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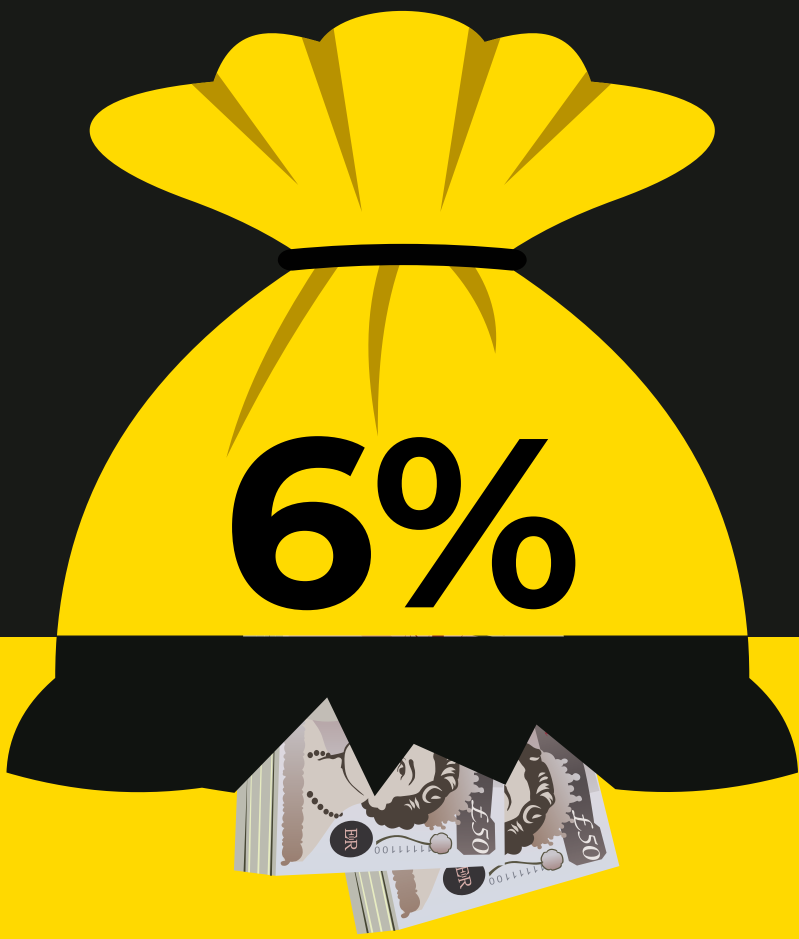
VOL 21 / ISSUE 20 / 23 MAY 2019 / £4.49

SHARES

WE MAKE INVESTING EASIER

GIGANTIC DIVIDENDS



A quarter of the FTSE 100 yields 6% or more – WHAT'S THE CATCH?

PLUS

HOW **LABOUR'S RENATIONALISATION** PLAN COULD IMPACT INFRASTRUCTURE FUNDS

FROM BAD TO WORSE: WOODFORD INCOME FUND UNDER FIRE AGAIN

USING **LOW-COST ETFS** TO GENERATE AN INCOME

Helping you find the best sources of income

This week's Shares is packed with hints on how to spot sustainable dividends

Income is highly desired by investors but it not always easy to find sustainable dividends. This week's edition of *Shares* dives into this theme and looks at income choices from the perspective of three different product classes: shares, exchange-traded funds and investment trusts.

We've analysed these products from different angles to help you get an edge when looking for income choices. In this week's digital magazine you will find information on:

- **Stocks offering above-average yields**
- **Ways to check if dividends are sustainable**
- **The different types of dividend-themed ETFs**
- **Investment trusts with long track records of growing dividends each year – and, importantly, the ones growing ahead of inflation**

Global dividends rose by 7.8% in the first quarter of 2019 to a record high of $263.3bn, according to research by asset manager Janus Henderson. And the UK market is currently yielding 4.7% which is significantly greater than interest available on cash savings, albeit with higher risk.

So what's the catch? Many stocks and funds have generous yields because the value of their shares (or those in a fund's underlying portfolio) has fallen on market concerns about their financial health and earnings growth. Concerns about those issues can act as warnings signs and potentially lead to dividend cuts down the line. Income-hungry investors will therefore need to wade through a lot of information before making investment decisions.

There are several checks you can make to see if companies can afford to pay dividends or funds are picking the right types of assets – all of which are discussed in this week's edition of *Shares*.

In a broader context it is also worth considering the benefits of investment trusts with regards to dividend consistency. Investment trusts are able to retain up to 15% of income from their underlying portfolio and keep it in a rainy day pot to supplement future dividends when there is a fall in investment income. This flexibility has helped many investment trusts gain the reputation of being able to maintain or even grow dividends in both good and bad times.

Analysis by investment bank Stifel finds 31 investment trusts (investing in equities) with a 4% yield or higher – including **Henderson Far East Income (HFEL)** at 6.3% and **European Assets Trust (EAT)** at 5.8%. The number has increased from 21 trusts last August partially reflecting falling share prices but also dividend growth and some trusts putting greater emphasis on dividend returns.

Greater frequency of dividends is another growing trend. More than half of income-paying investment trusts now pay quarterly dividends, according to the Association of Investment Companies. Even stocks are getting in on the game. Banking group **Lloyds (LLOY)** is to switch from half-yearly to quarterly dividends from June 2020 in recognition that its 2.4m shareholders may appreciate a more regular flow of dividend income.

The opportunities are omnipresent; you simply need to pick the right ones which is where *Shares* will always do its best to help.

DO YOU HAVE ANY INCOME-RELATED QUESTIONS?

Please email editorial@sharesmagazine.co.uk with 'Income Question' in the subject line. We will do our best to respond in a future edition of *Shares*. Please note, we only provide guidance and we do not provide financial advice. If you're unsure please consult a suitably qualified financial adviser. We cannot comment on individual investment portfolios.

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What would Labour's plan mean for utility funds?

Amid ongoing political turmoil investors are turning their attention to the risks posed by a general election

Sterling continues to slide amid ongoing uncertainty over Brexit. It now looks like Theresa May will have one last shot at getting her Brexit deal across the line in early June before exiting stage left.

In the background the Brexit Party is leading in the polls for the looming European elections with results coming through in the early hours of 24 May.

Most observers think any hopes of May getting MPs on side are forlorn and with a general election one of the possible ways of breaking the deadlock in Westminster, markets have been reacting to some of the policies outlined by the Labour party should Jeremy Corbyn end up with the keys to Number 10.

Among the least market-friendly is the 'Bringing Energy Home' plan which would see utilities infrastructure taken into public ownership at below market value. Shares in **National Grid (NG.)** are down around 4% since details of the proposals first emerged.

Analysts at stockbroker Stifel have done some number-crunching to look at how UK infrastructure funds might be impacted.

These funds are exposed in two ways, both through private finance initiatives (PFIs) – where public sector projects are delivered by the private sector – and through direct exposure to the infrastructure or utilities themselves.

Stifel says: 'The threat of UK PFI nationalisation has been an issue for the sector for the past 18 months. We think that assuming the contractual obligations and payments due to PFI investors are met (potentially a big assumption), the impact of PFI nationalisation may be easier to quantify than utility nationalisation.

'The PFI projects are subject to significant legal documentation around contract termination compensation and the listed funds have already indicated what they may expect to receive in such a scenario. In the case of utilities, the valuation to be paid appears more subjective to the opinions of a government and parliament, which is a cause for concern.'

The table shows the utilities exposure of a selection of infrastructure funds with **International Public Partnerships (INPP)** seemingly the most exposed.

HOW EXPOSED ARE INFRASTRUCTURE FUNDS TO RENATIONALISATION RISKS?

Fund	UK Utility Investment	% of portfolio
HICL	Affinity Water	8.0
	Burbo Bank OFTO	0.3
	Walney Extension OFTO	0.8
	TOTAL	**9.1**
International Public Partnerships	Cadent	12.4
	Lincs OFTO	9.0
	Ormonde OFTO	6.2
	Dudgeon OFTO	2.2
	Other OFTOs/energy transmission	4.6
	TOTAL	**34.4**
Sequoia Economic Infrastructure	National Grid 5.625% 2073*	1.5

Source: Stifel Note: OFTO = offshore transmission owner *National Grid bond

From bad to worse: Woodford income fund under fire again

Investors are lining up to withdraw cash after dismal performance

Neil Woodford's flagship income fund has had its rating cut to neutral by analysts at data researcher Morningstar after prolonged underperformance and 'persistent redemptions'.

Morningstar analyst Peter Brunt says the manager's 'relentless willingness' to push the **LF Woodford Equity Income Fund's (BLRZQ62)** portfolio to its liquidity limit has left it facing risks from 'extreme positioning'.

Woodford is one of the UK's best-known fund managers and has built up a loyal following among the investment community after three impressive decades at Invesco.

But his contrarian approach is facing increasingly close scrutiny after struggling to match its benchmark FTSE All-Share total return index for more than two years.

According to data from Morningstar, £10,000 invested in the Woodford fund since October 2018 would now be worth just £8,005.72. Since the fund's inception in June 2014 the fund has returned just 3.5% to investors.

The dismal performance track record has left investors frustrated and sparked a wave of orders to withdraw cash from the fund, called redemptions. That trend has been accelerating in 2019 with around £158m of outflows during March alone.

The prolonged spell of withdrawals has seen total assets under management nearly halve since 31 December 2017 to £4.33bn (as of 30 April) and slump from £9.5bn at the end of 2016.

Woodford has also come under fire for his handling of stakes in private businesses, such as DNA research and technology developer Oxford Nanopore.

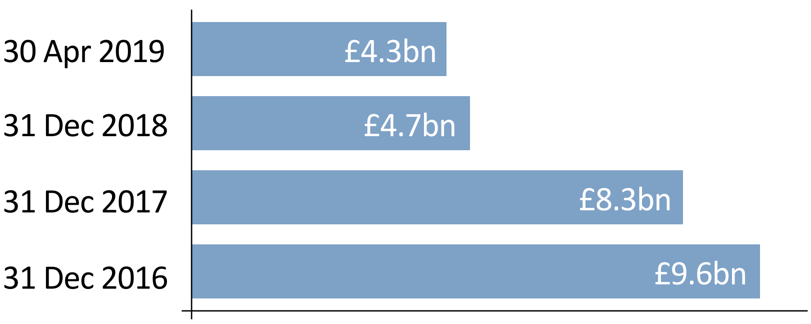
Several unquoted ventures have been slow to embrace a stock market listing, typically an opportunity to cash in on previous early stage investments.

This has forced Woodford to take 'extreme action' to keep the fund's exposure to unquoted companies below its 10% limit, says Morningstar's Brunt.

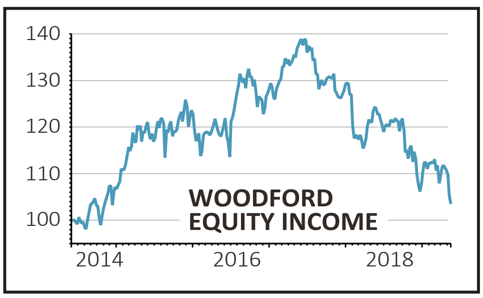
Woodford has reportedly acknowledged these investor concerns and vowed to reduce such holdings in the future, even promising to abandon investing in unquoted early stage ventures over the medium-term.

