportunities.

The Amati fund is flexible with its 'smaller companies' badge, casting an analytical eye over pretty much anything outside of the FTSE 100. Seven of its 10 largest stakes are in FTSE 250 businesses. Even **Burford Capital (BUR:AIM)** – which is listed on AIM so does not qualify for the main indices – would otherwise

AMATI FUND'S TOP 10 STAKES	
Diversified Gas & Oil	3.6%
Qinetiq	2.6%
Sabre Insurance	2.6%
OneSavings Bank	2.5%
Quixant	2.4%
Spirent Communications	2.3%
Burford Capital	2.1%
CLS	2.0%
Countryside Properties	2.0%
IG Group	2.0%

Source: Trustnet

be within sight of a FTSE 100 qualification with its rough £3.9bn market value.

Former fund favourite **Auto Trader (AUTO)**, for example, is being gradually sold down over the coming year after December's promotion to the blue chip index following a 15-month 50%-odd share price rally.

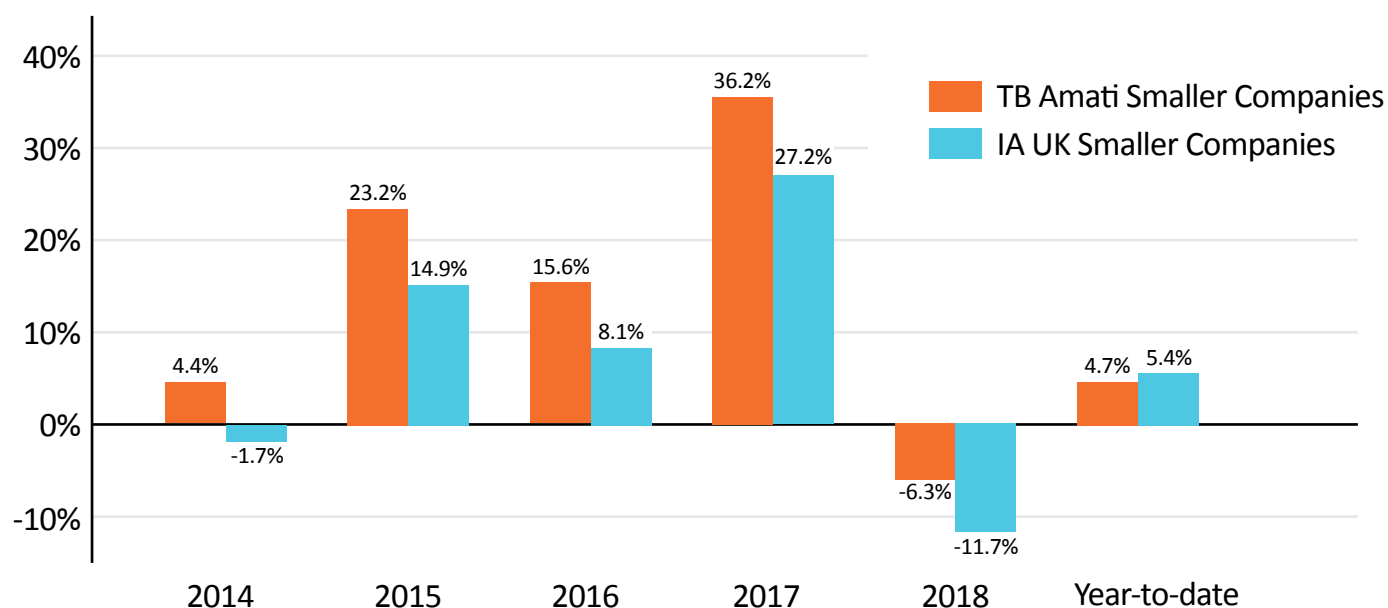
Other past successes include upmarket mixer drinks maker **FeverTree (FEVR:AIM)**, power switching kit designer **XP Power**

(XPP) and **DiscoverIE (DSCV)**, the electronic components maker that is now following a similar growth path to XP Power by designing more niche equipment itself.

