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VOL 21 / ISSUE 16 / 25 APRIL 2019 / £4.49

# SHARES

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UK'S **BEST PERFORMING  
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COMPANIES** SO  
FAR IN 2019

THE CLEVER WAY  
TO INVEST IN  
**COMPANIES WITH A  
COMPETITIVE EDGE**

# Looking for bright geographical spots as economic clouds darken

Japan, China and the broader emerging markets category look attractive

**I**t's been quite a whirlwind period since the start of the year with markets racing ahead despite plenty of negative economic news. While we've covered many of the warning signs in *Shares* in recent months, it is worth pointing out not everything is doom and gloom.

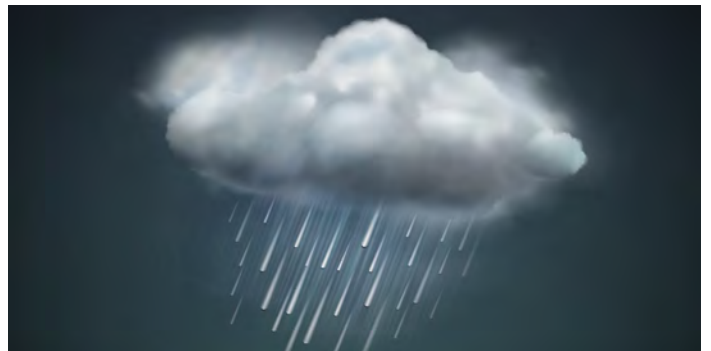
Our main feature this week looks at Japan where GDP growth is forecast to improve from 0.8% in 2019 to 1% in 2020, according to the International Monetary Fund (IMF). Optimism is also growing towards China after it released a number of economic, real estate and industrial output data points which imply a stronger economy than previously expected.

And interestingly, **Unilever's (ULVR)** first quarter trading update on 18 April showed that its sales growth was primarily driven by emerging markets.

All these factors illustrate the importance of not simply relying on UK stocks for your investment portfolio. Admittedly the UK market is very diverse with many companies earning money overseas. However, it is still worth tapping into specific foreign markets to get exposure to strong geographic territories, perhaps through an actively-managed fund or an exchange-traded fund.

For example, China's first quarter GDP growth of 6.4% was better than the 6.2% consensus forecast. Retail sales were better than expected and property investment grew at its highest rate in eight months. Industrial production jumped 8.5% in March, the fastest since mid-2014, and driven by infrastructure work and 5G production.

'Fiscal stimulus and telecommunication infrastructure have supported China's economy. And as such, the job market should remain stable overall. This has been the government's primary concern and having achieved this, it can now shift its focus to other areas such as financial stability,' says ING.



The investment bank has subsequently revised its 2019 GDP growth forecast for China from 6.3% to 6.5% on the back of the first quarter numbers.

The IMF has also recently upgraded its 2019 economic forecasts for China, up from 6.2% to 6.3% – its second upgrade since October 2018.

Against a backdrop of slowing economic growth in many parts of the world, it is important to note that emerging markets is the most favoured investment region for the 239 institutional investors who took part in Bank of America's latest global fund manager survey.

The bank's chief investment strategist Michael Hartnett says these fund managers have gravitated towards assets that outperform when growth and interest rates fall, such as cash, emerging markets and utilities. He says they are less keen on assets that require higher growth and higher rates, such as banks.

If you haven't got decent geographic or asset diversification in your portfolio, now is definitely the time to reshape your holdings so as to be better placed to navigate any setbacks to the market as the year progresses.



By **Daniel Coatsworth** Editor

SCOTTISH MORTGAGE  
ENTERED THE  
FTSE 100 INDEX IN  
MARCH 2017.

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Past performance is not a guide to future returns.

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\*Source: Morningstar, share price, total return as at 31.12.18. \*\*Ongoing charges as at 31.03.18. Your call may be recorded for training or monitoring purposes. Issued and approved by Baillie Gifford & Co Limited, whose registered address is at Calton Square, 1 Greenside Row, Edinburgh, EH1 3AN, United Kingdom. Baillie Gifford & Co Limited is the authorised Alternative Investment Fund Manager and Company Secretary of the Company. Baillie Gifford & Co Limited is authorised and regulated by the Financial Conduct Authority (FCA). The investment trusts managed by Baillie Gifford & Co Limited are listed UK companies and are not authorised and regulated by the Financial Conduct Authority.

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SHARES AS  
A PDF?**

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# Why mortgage innovation could spell trouble for housebuilders

The sector could be affected as signs of stress begin to emerge, with banks facing risks too

**O**ne follower of the housebuilding sector is alarmed to see the return of the 'flexible' mortgage given what it reveals about the state of the property market.

Shore Capital analyst Robin Hardy notes the launch of NatWest's HomeFlex product, which allows borrowers to take money out of their mortgage in his words 'as quickly and easily as withdrawing money from an ATM', and its similarity to products which played a key role in the credit crunch just over a decade ago.

Initially available to the bank's Premier customers, the product is set to be rolled out across the board by the end of 2019.

Lenders have already resorted to offering cheaper rates at higher loan-to-value and on longer terms, but the market remains stagnant.

In February the number of loans approved to home buyers fell to their lowest levels in nearly six years according to figures from UK Finance, a trade association for the UK banking and financial services sector.

Some 35,299 mortgage approvals for house purchase were recorded – the smallest monthly figure since April 2013.

Banks' desperation for new mortgage business needs to be closely monitored as it could lead to a rise in bad debts, putting pressure on balance sheets and undermining the sector's renewed commitment to dividends.

Hardy says: 'Overall, these evolutions in the mortgage market all point to market strains and stresses that highlight

## Upcoming trading statements from housebuilders

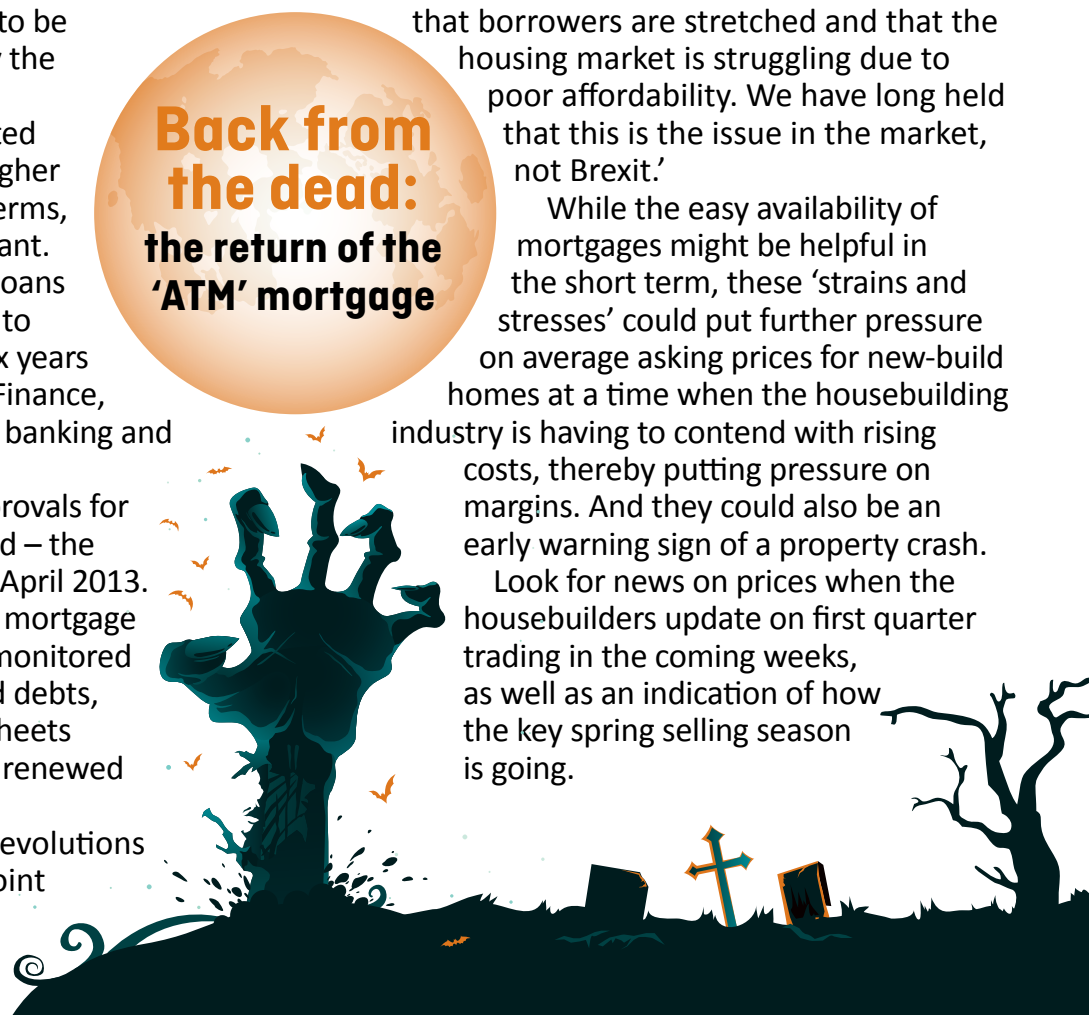
- Taylor Wimpey **25 April**
- Persimmon **1 May**
- Barratt Developments **9 May**
- Bovis Homes **22 May**

**Back from the dead: the return of the 'ATM' mortgage**

that borrowers are stretched and that the housing market is struggling due to poor affordability. We have long held that this is the issue in the market, not Brexit.'

While the easy availability of mortgages might be helpful in the short term, these 'strains and stresses' could put further pressure on average asking prices for new-build homes at a time when the housebuilding industry is having to contend with rising costs, thereby putting pressure on margins. And they could also be an early warning sign of a property crash.

Look for news on prices when the housebuilders update on first quarter trading in the coming weeks, as well as an indication of how the key spring selling season is going.



# UK profit warnings hit highest first quarter level since the financial crisis

We reveal which sectors were the biggest offenders over the period

**U**K-listed firms have issued 89 profit warnings in the first quarter of 2019, marking the highest first quarter total since the global financial crisis according to professional services firm Ernst & Young (EY).

Brexit-related challenges account for only 10% of profit warnings over the quarter. Other headwinds include trade war anxiety as the US and China are yet to come to a resolution and global growth concerns.

EY UK&I Restructuring head Alan Hudson says the UK is struggling with a range of issues such as uneven regional growth, low productivity, high debt and weak business investment.

## EMBATTLED RETAILERS

Investors may not be surprised to discover that UK-listed retailers reported 12 profit warnings during the first quarter of 2019, the highest of any sector.

Retailers have come under pressure amid rising costs as shoppers shun the high street in favour of online shopping.

Arguably of greater concern are the 10 profit warnings over the same period from FTSE financial services firms, which equals the same amount from the sector through the entirety of 2018.

## Top 5 reasons for profit warnings



**Sales short of forecasts**

35%



**Delayed or discontinued contracts**

20%



**Increasing cost and overheads**

18%



**Operational issues**

12%



**Brexit**

10%

Regulatory changes are impacting income and hiking costs as these businesses scramble to meet stricter rules.

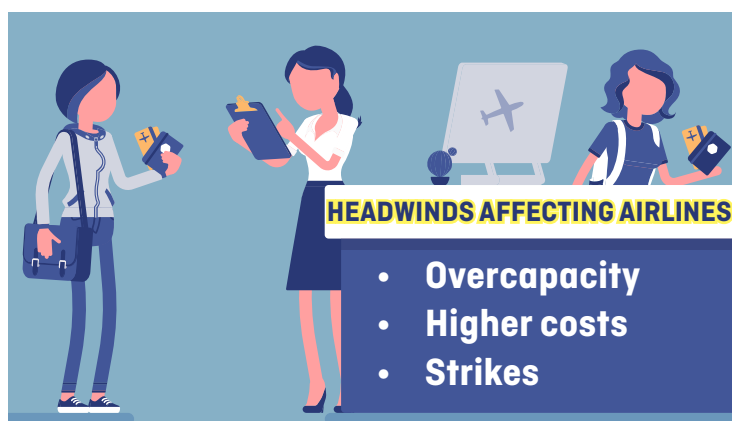
'Companies need to focus on managing regulatory change, risk and volatility and consider how their business model will adapt to changing markets,' comments Ernst & Young.

## WHICH SECTORS ARE ONES TO WATCH?

Based on its research, Ernst & Young says the technology hardware and equipment sector and travel sector are among the ones to watch out for in terms of future warnings.

The global technology sector is struggling with declining electronics sales, particularly in China, while 'excessive global inventory' for computer chips and displays is putting pressure on prices.

Overcapacity, higher costs and strikes are among many headwinds affecting airlines.



# Fintech 'bank' R8 eyes London summer IPO

New funds are needed to grow beyond crypto finance model



**F**inancial technology company R8 is preparing a London stock market share listing as it looks to raise extra growth funding, possibly as soon as July 2019.