Neil Woodford also runs a once-popular investment trust, the **Woodford Patient Capital Trust (WPCT)**. It has also left investors annoyed given that shares in the trust have declined around 20% to 80.7p since launching in 2015.

WOODFORD EQUITY INCOME FUND: TOTAL ASSETS SLUMP



Source: Woodford Asset Management



Entertainment One eyes large profit boost from China

Its content is in strong demand from Asian broadcasters and consumers

China presents a significant opportunity for media group **Entertainment One (ETO)**, according to chief executive Darren Throop. He tells *Shares* the country could be 'as big as the US from a consumer standpoint' in the future, meaning significant potential to earn large amounts of money from broadcasting and merchandise.

Broadcast and licencing revenue from its Family and Brands division – which includes *Peppa Pig* and *PJ Masks* children's cartoons – increased by 144% in the past financial year, partially down to strong demand from China.

'We've got new buyers of content including people in the Chinese marketplace, as well as ongoing demand from incumbents Netflix and Amazon. Our income is going up because if a streaming platform wants to hold on to subscriber numbers, they need to pay for high quality content,' explains Throop.

The company will increase the division's investment in productions from £6.4m in the past financial year to £10m this year. Having more content increases Entertainment One's chances to benefit both from selling the broadcast rights and also from toys, clothes and other related merchandise.

A new pre-school brand will be launched on Chinese streaming platforms in the summer called *Ricky Zoom*, followed by a launch on global broadcast networks later in the year with toys coming next summer.

The past few years have seen the company dramatically reduce investment in third party material, preferring to focus on developing its own content. This trend will continue – for example, television production investment will increase by nearly two thirds this year to £350m.

Pure Gold floats in London ahead of Canada mine revival

The company plans to reopen a former-producing mine next year

FANS OF GOLD mining stocks should note that **Pure Gold (PUR)** has listed on London's Main Market (21 May). The £78m company plans to reopen the Madsen Red Lake gold mine in Ontario next year. Its shareholders include large mining companies AngloGold Ashanti and Goldcorp.

Pure Gold has turned to the UK for investor support after seeing the Canadian market turn its back on smaller mining firms in favour of fast growth areas like cryptocurrency, cannabis, e-sports and blockchain.

The company believes the London stock market is underserved with mining companies owning high quality projects.

It is confident that 1m ounces of gold can be economically extracted from Madsen Red Lake at a grade of 9 grams per tonne, based on the current reserve statement, and it sees potential for significant additional ounces to be proved up.

A feasibility study says the mine will cost US$70m (C$95m) to build and will have a US$787 per ounce all-in sustaining cash cost, implying decent profit margin potential versus the current gold price of $1,272 per ounce.

News review: Thomas Cook, Metro Bank and more

We look at major share price movers and key announcements over the past week

Travel operator **Thomas Cook (TCG)** was battling all-time lows at the time of writing to trade a little above 12p. These lows were marked in response to a truly horrible set of figures for the six months to 31 March published on 16 May and showing a £1.45bn loss, with debt climbing over the £1bn mark.

Panic over the financial position was exacerbated by research from Citigroup where it published a 0p price target on the stock and argued the shares were worthless.

Thomas Cook's short-term future and £300m of fresh lending to see it through the coming winter are now seemingly dependent on a sale of its airline business.

METRO BANK RELIEF

Another company with question marks over its financial future, **Metro Bank (MTRO)** mustered a recovery to 670p on relief it had got its £375m emergency fundraise away at a smaller than expected discount (16 May). Reassuring words from regulator the Prudential Regulation Authority also helped.

Budget airlines **EasyJet (EZJ)** and **Ryanair (RYA)** both racked up losses in their first half periods, with results posted on 17 May and 20 May respectively. However, EasyJet endured a less turbulent market reaction as full year profit guidance was unchanged

thanks to tight control of costs.

Ryanair, with its warning of continuing pressure on fares with little to no visibility on when they might recover, got a more negative response from investors.

Both airlines face the challenge posed by increasing fuel costs, excess capacity in the European short-haul market plus all the complications for its passengers and operations posed by Brexit.

STAFFLINE SLUMPS

Recruitment firm **Staffline (STAF:AIM)** more than halved in value to somewhere just north of 300p on 16 May after its core business was hit by weak temporary hires, lower margins and slowing contract momentum.

The company, which specialises in supplying flexible blue-collar workers to the agriculture, drinks, driving, food processing, logistics and manufacturing industries, blamed Brexit for the wave of negative news. A delay to the publication of 2018 numbers linked to compliance with minimum wage rules also did not help.

FTSE 350 MOVERS OVER THE PAST WEEK – BEST / WORST PERFORMERS

STOCK	PRICE RISE	REASON
Metro Bank	15.5%	Secured new funding, alleviating balance sheet fears
Sophos	15.4%	Beats expectations with full year results
Premier Oil	8.9%	Raises 2019 production guidance

STOCK	PRICE FALL	REASON
Sirius Minerals	-9.5%	Market reacts to dilution implied by fundraise
Indivior	-9.4%	Shares fall back after brief rally on director share purchases
Entertainment One	-8.0%	First half results miss expectations

Source: Shares, Sharepad

What the current oil price rally means for investors

We look at what might be influencing the stance of producers' cartel OPEC ahead of key summit

Since the start of 2019 the global benchmark for oil prices, Brent crude, has enjoyed a rollercoaster ride.

For the most part the direction of travel has been upwards from a little more than $50 per barrel to above $70 per barrel.

The surge is being driven by multiple factors. These include fears of conflict between the US and Iran and the reimposition of sanctions on the latter by the former; conflict and turmoil in Venezuela and Libya; as well as industrial sabotage on key infrastructure in Saudi Arabia.

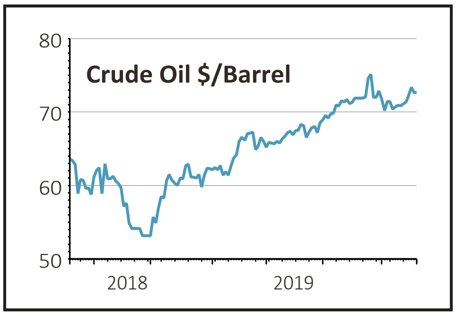
There have been significant stumbles along the way – for example, oil fell as much as 4% on 26 April when Donald Trump tweeted that he had asked oil producers' cartel OPEC to take action to keep a lid on prices.

So far he appears to have been politely ignored and while OPEC or OPEC+ (the moniker which encompasses other major producers like Russia) does not have the influence it did in its 1970s energy crisis heyday, the cartel remains influential.

OPEC MEETING IN FOCUS

Whether oil maintains its current trajectory could depend on how OPEC responds at its next big summit on 25 June.

In truth, given it is the member with the most influence and,



crucially, spare production capacity, the response will depend on Saudi Arabia.

In a recent piece of research BoA Merrill Lynch spelled out why the Saudis might be reluctant to ramp up output.

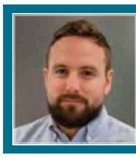
It says: 'Saudi Arabia has repeatedly stated its intention to give away oil market share in exchange for higher dollar prices in recent months. The rationale behind this decision is purely financial and connected both to its current account and government budget positions.

'According to our economists, the 2019 budget break-even oil price for Saudi Arabia is around $93 per barrel. In other words, we expect Saudi to bring production back slowly to avoid a repeat of the fourth quarter of 2018.'

In the final three months of 2018 oil prices fell sharply after Saudi increased its production in the expectation of a disruption to Iranian supply. This was put on pause as the US included more waivers in its sanctions than expected.

Oil price strength is a double-edged sword for UK investors. It is potentially good news for oil majors **BP (BP.)** and **Royal Dutch Shell (RDSB)** which occupy heavyweight positions in the London market.

However, when Trump tweeted that a retreat in oil prices to $55 per barrel in November 2018 was a big tax cut for America and the world, he was on to something. Logically the recent strength in oil prices may feel like a tax bill for businesses and consumers.



By **Tom Sieber**
Deputy Editor

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Tesco could make you good money as an investment

The UK supermarket is dominant, defensive and dividend paying to boot

The market is warming to supermarket group **Tesco (TSCO)** as it is showing the right qualities to cope with competition from discounters Aldi and Lidl. We think now is the perfect time to get on board as the shares are not expensive on 14.1 times prospective earnings and a 3.1% prospective dividend is the cherry on top.

It remains the dominant force in UK groceries and, given present economic uncertainties, we think the defensive element to food retailing is a huge positive and should underpin the share price should markets be rocked again going forward.

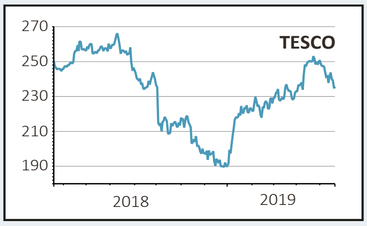
Forecast-beating full year results (10 Apr) revealed group sales up 11.3% with a boost from wholesale operation Booker and like-for-like sales up 2.9% in the core UK and Republic of Ireland business, representing a third full year of growth.

Operating profit grew an impressive 33.5% to £2.21bn and, reflecting confidence in its continuing cash generation, Tesco nearly doubled the full year dividend to 5.77p.

Following a fruitful four years in the hot seat, chief executive Dave Lewis said 'we have met or are about to meet the vast majority of our turnaround goals'. Significantly, the second half operating margin achieved sat well within Tesco's 3.5%-to-4% targeted range.

TESCO BUY
(TSCO) 236.9p
Stop loss: 189.5p

Market value: **£23.2bn**



At next month's capital markets day (18 June), Tesco will share some of its 'untapped value opportunities' with investors as it moves beyond the turnaround phase. This investor event could prove a catalyst for some bullish analyst commentary, hopefully nudging the shares higher still.

Offering exposure to the growing convenience and online channels, Tesco's competitive position has been strengthened by the Competition and Markets Authority's decision to block the mega-merger between **Sainsbury's (SBRY)** and Asda, a deal that would have seen the combined entity leapfrog Tesco in market share terms.

For now, Tesco's position as the UK's biggest grocer remains secure. The retailer commands a 27.3% share according to the latest Kantar data, ahead of Sainsbury's with 15.4%, Asda on 15.2% and **Morrison (MRW)** with a 10.3% slice of the pie.

Given cut-throat competition and a looming threat from Amazon, Tesco needs to stay vigilant. It is also cutting the number of products it sells as it fights back against the rapidly growing discount duo of Aldi and Lidl, which speak for a combined 13.6% of the market.

In a further fine tuning of its activities, Tesco Bank has announced (21 May) it has ceased new mortgage lending and is 'actively exploring options' to sell the existing mortgage portfolio.

This decision demonstrates welcome capital discipline from Tesco; if a business line isn't profitable, Lewis won't squander further funds in its pursuit. That approach should be applauded.

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

SThree has big growth prospects and cheap shares

Specialism in high growth markets should drive a revaluation of the shares

Shares in recruitment firm **SThree (STHR)** are really cheap versus the company's growth prospects. Buy the stock now as it should either re-rate in line with peers or an overseas rival could come and gobble up the business.