AIM REMAINS THE MAIN TARGET

AIM remains the core focus, as does its bottom-up stock selection approach. 'We're still stock picking,' says Stevenson, looking for 'quality businesses that can keep growing over the

DISCRETE CALENDAR PERFORMANCE



Source: Trustnet

longer-term' where returns can be compounded over the years.

Typically holding around 55 to 65 stocks, ideas are drawn from various wells, not least the deep knowledge of its managers. Amati is a great believer in team ethic. Other sources include simple number crunching and a network of industry contacts.

Perhaps Amati's key advantage is that the asset manager also runs a venture capital trust, backing start-ups and micro-businesses, so it already has a good understanding of any new companies that join AIM's ranks, even ones where Amati was not an active investor.

Stevenson is also looking at thematic, niche markets where there excellent structural growth and disruptive potential and where individual companies have some sort of barrier to entry.

'The internet allows asset-light businesses to emerge,' says Stevenson, and this is impacting how much people will pay, referring to price-to-earnings

multiples in excess of 20, high by traditional measures.

Compliance and regulatory risk software specialist **Ideagen (IDEA:AIM)** is an example that rolls off the fund manager's tongue, a company whose share price has increased more than three-fold in the five years or so since it moved up from the old Ofex market, and one of *Shares'* own running *Great Ideas*.

Auto engineer **AB Dynamics (ABDP:AIM)** is another Stevenson likes a lot, and is also familiar to us – it was our best performing pick for 2018, rallying 58%. We silently wonder if Stevenson has been plundering the *Shares* archive for ideas (probably not).

He admits that money is now being drawn out of AB Dynamics after such a fine run but it is clear this is a business Amati continues to rate highly.

HIGH CONVICTION TO HIGH QUALITY

The benefit to investors of the

funds' strategy is reflected in an impressive benchmark-beating performance in each of the past five years.

'The fund has outperformed the Numis Smaller Companies plus AIM ex-IT index and the UK Small Cap Equity category average by 5.4% and 4% per year on average respectively,' calculates Morningstar analyst Samuel Meakin.

Cut another way, the Amati fund features in the top decile of its category for the trailing three, five and 10 years and is top quintile in the trailing 15 year period, according to Morningstar.

There are something like 1,700 companies to choose from within Amati's wider smaller companies universe. That creates a lot of potential for wealth creation in both the short and the long term.



By **Steven Frazer**
News Editor



MONEY & MARKETS

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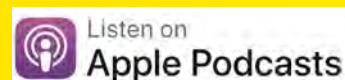
In each episode you'll get our thoughts on topical financial issues – from pensions to pocket money, from stock markets to savings.

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.

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SHARES



How to tell if oil's rally can continue

We look at four factors influencing the commodity price



Almost unnoticed, oil is trading near four-month highs at \$67 a barrel for Europe's Brent Crude benchmark and \$59 for America's West Texas Intermediate. According to OPEC's latest monthly report, demand is holding firm at between 97m and 98m barrels of oil a day.

This suggests that any tightness in the market is the result of supply, a view which seems logical enough in view of (limited) American sanctions on Iran, a sharp drop in output in Venezuela (thanks to economic and political chaos) and apparent Saudi determination to stick to the production cuts outlined by Riyadh at last December's Vienna OPEC summit.

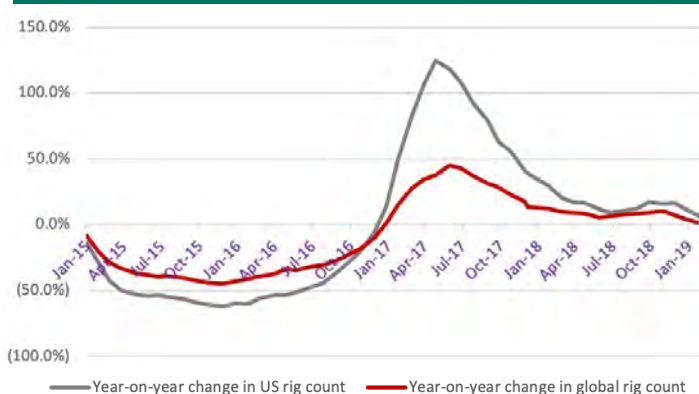
Besides these geopolitical and economic issues, four further, more tangible and easily measured, factors are at work: global oil rig activity, inventories, US shale output and positioning in the financial markets.