The company is believed to be sounding out new investors that could see it raise something like £20m of fresh funding, with speculation suggesting a £50m market valuation if it gets the IPO (initial public offering) away.

R8 recently raised around £4m from existing investors, including founder and chairman Jonathan Rowland.

Rowland spun the company out of Redwood Bank, the 'born in the cloud' challenger bank established by him and his father, property developer and former Conservative party treasurer David Rowland in 2017.

The core R8 project is *Mode*, a platform initially set up to serve emerging cryptocurrencies, such as Bitcoin. The ambitious plan is to expand *Mode* into a financial services ecosystem designed for both traditional customers and crypto enthusiasts, including becoming fully regulated with industry watchdog the Financial Conduct Authority (FCA).

Last year R8 launched *JGOO*, a mobile payments platform that connects UK and European brands with Chinese consumers. *JGOO* has payment partnerships with two of China's largest technology

companies, social media firm Tencent and Alibaba, the online shopping giant, according to analysis website TechMarketView.

R8 has largely avoided the public gaze during its embryonic growth phase and little financial information on the company is available. Other privately-backed fintech start-ups have hogged the headlines, such as Revolut, Monzo, Monese and Nutmeg.

But R8 now seems to be gearing up for closer scrutiny by consumers and investors, appointing Biz Stone as a non-executive director, the co-founder of Twitter.

Stone, who is also believed to have backed the company with his own money, has previously invested in several fast-growth start-ups, such as online scrap book Pinterest, integrated messaging app Slack and Square, the digital payments business.

Cutting edge fintech companies have a patchy track record on the London stock market. One-click payments provider **Bango (BGO:AIM)** and cross-border transfers platform **Earthport (EPO:AIM)** have to date failed to break-even after years of trying.

Peer-to-peer lender **Funding Circle (FCH)** bolstered the stock market fintech sector in 2018 but it, like smaller fintechs **Boku (BOKU:AIM)** and **eServGlobal (ESG:AIM)**, remains loss-making.



# Learning Technologies eyes cross-sell growth spree

Training platform business is putting organic growth at the heart of its business plan

**I**ncreasing bureaucracy and red tape can be a challenge for medium and larger organisations trying to retain their best staff in the face of more exciting opportunities at start-up enterprises. One way of preventing this brain drain is to provide the workforce with ongoing training such as services offered by **Learning Technologies (LTG:AIM)**.

The company provides a range of e-learning applications and technologies to more than 2,000 corporate clients and international government departments.

Since joining the stock market in 2013 it has actively pursued a buy-and-build strategy that has seen eight businesses acquired. The aim was to rapidly extend the product set and geographic reach, particularly into the large US market where more than half of revenue will be generated in the future.

The overall corporate e-learning market is growing at 11% a year. Sadly concerns about the pace of organic growth have previously capped investor enthusiasm with Learning

## LEARNING TECHNOLOGIES BUY

(LTG:AIM) 75p

Stop loss: 60p

Market cap: **£500m**



Technologies in the past, where one analyst calculates it achieved underlying revenue growth in the mid-single digits in the second half of 2018.

This situation, plus previous lumpy and unpredictable new business, explains why the share price was sold down so heavily late last year, although the entire UK market suffered a big sell-off during October.

Learning Technologies now appears to have the scale to pull significant cross-selling levers in the future.

The company believes it has been averaging just 1.2 products or services across its customer base compared to an average closer to four for its top 10 clients. This suggests that even modest improvements could have a big impact on growth in revenue and profitability and it is a major priority for management.

Consensus forecasts already anticipate last year's £93.9m revenue expanding to £126.4m in 2019.

Earnings quality is also starting to improve thanks to a greater proportion of recurring sales contracts – about 50% according to Canaccord's conservative estimates.

This underscores Learning Technologies' ambition to hit an annual revenue run-rate of £200m by the end of 2021 on which it believes £55m of operating profit is possible. Last year's operating profit came in at £27.3m, after one-off charges were stripped out.

Such potential upside is, we believe, not sensibly factored in to the share price on a 2019 price-to-earnings multiple of 9.5, even accounting for the accompanying risks.

Some analysts believe the stock could double in value to 150p over the next 12 to 18 months.



By **Steven Frazer**  
News Editor

# We strive to explore further.

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Investments

# Buy Aberdeen Asian Income Fund at a discount

There's scope for the re-rating of the investment trust to continue

**D**espite a narrowing of the discount to net asset value (NAV) from 11% to 7.7% at **Aberdeen Asian Income (AAIF)** there is still a value opportunity here.

The positive re-rating should continue as investors pick up on the fund's improving performance, attractive income credentials – a 4.2% yield – and continuing cheap valuation.

Aberdeen Asian Income seeks to provide investors with a total return primarily by investing in Asia Pacific shares, including those with an above-average yield, and aims to grow dividends (paid quarterly) over time.

Investment bank Stifel argues the recent narrowing of the NAV discount has further to go as performance has improved 'substantially' since the manager modified the investment process.

Although its five-year investment performance is the weakest within its peer group, Aberdeen Asian Income is the second best performing Asian income trust over three years on an NAV total return basis.

## ABERDEEN ASIAN INCOME FUND BUY

(AAIF) 216.5p

Stop loss: 173.2p

Market value: £64.6m



Analysts at Stifel say: 'Aberdeen Asian Income Fund remains our preferred choice in the Asian Income trust space. It is the cheapest trust in the sector by some margin, its investment style could be viewed as appropriate for a weakening economic backdrop and its performance has improved markedly since the manager reviewed their investment approach.'

Aberdeen Asian Income Fund outperformed on a relative basis during 2018 as volatility returned to the markets. While its NAV total return fell 5.5%, this was ahead of the 8.3% decline for the MSCI All Country Asia Pacific ex-Japan index thanks to a focus on quality companies with strong franchises exposed to longer term growth trends and with the

balance sheets to support plump dividend payouts.

Despite a strong rally in Asian markets since the start of 2019, the trust has managed to keep pace.

Prospective investors are buying exposure to such locations as Singapore, a gateway to the emerging Asian economies and a good source of well governed, cash generative, dividend-paying companies such as tech firm Venture Corporation and conglomerate Jardine Cycle & Carriage.

Underweight China, the manager nevertheless maintains its positive view on the Asian powerhouse's long-term consumer demand potential.

Other portfolio positions include TSMC and Samsung Electronics, a tech pair with consistently growing dividends, Indian IT services firm Infosys and Korea-listed LG Chem, which has a platform for growth in the electric vehicle battery market.



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



## TELECOM PLUS

(TEP) £14.26

**Gain to date: 4.5%**

**Original entry point:**

**Buy at £13.64, 6 December 2018**



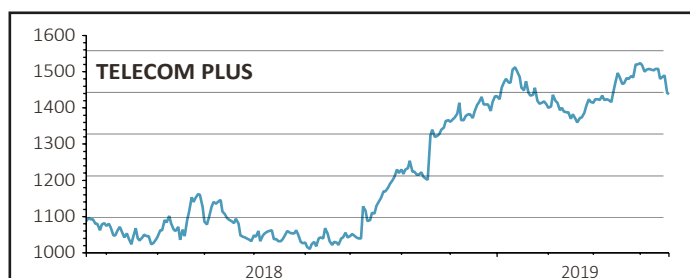
THERE WAS good and bad news with **Telecom Plus' (TEP)** full year trading update. Positive news about growth with customer and service numbers has been offset to a degree by circa £56m pre-tax profit being at the lower end of previous guidance.

Earnings were hit by a very mild winter which reduced energy revenue. It also incurred modest losses from expanding into other business areas and it looks like competition is heating up again.

Telecom Plus' firm refusal to use existing customers to supplement discounted rates for new ones can hamper growth at times. The expectation is that stricter rules on new suppliers will lower the number of entrants running at a loss in a desperate customer land grab, helping Telecom Plus.

But perhaps more importantly, the company is helping itself, cleverly tearing up its wholesale supply deal with nPower to nail down a new, more flexible one.

Wholesale supply deals can be a profit driver and this is reflected in pre-tax profit forecasts for this year of £60m to £65m, implying up to 16% growth. Investors can also look forward to high single-digit increases to dividends.



### SHARES SAYS: ↗

This is a great company to own for the long-term. Keep buying.

## ICG ENTERPRISE

(ICGT) 860.2p

**Gain to date: 6.1%**

**Original entry point:**

**Buy at 811p, 31 January 2019**



SLOWLY BUT SURELY private equity investment trust **ICG Enterprise (ICGT)** is starting to narrow the still significant discount to net asset value endured by the shares.

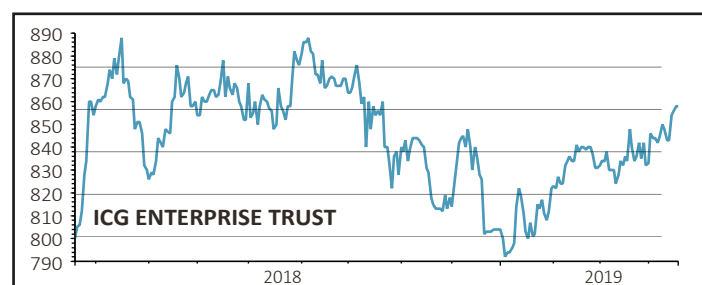
This process was supported by a strong set of full year numbers for the year to 31 January 2019. The net asset value at the end of the period hit £10.46 which represents a year-on-year increase of 10.1%.

The company realised value from 60 of its unquoted investments in the year with an average valuation uplift of 35% to carrying value and at 2.4 times their initial cost.

The trust has moved to paying quarterly dividends and total dividends for the full year came to 22p – slightly higher than the 21p paid a year earlier.

One thing for investors to watch is the replacement of Emma Osborne who has led the investment team since 2004 and is moving to a senior adviser role at the end of 2019 which means she won't be as hands-on with the day-to-day running of the trust.

Broker Stifel comments: 'We think prospects for net asset value growth continue to look good, both from an earnings perspective and in terms of realisations.'



### SHARES SAYS: ↗

Still at a 20% discount to net asset value, this remains a compelling buying opportunity.



# In Japan you need to look past the noise.

## LET'S TALK HOW.



### FIDELITY JAPAN TRUST PLC

**With over 3,500 listed companies, there's a lot of financial noise on the streets of Japan. That can be deafening to untrained ears.**

Through a hands-on research process, Nicholas Price and our team of analysts hone in on stocks with something to shout about that haven't been picked up by other investors. These opportunities are often found in smaller and medium-sized companies not frequently visited by analysts, although they could also be found in other areas of the market.

#### PAST PERFORMANCE

	Dec 13 – Dec 14	Dec 14 – Dec 15	Dec 15 – Dec 16	Dec 16 – Dec 17	Dec 17 – Dec 18
<b>Net asset value</b>	<b>5.0%</b>	<b>26.7%</b>	<b>22.3%</b>	<b>36.2%</b>	<b>-14.5%</b>
<b>Share price</b>	<b>1.8%</b>	<b>22.5%</b>	<b>18.8%</b>	<b>51.5%</b>	<b>-15.1%</b>
<b>TSE TOPIX Total Return Index</b>	<b>10.1%</b>	<b>24.4%</b>	<b>6.6%</b>	<b>11.2%</b>	<b>-9.4%</b>

**Past performance is not a reliable indicator of future returns.**

Source: Morningstar as 31.12.2018, bid-bid, net income reinvested.

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So if the growth prospects of the world's third-largest stock market sound appealing, listen to your instincts and discover more about Fidelity Japan Trust PLC.

The value of investments can go down as well as up and you may not get back the amount you invested. Overseas investments are subject to currency fluctuations. The shares in the investment trust are listed on the London Stock Exchange and their price is affected by supply and demand. The investment trust can gain additional exposure to the market, known as gearing, potentially increasing volatility. This trust invests more heavily than others in smaller companies, which can carry a higher risk because their share prices may be more volatile than those of larger companies.

**To find out more, go to [fidelity.co.uk/japan](http://fidelity.co.uk/japan) or speak to your adviser.**



## GB GROUP

(GBG:AIM) 606p

**Gain to date: 43.4%**

**Original entry point:**

**Buy at 422.5p, 20 December 2018**



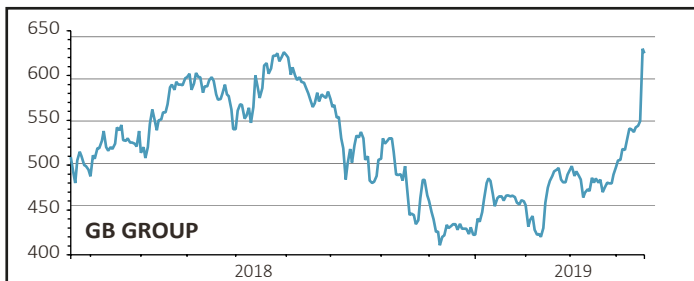
A RELATIVELY short but sweet trading update from identity data intelligence supplier **GB Group (GBG:AIM)** gave investors everything they need to read before getting their teeth into the actual results, scheduled for 3 June.