SThree is a global player specialising in the fields of science, technology, engineering and mathematics (STEM). It provides permanent and contract staff to the information and communications technology sector, as well as to the banking, finance, energy, engineering and life science industries.

Given its focus on STEM recruitment, which has a higher growth rate than the overall market, and its strength in contracting which is less cyclical than permanent recruitment, we believe that SThree should trade on at least the same valuation multiple as its global peers rather than a 30% to 40% discount.

The STEM markets which the business primarily serves are seeing high growth and are critically under-supplied with talent. Therefore SThree is well placed to charge more to find suitable candidates. In the UK, jobs in science, research, engineering and technology are predicted to grow twice as fast as other careers while the US market faces a dearth of over 1m workers for STEM roles by 2024 according to the firm.

STHREE BUY
(STHR) 290p
Stop loss: 230p

Market value: £380m

The focus on contract recruitment, which makes up over 70% of revenues, gives it visibility of earnings in strong markets and resilience in uncertain times.

Also its geographic diversification, with over 80% of revenues generated outside the UK and Ireland in markets like the US, Japan and Germany, allows it to pursue growth opportunities wherever they occur while limiting its exposure to individual markets.

Matthew Tillett, manager of **Allianz UK Opportunities Fund (B8BB944)**, is also a fan of the stock. He says: 'The valuation at 8 to 9 times earnings is attractive both in relative and absolute terms, and in no way reflects the excellent long-term growth prospects of the business or the growth potential of the company.'

SThree's new chief executive Mark Dorman, who joined the business in March, brings a wealth of experience in helping international businesses scale up and grow their market share.

He says: 'SThree is in an incredibly strong position and its focus on being the number one STEM talent provider in the best STEM markets is the right strategy.

'These markets are set to grow significantly with wholly positive secular trends. This presents a tremendous opportunity and our priority is to drive growth through a data-led approach while enhancing our global platform to fully capitalise on the substantial opportunities ahead of us.'

By Ian Conway
Senior Reporter

FANTASTIC STOCKS FOR 2019

EUROMONEY
(ERM) £13.76

Gain to date: 17.4%

Original entry point:

Buy at £11.72, 20 December 2018

MEDIA OUTFIT **Euromoney (ERM)** continues to justify our faith as a key pick for 2019 as results for the six months to 31 March came in ahead of expectations at the adjusted earnings level.

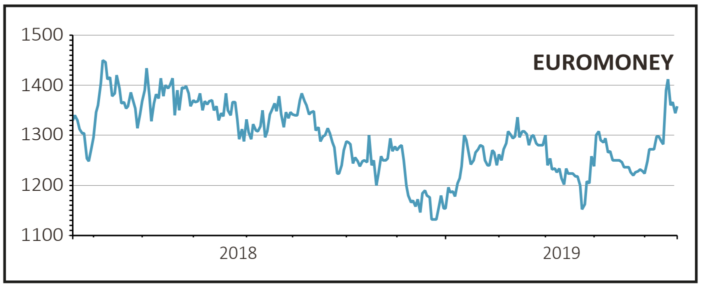
Adjusted earnings before interest, tax, depreciation and amortisation (EBITDA) came in at £46.2m against a forecast £40m amid a reduction in costs. The main driver of growth was the price and data business which is the main reason we find the investment case compelling.

The asset management arm, made up of the publication *Institutional Investor* as well as BCA investment research, saw revenue fall 3%, compared with the 5% slide reported for the same period a year ago.

Finance director Wendy Pallot tells *Shares* modest investment on the marketing side for the asset management business contributed to the slowing decline.

As Pallot points out, if the company could turn this business from a negative contributor to performance to a point where it was holding steady, this could make a big difference to the way the group as a whole is perceived by the market.

Numis analyst Steve Liechti notes: 'Now fully independent, Euromoney can drive its focused growth strategy with full financial flexibility, a broader more liquid shareholder base, and strong management team. Net balance sheet cash and strong cash flow give strategic options.'



SHARES SAYS: ↗

Encouraging results. Keep buying.

BRITISH EMPIRE TRUST
(BTEM) 728p

Loss to date: 4%

Original entry point:

Buy at 758p, 24 May 2018

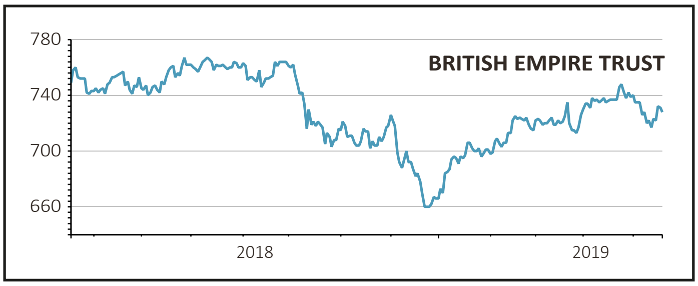
DESPITE A year-to-date rebound, our 'buy' call on **British Empire Trust (BTEM)** is modestly in the red. We remain convinced the trust offers investors plenty of value, both within the underlying assets of the portfolio and with the shares trading at a 9.4% discount to NAV (net asset value).

Joe Bauernfreund-managed British Empire aims to achieve long term absolute returns by investing in undervalued assets. Since Bauernfreund took sole responsibility for the portfolio in 2015, he has concentrated the portfolio, sharpened the focus on ideas with an identifiable re-rating catalyst and is seeing opportunities with attractive discounts.

British Empire is a useful portfolio diversifier given the idiosyncratic nature of the strategy and the 'very different return drivers' from many of its peers, according to research group Kepler.

Kepler argues the underlying holdings of each investee fund are often 'highly diversified', meaning the portfolio isn't as concentrated as it looks.

It points out that 'the discount remains wide both in absolute terms, but also relative to other investment trusts'.



SHARES SAYS: ↗

Value investors should stick with British Empire Trust at 728p with Bauernfreund continuing to find bargains and given significant re-rating scope.

HEAD IN THE CLOUD

Tom Slater 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.

Reflecting on his future-gazing session in Seattle with Jeff Bezos, Tom Slater considers the fast-growing Cloud business Amazon Web Services.

In the eyes of Jeff Bezos, the likely impact of 'the Cloud' is still not fully understood. He sees it as a fundamental change in computing that will play out over decades.

Why does he think this? Because Information Technology (IT) is becoming a central and strategic activity for many businesses outside the traditional IT industry, and it facilitates many of the products and services mentioned previously in this series. The digital assistant Alexa, Amazon Prime Video, as well as other media names in the portfolio such as Netflix and Spotify all exist because of the Cloud. Advances in computing power, twinned with development of faster telecommunication networks, foster new business models that were not possible as recently as a decade ago.

Going back to the early days of computing, large mainframe computers sat in enormous, room-sized metal cabinets, and anchored local networks with end user terminals. As Moore's Law progressed, computers became cheaper and more powerful, but most importantly physically smaller. This heralded the era of personal computing, with machines appearing in enterprises, homes and ultimately pockets and palms.

With the advent of the Cloud, we are at another critical juncture, where computing workloads are moving away from the enterprise and the home, back to a centralised structure. This is a profound change that should be thought of as the digital transformation of an enterprise.

Amazon Web Services (AWS) is the current market leader in the Cloud computing market and

although now a household name, it came from humble beginnings. In 2000, Amazon was still a young ecommerce company struggling to achieve scale. The company had to make substantial investments in its internal systems to cope with this growth which conveniently laid the foundations for what would eventually become AWS.

Mr Bezos's preference for spending most of his time "living in the future" has already been mentioned. AWS is a prime example of the benefits of such prescience. An ecommerce start-up like Amazon should not have been able to challenge the traditional IT giants at data storage, but on-premise storage giants like Oracle and SAP failed to find ways to adapt their business model to embrace Cloud. Amazon's nimbleness, adaptability and future-thinking has resulted in AWS, yet another exemplary Amazon business.

AWS now leads the global Cloud market with around 35 per cent share, more than its next four competitors, Microsoft, Google, IBM and Alibaba, combined. The business is only 10 per cent of Amazon's sales but it accounts for over 50 per cent of operating income and is growing at a faster rate than the company as a whole. The transition to the Cloud is still in its infancy, with recent market analysis suggesting the global Cloud market could rise six-fold by 2025 to $1.25 trillion from over c.$200 billion at present. Broadly, there is scope for any of the tens of millions of enterprises around the world to leverage the benefits of Cloud, so the opportunity is suitably gigantic.

In our meeting, Bezos got most enthusiastic about databases. He thinks that the advantages of a Cloud-based system are big enough for corporates to consider switching. At the very least it seems unlikely that any startup today would tie themselves to the legacy Oracle ecosystems that many enterprises still use. Amazon's Cloud database, Aurora, has been a long time in the making but in Bezos' view, the long learning time only goes to show how vast the prospects are. Aurora provides the security and reliability of commercial databases at one-tenth the cost. The attractions are obvious.

As in many other facets of internet and technology, the Cloud world is increasingly polarised between US and Chinese spheres of influence. In fact, the very idea of Cloud infrastructure is different in the Chinese context. Alibaba's Cloud business is doubling each year and focuses on providing basic tools to the small and medium-sized business sector to which it has never previously had access. Chinese enterprises have historically built their own software whilst SMEs have used manual processes that exploit the abundance of cheap labour or used pirated productivity tools. All of this means that the business software sector has not yet established itself. Alibaba is changing this with affordable connected tools and is clearly channelling a big pool of pent-up demand.

No matter where a business is based, the attractions of the Cloud are apparent. The likely cost savings are appealing but the value from the business intelligence it creates is even more significant. With 5G networks soon to be rolled out globally, and the explosion in data continuing, enterprises are looking for insights that can benefit their decision-making. This is where Artificial Intelligence (AI) comes into play as it excels when making predictions from large datasets and ultimately, the Cloud is how many companies are going to make use of AI.

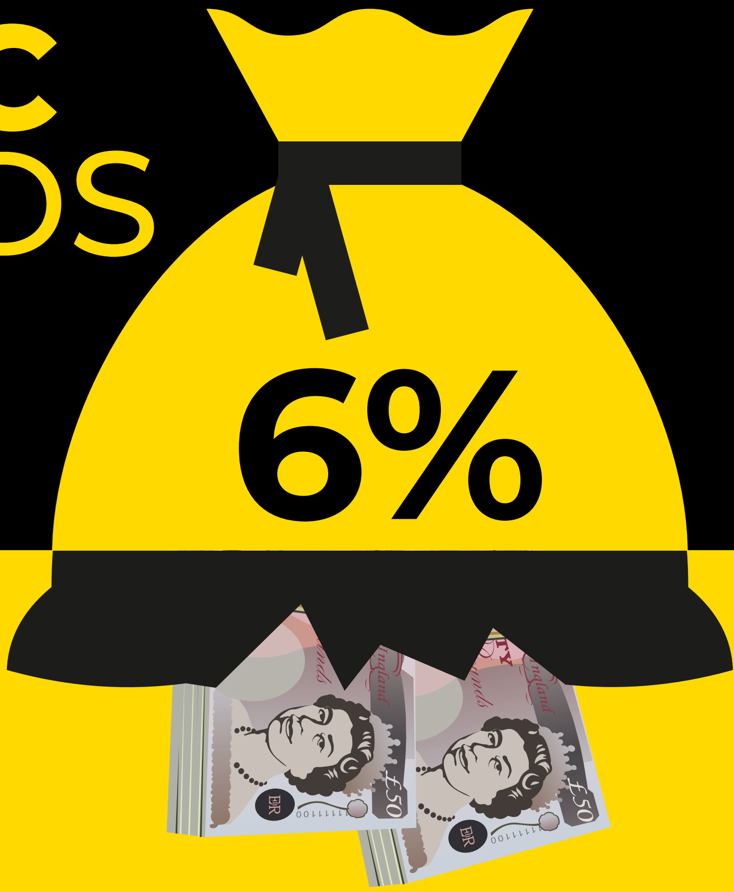
Streaming companies such as Netflix and Spotify that host their platforms in the Cloud use AI tools to recommend films and songs that they hope are to our tastes. Amazon's product recommendations on their website are generated using machine learning algorithms hosted on AWS.