Thankfully, they are all a little easier to judge and measure than the affairs of state in Caracas or the workings of US President Donald Trump's foreign policy.

RIG WORK ROLLS OVER

A slowdown in growth in American and global oil rig activity would point to a better balance between supply and demand and one suited to the plan formulated by Saudi Arabia and Russia late last year to support the price of crude. Growth in active US rigs looks to be slowing while the global rig count is now up by just 2% year-on-year.

GROWTH IN GLOBAL RIG ACTIVITY IS SLOWING DOWN



Source: Baker Hughes

American oil inventories may have also stopped growing, at least if a recent unexpected drop is any guide, with stockpiles are now just 4% higher than they were a year ago.

GROWTH IN US OIL STOCKPILES ALSO SEEMS TO BE MODERATING



Source: US Energy Information Administration

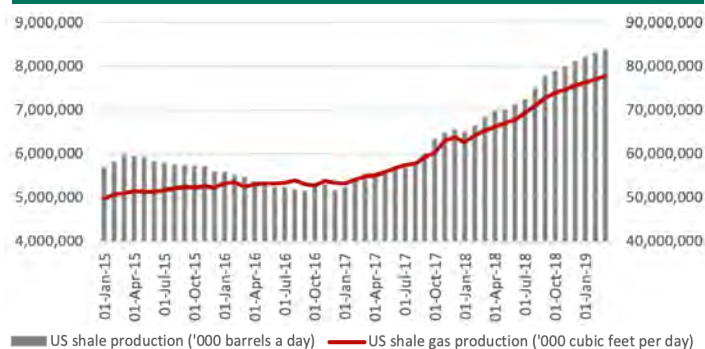
SHALE SURPRISE

This could be seen as reasonably bullish for oil but seasoned commodity watchers will know it is never that simple.

American shale output remains a major wildcard. Rig activity may not be rising but output per rig is and shale production in the US continues to advance as a result. It now stands at 8.4m barrels of oil a day, up by 1.6m barrels a day when compared to March 2018, a surge that offsets much if not all of the loss of Iranian, Venezuelan, Saudi and Russian production.

There is no sign of shale output slackening any time soon and this is a potential cap on the price of crude, at least on the other side of the pond.

US SHALE OUTPUT CONTINUES TO POWER HIGHER



Source: US Energy Information Administration

Intriguingly the fourth and final factor is the one whose influence is most frequently underestimated – how financial speculators are positioned via the futures market, where each contract is worth 1,000 barrels of oil.

According to data from the CME the number of long futures contracts in early July 2018, where traders were betting on oil price increases, was 771,350 against just 68,994 that were short and betting on oil price declines.

That made for a net long exposure of 702,356 contracts – so, surprise, surprise, oil promptly plunged from nearly \$80 to barely \$40. When it looks like everyone is already bullish it can be hard for an asset to do well, at least in the near term.

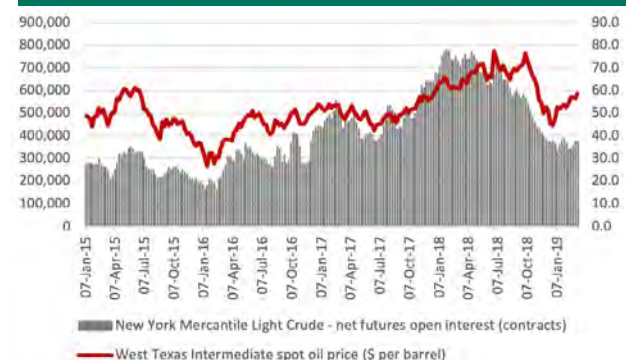
The picture is now a lot less clear cut. Long positions have been cut to 473,621 contracts but shorts are still rare at just 99,757 for a net bullish position of 373,864.