News of 20%-odd growth in headline revenue and adjusted operating profit was better than expected while organic growth was 11% for the year to 31 March 2019.

The switch from a £13.5m cash-rich position a year ago to net debt of £66.3m also illustrates what a whirlwind year for the company it has been, including its biggest acquisition to date, the \$300m Idology buy in February.

This hints at GB's technology edge over competitors where it increasingly taps into capital markets to cherry pick niche solution suppliers to build out its own product set, with the US particularly interesting to management.

Most analysts are leaving 2020 forecasts and beyond alone for now, but the gun feels loaded for when those detailed figures emerge in just over a month's time.



### SHARES SAYS: ↗

With the market opportunity getting bigger by the day as more retail spend moves online, GB remains a unique technology play. It is one of our top picks of the year and we're really happy with the performance so far.

## DISCOVERIE

(DSCV) 434p

**Gain to date: 6.9%**

**Original entry point:**

**Buy at 406p, 14 February 2019**



ENHANCED GROWTH prospects and reduced debt is how one analyst describes the latest situation for electronics engineer **DiscoverIE (DSCV)**.

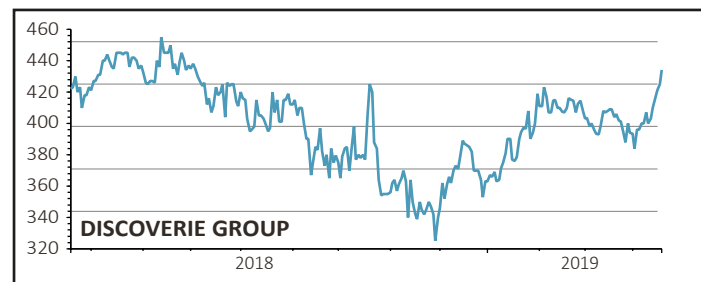
Last week the company forked out £15.9m on a pair of custom design engineering businesses – Hobart Electronics and Positek – with manufacturing in the US and Mexico.

The deals should provide cross-selling opportunities in time, plus some potential for stripping out operating costs.

Both Hobart and Positek underscore a key theme of our original investment idea – namely that DiscoverIE is stepping into higher margin projects through complex design and manufacturing rather than just distributing parts.

A £29m fundraise will help to pay down borrowings, taking net debt-to-EBITDA (earnings before interest, tax, depreciation and amortisation) from approximately 1.9 to 1.5-times. That leaves plenty of headroom for additional bolt-on acquisitions as opportunities emerge.

The stock has made reasonable progress in the short time since we first flagged the investment opportunity yet DiscoverIE still trades at a 15% to 20% discount to peers.



### SHARES SAYS: ↗

A clear vision and strategy to execute, analysts see 500p as a 12-month target for the stock. We think the upside could be greater.



# HOW ARE UK SMALLER COMPANIES FARING?

Jonathan Brown and Robin West, Fund Managers of the Invesco Perpetual UK Smaller Companies Investment Trust plc, share their thoughts on the smaller end of the UK equity market. Is the future bright for smaller companies? How are they preparing for Brexit?

**In this video, they answer the following questions and more:**

- What is your outlook for UK smaller companies?
- How are these companies positioning themselves ahead of Brexit?
- Where are you finding opportunities?
- Why do smaller companies tend to outperform larger companies over the long term?
- What are the benefits and challenges of investing in smaller companies?



## **Investment risks**

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

When making an investment in an investment trust you are buying shares in a company that is listed on a stock exchange. The price of the shares will be determined by supply and demand. Consequently, the share price of an investment trust may be higher or lower than the underlying net asset value of the investments in its portfolio and there can be no certainty that there will be liquidity in the shares.

As this is a smaller companies product, investors should be prepared to accept a higher degree of risk than for a product with a broader investment mandate.

The product uses derivatives for efficient portfolio management which may result in increased volatility in the NAV.

The use of borrowings may increase the volatility of the NAV and may reduce returns when asset values fall.

## **Important information**

Where individuals or the business have expressed opinions, they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice.

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# ALEXA, HOW BIG CAN YOU GET?

*Tom Slater, joint manager of Scottish Mortgage Investment Trust, on tomorrow's opportunities*

The value of your investment and any income from it can go down as well as up and as a result your capital may be at risk.

When Tom Slater met Jeff Bezos in Seattle recently, the Amazon CEO explained how little he cared about daily market news. Better, he said, to spend his time "living in the future ... a wonderful place".

In their discussions Bezos touched on a number of business areas: cloud, media, grocery and other projects that he thinks will shape what that future will look like. Following on from that conversation, Tom Slater shares some thoughts on the topics that excite Mr Bezos – and Scottish Mortgage managers, starting with Amazon's ubiquitous voice-activated assistant.

The Amazon Echo speaker and Alexa, its integrated voice-activated assistant, are already everywhere. cursory analysis might suggest that the smart speaker market is therefore maturing and the fastest revenue growth phase is behind us. According to this view, Alexa will be another contributor to a slowing top line at Amazon over the coming years.

It is exactly this narrow kind of thinking that has led Wall Street to underestimate Amazon for the past two decades. We would not disagree that the smart speaker market is no longer of much interest. But far more importantly Amazon has laid the foundations of a new era of computing.

Alexa's success has created an expectation that we ought to be able to speak to our devices. The monitor, the keyboard and the mouse are too cumbersome to fit with our mobile lifestyles and consumers are embracing their alternative. With 28,000 Alexa-compatible smart home devices from more than 4,500 brands Alexa, is coming to



your microwave, to your television, to your car, and even your bicycle. 'Ambient computing' is becoming a reality.

The rise of this computing-on-the-go, where devices work in concert with our everyday activities, has been predicted for decades. Voice as the primary computing interface could reduce friction in communicating, searching, and most important to Amazon, buying stuff.

Some readers may remember paging through a multi-volume encyclopaedia or even asking someone more informed to fill in knowledge gaps. Search engines made this task less laborious, although initially they were far from reliable. We needed to choose the right keyword, then navigate pages of search results hoping that the information sought would surface. Voice computing, on the other hand, requires and



demands a more straightforward approach – the correct answer first time.

As the pace of change in the computing era accelerates, we see new business models appearing, each with the ability to disrupt conventional methods. Voice has the potential to do that with search – whether seeking a piece of information or actively making a purchase.

Tough questions are asked of advertisers as the intersection of computing and human language continues. The ‘real estate’ available to them reduces in a voice-driven economy and naturally, what remains becomes more valuable. As Alexa improves and the product becomes more widespread, advertisers will increasingly shift their attention to voice over text search. We may be seeing this already. Growth in ad revenues from Amazon’s ecommerce business show this area becoming a lucrative income stream for the company. Product advertisers already realise the importance of being one of Alexa’s coveted answers.

Very few other companies have the infrastructure to create a product like Alexa. Amazon has over 100 million Alexa-enabled devices in circulation which means it is collecting data faster than rivals. Its competitive edge is increasing. Data matters because of how

inadequate Alexa currently is relative to our expectations. We want to interact with ‘her’ like a person, where as in reality ‘she’ is a four-year-old algorithm. Those managing the business see themselves as a four-year-old start-up. The things they need to improve are predominantly engineering problems within their control. They need to improve their natural language processing and in ‘contextualised search’: the ability to give results based on user preferences and circumstances. According to results published in January, Alexa already boasts 80,000 skills. Amazon needs to connect Alexa to more devices, and to strike more partnership deals. As the future-dwelling Mr Bezos knows, these priorities have nothing to do with current market vagaries.

Think of the potential: if this technology becomes our default household assistant and the means by which we organise our households, then Amazon has just taken an important step closer to influencing the way we decide to spend our money. And crucially, it can monetise this role by selling shoes, not just advertising shoes. This is a business model edge that no others can match. No wonder Jeff was so excited.

For more information on Scottish Mortgage Investment Trust please [click here](#).

As with any investment, your clients’ capital is at risk. The views expressed in this article should not be considered as advice or a recommendation to buy, sell or hold a particular investment. The article contains information and opinion on investments that does not constitute independent investment research, and is therefore not subject to the protections afforded to independent research.

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### Biography – Tom Slater

Tom graduated BSc in Computer Science with Mathematics from the University of Edinburgh in 2000. He joined Baillie Gifford the same year and worked in the Developed Asia and UK Equity teams before joining the Long Term Global Growth Team at the start of 2009. Tom became a Partner in the firm in 2012. Tom was appointed Joint Manager of Scottish Mortgage Investment Trust in January 2015 having served as Deputy Manager for the previous five years. In 2015 Tom was appointed Head of the US Equities Team and is a decision maker on Long Term Global Growth portfolios. Tom’s investment interest is focused on high growth companies both in listed equity markets and as an investor in private companies.

# The rise of the regulators

What's good for consumers may not be so good for investors



**L**ed by the UK's Competition and Markets Authority (CMA), anti-trust regulators around the world are having a bigger say than ever in corporate affairs. While this is good news for consumers, for investors the regulators represent another level of risk and complexity.

There are many current examples involving UK-quoted shares such as news last week that the CMA was opening a full investigation into last September's acquisition of **Mitie's (MTO)** pest control business by **Rentokil Initial (RTO)**.

The regulator says that because the two firms are among the top four suppliers of pest control services in the UK, 'there could be a substantial reduction in competition, which may lead to higher prices or reduced quality for customers

that primarily use a single provider across the whole or a large part of the UK'.

To put this into perspective, Rentokil made 42 pest control acquisitions in 22 countries last year from the Dutch Antilles and Indonesia to the UAE and not one of them was considered likely to lead to reduced competition, except for the Mitie deal.

## THE REGULATOR SENDS ITS REGARDS

The CMA says it works to promote competition for the benefit of consumers, both within and outside the UK. 'Our aim is to make markets work well for consumers, businesses and the economy,' it adds.

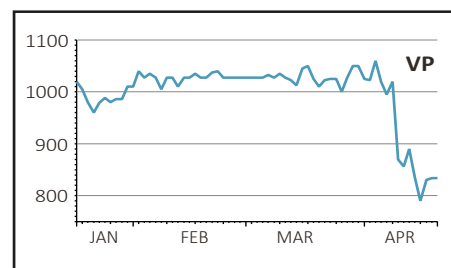
And it has certainly been a busy time for the watchdog. Last June it opened a review of the funeral market amid concerns that 'prices had been increasing

substantially'. It subsequently launched a full-blown investigation, sending shares in funeral operator **Dignity (DTY)** close to five-year lows.

In December it announced a review of pricing across mortgages, car and home insurance, broadband and mobile services, where it found that loyal customers were being charged 'significantly' higher prices than new customers.

In its preliminary report it accused firms of 'damaging practices' designed to 'exploit unsuspecting customers' with stealth price rises, costly exit fees and overly complicated processes to cancel or switch providers.

Recently it has looked into price fixing in the market for rented groundwork products used in big, largely publicly-funded infrastructure projects, and has singled out **VP Group (VP.)** for further investigation. VP shares collapsed 15% on the news.



It has also warned travel booking firms over their cancellation policies and fees, and has called for the Big Four accountancy firms to split their audit units from their other

group operations, drawing anger from the CBI business lobby group.

Responding to the CMA's audit recommendations, CBI president John Allan says: 'The UK's position as a world leader on corporate governance is highly-prized. But with the eyes of the world on the UK, some CMA proposals risk damaging that reputation.'

'Mandating joint audits will add cost and complexity for business with no guarantee of better outcomes. Operational splits could restrict access to the skills required to carry out complex audits,' he adds.

### UNEXPECTED PROBE IN BAGGING AREA

One of the most high-profile CMA cases is the proposed merger between supermarkets **Sainsbury (SBRY)** and Asda.

In late February the regulator confirmed it was launching a full investigation into the merger on the basis that shoppers could face 'higher prices or a worse quality of service' while the supermarkets would wield excessive 'buyer power' over their suppliers. Sainsbury's shares dropped 19% on the news.

A verdict is due on or by 30 April but it seems unlikely that the merger will be approved without sizeable concessions, which could scupper the economics and the rationale behind the deal altogether.

### THE MUSCLE FROM BRUSSELS

The EU's competition commissioner, Margrethe Vestager, is renowned for taking on big business and has become



The CMA has concerns about the proposed merger between Sainsbury's and ASDA

one of Europe's most influential politicians.

Earlier this year Vestager fined Google €1.49bn for restricting third party advertising services on displaying search ads. That brings the total antitrust fines against Google to over €8bn.

France's Alstom and Germany's Siemens, two of Europe's largest industrial firms, recently fell foul of EU anti-trust rules over their proposal to combine their rail operations.