There is potential that as these gradually improve, it may become more economical and profitable for Amazon to send products before the user has requested them. Their taking out a patent for 'anticipatory shipping' shows they are serious. This is only possible due to the Cloud, the intersection of deeper datasets and more powerful AI tools. Our holdings in Amazon, Alphabet and Alibaba should all benefit as this transition continues.

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.

GIGANTIC DIVIDENDS

A quarter of the FTSE 100 yields 6% or more



WHAT'S THE CATCH?

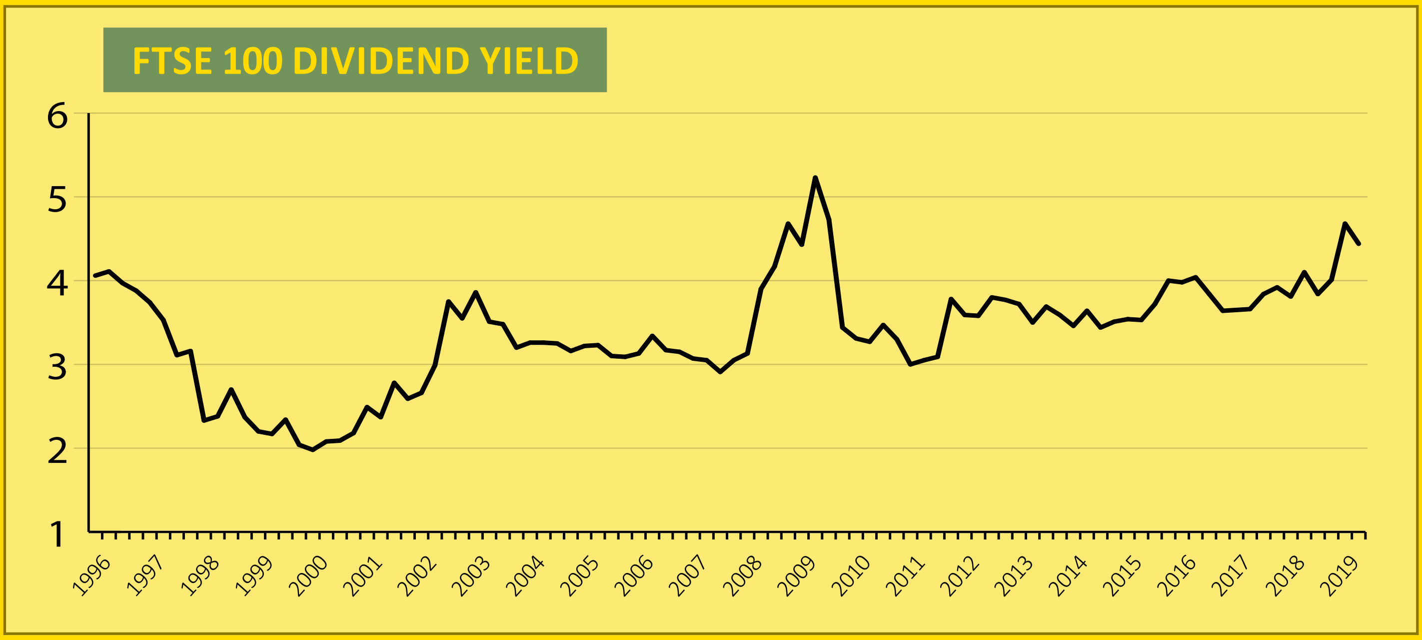
Approximately one quarter of the FTSE 100 is yielding 6% or more, according to analyst forecasts collated by SharePad.

This seems unusually high and begs the question: are UK stocks simply very cheap or are investors pricing in very bad news for many of the biggest companies?

In last week's *Editor's View* column we asked why income investors had fallen out of love with a large number of UK stocks trading on high yields.

Given the current global environment of low interest rates and low real returns, the lack of interest in big dividend-paying companies is particularly curious.

In the past, investors would have happily mopped



Source: Refinitiv

up stocks yielding 6% or more, effectively putting a 'floor' under valuations, yet in today's market it's not uncommon for leading stocks to trade on 8%, 9% or even 10% yields.

One reason may be that these companies come with stock-specific risks which are putting investors off. Another theory is there is more demand for companies which are increasing their earnings and dividends at a decent pace although their current yields are in line with or below the market average.

MARKET IS YIELDING 4.7%

According to AJ Bell Youinvest's latest Dividend Dashboard study, which takes analysts' forecasts for regular dividends for all the FTSE 100 companies, the prospective yield on the UK stock market is 4.7% for this year.

Compared with top savings rates of 1.5% on easy-access accounts at high street and online banks, and a yield of just 1.06% on 10-year UK government bonds (Gilts), a 4.7% yield on the FTSE ought to look attractive to income investors.

Historically, a yield of 4.7% is towards the upper end of the market's range: the only time that the yield has been higher in the past 20 years was during the 2008 financial crisis.

Allianz Global Investors' head of UK equities Simon Gergel says compared with other global stock markets the yield on the FTSE 100 is the most attractive it has been since 2000.

FTSE 100 STOCKS YIELDING 6% OR MORE

NAME	PROSPECTIVE YIELD (%)	SHARE PRICE YEAR-TO-DATE (%)
Evraz	11.6	19.6
Persimmon	11.1	8.8
Taylor Wimpey	10.2	29.2
Centrica	9.9	-29.3
Imperial Brands	9.6	-10.2
BHP	9.4	5.4
Direct Line Insurance	9.1	-0.9
Standard Life Aberdeen	8.3	2.5
SSE	7.8	-5.1
Aviva	7.8	9.8
BT	7.5	-13.7
Barratt Developments	7.4	32.0
British American Tobacco	7.3	15.4
ITV	7.1	-10.8
Royal Bank of Scotland	6.9	5.3
Phoenix	6.9	19.8
TUI	6.6	-27.7
Legal & General	6.5	17.3
Rio Tinto	6.5	20.3
Vodafone	6.3	-17.0
WPP	6.3	11.8
Admiral	6.2	-0.1
HSBC	6.1	1.7

Source: SharePad

FAT TAIL OF HIGH-YIELDING STOCKS

Gergel, who with Matt Tillett co-manages the 130 year-old **Merchants Trust (MRCH)** investment fund, believes the market has become polarised with too many investors over-paying for what are perceived to be quality, defensive growth companies with below-average yields.

That has left a large swathe of good companies with rising earnings and dividends, as well as attractive yields, looking very cheap by comparison.

As an exercise we screened the FTSE 100 index to look for stocks yielding 6%, or 25% more than the current market average.

What we found was a surprisingly large number of well-known, well-run companies which in many cases are yielding significantly more than the market average.

This 'fat tail', as it is known in statistics, includes some of the biggest stocks in the FTSE by market value and some of the biggest dividend payers in absolute terms.

In fact, of the 10 biggest dividend contributors to the FTSE overall, four stocks are yielding more 6% while another three are yielding just under 6%.

Despite recently cutting its dividend by 40%, mobile operator **Vodafone (VOD)** still scrapes into the top 10 in terms of contribution to total dividends although its share price has been very weak in the past few years, much to the frustration of its shareholders.

HIGH PROPORTION OF FINANCIAL STOCKS

We found that 23 out of the 100 stocks in the index have dividend yields of 6% or more, with the biggest concentration in financial firms. Along with financials, there are smaller clusters of miners, utilities and telecom operators, housebuilders, media and tobacco companies.

It's worth noting that at the other end of the spectrum there are two stocks which pay no dividends at all: fast-food delivery firm **Just Eat (JE.)** and online grocer **Ocado (OCDO)**.

> "VODAFONE STILL SCRAPES INTO THE TOP 10"

Within financial stocks, two of the top yielders are high street banks **HSBC (HSBA)** and **Royal Bank of Scotland (RBS)** while the other six are insurers.

WHY IS THE MARKET SO SCEPTICAL?

When stocks are trading on high single-digit or low double-digit yields it is normally a sign that the market thinks either the company isn't going to meet its profit forecasts, or it doesn't physically have the cash to pay the dividend, and therefore the yield isn't sustainable.

That was clearly the case at outsourcers Carillion and Interserve, which were both yielding well over 10% on paper before they failed, and at Vodafone before it slashed its payout in order to fund its 5G investment programme.

However, when stocks such as miner **BHP (BHP)**, cigarette maker **Imperial Brands (IMB)** and housebuilder **Persimmon (PSN)** are yielding upwards of 9%, we have to ask how much bad news the market is pricing in and whether or not it is being rational.

There are four quick checks we can do to tell whether the dividend is safe, at least in theory:

- Are dividends covered by earnings?
- Are dividends covered by cash flow?
- How much are interest payments covered?
- How big is the pension deficit?

The first two are straightforward and use the profit and loss and cash flow statements. The second two are less straightforward and involve looking at the balance sheet but interest costs and pension deficits are higher up the list of priorities than dividends when a company comes to divvying up its cash.

The question of the pension scheme is particularly relevant because, after the scandal involving BHS, financial regulators have become much less tolerant of companies paying out large dividends while they still have big deficits.

HOW TO DO THE CALCULATIONS

DIVIDEND COVER

Prospective earnings per share (EPS) ÷ prospective dividend per share (DPS)

OPERATING FREE CASH FLOW COVER

Net operating profit - tax + depreciation and amortisation - capital expenditure - increase in working capital

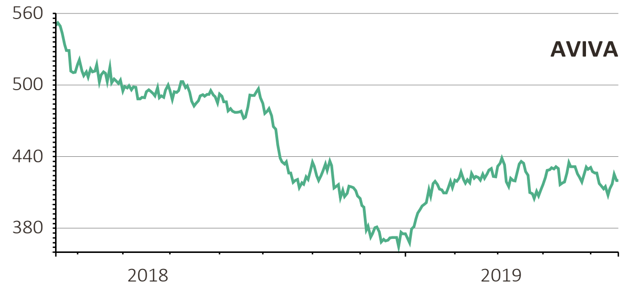
INTEREST COVER

Operating income + interest income ÷ interest expense

THREE STOCKS TO BUY FOR HIGH YIELDS

Out of the 23 stocks yielding 6% or more, three seem to us worthy of buying at the current price: in the financial sector, **Aviva (AV.)** and **Standard Life Aberdeen (SLA)**, and in the consumer sector **Imperial Brands (IMB)**.