On balance that is still toward the top of the historic range for net 'longs' but the message



seems to be that even the professionals who constantly look at oil do not necessarily have a strong view right now.

NET LONG OIL FUTURES POSITIONS ARE DOWN TO 2.5-YEAR LOWS



Source: CME, Refinitiv

PUMP UP THE DIVIDENDS

Taking a punt on oil via a handful of oil producers or explorers through an industry-related exchange traded fund (ETF) or a tracker fund that follows the stock market of an oil-related region or country, such as the Middle East, Saudi Arabia or Russia, therefore looks risky.

But perhaps investors in UK equities can draw some degree of comfort from oil's latest ascent. After all, **BP (BP.)** and **Royal Dutch Shell (RDSB)** between them represent 15%, 18% and 19% of the FTSE's market cap, forecast profits and forecast dividends respectively for 2019.

And the more firmly the oil price is underpinned, the better their dividend cover and by implication the 4.7% dividend yield currently on offer from the FTSE 100, according to analysts' consensus forecasts.

So whatever you think of Brexit, at least investors are being paid to sit patiently as they wait for the negotiations to conclude, helped by oil's latest rally.



By Russ Mould
AJ Bell Investment Director

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Chemicals sector remains attractive despite sell-off over past six months

Discover why parts of the sector have lost momentum and whether you should be concerned

The chemicals sector has historically been a very good place to invest with significant share price gains over the past decade and occasionally generous dividends.

Unfortunately momentum has stalled in parts of the sector over the past six months amid concerns about a global economic slowdown and how that could feed into weaker demand for chemical products. There have also been some concerns about growing competition, falling margins and high inventory levels.

This has resulted in widespread share price weakness which has pulled down, on a broad basis, what are often high valuations for the sector.

Investors with a long-term view may therefore wish to take advantage of this situation.

TWO STOCKS TO BUY

Our top pick among the sold-off shares is **Synthomer (SYNT)** which has a cheap valuation and boasts higher returns on money invested in its business than the peer group average.

We also like **Croda (CRDA)** as a best-in-class chemicals business although investors will need to pay a premium to own the stock.



BROAD RANGE OF APPLICATIONS

The London-listed chemicals sector has a wide range of companies providing products used to make a very large range of goods.

For example, **Johnson Matthey (JMAT)** manufactures emission control catalysts to control the amount of harmful pollutants from cars, while **Zotefoams (ZTF)** creates high-performance foam materials for the likes of Nike.

Synthomer's products are used in many different places such as footwear insoles, condoms, packaging tapes, carpets and waterproofing products. **Trealt (TET)** helps food and drink taste better and **Victrex (VCT)** makes a high-resistance plastic.

All of these companies have stand-out products and are vital to the needs of businesses and consumers around the world.

Sadly various headwinds have led some investors to turn their back on the sector. In particular, investors are concerned about a slowdown in industrial production in China and what will happen in the event of a no-deal Brexit, says Berenberg analyst Sebastian Bray.

'China currently accounts for over 40% of global chemicals demand and this is predicted to rise to 50% by 2030,' comments the analyst.

This means Chinese industrial production is vital for setting the chemical industry's growth expectations. When Chinese factories struggle, they will buy

fewer chemicals and this has depressed the market's growth expectations for the sector according to Bray.

VICTREX BATTLES COMPETITION ISSUES

On a stock-specific basis, Victrex has already seen falling medical sales hit gross margins. These could fall further as much of its growth comes from industrial sectors where it will need to expand capacity in order to stay competitive. There are also market concerns that competition is growing for Victrex's flagship product called Peek, a super-strong, heat resistant and lightweight plastic used as an alternative or replacement for metal in areas like transport, the industrial sector, electronics and medical devices.