Even though a deal was backed by the French and German governments who want to form a European champion capable of competing globally, the commissioner opposed the merger on the basis that it would pose 'serious competition problems' for the firms' European customers and could lead to 'higher prices, less choice and less innovation'.

Germany's beleaguered car makers are also under scrutiny after the EU commissioner launched a probe into whether they conspired to limit the development of clean emissions technology.

Already facing billions of euros in fines following the 'Dieselgate' scandal, the 'circle of five' – Audi, BMW, Daimler, Porsche and VW – are being investigated for acting jointly to restrict

the development of engine technology which would have reduced harmful emissions.

The industry has already been investigated for operating cartels in the manufacturing of parts such as bearings, brakes and spark plugs.

### THE US REGULATOR IS JOINING IN

The US Justice Department is reported to have waded into the \$26bn merger between T Mobile US and Sprint this month to tell both parties that it has concerns about the structure of the deal.

The companies insist that the merger will allow them to invest more money faster in 5G networks to compete more effectively with AT&T and Verizon.

However critics say that reducing the number of national mobile operators would be negative for consumers.

Shares of Sprint fell 9% on the news while T Mobile shares fell 4%, illustrating again the danger for investors in companies which wittingly or unwittingly fall foul of the regulators.



By Ian Conway  
Senior Reporter



# UK's best performing technology companies so far in 2019

Who are they, what do they do and what does the future hold?

**U**K technology stocks have soared in 2019, matching or beating the performance of much better-known benchmarks for leading technology companies such as the Thomson Reuters Global Technology index or the US-based NASDAQ.

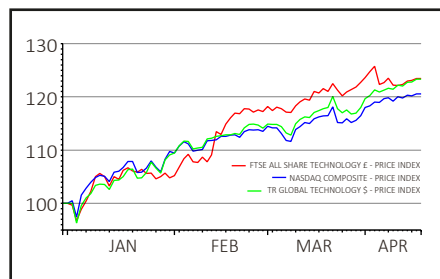
While recent technology headlines have been captured by Uber's IPO, Apple's iPhone sales, intensifying competition for Netflix or a tightening regulatory screw on social media companies, many UK technology stocks have been quietly knocking the lights out.

Year-to-date the FTSE All-Share Technology index has rallied 23.4%. That's better than NASDAQ'S 20% gain and far surpasses the near-11% rally in the FTSE 100.

You might think this eye-catching performance so far in 2019 is being driven by fast-growing, highly-rated tech stocks, but you'd be wrong.

## UK TECH: WHO ARE YOU?

While some of the world's largest companies – Amazon, Microsoft, Apple – dominate technology indices and stock markets worldwide, it is long-established suppliers of IT services and software in areas like accounting, financial services



and engineering that power the UK space.

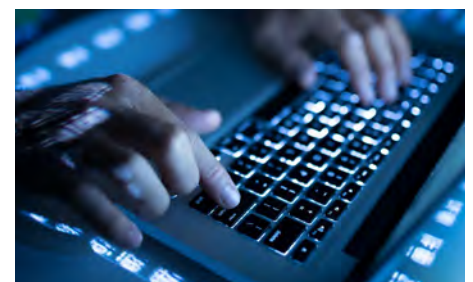
Accounting specialist **Sage (SGE)** and infrastructure group **Micro Focus (MCRO)** have provided much of the share price fuel for the UK technology sector so far this year. Worth approximately £7.8bn and £8bn respectively, these are more mature software suppliers which have been around for several decades, where growth is less racy but profits and cash flows are huge.

They are the industry's sole

members of the FTSE 100 index. Together with £5.2bn engineering design firm **AVEVA (AVV)** – which narrowly missed out of FTSE 100 promotion in February – they account for roughly two thirds (61.8%) of the UK stock market's technology value.

Micro Focus and AVEVA are two of the sector's top five performing tech stocks so far this year, up 40% and (nearly) 35% respectively.

Part of the reason for this share price strength is improving





## Who's in the UK's Technology index?

Name	Share price year-to-date (%)
Softcat	46.3
Micro Focus	40.3
Kainos	37.0
Nanoco	35.8
AVEVA	34.8
FDM	25.8
Spirent Communications	23.5
Alfa Financial Software	18.9
Sage	18.3
Aptitude Software	14.2
SDL	9.7
Computacenter	7.2
BATM Advanced Communications	3.2
Avast	0.0
NCC	-1.8
Sophos	-4.2
Funding Circle	-7.8

Source: Reuters Eikon, 17 April 2019

investor optimism on the integration benefits of past large and complex acquisitions.

There is also renewed hope that Sage's new management team can finally get a better grip on cloud delivery, helping lift its share price by 18.3% so far in 2019.

Other strong contributors to the UK technology sector's strength come from IT reseller and consultancy supplier **Softcat (SCT)** and digital transformation specialist **Kainos (KNOS)**, where both are seeing surging demand from enterprise and public sector customers alike.

## NEW TECHNOLOGY DAWN

But as the world is redrawn with a new technology pen it is worth looking beyond the UK technology establishment for compelling investment ideas.

Companies listed on the AIM junior market are not included in the main benchmark indices and so do not contribute to the performance of the FTSE All-Share Technology index. Yet AIM is home to some of the brightest emerging stars.

For example, digital workforce tools designer **Blue Prism (PRSM:AIM)** is a company which *Shares* recently suggested may be the 'best growth stock on the UK market'. Worth about £1.2bn, after rallying 43% since 31 December 2018, we calculate that it would now add an extra 3.5% to the FTSE technology sector if it qualified for inclusion.

Shares in Northern Ireland-based big data analytics company **First Derivatives (FDP:AIM)** have done even better, up 48% in 2019 so far. Investors seem to be getting their confidence back



Name	YTD (%)
First Derivatives	48
Blue Prism	43
Earthport	30
GB Group	30
WANDisco	30

Source: Sharepad, 16 April 2019

after the company was targeted in a short selling attack last year, when traders bet that the stock would fall, due to accounting question marks.

Other strong AIM performers this year include global payments platform **Earthport (EPO:AIM)**, the subject of a bid battle between credit card giants Visa and Mastercard, and data replication platform **WANDisco (WAND:AIM)**.

Lastly, **GB Group (GBG:AIM)**, which supplies niche identity data intelligence solutions, last week reaffirmed its long-term growth potential with double-digit growth metrics.

It is arguably a mistake to think the UK is going to create a technology giant to compare with Google or Facebook – most experts believe it highly unlikely, if not impossible. But the UK is certainly not short of promising technology businesses with plenty of scope for future growth.



By **Steven Frazer**  
News Editor

# RETAIL APOCALYPSE? WHY INVESTORS SHOULD SEPARATE FACT FROM FICTION

ADVERTORIAL

Schroders

If you want to gain an investment edge with UK retail stocks then it's imperative to look beyond the headlines.

Following some dire headlines you might rightly wonder why the share prices of UK retailers have recorded double-digit gains this year.

The gap between the perception of how retailers are trading and their actual performance appears to be a classic case of "confirmation bias", which is the human tendency to seize on things that confirm pre-existing beliefs. Rather than being dire, trading can perhaps be better summarised as "tough but not getting any worse".

This gap between perception and reality has been apparent for a while – last spring it was possible to discern improving revenue and margin trends as pressures facing the UK consumer began to ease. However, it's the profit warnings and administrations which continue to grab the headlines while broker "sell" recommendations remain numerous. Expectations are sufficiently low to set the scene for further recovery.

Recent surveys indicate that UK consumers are more confident about their personal economic situation than about the country's general economic prospects.

A strong jobs market, higher wages and tax changes appear to have underpinned spending. Wages are growing at the fastest rate since 2008, outstripping the rate of inflation which has moderated, falling to a two-year low in January.

## Ratings out of kilter

Towards the end of 2018, a number of consumer-focused sectors, including UK general retailers, "de-rated" significantly in excess of the wider market. In other words, their shares fell sharply without any marked change in underlying earnings expectations as investors became concerned there could be further bad news to come.

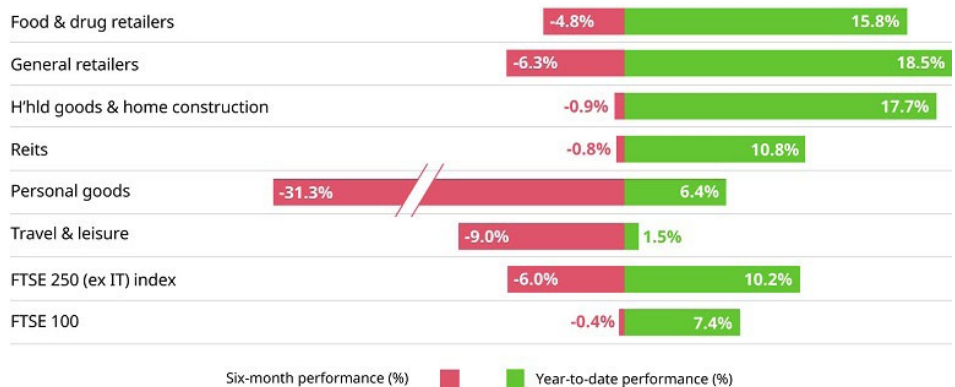
In the event, the trading updates since the start of 2019 have not borne out these fears. A number of the more challenged retailers reassured that trading had not deteriorated further. Meanwhile, several specialists, for example Pets at Home, Dunelm and JD Sports, reported strong same-store sales growth.

With expectations so low, the mood didn't need to lift much for shares to bounce back.

## Cautiously optimistic outlook

There has historically been a close correlation between real wage growth and retail and labour market data from the Office for National Statistics suggests that the backdrop for wages remains supportive. The

### UK consumer-focused sectors bounce back



Source: FactSet. The sector data is based on FTSE All-Share sectors, except for the household goods & home construction and personal goods sectors. These two groupings respectively include the multi-national large cap consumer goods companies Reckitt Benckiser and Unilever, so FTSE 250 (ex Investment Trusts) sector data is used in place of FTSE All-Share data as it better reflects the performance of their UK consumer-focused constituents. All data based on total returns to close 12/03/2019. CS1101

Past performance is not a guide to future performance

### UK retail sales (ex auto fuel) versus real wage growth



Source: Refinitiv, January 2019.

UK unemployment rate is at its lowest since the 1970s, although business investment has fallen against the backdrop of Brexit uncertainty and we are closely monitoring the impact on the jobs market.

Consumers should also get a boost to their disposable income this year from tax changes announced in last autumn's Budget, in part funded by an improvement in the UK's fiscal position as tax revenues have been strong.

## Specialist retailers shine through

Some major bricks-and-mortar retailers have suffered sharp sales slowdowns resulting in multiple profit warnings last year and this. But among businesses that are better adapting to

the structural shifts reshaping the high street, the news has been encouraging; many have capitalised on their competitors' weaknesses.

A number of the specialists have well-developed "multi-channel" strategies, having discovered the most effective blend of in-store and online offerings, and delivered growth as a result, with Dunelm being a good case in point. Meanwhile, innovative new management teams at several of the other niche retail operators are repositioning their businesses with the aim of turning performance around.

The financial fundamentals of many UK retailers are solid: attractive dividend yields are well covered by earnings and therefore

look sustainable. Retail rents, which are a significant cost component of bricks-and-mortar retailers, are falling, which should help to protect these companies' cash flows.

Market participants are overlooking the positive impact of falling costs, as alluded to in comments accompanying Next's recent inline results from CEO Simon Wolfson. Referring to often being asked "How much less space will you need in the future?", Wolfson said the question was wrong as Next does "not have too much space, we have too much rent, rates and service charge".

In our opinion, investors remain overly focused on the online threat. This threat has now been addressed in many cases where "self help" measures (management initiatives to enhance performance, such as Dunelm's drive to sell additional goods online via in-store tablets), have significantly increased the proportion of e-commerce sales.

Despite today's near-universal pessimism there are plenty of reasons to be optimistic about the outlook for the UK's dynamic and innovative retailers.



Jean Roche, Fund Manager, Pan-European Small and Mid Cap Team



Andy Brough, Head of Pan-European Small and Mid Cap Team

### Double discount

Negativity toward UK equities and domestically focused equities has impacted

the Schroder UK Mid Cap Fund. Shares in the trust have failed to keep track with the performance from the underlying portfolio). As a result they are trading at a discount of 11.5% to net asset value (Schroders, as at close 12/03/2019) despite having rallied 21% year to date (Refinitiv, sterling total returns, to close 12/03/2019).

Not only has the trust's share price lagged but its domestically focused holdings have underperformed and are trading at a significant valuation discount to large-cap multinationals. The trust can therefore be said to offer a "double discount". The share prices of many of these holdings have fallen in absolute terms since 2016, despite operating in areas of structural growth, where demand exceeds supply and delivering strong earnings and dividend growth. Our holdings include JD Sports, Dunelm and Pets at Home, as well as housebuilders Redrow, Crest Nicholson and Bovis Homes.