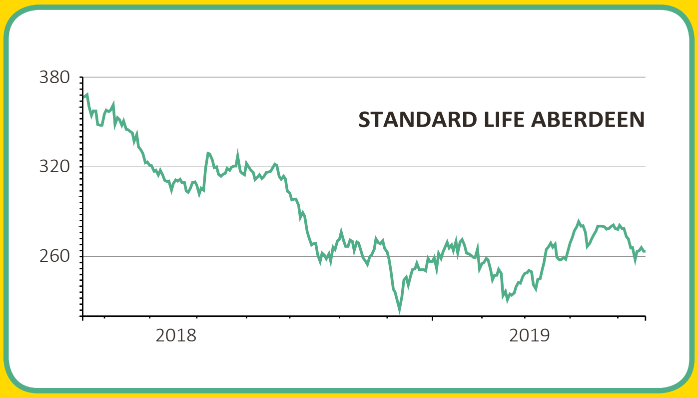
AVIVA
7.7% YIELD



Aviva's (AV.) forecast dividend for this year of 32.2p puts the shares on a prospective yield of 7.7% and it passes the first two tests with flying colours. The payout is covered almost twice by earnings and more than four times by cash flow.

Moreover it has no debt and, fittingly for the biggest corporate pension provider in the UK, the 2018 report and accounts show that it has a pension surplus of £3.25bn, not a deficit. This article provides more detail on why we like Aviva as an investment.

STANDARD LIFE ABERDEEN 8.5% YIELD



Standard Life Aberdeen's (SLA) forecast dividend for this year is 22.1p, putting the shares on a prospective yield of 8.5%. While this isn't fully covered by earnings or cash flow, at the end of last year the company had £1.3bn of cash and liquid resources and £1.6bn of distributable reserves against a dividend payout of just £345m so there is more than enough cover.

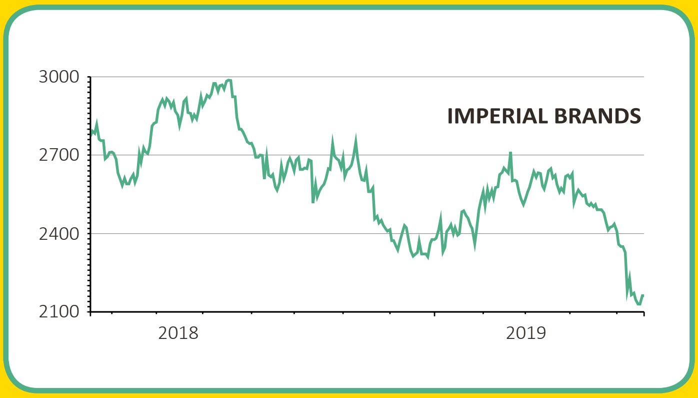
It's also worth pointing out that the firm is buying back shares, which increases the total shareholder return. According to the annual report the equity value of its stakes in quoted companies **Phoenix (PHNX)**, HDFC Asset Management and HDFC Life was roughly £4.5bn as of March this year. That compares with a current market value of £6.5bn for the whole group.

Like Aviva it has no debt and its pension scheme is in surplus to the tune of £1.1bn.

Historically we've been negative on Standard Life Aberdeen's investment case, voicing concerns about outflows from its funds and tough competition from lower-cost funds.

However, the shares do look compelling on a sum-of-the-parts basis. Stockbroker Numis sees future catalysts for the stock as being further disposals of non-operating assets, the ongoing efficient efforts, greater focus on the growing and potentially high value platform business and possible long-term operating business recovery.

IMPERIAL BRANDS 9.6% YIELD



Imperial Brands (IMB) is a more risky proposition. Although its forecast 205p dividend and 9.6% prospective yield are just about covered by earnings and cash flow, it has a considerable amount of debt which needs servicing.

It also had a pension fund deficit of £463m at the end of last year, which was a £250m improvement on the previous year but still represents a risk.

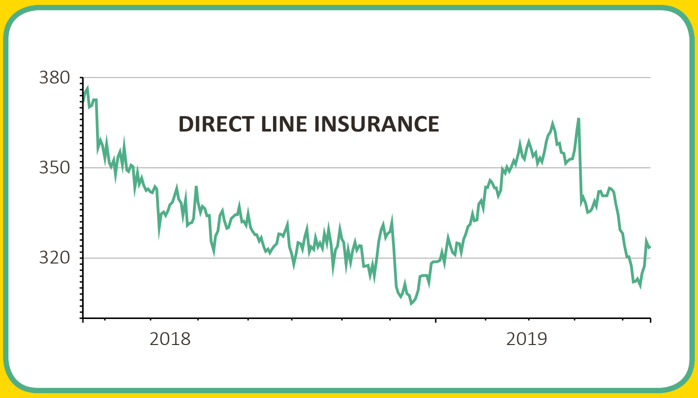
Against this, it had £775m of cash and liquid resources on its balance sheet at the end of last year although £220m of this was in countries where prior approval is required to transfer the funds abroad.

Being a tobacco producer, it must be said that there is also considerable risk of litigation. So far the company hasn't had a successful claim against it but if a case were to succeed it might result in a significant liability for damages and might lead to further claims against the business, says Imperial. It adds: 'Regardless of the outcome, the costs of defending such claims can be substantial and may not be fully recoverable.'

Therefore a 9.6% yield may say less about the company's short-term earnings prospects and more about its long-term liabilities, meaning investors should decide for themselves whether Imperial fits their personal appetite for risk.

TWO HIGH-YIELDING STOCKS TO AVOID

DIRECT LINE
9.1% YIELD



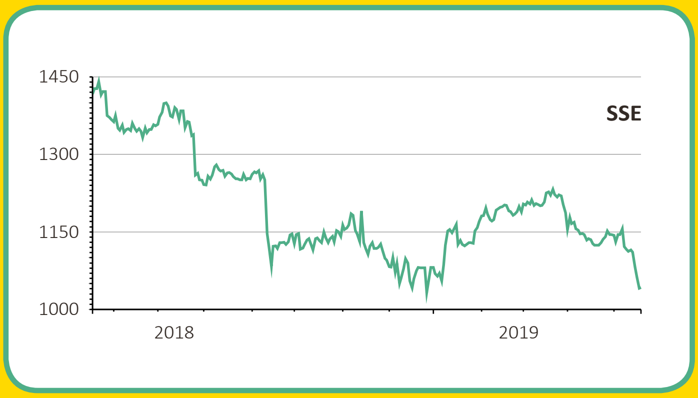
Insurer **Direct Line (DLG)** is yielding 9.1%, generous because it also assumes it pays a special dividend.

As it stands the payout is barely covered by earnings and is uncovered by cash flow, so in the event that the business takes a hit from higher claims, higher costs or regulatory intervention the first thing to be cut will be the dividend.

By way of illustration, last year the 'Beast from the East' pushed up property claims sharply, leading to a drop in operating profits and leaving the 2018 dividend of 29.3p significantly down on 2017's payout of 35.4p, due to a less generous special dividend.

It has no debt, the pension scheme is £17m in surplus and at the end of last year it had £236m of short-term deposits, plus in the last two years it has released £840m of reserves set aside for claims so there is scope to stick to the dividend forecast. However for our money there are safer FTSE dividends out there.

SSE
7.8% YIELD



The second stock to avoid is **SSE (SSE)** where the company has announced plans to cut its dividend from the current financial year onwards.

The utility firm announced plans to pay 97.5p per share for the financial year ended 31 March 2019. However, it says the payout will then drop to 80p for the new financial year.

As is typical for a utility it has a large amount of debt so interest costs eat up a big chunk of profits before dividends can be paid. The results for the year to 31 March have just been released and net finance costs amount to over 35% of operating profit against less than 30% the previous year. With net debt expected to increase from £9.4bn to £10bn this year, finance costs will be even higher.

The group's pension schemes are in surplus by £287m and the firm has £432m of cash on the balance sheet but the energy price cap and a tough competitive market are expected to keep revenues and operating profits under pressure.

That gives SSE very little room to manoeuvre, and the final nail for us is the spectre of a Labour-led government set on nationalising the energy distribution sector at the expense of shareholders.

By **Ian Conway** Senior Reporter

Three reasons why the UK stock market looks compelling

Schroders

Perspective: UK equities are unloved, undervalued and high yielding: an ideal scenario for stock pickers.

Sue Noffke, Head of UK Equities

Whatever the opposite of a sweet spot is called many investors think UK equities are currently in one. With Brexit still unresolved, some have put the market in the "too difficult" basket. While it is understandable to fear uncertainty, as stock pickers we embrace the mis-priced opportunities created by it.

The global nature of the market means that international developments often set the tone for UK equities, and following the trough in the wake of the global financial crisis (GFC) of 2007/08 they've had a good run, as have equities generally. However, Brexit has still loomed large and been a drag on returns.

UK equities have underperformed global equities since the EU referendum. As a consequence, relative to global equities they are now the most lowly valued for decades. The market also looks very attractive in absolute terms, its current dividend yield is significantly in excess of the long-term average yield.

1. Unloved

The negativity of international investors towards UK equities is entrenched – global fund managers have been "underweight" the UK for three years, according to the Bank of America Merrill Lynch's global fund manager survey. Investors are said to be underweight an asset class when they are allocating less capital to it than would normally be the case.

As patient investors, we are often interested in how corporate investors are behaving since we share their long-term mentality. Overseas companies (and private equity) buyers are capitalising on the relative valuation opportunity of UK equities, and sterling weakness.

To cite two recent examples, Coca Cola has acquired the Costa Coffee chain from FTSE 100 group Whitbread, while shareholders in mid-cap speciality pharamceutical company BTG have approved a bid from Boston Scientific.

Costa Coffee generates the bulk of its profits from the UK, although has a fast growing international franchise business. In contrast, 90% of BTG's revenues derive from customers based in the US[1] . To our minds the bids for these assets underline the indiscriminate negativity towards UK equities – many investors have sold ALL UK equities, both their domestically and internationally focused ones. Remember the UK equity market derives more than two thirds of its revenues from overseas.

Share buybacks[2] by companies are another interesting theme. It is, perhaps, no coincidence that Whitbread has proceeded to use the larger part of the the Costa sale proceeds to repurchase stock.

Whitbread has joined a number of other UK quoted companies which have either recently initiated, or extended share buyback programmes, including Standard Chartered and UK-focused peer Lloyds Banking.

It seems to us that many UK corporates see their own shares as undervalued, so are sending another valuable signal.

2. Undervalued

Indeed, valuations reflect the degree to which investors have shunned UK equities. The chart below tracks the market's valuation discount versus global equities based on the average of three metrics. The metrics used are the price-to-book value (PBV) ratio and price-to-earnings (PE) and price-to-dividends (PD) ratios.

All valuation metrics have their strengths and weaknesses, so combining three reduces the risk of distortions (see the end of the article for a description of these metrics).

Based on this analysis, UK equities are trading at a 30% valuation discount to global peers, close to their 30-year lows. While it is likely to persist until there is some form of clarity over the terms of any Brexit deal, the valuation gap provides an attractive entry point for investors with long time horizons.

Please be aware 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.