Shares in Victrex have enjoyed a very good run over the past decade up until late 2018. The same applies to Synthomer whose shares have recently been hurt by weaker demand and lower prices. It has also faced the threat of competitors expanding capacity for nitrile latex – Synthomer is the world's largest producer and nitrile accounts for more than half of its organic growth.

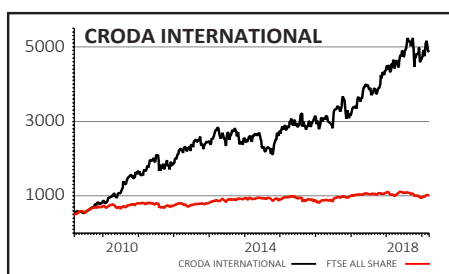
At 384.4p, Synthomer's shares now trade at close to a 25% discount to the five-year average of 14.3 – the current price-to-earnings ratio is 10.9-times based on 2019's forecasts. 'The shares are set to grow operating earnings in line with the wider European chemicals sector, and at higher returns (16% versus 14% return on capital employed),' notes Bray at Berenberg.

The analyst believes recent negative issues are only temporary. He says nitrile latex market tightness bodes well for 2019 and that that Europe and North America should return to volume growth this year. On that basis, negative factors look fully priced into the shares, although investors should treat this as a higher-risk stock for now.

CRODA'S BRIGHT OUTLOOK

Croda is highly regarded in the world of business and has rewarded shareholders with 999% total return (share price gains and dividends) over the past decade.

It creates and sells speciality chemicals for a range of beauty products, including moisturisers and colour cosmetic products, among other areas.



The shares have been volatile of late, partially down to earnings downgrades from analysts linked to US production delays. That should only be a temporary set-back.

Investment bank UBS believes the personal care side of Croda could do well in 2019. 'Recent comments by L'Oreal, especially on the China skin care market, and innovation initiatives underway at Henkel bode well for new project growth,' it says. 'Croda's doubling of research and development labs in the last four years is hardly likely to be speculative investment, more a direct response to customer demands, in our view.'

Croda hopes to drive future growth by investing in speeding up product innovation and focusing on new technologies, which will hopefully accelerate sales over time.

At £48.67, Croda trades on 24.4 times forecast earnings for 2019. UBS believes capital expenditure peaked in 2018 and so this highly cash-generative company should have more

CHEMICAL SECTOR: MOMENTUM HAS RECENTLY STALLED



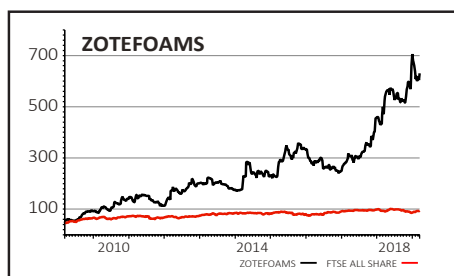
COMPANY	10 YEAR TOTAL RETURN	6 MONTH TOTAL RETURN
Zotefoams	1260%	18%
Croda	999%	-5%
Johnson Matthey	239%	-9%
Treant	1020%	-12%
Elementis	811%	-27%
Victrex	502%	-28%
Synthomer	1480%	-30%
Scapa	2790%	-33%

Source: Sharepad

money to pay down debt, pay dividends in the future or even make acquisitions. It estimates Croda will have virtually no debt by the end of 2021.

Investors buying shares in Croda are getting a company with a solid track record of achieving great returns from money invested in its business, slow but steady sales growth and a rising stream of dividends.

Zotefoams is another standout performer in the UK-listed chemicals space in share price terms. Its lightweight foam sheet material is used in packaging, transport goods and shoe padding among other things. The company is investing in capacity to try and keep up with demand.



WHAT HAS GONE WRONG AT ELEMENTIS?