We believe that our unique and consistent investment process, which takes a stock-specific approach with an emphasis on growth companies, will continue to deliver superior long-term returns.

## CUMULATIVE PERFORMANCE TO 31 JANUARY 2019 (%)

	3 Months	1 Year	3 Year	5 Year	10 Year	Since launch**
<b>Net asset value cum income</b>	2.3	-4.4	26.2	31.1	345.1	819.2
<b>FTSE 250 (ex Investment Trusts) index*</b>	-1.0	-6.3	19.9	32.7	306.4	524.5
<b>Relative</b>	3.3	1.9	6.3	-1.4	38.7	294.7
<b>Share Price</b>	6.6	-2.3	19.9	19.0	394.8	887.5

\*With effect from 1 April 2011 the company's benchmark changed to the FTSE 2250 (ex Investment Trusts) index. Prior to that date, the benchmark was the FTSE All-Share (ex Investment Trusts) index, ex FTSE 100. The 10 years and since launch data has been chain-linked to reflect this change.

\*\*From launch on 30 April 2003 (close) to 31 January 2019. The net asset value performance is based on ex income figures as cum income figures unavailable pre 2008.

### 1<sup>st</sup> out of 9 trusts in the association of investment companies' UK all companies sector since fund launch<sup>1</sup>

Ranking in Association of Investment Companies' UK All Companies sector, as at 31 December 2018, sourced from Morningstar, covering period from close 30 April 2003 to 31 December 2018 (NAV ex Income TR) - only 9 funds in the sector have a track record for this period.

## DISCRETE YEARLY PERFORMANCE (%)

	2018	2017	2016	2015	2014
<b>Net asset value cum income</b>	-15.5	24.7	2.5	14.6	-3.0
<b>FTSE 250 (ex Investment Trusts) index</b>	-15.2	18.2	5.1	12.0	2.8
<b>Relative</b>	-0.2	6.4	-2.6	2.6	-5.8
<b>Share Price</b>	-17.3	28.6	-8.2	14.0	-10.5

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested. Investing in a concentrated geographical region may result in large changes in the value of any investment.

### What are the risks?

The trust may be concentrated in a limited number of geographical regions, industry sectors, markets and/or individual positions. This may result in large changes in the value of the fund, both up or down, which may adversely impact the performance of the fund.

As a result of fees being charged to capital, the distributable income of the fund may be higher but there is the potential that performance or capital value may be eroded.

The trust may borrow money to invest in further investments, this is known as gearing. Gearing will increase returns if the value of the investments purchased increase in value by more than the cost of borrowing, or reduce returns if they fail to do so.

# JAPAN: GROWTH IS ACCELERATING AND SO COULD YOUR RETURNS

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We pick three funds to play the recovery in the Japanese stock market

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**S**ince Tokyo's Nikkei 225 index peaked at 39,000 in 1990, investors have been well served by avoiding the Japanese stock market. Although it rallied strongly in 2016 and 2017, the benchmark is still down almost 50% from its highs making it the worst-performing major index by a wide margin.

However, with the Nikkei now trading at just over 20,000 points, half its level of nearly 30 years ago, and the economy growing at its best rate in decades, we think it's time for investors to take another look at Japan.

## FROM BOOM TO BUST

In the late 1980s, when much of the West was seen as in decline, Japan experienced an enormous bubble in domestic real estate and share prices.

Ultra-low interest rates and government stimulus sent property prices through the roof. Valuations became so detached from reality that by 1989 the grounds of the Emperor's palace in Tokyo were said to be worth more than the entire state of California.

At the same time Japanese banks became the biggest in the world by market value and the chief executives of major corporations competed for trophy assets like New York office buildings, fine art and classic cars.

Even dull, run of the mill stocks were chased up to 50 to 100 times earnings, helped by Japanese companies using the cash on their balance sheets or gearing themselves up to play the market, a practice known as 'zaitech' which gave business leaders great bragging rights.



In late 1989 a new governor took over the Ministry of Finance with a mission to crack down on speculation. The stock and property markets continued to climb into 1990 but finally they cracked in spectacular style.

The deflationary bust that followed the market collapse saw economic growth turn negative along with wage growth and consumer spending and Japan went into what became known as the 'Lost Decade'.

Bad loans grew at such a rate that the government had to bail out many of the smaller banks, which became known as 'zombies' because they could neither lend nor borrow but were just kept from failing.

Productivity stagnated, consumers saved their money rather than spending so domestic demand collapsed, and finally inflation turned into deflation.



## EXTRAORDINARY TIMES CALLED FOR EXTRAORDINARY MEASURES

With core inflation turning negative, in February 1999 the Bank of Japan introduced a zero interest rate policy to try to stimulate the economy and dispel fears of deflation.

By the summer of 2000 prices seemed to have turned back up and the central bank called an end to zero rates, but it was premature and six months later had to reverse course again.

As well as zero rates, the bank experimented with quantitative easing (QE) by pumping money into the financial system and buying government bonds, a policy which it carried on until 2006 when inflation turned positive.

Unfortunately the bank exited QE just as the world was about to enter the great financial crisis which sent inflation and the economy into another downward spiral.

## GROWTH HAS RECOVERED THIS DECADE

The election of current prime minister Shinzo Abe in 2012 brought much-needed change on an economic and a political level.

As well as introducing a three-pronged approach to revitalise the economy, dubbed 'Abenomics', the new prime minister brought political stability:

## RIISING DEMAND FOR JAPANESE STOCKS

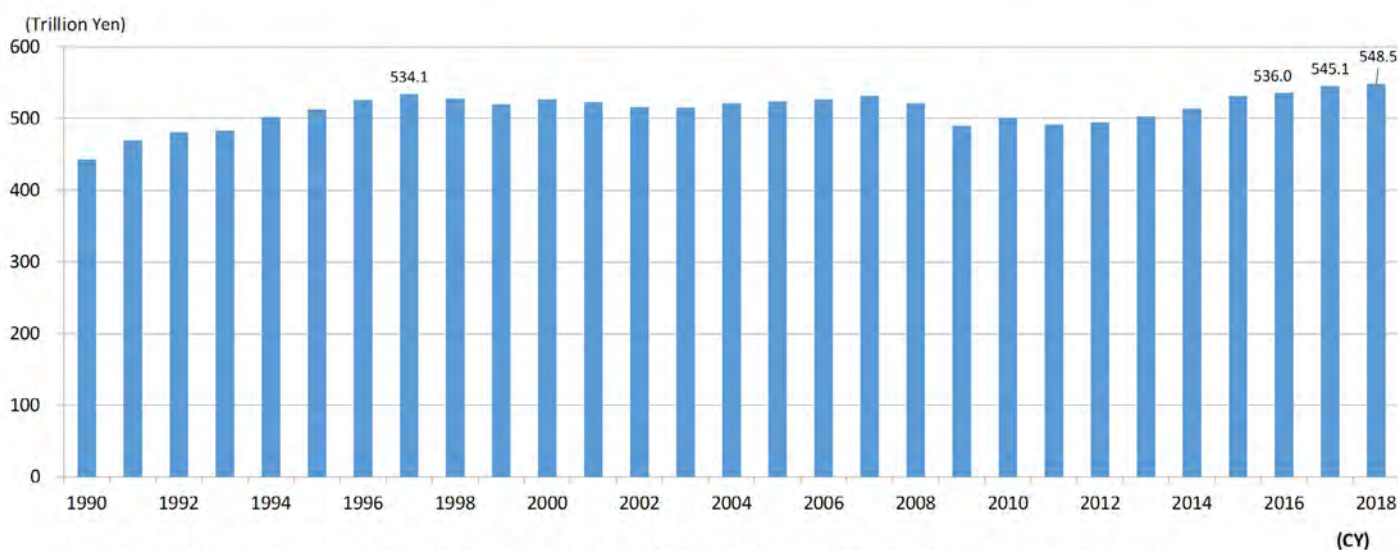
Data from Japan's stock exchanges shows that foreign investors turned net buyers of Japanese stocks since the start of April.

Overseas investors bought a net ¥800bn (\$7.2bn) of stocks and futures in the first week of this month, their biggest weekly net purchase since last September.

before Abe's election there had been six prime ministers in six years.

With the economy improving and a shortage of workers due to Japan's well-documented declining population, wages began to rise which

## Nominal GDP, Japan, 1990-2018: It took about 20 years to recover



(Source) Cabinet Office, Government of Japan, Quarterly Estimates of GDP - Release Archive - 2018 > Oct.-Dec. 2018 (The 1st preliminary), 1990-1993: National Accounts of 2009

fed through into higher consumer confidence and higher spending.

Christian Keller, head of economic research at Barclays, notes that Japan's economy is experiencing its longest post-war expansion this decade.

'Contrary to widespread perception, per-capita GDP growth since the great financial crisis has actually been stronger in Japan than in the US, the Euro area, the UK or Canada,' he adds.

The tight labour market has lifted salaries for low-paid workers which means that the gap



between the highest-paid and the lowest-paid has narrowed, improving social equality.

Meanwhile more women have entered the workforce, and salaries are rising: from this April, all Japanese companies are required by law to pay women and men the same salary for the same job, which will help reduce the 'gender gap'.

Inflation, while some way short of the government's official target of 2%, is rising and the threat of deflation looks to have been defeated.

### **ECONOMIC FORECASTS ROBUST DESPITE GLOBAL SLOWDOWN**

In its latest World Economic Outlook the International Monetary Fund cut its forecast for global growth this year from 3.7% to 3.3%, the slowest rate of increase since 2009.

The best growth is seen in 'emerging' economies, including China, which make up close to 60% of global GDP and are expected to grow by 5%, while 'advanced' economies including Japan make up the other 40% and are seen growing by less than 2%.

However, while the US and the Euro area are seen slowing this year – US growth from 2.9% last year to 2.3% and the Euro area from 1.8% to 1.3% – growth in Japan is seen accelerating from 0.8% to 1%.

There are risks to these forecasts from an

escalation of the trade war between the US and China, currently huffing and puffing like a pair of sumo wrestlers, but the implications for Japan are positive.

Moreover Donald Trump's decision to abandon the Trans-Pacific Partnership has been good news for Japanese companies who have been able to increase their share of regional trade without having to compete with US firms.

There are also structural changes afoot within Japan which could cushion its economy and its stock market to a degree should a trade war develop.

### **DEMOGRAPHICS COULD BE A BLESSING AS WELL AS A CURSE**

Japan's shrinking population is driving structural and technological changes which may offer clues for Europe as it confronts its own demographic problems in the next couple of decades.

As the shortage of people entering the workforce led to higher wages, Japanese companies have looked for ways to improve their productivity: if they can't hire more workers, they need their existing workers to be more productive.

With company earnings at high levels, more money is being invested in software and services not to replace workers but to help them do their jobs faster and better.

Eiji Saito, Tokyo-based manager of investment trust **JPMorgan Japan Smaller Companies (JPS)**, is a firm believer that the technology sector is set to be a big winner.

'We are overweight technology, especially companies serving the financial industry. That means that we can be underweight traditional financial stocks like regional banks,' says the manager.

The terms overweight and underweight are used by fund managers to indicate their preference for





## WHAT IS ABENOMICS?

Abenomics refers to a set of aggressive fiscal and monetary policies and structural reforms designed to pull Japan out of its decades-long deflationary slump.

Fiscal stimulus began in 2013 with a ¥20trn (\$210bn) package of which ¥10.3trn (\$116bn) was direct government spending on big infrastructure projects like earthquake-resistant bridges, tunnels and roads. Another ¥5.5trn boost followed in April 2014, and after the December 2014 elections Abe pushed through another spending package worth ¥3.5trn.

The Bank of Japan's unorthodox quantitative

easing policy, which dates back to the early 2000s, is central to Abenomics. *The Wall Street Journal* called it 'a gigantic experiment' yet the Federal Reserve and the European Central Bank later adopted the same policies to support their own economies in the aftermath of the financial crisis.

Structural reforms of Japan's economy were long overdue. Changes included slashing business regulations, opening up the labour market and the agricultural sector, cutting corporate taxes, and increasing workforce diversity. The reforms were aimed at rejuvenating the economy but also at reviving Japan's competitiveness internationally.

stocks or markets relative to particular indices or benchmarks.

For Saito, the issue of demographics is also a reason to be underweight real estate, consumer staples and consumer discretionary stocks.

## CORPORATE GOVERNANCE IS IMPROVING

One of the biggest issues foreign investors have had with Japanese companies is their poor corporate governance compared with international standards.