The valuation of domestically-focused equities is particularly attractive, and consequently we have been increasing exposures to this area of the market. The uncertainty created by Brexit has driven a slowdown in the UK economy since the EU referendum (albeit, by less than feared), while the global economy has held up well.

Associated UK political uncertainty is further weighing on valuations, and might continue to do so given the relatively high probability of either a leadership election or a UK general election in 2019.

3. Attractive yield

Over the past 30 years the dividend yield of the UK equity market, relative to the rest of the world has only been higher during the 1991 recession and at the peak of the technology media and telecoms (TMT) bubble (see chart, below).

In absolute terms, the UK equity market

Source: Morgan Stanley, as at 13 March 2019. 1 Valuation ratios: PE = price to earnings, PBV = price to book value, PD = price to dividends. CS1445

Past Performance is not a guide to future performance and may not be repeated.

[1]See page 124 of BTG's 2018 annual report and accounts, at: https://btgplc.com/BTG/media/BTG/pdf/annual-report-and-accounts-2018.pdf

[2]Share buybacks are where a company repurchases its own shares in the open market. Similar to dividends, it is a way for companies to return cash to shareholders.

is currently yielding c. 4.5% (MSCI UK index), which compares very favourably to the average dividend yield over the past 30 years of 3.5%. For yields to revert back to their long-term average, either the market has to rise or bad news needs to arrive soon and companies cut payments. They would need to cut by a good margin more than they did following the GFC and ensuing global recession – is this likely?

Following the GFC, UK dividends fell by 15% over two years on a cumulative basis, and that includes the effect of BP suspending its dividend following the Deepwater Horizon disaster in the Gulf of Mexico. We don't believe we are on the cusp of a recession like the one which followed the GFC. Despite some recent high profile and material dividend cuts from Vodafone and Marks & Spencer, overall we still believe that the market's dividend payment will continue to rise.

If we do experience a recession in the near term, we would expect it to be local to the UK (possibly the result of a disordely Brexit) rather than a global one, although we are in the latter stages of the economic cycle. This gives us a degree of comfort that the UK equity market's yield is sustainable as the large majority of UK stock market dividends derive from overseas.

The charts and data highlighted help put the opportunities within UK equities into a broader context. In light of these conditions it is perhaps unsurprising that our allocation to overseas equities is currently at the lower end of its historical range.

As stock pickers we see plenty of opportunities within the UK – across all parts of the market, large as well as small and mid-sized companies – which could help build portfolios capable of generating superior long-term returns.

Source: Thomson Reuters Datastream, as at 29 March 2019. 1 MSCI UK relative to MSCI World. CS1445

What are the risks?
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. Investments concentrated in a limited number of geographical regions can be subjected to large changes in value which may adversely impact the performance of the fund.

Equity [company] prices fluctuate daily, based on many factors including general, economic, industry or company news.
Please be aware 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.

Price-to-book value (PBV) ratio A company's "book value" is the value of its assets minus its liabilities (net asset value), at a set point in time. If a company's share price is lower than its net asset value (PBV ratio of less than one) then it might be considered as potentially good value and worthy of further analysis. However, for companies with little in the way of physical assets, such as technology companies, PBV ratios have their limitations.
Price-to-earnings (PE) and price-to-dividends (PD) ratios.

The PE ratio compares a company's share price to its earnings per share. The PD ratio is a company's dividend per share divided into its share price. Because a PD ratio accounts for cash actually being paid out to investors (dividends) as opposed to earnings, which are an accounting concept, it can be a more reliable valuation metric.

The dividend heroes that have beaten inflation

We look at trusts raising dividends by more than the cost of living

Investment trust dividend heroes are classified as funds that have increased their dividends every year for at least 20 years in a row. While this list, published by the Association of Investment Companies (AIC), will help you spot products with a dividend growth track record, it doesn't tell you the level of growth and what it would be in 'real terms' when adjusting for inflation.

If growth in dividends does not keep pace with the cost of living then the 'real' value of these dividends will be eroded.

Fortunately we have the prized information. *Shares* has crunched the past 20 years' data to see which dividend hero investment trusts have managed to consistently beat inflation with their level of dividend growth.

Three investment trusts have passed the test over the past two decades: **Bankers Investment Trust (BNKR)**, **Caledonia Investments (CLDN)** and **JPMorgan Claverhouse (JCH)**. They've achieved 6.5%, 5.4% and 7.5% average dividend growth, respectively.

Credit should also go to **Witan Investment Trust (WTAN)** which has grown dividends in excess of inflation over the past 10 years, averaging an 8.8% hike annually over that period.

We've used the CPI (consumer price index) measure of inflation, which represents a basket of goods and services that impact all of our day-to-day lives.

QUALIFYING AS A "HERO"

The concept of dividend heroes has really taken off in recent years with qualifying investment trusts eager to hold on to their position within the AIC's index.

It can be seen a valuable marketing tool, hence investment trusts will do their upmost to stay in the index. The risk is that investors may only get a small increase in the dividend. After all, a trust would only need 0.01% annual dividend growth to stay classified as a dividend hero once they've qualified for the 20-year growth stretch.

For example, **Merchants Trust (MRCH)** has increased its dividend by less than 1% in six out of the past 10 years, according to data from the AIC and Morningstar. **Scottish American (SCAM)** has a reputation for volatile annual dividend growth – its highest was 13.3% and its lowest was 0.4% over the past two decades.

20 TRUSTS ON THE LIST

Overall there are 20 investment trusts qualifying for dividend hero status. In 2018 Bankers Investment Trust, **City of London Investment Trust (CTY)** and **Alliance Trust (ATST)** achieved

DIVIDEND HEROES GROWING DIVIDENDS BY MORE THAN INFLATION EACH YEAR OVER THE PAST 20 YEARS

Investment Trust	Average dividend increase over past 20 years
Bankers Investment Trust	6.5%
Caledonia Investments	5.3%
JPMorgan Claverhouse	7.5%

Source: AIC/Morningstar

their 52nd year in a row of increasing dividend payments to shareholders.

This means these three trusts started paying their shareholders higher dividends in the same year that England won the World Cup, and they've not stopped since.

Caledonia Investments made it a 51-year run in 2018, while there are half a dozen others closing in on their big 50.

RECENT DIVIDEND GROWTH

Last year **BMO Global Smaller Companies (BGSC)** hiked its annual payout by nearly 18%, from 12.25p to 14.4p per share, the biggest increase in 2018 of all the dividend heroes.

Investment trusts Witan, **Brunner (BUT)** and **Temple Bar (TMPL)** posted double-digit increases to their dividends, to 23.5p, 18.15p and 46.72p respectively.

But not all increases were so impressive. Those from **British & American Investment Trust (BAF)** and **Murray Income Trust (MUT)** were particularly dismal, failing to beat 2018's benign 2% inflation rate at 1.16% and 1.53%, respectively.

INVESTMENT TRUST DIVIDEND HEROES

	10 year average dividend growth	Yield
Alliance Trust	5.7%	1.8%
Bankers	6.0%	2.2%
BMO Capital & Income	3.2%	3.4%
BMO Global Smaller Companies	11.8%	1.1%
British & American	2.8%	17.9%
Brunner	4.5%	2.3%
Caledonia	5.8%	1.9%
City of London	4.3%	4.3%
F&C Investment Trust	5.6%	1.6%
Invesco Income Growth	3.0%	4.1%
JPMorgan Claverhouse	5.4%	3.9%
Merchants	1.4%	5.2%
Murray Income	2.1%	4.0%
Schroder Income Growth	3.1%	4.1%
Scottish American	2.7%	3.0%
Scottish Investment Trust	9.0%	2.7%
Scottish Mortgage	4.1%	0.6%
Temple Bar	3.6%	3.6%
Value and Income	4.5%	4.3%
Witan	8.8%	2.2%

Source: AIC *Yield based on 2018 dividends

In fact, Murray Income has now failed to beat inflation with its dividend increase in each of the past three years, unique on the dividend heroes list.

You have to go back to 2013 to find its last time the trust raised its income payout by more than 3%. Yes, Murray has been increasing payouts for 45 years, yet evidently, not always meaningfully so.

There are caveats, such as income yield. Murray Income yields 4% based on the latest share price and historical payout. Even higher is a 5.1% yield on offer from the Simon Gergel-run Merchants Trust. Its dividend grew by 2.5% last year.

Gaining dividend hero status undoubtedly buys hard-earned credibility with income-seeking investors – kudos that investment trust managers will not give up lightly. But investors need to be aware that retaining that status could influence dividend policy in the future in ways that you may not want.

This could mean that investing

in dividend hero trusts are not necessarily the best way forward for every income-seeking investor. Questions need to be asked regarding what's right for every individual.

For some, a relatively high yield and capped growth may be the way forward, such as those already in retirement and living off their savings. But others, especially those with a longer-term horizon, higher dividend growth may suit future needs better.

THREE INFLATION-BUSTING DIVIDEND HEROES TO BUY

JPMorgan Claverhouse Investment Trust (JCH) 702p
Already a popular investment trust selection for investors who want attractive income returns to bolster capital growth, JPMorgan Claverhouse is a particularly attractive pick for investors happiest putting their money in the UK companies space. It focuses on a mixture of growth and income stocks. Dividends are paid quarterly which will be attractive for retirees living on investment income.

Portfolio holdings include:
Royal Dutch Shell, Unilever, JPMorgan Smaller Companies

- **3-year total return: 44.3%**
- **Yield: 3.9%**
- **Discount to NAV: 3.2%**

Witan Investment Trust (WTAN) £10.60
A global equities remit that aims to produce less volatile returns than many of its peers, Witan is unusual in its management strategy.

Rather than lean on on in-house team, the trust draws on the expertise and experience of up to 10 third party managers that influence investment decisions. They include some well-known names, such as Nick Train of Lindsell Train and Derek Stuart of Artemis.

Portfolio holdings include:
Syncona, Diageo, Lloyds

- **3-year total return: 54.0%**
- **Yield: 2.2%**
- **Discount to NAV: 1.6%**

Bankers Investment Trust (BNKR) 895p
Bankers is attractive to investors thanks to its long dididend growth track record and making a real virtue of diversification and achieving decent capital gains.

It had close to 200 stocks in its portfolio at the end of 2018 from all over the world, and its top 10 investments were worth just 16% of the combined value. Add in the dividend track record that extends more than half a century and you can see why it is a popular choice with investors.

Portfolio holdings include:
Microsoft, Berkshire Hathaway, BP

- **3-year total return: 56.6%**
- **Yield: 2.2%**
- **Discount to NAV: 1.6%**

By **Steven Frazer**
News Editor

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Using low-cost ETFs for investment income

We look at dividend-focused passive funds and how their selection criteria works

Investors looking to get a regular income from their portfolio have the option of investing in a range of low-cost exchange-traded funds (ETFs) specifically designed to track certain types of dividend-paying assets.

However, not all dividend-focused ETFs are created equal. In this article we will look at the pros and cons of the relevant products and discuss the mechanics around ETFs and dividends.

TIGHTENING THE RULES

An increasing number of ETFs track a basket of companies which have been filtered according to certain criteria – factors such as volatility, share price momentum and valuation.

Unsurprisingly, given dividends are a key reason many people buy stocks and shares, these factors have also encompassed yield.