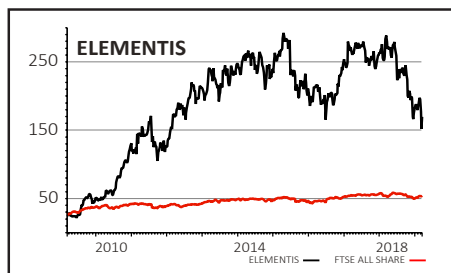
Elementis' shares have struggled since 2016. It provides additives for hair, skin care and cosmetic products. The company also supplies high value additives to help improve and preserve products and serves a range of end markets, including life sciences and aerospace.

Coatings, Elementis' biggest division representing approximately 40% of sales, has been struggling with lower demand for coatings and paint – a trend also flagged by chemicals giant AkzoNobel.

Its acquisition last year of industrial talc additives producer Mondo Minerals also divided



investor opinion. Shareholders initially expressed concern over the \$600m acquisition price and told it to renegotiate. The deal was then secured for \$500m but at a cost of rising debt and a dilutive rights issue.



Elementis plans to grow its position in personal care, coatings and Asia, get rid of unloved assets, improve manufacturing productivity and expand its product pipeline.

OTHER CHEMICAL STOCKS

Johnson Matthey's shares have been very volatile since 2014. Investors have increasingly questioned whether its catalytic converter business has a future given the

shift from combustion engines to electric vehicles which don't need the anti-pollution devices.

The FTSE 100 member is developing an enhanced lithium nickel oxide cathode material for use in the electric vehicle market but the proposition is still in the development stage.

Also exposed to the automotive market is Victrex, which creates high performance polymer solutions for a range of products, including smartphones, aeroplanes, cars and medical devices.

Victrex has been hit by market softness in its automotive division and underwhelming consumer electronics sales, but there has been an improvement in the former in January and February.



By **Lisa-Marie Janes**
Reporter



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Speaker:

James Menzies, CEO

Coro Energy (CORO) is an oil and gas exploration company focused on delivering long-term production of natural gas.

HARDIDE

Speaker:

Philip Kirkham, CEO

Hardide (HDD) is a leading global innovator and provider of advanced tungsten carbide coatings that significantly increase the life of critical metal parts.

OPG POWER VENTURES

Speaker:

Dmitri Tsvetkov, CFO, Director

OPG Power Ventures (OPG) is a developer and operator of power generation plants in India.

SAFESTAY

Speaker:

Nuno Sacramento, COO

Safestay (SSTY) is the owner and operator of an international brand of contemporary hostels.

THOR MINING

Speaker:

**Michael Billing, Executive
Chairman & CEO**

Thor Mining (THR) is an exploration and development company with a growing tungsten resource and a copper development project.

WENTWORTH RESOURCES

Speaker:

Eskil Jersing, CEO

Wentworth Resources (WEN) is an east Africa focused oil and gas company.

Event details

Registration 17:30

Presentations to start at 18:00

Complimentary drinks and canapés available after the presentations

Contact

Lisa Frankel, Events Operations Manager

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- **AIM**
- **Investment Trust**
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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

22 March: Henry Boot, Sanne Group. **25 March:** Bigblu Broadband, Medica. **26 March:** Alliance Pharma, AG Barr, T Clarke, Fevertree, Moss Bros, Vectura. **27 March:** Hilton Food.

Half year results

22 March: Smiths Group. **27 March:** Bellway. **28 March:** Eddie Stobart Logistics.

Trading statements

25 March: Pennon. **26 March:** United Utilities. **27 March:** Diploma, Imperial Brands. **28 March:** Mitie.

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	REPORTER: Lisa-Marie Janes @SharesMagLisaMJ	

ADVERTISING Senior Sales Executive Nick Frankland 020 7378 4592 nick.frankland@sharesmagazine.co.uk	PRODUCTION Head of Design Darren Rapley Designer Matt Ely
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