For Lucy Macdonald, who heads the global equities team at Allianz Global Investors, the list

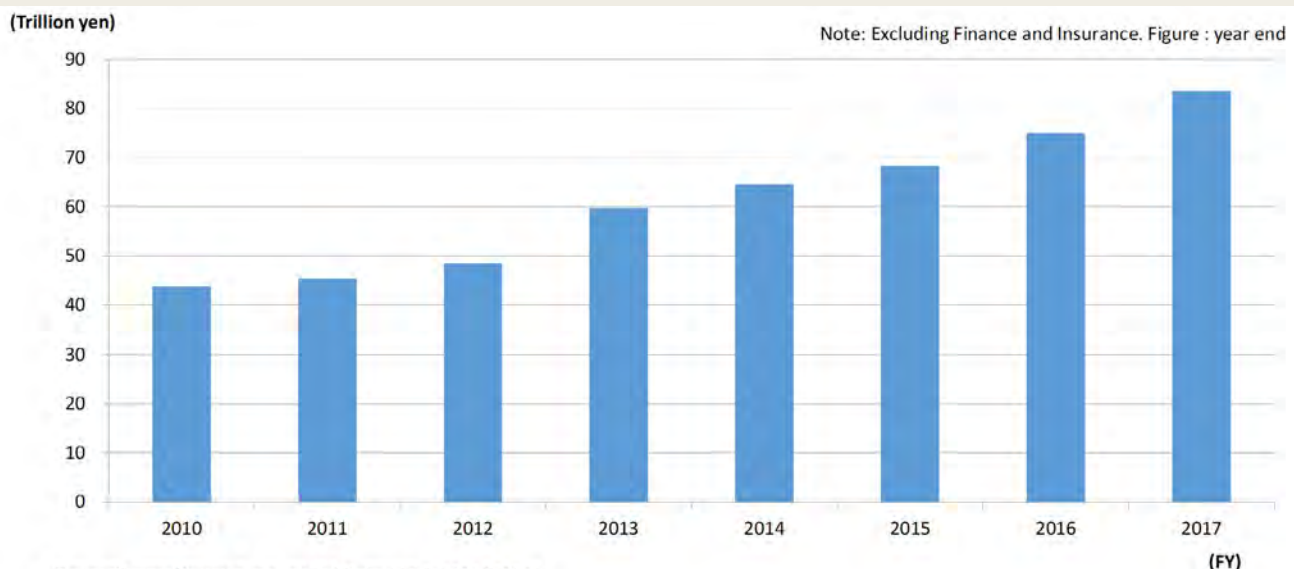
of companies which meet the desired governance criteria is so small that 'either everyone ends up owning the same stocks or they are priced out'.

However the Corporate Governance Code, which was introduced in 2015 and updated last year, seems to be making a difference.

A major target of the code is 'keiretsu' or the decades-old practice of cross shareholdings built up to defend the interests of groups of companies. The 2018 revision to the code explicitly states that companies should have a policy for reducing cross shareholdings.

Other targets include freeing up cash on the

## Recurring Profits at All Industries, Japan, 2010-2017



(Source) <https://www.e-stat.go.jp/dbview?sid=0003060791>



balance sheet to increase shareholder returns, for example through increased dividends or share buybacks.

In February this year, Japan Tobacco, Softbank, Sony and Yamaha Motor all surprised investors by announcing they would buy back their own shares in response for calls for higher returns.

Joe Bauernfreund, lead manager of investment trust **AVI Japan Opportunity (AJOT)**, says: 'Activism or shareholder engagement is no longer a rarity in Japan. Attitudes have shifted dramatically since the taboo days of 2005 when activists' arguments were seen as myopic. Companies today are open to suggestions and in some cases welcome them.'

### RISKS VERSUS REWARDS

As well as the risk of an escalation of trade wars, Japan's economy is saddled with a high level of government debt from the various rounds of QE used to stimulate the economy.

According to the OECD, at the end of last year Japan's government debt was equal to 238% of GDP, the highest ratio of any G20 country and more than double those of its major trading partners like the US (104%), China (50%) or Germany (60%).

The government is raising VAT by 2% this autumn in an attempt to increase its income but in order to head off a drop in consumer spending – as happened when the last hike was introduced in 2014 – it has had to launch various spending packages to help households.

There is also political risk. Despite the fact that Shinzo Abe was re-elected as prime minister, there is a risk that he becomes a victim of the backlash against the Liberal Democratic Party which has been embroiled in a number of public scandals.

Finally, the yen itself contains risk. Considered a 'safe-haven' currency by global investors, it tends to rally when volatility and nervousness increase. This has the effect of depressing Japanese stocks because a strong yen makes exports less attractive.

However, given the potential for Japanese companies – especially those plugged into the structural changes taking place in the domestic economy – to grow their earnings sustainably over the next five to 10 years this looks like a market to buy sooner rather than later.



By **Ian Conway** Senior Reporter

## THREE FUNDS TO BUY FOR EXPOSURE TO JAPAN



Investment fund **Baillie Gifford Japanese (0601113)** invests in 'quality growth' companies with a highly concentrated portfolio of holdings and has achieved 13.55% annualised returns over the past decade.



**Man GLG Japan Core Alpha (B0119B5)**, another fund, looks for unloved 'value' stocks. It has achieved 9.81% annualised returns over the past 10 years.



Investors simply looking for a low-cost way to get exposure to the market should snap up exchange-traded fund **Vanguard FTSE Japan ETF (VJPN)** which tracks the performance of large and mid-cap companies in Japan including Toyota and SoftBank. Launched in 2013, it has achieved 12.08% annualised returns over the past five years.



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# A year of two halves?



**Alex Crooke, Fund Manager of the Bankers Investment Trust, explains how the team is preparing for a different investment landscape in the second half of 2019.**

It's in our nature as fund managers to continually contemplate about the future, but the level and scope of uncertainty facing investors today is almost unprecedented. What's disappointing is that many of the questions that dominated 2018 have still not been answered as we move into the second quarter of 2019.

The most prominent of those questions include the 'trade war' between the world's two largest economies; the UK's expected exit from the EU; a tightening of monetary policy by central banks in key economies and the corporate profit growth outlook. You'd have thought by now we would have more certainty around some of these issues, but clarity is coming.

At The Bankers Investment Trust - a Janus Henderson-managed trust - we believe the second half of the year will look and feel very different to the current state of play; and we are positioning the portfolio to benefit from that clarity, which we think will restore market confidence as 2019 rolls into 2020.

It's important to remember that markets are discounting mechanisms by nature, matching buyers and sellers. Markets are also forward looking, so the sharp sell-off we saw last October was a message from the sellers that global growth had probably peaked and a global recession is coming.

As I outlined in a recent piece, Banking on Diversification, I don't see enough signs of stress in markets to warrant such a negative outlook. Global growth is slowing and it appears we are in the latter phases of the business cycle, but without a significant trigger I can't

see a sharp global recession or economic crisis coming this year.

## **GOLDILOCKS AND THE THREE BEARS**

My central view is that we continue to live in the 'goldilocks' environment where the economy is not too hot and not too cold, with modest returns in a long cycle. Around that view the Bankers investment team has identified three alternative scenarios we think could feasibly play out this year. The first comes back to the US-China tariff war. An escalation of tensions between the two nations could have hugely damaging consequences for global economic growth. It's not in anyone's interest to go down that route, so I only give it a fairly slim chance of unfolding into an all-out trade war and altering our view of the world.

The second and third scenarios relate to the US economy, which grew at an impressive rate last year relative to the rest of the world. There is a danger that the US' central bank, the Federal Reserve, has 'left the taps open' a bit too long. By that I mean the economy is in some danger of overheating and may need action from the Fed in the form of steeper interest rate hikes, but I think that's unlikely.

In equal measure, the US economy could slump if the Fed has overdone it with its incremental interest rate hikes over the past two years. Personally, I don't think the banking system has been lending aggressively so I discount this risk, but the tools to get another recovery going are relatively limited from here, so we should be careful about this scenario.

The US is still the single most dominant economy in the world and the largest market in stock market terms. The Federal Reserve in the US has maintained a loose monetary policy stance in recent years but it's probably as good as it's going to get. There are worries that we will shortly witness a US economic slump and a dramatic one at that, but I don't buy that. I don't see a recession



coming in the US but I'm also struggling to see how it gets any better.

This brings me back to the central view we hold at Bankers, for which I give about a 50% likelihood of playing out this year. In this scenario, the long business cycle continues with the ongoing global economic slowdown bottoming in the summer months before picking up gradually in the latter part of the year. It might sound a bit dull but it's not a bad world to be in and it's one we can position ourselves for. Essentially, it rests on the notion that the economy is not broken and that markets will pick up as we get more clarity on the questions alluded to earlier.

### A BROAD VALUE CHURCH

As fund managers, it is our job to look for opportunities where the market has over-discounted bad news and where prices could recover. We've already seen a bit of that in the year-to-date, for example Chinese equities endured a rough ride in 2018 and share prices came down as the trade war rumbled on, but they have recovered well in the New Year. Our direct exposure to China (c.9%) has been creeping up in the past 12 months as more value-driven opportunities became available over the course of 2018.

I am at heart a value investor and I like to think of it as a church; you can either follow religiously buying rock bottom price-to-earnings (P/E) and price-to-book (P/B) metrics; or take account of wider measures of value. I tend to prefer looking for companies with growth opportunities but am careful not to overpay for these investments. I also look for companies with potential to grow their free cash-flow and therefore hopefully deliver dividend growth.

Since the financial crisis it has largely been one-way traffic with growth stocks outperforming value stocks on earnings growth and share price total return. The Bankers portfolio reflected that with good growth names in the US, Europe and Asia, but last year growth stocks became very expensive. Earnings growth has been decelerating on average for the largest growth companies in the past 12 months and so it looks like a sea change could be coming.

### QT FAVOURS VALUE

Our belief at Bankers is that there is probably going to be a shift towards the end of 2019 with value stocks beginning to outperform against growth. This could be even more likely if central banks - the likes of the ECB, US Federal Reserve and Bank of England - extend their tightening measures, colloquially known as quantitative tightening (QT), which in simple terms refers to a number of monetary policy actions that aim to normalise interest rates and mitigate rising inflation. The US Federal Reserve has indicated it has paused its increases in interest rates but a resumption in global growth could mean a reversal of this policy.

QT would mark a significant shift from the past 10 years during which central banks dominated asset prices by driving down the cost of long-term money to support businesses and keep employment high. Once quantitative tightening measures begin to roll out and money becomes more expensive, there will be a shift in market sentiment.

We are positioning the Bankers portfolio to benefit in this scenario, while also maintaining a healthy balance and diversification across styles, sectors and geographies. We are overweight relative to the benchmark on consumer goods and services because we think the very low levels of unemployment will be persistent and wage growth will pick up in the US and UK, as it has in Asia and China.

We have topped up our position in premium cosmetics group Estée Lauder Companies, which is now the Trust's joint-largest position at 2% of the portfolio along with Microsoft; and we are finding more value-driven opportunities in European companies, where market sentiment is low and share prices are depressed.

All in all, I am of the belief that the global economy is not broken and the future is bright. Without a significant trigger I don't see a dramatic recession coming but rather a gradual contraction and subsequent expansion towards the end of the year. Once we get some clarity on the macroeconomic and political questions hanging over markets, it's quite probable confidence will be restored and some of the fantastic value opportunities of today will be gone.

## GLOSSARY

**Price to earnings (P/E):** A popular ratio used to value a company's shares. It is calculated by dividing the current share price by its earnings per share. In general, a high P/E ratio indicates that investors expect strong earnings growth in the future, although a (temporary) collapse in earnings can also lead to a high P/E ratio.

**Price to book (P/B):** The ratio of market value of a company's shares (share price) over its book value of equity. The book value of equity, in turn, is the value of a company's assets expressed on the balance sheet. This number is defined as the difference between the book value of assets and the book value of liabilities.

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**SHARES**



# The clever way to invest in companies with a competitive edge

We reveal a way to tap into Morningstar's moat ratings system

**A**re you looking for undervalued and high quality companies that have the right characteristics to potentially fend off even the fiercest of rivals for at least 20 years?

If so, analysis from financial services firm Morningstar may be able to point you in the right direction.

Morningstar uses five sources of long term competitive advantage which, where present, may indicate a company has something called an 'economic moat'. This term focuses on a company's ability to maintain competitive advantages over rivals to protect market share.

## THE FIVE SOURCES ARE:

1. Intangible assets. These are brands, patents or valuable licences that explicitly keep competitors at bay.
2. Cost advantage. A firm that can provide goods or services at lower cost than its peer group has an advantage because it can undercut rivals on price. The firm may also wish to sell products and services at the same price but get a bigger profit margin than competitors.
3. Switching costs. It may not



sound customer-friendly, but Morningstar says there is a competitive advantage in charging chunky exit fees to leave a company's service. It stops customers leaving, unless they are offered a large improvement in either price or performance with a third party.

4. Network effect. Strong companies can get even stronger when more people use their product or service.
5. Efficient scale. This is when a market of limited size is effectively served by one or just a few companies. It's not worth another party entering the market, because their participation would result in insufficient returns for all players.