While these products can be more expensive than ETFs that simply match the performance of a mainstream index like the FTSE 100, they are typically cheaper than equity income funds. But do they deliver?

The accompanying table shows a section of income ETFs and information on charges and dividend yield.

iShares UK Dividend (IUKD) takes a fairly simple approach of selecting stocks for its index based on dividend yield. Specifically it tracks an index composed of 50 stocks with leading dividend yields from UK-listed companies.

The problem with this approach is that high yields can often be a signal that a dividend cut is on the way. Notably **Vodafone (VOD)** is among the top holdings within the product and the telecoms group recently cut its dividend by 40%.

For this reason there is an argument that dividend growth or at least sustainability

> “WHILE THESE PRODUCTS CAN BE MORE EXPENSIVE THAN ETFS THAT SIMPLY MATCH THE PERFORMANCE OF A MAINSTREAM INDEX LIKE THE FTSE 100, THEY ARE TYPICALLY CHEAPER THAN EQUITY INCOME FUNDS. BUT DO THEY DELIVER?”

OUR TOP PICK IS **SPDR S&P UK DIVIDEND ARISTOCRATS** ETF

COMPARING INCOME ETFS

ETF	Code	Ongoing charges	Historic yield
iShares UK Dividend	IUKD	0.40%	6.9%
WisdomTree UK Equity Income	WUKD	0.29%	6.1%
BMO MSCI UK Income Leaders	ZILK	0.25%	4.9%
Invesco FTSE RAFI UK 100	PSRU	0.39%	4.5%
SPDR S&P UK Dividend Aristocrats	UKDV	0.30%	4.0%

Source: ETF provider factsheets

is more important than your starting yield.

SPDR S&P UK Dividend Aristocrats (UKDV) product tracks an index of stocks created by Standard & Poor's (S&P). It includes the 40 highest-yielding UK firms which have either increased or maintained their dividend payment for at least seven consecutive years.

To be eligible companies also have to meet market cap and liquidity criteria.

The portfolio is rebalanced on a quarterly basis and shares are removed from the index on the first business day of the following month if a dividend is cancelled or suspended.

INDEX PROBLEMS

An error by S&P saw construction group Carillion stay in its index until it went bust in January 2018 despite the company having said in July 2017 it would axe its dividend.

Retailer **Marks & Spencer (MKS)** is one of the largest holdings in the ETF. It announced a dividend cut in February 2019 but should leave the index at the next quarterly reshuffle in June.

Notwithstanding the Carillion fiasco, we believe the SPDR S&P UK Dividend Aristocrats product is the more attractive option for a long-term investor because of the tighter eligibility criteria for companies to be in the index.

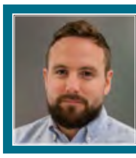
OTHER WAYS TO FILTER THE MARKET

While the Dividend Aristocrats ETF uses backward-looking measures to identify its basket of stocks there are alternatives which try to use forward-looking measures to try to judge the likelihood of a company continuing to pay a high dividend.

One example is **BMO MSCI UK Income Leaders (ZILK)**. This tracks companies which have higher dividend yields and also rank highly based on index provider MSCI's quality scores which measure things like the level and consistency of returns and the state of the balance sheet.

A word of caution as this ETF only has £3m in assets. A risk to consider, particularly when looking at smaller niche products, is that the product could be closed down due to lack of interest.

A final consideration is that dividend-focused products are more expensive than traditional broad-market ETFs. Therefore an alternative approach might be to look at a straightforward FTSE 100 ETF given that the blue chip index is yielding 4.7% at present. An example is **iShares Core FTSE 100 (ISF)** which tracks the index for a low cost of 0.07%.



By **Tom Sieber**
Deputy Editor

Overpriced tracker funds could cost you dearly

How buying a more expensive passive fund can really eat into your returns

When it comes to putting your money away for a rainy day, just sticking it in a fund that follows something like the FTSE 100 can sometimes be the simplest thing to do.

After all, the theory goes that markets are efficient and you'll struggle to outperform over the long-term.

In America, a 2016 analysis of active US equity funds by S&P Dow Jones, for example, found that 99% failed to beat the S&P 500 over 10 years.

PASSIVE SHOULD MEAN CHEAPER

Passive funds track a market or index, and are typically a lot cheaper than active funds, particularly when it comes to investing in large UK or US companies.

Many have very low fees, often below 0.4%. However, there are numerous examples of tracker funds with significantly higher fees – and ones which seem unjustified.

Halifax and Scottish Widows both have UK tracker funds which follow the FTSE 100. Halifax charges 1.06% for its **Halifax UK FTSE 100 Index Tracking fund (3181225)** and Scottish Widows 1% for the **Scottish Widows UK Tracker (3163278)**. Both funds follow the FTSE 100 Total Return Index.

In comparison, another fund following the same index is **HSBC FTSE 100 UCITS ETF (HUKX)** and it only charges investors 0.07%.

Stocks have historically generated somewhere around 7% a year on average. Taking this as a guide, if you put £10,000 in the Scottish Widows fund at 1% around 10 years ago, before charges your money would have grown to £19,671.51.

Assuming there's no initial charge, when you add the 1% management fee that figure goes down to £17,790.54, with £1,405.73 paid to Scottish Widows.

IT MAKES A BIG DIFFERENCE

Put into the HSBC fund for example, which does exactly the same thing as the Scottish Widows fund, and you'd be paying £102.84 in total to HSBC and your closing pot would stand at £19,534.58. That's a whopping difference of £1,744.04 extra money paid for a fund which does exactly the same thing as the cheaper option. All figures are before tax.

Lloyds Banking (LLOY), which owns Halifax and Scottish Widows, has defended the cost of the funds, and says that is a bundled price, not an investment only price, meaning it also includes other services.

It hadn't responded to our requests for clarification of these services by the time *Shares* went to press.

Virgin Money bowed to pressure earlier this year when it slashed the 1% fee on its **Virgin UK Index Tracking Trust (0930431)** down to 0.6%. Comparative tracker funds charge anywhere between 0.07% and 0.1%.

The popularity of these expensive funds is surprising. The Virgin fund has £2.7bn in assets, while the Halifax fund has £1.2bn and the Scottish Widows one a considerably less £403m, but still bigger than the £105m in the HSBC ETF.

A lot of these expensive trackers come from banks and customer-facing companies like Virgin Money, which are often used by first time investors with little knowledge of how to compare costs.

Virgin has previously defended the cost of its fund saying that it includes the cost of its ISA. But even then, you can still move to a platform like AJ Bell Youinvest, where you can buy the HSBC fund and still pay significantly less than 1%.

FTSE 100 trackers are the most popular when it comes to passive funds, but they are by no means the only ones available.

And they are also not the only ones with very big price discrepancies between products which both seemingly do the same thing.

Like the FTSE 100, another simple and often effective area to invest can be UK government bonds, also called gilts.

Gilts are generally considered low risk investments, because it's unlikely the UK government will ever go bust and default on its debt. A great way to access gilts is through passive funds, and there are no shortage of options out there.

But again beware – while some gilt ETFs can cost as low as 0.07%, others can charge you up to 10 times more. For example, **Quilter Investors Gilt Index Fund (B7KHZ15)** costs 0.7%.

These funds may look the same, and indeed invest in similar thing, but the companies behind the more expensive ones sometimes point out they follow different benchmarks, with different durations and maturities in the bonds.

Quilter has defended the cost of its gilt index fund, and says the 0.7% fee is part of a rebate-paying share class where generally part of the charge is paid back to end clients. It also says it reviews the cost of all its funds annually.

> "IT IS VITAL TO SHOP AROUND FOR THE LOWEST CHARGES ON TRACKER FUNDS"

IS YOUR EUROPEAN FUND TOO PRICEY?

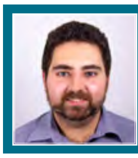
Away from the UK, another popular area to invest is big European companies. While the price differences aren't as egregious as the FTSE 100, there are plenty of options to choose from if you want to invest in European large and mid caps, and also a big difference in the price.

In some cases this can be justified by a different focus, particularly for funds investing in the more medium-sized companies, but not always.

M&G Investments, for example, has the **M&G European Index Tracker (3092918)** with a charge of 0.69%. Index provider State Street has a fund, **SSgA Europe ex UK Equity Tracker (GB00B0FR9V92)**, which tracks a similar benchmark for 0.25%.

In response, M&G reiterates that it is an active manager and while it does have some passive funds, they are not actively marketed, noting that the European fund has less than £80m in assets – a small sum for a company the size of M&G – and is unlikely to grow that any time soon.

So while it can be easier to stick some money in a tracker fund offered by your bank and come back to it in five to 10 years, beware of how much you're paying, because without even knowing it you could be handing over thousands for literally nothing extra in return.



By **Yoosof Farah**
Reporter

THIS IS AN ADVERTISING PROMOTION

Janus Henderson INVESTORS

The relief of revenue reserves

There is no question that we find ourselves in uncertain times. It is during periods of uncertainty that the investment trust structure has distinct merits. That's because investment trusts, which are listed companies in their own right, can store future income away for a rainy day – a unique function of investment trusts called revenue reserves.

Revenue reserves are the means by which investment trusts can continue to grow their dividends even when dividends across the stock market are falling, typically during economic downturns. Investment trusts do not have to distribute all of their income in each financial year. They are allowed to hold back up to 15% of their annual income. For example, in a good year for investment income, an investment trust might hold back 5% of its income, while distributing the other 95% in dividends to its shareholders. The 5% that is held back will be added to the revenue reserve. Over the years, the revenue reserve can build up to a substantial sum if the investment trust is able to make further retentions.

In contrast, during an economic recession, there will be dividend cuts. If during these times an investment trust's income from its portfolio declines, it is still possible to grow its dividend by drawing down from the revenue reserve. Obviously, revenue reserves are finite and so using the revenue reserves to sustain dividend growth can only take place for a limited number of years. The revenue reserve of an investment trust is revealed each year in its annual report and accounts. The largest revenue reserves tend to be found in old investment trusts which have accumulated them over many years.

CITY OF LONDON'S USE OF REVENUE RESERVES

I have now managed City of London Investment Trust for more than 27 years and we have grown our dividend in each of those years. We have had to use revenue reserves in seven different years to increase the dividend. Our financial year ends on 30th June and I can well remember how difficult it was for world equity markets over the twelve months to 30th June 2002. During those 12 months, City of London's earnings per share (including all its investment income) fell by 11.0% to 7.48p and yet we were still able to increase the dividend per share by 5.9% to 7.94p. The difference between 7.94p and 7.48p, or 0.46p, was paid from the revenue reserve.

The following year (to 30th June 2003), earnings per share recovered by 5.2% to 7.87p but it was still not enough to cover the dividend per share, which we increased by 1.6% to 8.07p using the revenue reserve. The next year (to 30th June 2004,) earnings per share grew by 4.7% to 8.24p but again failed to cover the dividend per share, which grew by 3.2% to 8.33p. It was after three years of using revenue reserves, in the 12 months to 30th June 2005, that the dividend per share of 8.62p (up by 3.5%) was covered by earnings per share of 8.88p (up by 7.8%) and revenue reserves were once again added to.