## UK STOCKS WITH WIDE MOATS

Morningstar has three categories for economic moats: no moat, narrow moat and wide moat. A narrow moat rating is given when it finds at least one source of competitive advantage and that economic profits are expected to be positive for at least 10 years.

A company is deemed to have a wide moat if Morningstar thinks economic profits will endure for at least 20 years.

Nine stocks in the FTSE 100 qualify for Morningstar's wide moat category. These are **AstraZeneca (AZN)**, **British American Tobacco (BATS)**, **Diageo (DGE)**, **Experian (EXPN)**, **GlaxoSmithKline (GSK)**, **Imperial Brands (IMB)**, **London Stock Exchange (LSE)**, **Reckitt Benckiser (RB.)**



and **Unilever (ULVR)**.

If you invested in these companies over the last 10 years, you would have enjoyed an average total return of 298% versus 166% from the FTSE 100.

London Stock Exchange delivered the biggest total return over the last 10 years at 726% followed by Experian with a 440% total return.

Pharmaceutical colossus GlaxoSmithKline was the weakest performer in the group on a total returns basis, but still generated 123% over 10 years – not as good as the FTSE 100 but still respectable.

## ADDING VALUATION METRICS TO THE EQUATION

The aforementioned selection process from Morningstar doesn't take valuation into account so you would need to do further research looking at metrics such as price-to-earnings and price-to-book.

However, there is another way to use the moat approach which automatically takes into account valuation. Morningstar has created the Wide Moat Focus Index which contains the most undervalued companies – trading at the lowest current market price-to-fair value ratios – which qualify for its wide moat status.

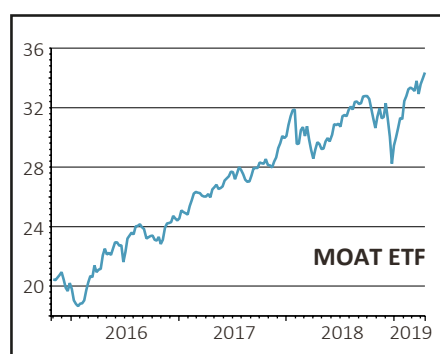
None of the aforementioned nine London-listed companies feature in the index; instead, it is populated by US-listed stocks such as retailer Amazon, financial services group Charles Schwab and fast food giant McDonald's. You can see the full list [here](#).

UK investors can track the performance of the Wide Moat Focus Index via London-listed

UK-LISTED STOCKS WITH 'WIDE MOAT' STATUS*	10 YEAR TOTAL RETURN
London Stock Exchange	726%
Experian	440%
Diageo	354%
Unilever	311%
Astrazeneca	227%
British American Tobacco	190%
Reckitt Benckiser	171%
Imperial Brands	143%
GlaxoSmithKline	123%

\*as categorised by Morningstar. Data source: SharePad

exchange-traded fund **VanEck Vectors Morningstar US Wide Moat UCITS ETF (MOAT)**.



It has delivered 16.47% annualised trailing returns over the past three years versus 14.09% from the Russell 1000 total return benchmark index.

As of the end of March, the index – and therefore the ETF – has the largest weighting to the healthcare, technology and financial services sectors. The portfolio trades on an average of 14.77 times prospective earnings.

## DOES THE MOAT SYSTEM PREDICT STOCK RETURNS?

In the 2014 book *Why Moats*

*Matter*, Morningstar's head of quantitative research Warren Miller said research had shown that wide moat stocks 'exhibit less downside risk and less upside potential'.

In times of market fear or distress, wide moat stocks outperform no moat stocks, but then underperform when risk aversion subsides, according to Miller.

'The evidence isn't quite strong enough to claim that all wide moat stocks generate excess risk-adjusted returns, but we do find that undervalued wide moat stocks have done so,' he added.

'We think it's safe to say that the moat rating is a valuable risk-management and security-selection tool, especially when used in conjunction with valuation-based metrics.'

By Daniel Coatsworth  
and Lisa-Marie Janes

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# Why the experts are excited about investing in regional offices

A lack of new supply and robust demand provides opportunities in this market

**A**nyone visiting or living in London will be aware that office blocks continue to spring up all over the place, with the skyline dominated by cranes as developers press ahead with new projects.

But if you move outside the M25 the story is very different as we explain in this article.

We've spoken to Midlands-focused property investor **Real Estate Investors (RLE)**, or REI for short, and Glasgow-headquartered **Regional REIT (RGL)** about the attractiveness of regional offices as an asset class.

The managers of the two real estate investment trusts say that very few new commercial buildings have been built outside



London in the past decade. As a result, there is healthy demand for the already-built stock of offices.

## BIG YIELDS ON OFFER

The aforementioned trusts have an appetite for commercial

property and offer generous dividend yields in excess of 6.5%.

According to real estate group CBRE, regional offices delivered returns of 11.5% in 2018 against 5.3% for Central London. Rental growth of 2.2% also outstripped the 1.1% achieved in the heart of the capital and rents have typically been more stable in the regions in recent years.

Research from property all-rounder **Savills (SVS)** shows strong occupier demand is continuing to reduce availability of office space – by 14% across nine key regional office markets in 2018.

Stephen Inglis, chief investment officer at London & Scottish Investments which manages Regional REIT, says:

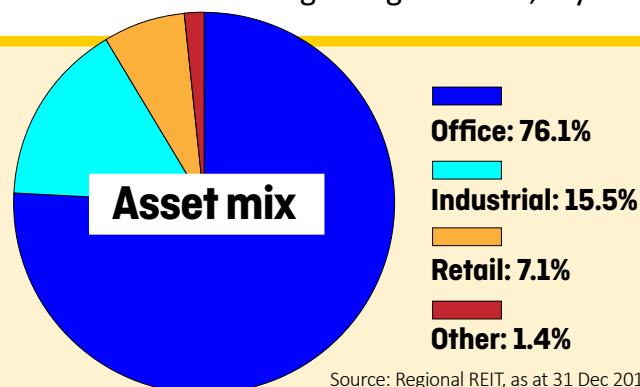
## REGIONAL REIT

Amid some rejigging of the portfolio in 2018 the trust is now more than 70% commercial property with the remainder in a mix of industrial and retail.

The emphasis is very much on providing a secure stream of income so it avoids development assets due to the longer wait for returns and greater risks.

The investment trust also does its own property management, which involves greater costs but, in its view, provides better control of the assets.

Results announced on 28 March revealed a record annual profit of £67.4m, up 149% year-on-year, and net rental income up 19% to £15.4m.



Source: Regional REIT, as at 31 Dec 2018

## Regional REIT in a nutshell

- Share price: **105.4p**
- Trailing dividend yield: **7.6%**
- Discount to net asset value: **6.5%**

Source: AIC



‘There have been hardly any new developments (outside London).’ He adds that the stock market as a whole has not yet picked up on these attractive supply and demand dynamics to the extent it has in the industrial/logistics space.

## MOVING FROM SHEDS INTO OFFICES

The growth of online retail has created demand for warehouses but the clamour for these sites has led some to warn of a ‘bubble’ in the space. Inglis observes: ‘Some of the prices being paid for these assets is unsustainable, often for quite average stock.’

In 2018 Inglis sanctioned the sale of nearly 50% of Regional REIT’s industrial holdings into what he sees as this overheated market.

This included the sale of a portfolio of 15 industrial assets for £39.1m in July 2018 – a sale price which represented a 24.1% uplift against the valuation of the

properties as at the end of 2017.

REI has a portfolio of 1.55m square feet in the Midlands where HS2, population migration from London and refocusing of investors on the regions is driving increased value in property assets.

As chief executive Paul Bassi says: ‘Between us we have more than 100 years of experience of investing in this market and this gives us a significant advantage.’

Both Bassi and Inglis observe that their knowledge of their respective markets and the industry enables them to complete a significant proportion of deals off market and not get involved in auctions where there is arguably a greater risk of overpaying for assets.

## THE RESIDENTIAL OPPORTUNITY

Bassi notes that another advantage of regional commercial property is that it often has the capacity to

be converted to residential, something made easier by new Permitted Development rules introduced in 2013.

This can result in a material uplift to valuation and REI has earmarked 250,000 square feet of its existing real estate assets as suitable for conversion to residential use.

Investment bank Liberum notes: ‘We believe the outlook for Midlands real estate remains attractive, with REI well-positioned to benefit, particularly should any market dislocation materialise due to political uncertainty or continued negativity towards the retail sector.’

‘Improving regional conditions provide the backdrop for further growth in rents, which should enhance REI’s already high income return. Management’s market connections and opportunistic approach also provide numerous additional capital growth angles.’

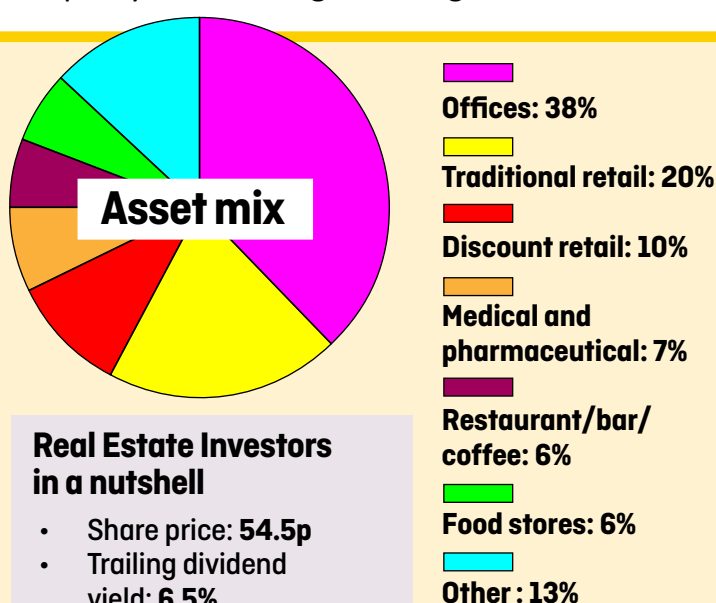
## REAL ESTATE INVESTORS

Around 40% of the portfolio is in offices, with a further 30% split between traditional and discount retail and the remainder is in a variety of different areas like car parks, hotels, bars and coffee shops.

The company looks to be opportunistic and acquires mis-priced assets. It very much

sticks to the knitting in terms of geographic exposure with a focus on the Midlands region where management have an edge thanks to their insight and experience.

Its 2018 results showed an occupancy rate of 96.1%, a 5.1% increase in revenue to £15.6m and a 14% increase in the dividend to 3.56p.



### Real Estate Investors in a nutshell

- Share price: **54.5p**
- Trailing dividend yield: **6.5%**
- Discount to net asset value: **24%**

Source: Liberum

Source: Real Estate Investors, as at 31 Dec 2018

# A maths whizz reveals how he picks stocks

Crux's Jamie Ward buys great companies at fair prices

One of the market's smaller UK funds at £64m is the somewhat unheralded **FP CRUX UK Fund (B5839S6)**. Managed by CRUX Asset Management's Jamie Ward, mathematics whizz, former equity analyst and sole manager since March 2018, the fund aims to preserve and enhance the real value of investors' money over time.

While sentiment towards UK stocks is presently poor – and understandable given political uncertainties – the determined Ward isn't worried about Brexit, being a long-term investor in 'truly great businesses' whose qualities should be rewarded over time.

FP CRUX UK Fund has generated 7.5% annualised returns over the past five years versus 6.9% from the FTSE All-Share total return index, according to Morningstar. Year-to-date the fund is up 11.6%.

## THE INVESTMENT PROCESS

It has a high conviction, concentrated portfolio of 20 to 30 stocks of roughly equal weighting. Ward employs a rigorous screening process that poses three key questions: 'Do we understand the business?', 'Is the business comfortably economic over the cycle?', and 'Do we trust the management?'

Companies that pass all three stages of this screen are



Catering group Compass is on the menu for CRUX UK Fund

evaluated for their characteristics and cash generation through the business cycle.

This process tends to lead to Ward owning companies with low capital intensity, consumer brands, strong balance sheets, barriers to entry and durability.

Typically, they are cash generative dividend payers, although dividend income isn't the sole reason he invests in a stock.

## EXPLOITING INEFFICIENCIES

Ward pursues a long-term, low-turnover approach that looks beyond short-term volatility to deliver dividend and capital growth.

He believes that price matters most. Buying companies at the right price – exploiting market inefficiencies to pocket them below their intrinsic worth

– is the key to investment outperformance over time.

## HOW DOES IT RESEARCH COMPANIES?

'I try to be quite arm's length,' stresses Ward on the topic of meeting management teams. He feels this enables him to be objective in his assessment of the business.

Ward also uses the EV/IC valuation framework, an alternative version of the more commonly used price-to-book ratio, in which market cap is replaced by enterprise value and invested capital replaces net asset value.

EV/IC tells the investor the value or multiple the market is putting on each pound of capital invested in a company. He focuses on a company's return on invested capital on a through-

the-cycle basis, explaining he is not interested in what this figure looks like over the past five years, but how it averages out over the long term.

### WHAT'S IN THE PORTFOLIO?

While there is a key focus on UK-listed companies, the fund also has the ability to invest up to 15% in stocks listed overseas which explains the presence of banking group JPMorgan Chase in the top 10 holdings.

Leading portfolio positions include global businesses such as **GlaxoSmithKline (GSK)**, medical devices maker **Smith & Nephew (SN.)**, oil major **BP (BP.)**, banking giant **HSBC (HSBA)** and global catering play **Compass (CPG)**.

Investee companies also include outsourcer **Serco (SRP)**,



The fund has sold its stake in Greene King

which Ward claims to have been 'horribly mis-managed' before chief executive Rupert Soames took over and began to turn the business around.

Another position is **PZ Cussons (PZC)**, the consumer products group behind brands including *Imperial Leather* soap and *St. Tropez* tan.

'The Nigerian economy isn't going great,' explains Ward, 'but in Nigeria PZ Cussons'

brands definitely have value.' He describes the stock as an 'underappreciated value' name.

Albeit one of Ward's poorest investments over the past few years, disappointments largely driven by difficulties in Nigeria, he recently wrote: 'Shorter-term issues aside, we continue to believe that its current travails are transitory and the long-term strategic value of having strong brand values and distribution networks in demographically exploding regions is much higher than implied by the share price.'

In terms of sell discipline, it is never purely down to valuation for Ward and if a stock becomes too expensive, he says: 'I'll sell down but I won't eliminate it.'

One stock no longer in portfolio is **Greene King (GNK)**, added to the fund in the summer of 2017 at an average price of 667p and sold at an average price of 605p with a total of 66.4p per share of dividends received during the investment.

Ward was alarmed by the unexpected retirement of CEO Rooney Anand, saying 'he is Greene King'. The fund manager believed its competitive position within the UK dining market was deteriorating and he was worried that the pub group's real estate valuations look vulnerable to being downgraded.



### FP CRUX UK Fund top holdings

GlaxoSmithKline	4.7%
JPMorgan Chase	4.4%
Smith & Nephew	4.4%
Barclays	4.3%
Daily Mail & General Trust	4.2%
BP	4.1%
HSBC	4.1%
Sage	4.0%
Schroders	3.9%
Compass	3.8%

Source: CRUX Asset Management, as of 28 Feb 2019



By James Crux  
Funds and Investment  
Trusts Editor

### FP CRUX UK Fund annual returns %

Year	2016	2017	2018	2019
Fund	+18.73	+8.09	-6.97	+8.61
Benchmark	+16.75	+13.1	9.47	+9.41

Source: Morningstar



# Planning for a 100-year life

As the number of centenarians grows we discuss how to make financial arrangements for reaching this milestone

**W**hen am I going to die? This question, while slightly morbid, is essential when devising a retirement income plan.

In a recent survey of savers who had entered drawdown – keeping their pension pot invested while taking an income – since April 2015, respondents aged 55 to 59 on average thought they would live for 21 more years.

In fact, according to official projections from the Office for National Statistics (ONS) a healthy 55-year-old man has an average life expectancy of 85 – meaning those in the 55 to 59 cohort are underestimating life expectancy by up to nine years.

A 55-year-old woman can expect to live a further 33 years on average.

But what is the likelihood of living beyond this point? ONS analysis suggests a 55-year-old man has a one in four probability of reaching 93 and a 6% chance of celebrating their 100th birthday.

The equivalent woman has a 1 in 4 chance of reaching 95 and a 10% chance of celebrating her centenary.

If long-term life expectancy improvements continue, younger generations will become increasingly likely to reach three figures.

So how do you prepare for a 100-year life?



## Probability of a 100-year life

Age now	Chances of living to 100	
Year	Female	Male
25	19.0%	14.1%
35	15.4%	11.0%
45	12.2%	8.4%
55	9.5%	6.3%
65	7.4%	4.7%

Source: ONS

## MAKING YOUR PENSION LAST TO AGE 100

The surest way to make your pension last a lifetime is to buy an inflation-protected annuity – an insurance product

which pays a guaranteed income for life.

If you're going to go down this route, shopping around for the best rate – and making sure your provider knows of any health conditions which might impact on your life expectancy – is essential.

However, a combination of poor rates driven by record-low gilt yields – which insurers use to price annuities – and inflexibility has seen sales plummet, with most savers now opting to keep their pension invested through drawdown.

The extent to which a withdrawal strategy in drawdown

## Five top tips to ensure you don't run out of money in retirement

- 1. Set a reasonable income target**  
– 4% of your initial fund value, with income increasing in line with inflation, is a decent starting point for a healthy 65-year-old. You might be able to take more than this if you retire later (or have other income sources), and less if you retire earlier
- 2. Make a budget and stick to it.** This will help ensure you stick to your spending limits during retirement

**3. Shop around the market and keep costs as low as possible.** This will help ensure your fund isn't eaten up by unnecessary charges

**4. Get all your pensions in one place if you can** (but be careful not to lose any valuable guarantees in the process). Savers often lose track of pensions during their lifetime, potentially leaving them facing an income shortfall in retirement



**5. Review your funds, provider and withdrawal strategy regularly** (at least once a year). If your funds have performed well you might be able to increase your withdrawals. Equally, if they've struggled you might need to think about cutting back your income

is sustainable will depend on a number of things including overall investment returns, the timing of those returns and inflation.

If someone wants to retire today on a UK average salary of £28,000, they can expect around £8,000 from their state pension (based on the flat-rate amount), so will need to be aiming to generate £20,000 from their private pension pot.

If we assume 5% annual investment growth, a 65-year-old would need a pension fund of £447,000 to be able to withdraw £20,000 a year, inflation-linked at 2% a year and still see their pension last until age 100. If growth was

lower the pot would need to be bigger.

However, if they delay retirement five years to age 70 the size of pension fund needed to reach age 100 would reduce to £407,000.

### SAVING LEVELS REQUIRED

The best way to ensure a comfortable retirement is to start saving early and often. To save the £447,000 required for an average salary in retirement from age 65 to 100, a 25-year-old would need to put away £235 a month.

Delaying by 10 years to start saving at age 35 sees the monthly saving figure almost double to £428 and if you wait

until age 45 it is a whopping £859 a month.

If these amounts sound unrealistic it's still worth saving what you can, making the most of the bonus of pension tax relief and the matched employer contribution through automatic enrolment.

You also need to think carefully about the investment risk you want to take. Younger investors in particular should be able to take more risk than their older counterparts, giving their fund the chance to grow over time. In addition, high charges can have a seriously detrimental impact on your retirement over the long-term, so shopping around is absolutely critical.

If people get this bit right and build a decent pension pot in the first place, it becomes much easier to make that pot last – even over a lengthy retirement.

### Pension fund needed for an inflation-linked pension income of £20,000 to last until age 100:

Retirement age	Starting income	Pension fund required	Total income taken to age 100
65	£20,000	£447,000	£999,890
70	£20,000	£407,000	£811,362
75	£20,000	£362,000	£640,606

Assumes 5% investment returns post charges, income taken increases in line with 2% inflation, pension fund runs out at age 100



By Tom Selby  
AJ Bell  
Senior Analyst

# Is it worth saving into a pension for a child?

We explain how Junior SIPP's work and the key issues to think about



**T**here are a number of ways that parents and grandparents can start saving for children and each has its pros and cons. In recent years, Junior ISAs have become the go-to savings account for young people, with almost 1m opened in the 2017/18 tax year. Junior ISAs let you save or invest up to £4,368 a year for young people, who gain control of the account at age 16 and can access the cash at age 18.

But it is this last point which puts off many relatives, who fear their kids may spend the money they have so carefully saved for them as soon as they hit 18.

Figures from AJ Bell suggest this may not be the case – it found that just 7% of Junior ISAs are cashed out when an account holder reaches age 18.

Anecdotal evidence suggests that when children are made aware of the savings accounts and involved in the decisions about where the money is invested, they are more likely to continue investing once they take control of the account.

But for those parents who want to lock up their children's savings for the long-term, there are other options.

## CHILDREN'S PENSIONS

A Junior SIPP (self-invested personal pension) is a great way to help your child start saving for retirement. These allow relatives to save up to £2,880 a year, which receives 20% tax relief from the Government just as with any other pension, effectively topping up the amount to £3,600. Crucially, the

money can't be accessed until the child reaches age 55, a limit which is set to rise as the state pension age increases.

Tom Selby, senior analyst at AJ Bell, says: 'Starting a pension for a child has to be the ultimate long-term investment. Because the money is locked up, parents and grandparents don't need to have any concerns about the child reaching age 18 and then splurging the lot down the pub or on a holiday as they could with others savings pots.'

## MULTIPLE BENEFITS

The benefits of saving for your child in such a way are plentiful. As defined benefit, or final salary, pension schemes become a rarity, young people face a greater challenge in saving enough to supply a decent



income at retirement.

That is particularly true when you consider that many young people are graduating with large amounts of debt from university and then face the challenge of saving for a deposit to get a foot on the property ladder.

Providing a helping hand in the form of pension savings can be incredibly valuable to those young people trying to meet these challenges.

As well as that, such long-term savings have the potential to get the ultimate boost from compound interest, where your returns grow at a faster rate as you earn interest on interest.

For example, let's say you saved £240 a month in a child's SIPP – topped up to £300 by tax relief – from birth and you

“THE FINAL DECISION SHOULD BE BASED ON WHAT YOU WANT THE CHILD TO DO WITH THE MONEY ONCE THEY'RE OF ADULT AGE

AMMO KAMBO FROM BREWIN DOLPHIN ON SAVING FOR CHILDREN”

incur 1.25% annual charges. You would have contributed £54,000 by the time they turn 18.

Assuming 5% annual growth rate from the start and no further contributions after they turn 18, your child's SIPP would be worth nearly £330,000 by the time they reach age 60.

But there are drawbacks to this approach too, experts point out. First and foremost is that parents and grandparents saving for their young relatives in this way are unlikely to ever get to see the child reap the benefits of their hard work. This flies in the face of the idea of a 'living inheritance', where money is gifted during someone's lifetime rather than left in a will, which is becoming increasingly popular among those looking to pass on their wealth.

Also worth considering is the potential tax problem you are creating for a young relative by saving in this way. We have used 5% annual growth in these calculations but in recent years investors have enjoyed double-digit gains in their portfolios – higher growth could see the pension pot breach the lifetime allowance of £1,055,000, after which pension savings are subject to hefty tax.

Ammo Kambo, chartered financial planner at Brewin Dolphin, says: 'There are many things to consider when saving for children but the financial goal at the outset is often the sensible first step – the final decision should be based on what you want the child to do with the money once they're of adult age.'

## OTHER WAYS TO PASS WEALTH TO CHILDREN:



- **Money left in trust** – a legal arrangement set out in a will, whereby a young person can be left money that they can't access until a specified age. May fall outside of the value of your estate for inheritance tax purposes – although it is worth seeking tax advice to fully understand the rules.
- **Premium Bonds** – no guaranteed return but the value of the bonds will never fall
- **Life insurance** – a policy which will pay out £100,000 to children when you die can cost just a few pounds a month



By **Holly Black**

22<sup>MAY</sup> 2019

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**Speaker: Dmitri Tsvetkov, CFO**

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**PHOENIX GLOBAL MINING LTD**

**Speaker: To be confirmed**

**Phoenix Global Mining Ltd (PGM)**, is a North American-focused base and precious metals exploration and development company. It wants to reopen the Empire Mine in Idaho. It is also exploring for cobalt in Idaho and gold in Canada.



**VALIRX**

**George Morris, COO**

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### Full year results

**29 April:** Horizon Discovery. **30 April:** Whitbread.  
**1 May:** Circassia, J Sainsbury.

### Half year results

**26 April:** AstraZeneca. **29 April:** Lok'nStore, Evraz.  
**30 April:** BP. **1 May:** Avon Rubber, GlaxoSmithKline.  
**2 May:** Indivior, Lancashire Holdings, Royal Dutch Shell, Smith & Nephew.

### Trading statements

**26 April:** AJ Bell, Pearson, Royal Bank of Scotland, Rotork, WPP. **30 April:** Elementis, Greene King, Jupiter Asset Management, Standard Chartered, St James's Place, Weir. **1 May:** London Stock Exchange, Next, Persimmon, RPS. **2 May:** Coca-Cola HBC, James Fisher & Sons, Howden Joinery, International Personal Finance, Lloyds Banking, Reckitt Benckiser, Schroders.

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All chart data sourced by Refinitiv unless otherwise stated

### PRODUCTION

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Shares magazine is published weekly every Thursday (50 times per year) by  
AJ Bell Media Limited, 49 Southwark Bridge Road, London, SE1 9HH.

Company Registration No: 3733852.

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