In City of London's portfolio, I aim to be invested in companies that can consistently grow their profits and dividends through the cycle. However, during economic downturns, there are bound to be companies that disappoint. Open Ended Investment Companies (OEICs) have to distribute 100% of their income each year and are not permitted to have a revenue reserve. I would have not been able to achieve 27 years of annual dividend increases if I had been managing an OEIC.

City of London's annual dividend stood at 4.56p in 1991, the year when I was appointed its Fund Manager. The quarterly dividend is now 4.75p and the investment trust's Board of Directors has announced that it intends to pay an annual dividend of 18.60p for the year to 30th June 2019.

DIRECTOR OF GLOBAL EQUITY INCOME,
JOB CURTIS

BIOGRAPHY

Job Curtis is Director of Global Equity Income at Janus Henderson Investors, a position he has held since 2006. He has been Portfolio Manager of the City of London Investment Trust since 1991 and is also co-manager of the Global Equity Income and Global Dividend & Income strategies. Job joined Henderson in 1992 following Henderson's acquisition of Touche Remnant, where he had served as a unit trust and investment trust manager since 1987. Prior to this, he was an assistant fund manager at Cornhill Insurance from 1985 to 1987 and a graduate trainee at Grieveson Grant stockbrokers from 1983 to 1985. Job holds an MA in philosophy, politics and economics from Oxford University. He is an associate member of the Society of Investment Professionals (ASIP) and has 36 years of financial industry experience.

Henderson Global Investors merged with Janus Capital Group in May 2017.

'Can you help with lifetime allowance calculation?'

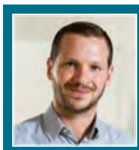
AJ Bell pensions expert Tom Selby explains the rules

I'm 56 and have a defined benefit pension which will pay approximately £32,000 per year at age 60 and I also have a SIPP (present value around £200,000).

I'm interested in the lifetime allowance calculation; particularly the test at age 75. Is the defined benefit pension (which increases at 5% per year) recalculated for the lifetime allowance test at age 75?

And what of my SIPP? If this is uncrystallised is it taken into account at 60 or indeed even at 75?

Michael



Tom Selby
AJ Bell
Senior Analyst says:

Because defined benefit (DB) pensions provide a guaranteed income for life (rather than being a pot of money like SIPPs) the Government has a formula to work out how much they are worth in relation to the lifetime allowance (which currently stands at £1,055,000).

To estimate how much lifetime allowance your DB pension might use up, multiply the income to which you are entitled at the scheme's normal pension age (in this case 60) by 20. In your case that's £640,000.

Note that if you are entitled to a lump sum as part of your DB arrangement this is included in your lifetime allowance calculation. Where a scheme has guaranteed increases above 5% a higher factor than 20 could be used in valuing your benefits, but this shouldn't affect you.

If you take your DB pension at age 60 the test will be applied in relation to the lifetime allowance at that point in time (the allowance rises in line with CPI inflation each year).

Let's says the lifetime allowance rose to £1,150,000, as an example, by that point (roughly in line with 2% inflation) your DB pension would have used up about 56% of this amount. This would not be tested against the lifetime allowance again.

Your SIPP, on the other hand, will be tested against the lifetime allowance when you 'crystallise' it – meaning you pick a retirement income route, usually either by entering drawdown or buying an annuity.

The timing of this test is based solely on the decisions you make regarding your SIPP, so isn't linked to the point at which you are entitled to receive benefits from your DB scheme.

If you leave any of your fund untouched ('uncrystallised' in the jargon) then a lifetime allowance test will be applied on this money at age 75 to determine how much you have used up.

This will then be added to the lifetime allowance used up by your DB pension (and any other pensions) to work out if a tax charge should apply on any excess.

Any investment growth you enjoy on funds that have been crystallised in drawdown but not yet taken as an income will also be tested against the lifetime allowance.

Finally, caveat time: the above is correct in relation to the tax rules now but the Government has an annoying habit of tinkering with these, particularly at Budget time.

And as always, this is guidance rather than advice. If any of this is unclear you should consider speaking to a regulated financial adviser.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

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

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

How to structure your income portfolio

We examine how to get diversified exposure to dividends

The prospect of companies cutting their dividends is looming large again. On 14 May **Vodafone (VOD)** cut its dividend, ending a two-decade long steak of increases, while there are further warnings that other sectors such as insurers are feeling the crunch and could take the axe to their payouts.

This will be a worry for many retirees, who rely on the steady drip-feed of dividends from these companies to provide the income they draw from their pension. Whether you invest in the stocks directly or have exposure via funds, it's likely that your retirement pot will be affected if some of these giants start cutting.

That doesn't mean you need to panic, but it can be a good time to revisit where you get your income from and how to splice up your portfolio to give you the best chance of having a steady, but also growing, income.

DIVIDE AND CONQUER

Many professional fund managers who run income funds will cut their portfolio up to target different needs. They are expected by investors to provide a decent income today, but also to ensure that the income keeps pace with rising prices,

namely inflation.

An investor in a fund getting a 4% yield today, so a £40 payout on every £1,000 they have invested, is not going to be happy getting that same £40 payout in 10 years' time, as the spending power of that money will have diminished.

In real-world terms, if you retire today and work out that you can withdraw a £20,000 annual income from your pension pot, you want that amount to grow with time, in the same way as a salary would increase each year.

In 10 or 20 years' time that £20,000 will buy you far less. As an example, a £20,000 income in 2008 would need to be £26,215 today just to have kept pace with inflation.

You need to balance this growth for the future with income today. Here's how.

THE STEADY EDDIES

You need some income payers in your portfolio that are reliable dividend payers. It's impossible to know whether a company or fund will continue its current payout, but you can look at the track record and the financials to give you a good idea.

This group of stocks or funds should be the backbone of your portfolio, they should pay out a decent income and have a solid track record of doing so in the past.

If you pick stocks they are likely to fall into some of the less volatile sectors, such as consumer staples, but they will be on the more boring side, plodding along churning out a decent dividend and not giving you too many sleepless nights.

In an ideal world the income-producing characteristics of these investments will mean they are attractive to other investors too, and so their share price could also rise in time, delivering you some capital growth too.

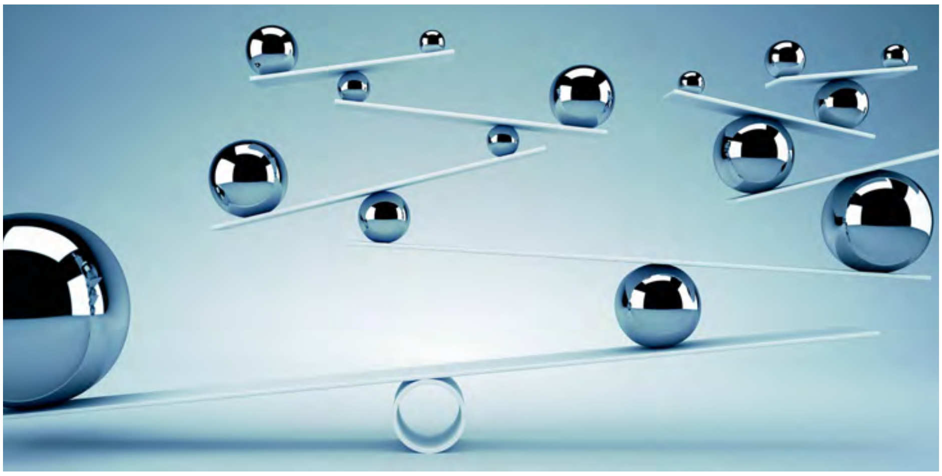
THE YOUNG UPSTARTS

These stocks or funds might not be yielding enough today for you to think of them being worthy of inclusion in an income portfolio, but these are your winners of tomorrow.

Thanks to the aforementioned solid backbone of investments (and the next group below), you can afford a slightly lower income today from this group of companies or funds. However, what you're looking for here is the ability to increase the dividend ahead of inflation in future years.

These are the assets that will help you to get a growing income in the future. They are likely to be younger, smaller companies (but not always) who are growing faster than your

> "you also need to think about whether you're willing to sacrifice capital growth today for a higher income, or if you're more reliant on growing the income in the future"



Steady Eddies and are focused on a good dividend policy, or funds that invest in these stocks. As they grow and increase their revenues, they'll also be able to grow their payouts faster.

THE BIG PAYERS TODAY

To balance out these lower payers today you will want to allocate to some companies or funds that are delivering a high yield right now.

If stocks, they will be handing out decent dividends in comparison to their share price and will help bolster your portfolios' payouts in the short term.

Typically stocks with larger yields are higher risk, as the market has pushed down their share price due to uncertainty around the future earnings or growth prospects.

If you go down the fund route, the group you're likely to be looking at are so-called 'income maximiser' funds for this section of your portfolio.

These funds use derivatives, and so are a bit more complicated than your average fund, and they effective sell some of the future capital growth of the fund in exchange for higher income today. Like the stocks above, they are riskier.

HOW DO I BALANCE THESE THREE GROUPS?

How much you allocate to each group depends on myriad factors. Most importantly you need to look at the risk you're willing to take with your income portfolio, but also the level of income you want today and how reliant you are on that.

You also need to think about whether you're willing to sacrifice capital growth today for a higher income, or if you're more reliant on growing the income in the future. Whatever split you decide on, make sure you monitor all of the constituent parts to make sure they're living up to your expectations.

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

Is it time to switch from growth to value strategies?

Value stocks have often performed well when inflation starts to pick up

Growth and momentum strategies have, by and large, been the only game in town for the last five years. Something evidenced by the meteoric rise of the NYSE Fang+ Index.

Established in 2014, this benchmark contains 10 high-octane growth stocks – America's Facebook, Amazon, Apple, Netflix, Alphabet (the parent of Google), NVIDIA, Tesla and Twitter and China's Baidu, Tencent and Alibaba.

NYSE FANG+ INDEX EXEMPLIFIES HOW SUCCESSFUL GROWTH STRATEGIES HAVE BEEN

Not all investors will have the time or inclination to examine the shades of grey that characterise the different Fang+ names. But they will know that 'growth' has left 'value' for dead. The questions to address now are whether this is going to change and – if so – when and why?

GROWTH STRATEGIES HAVE EASILY OUTPERFORMED VALUE OVER THE PAST DECADE

	UK*	UK*	US**	US**
Time period	Value	Growth	Value	Growth
10 years	43.6%	99.5%	167.4%	287.1%
5 years	(7.4%)	25.8%	29.9%	76.1%
3 years	17.5%	21.1%	25.0%	52.3%
1 year	(10.1%)	4.2%	1.8%	9.2%
6 months	2.0%	8.7%	1.9%	8.1%
3 months	(0.3%)	4.4%	1.1%	5.9%

Source: Refinitiv data. *UK data based on MSCI UK Value and MSCI UK Growth indices. **US data based on S&P 500 Value and S&P 500 Growth indices.

ONE-WAY TRAFFIC

There are two inter-related reasons for the predominance of growth strategies over the past decade.

First, economic growth has been modest at best, at least in the West, since the end of the 2008 financial crisis. Any company capable of providing growth in such an environment has thus become highly prized, by virtue of their relative scarcity.

Second, interest rates remain anchored at or near rock-bottom levels – even US interest rates seem destined to top out at 2.5% after the Federal Reserve's policy U-turn back in January. This has three effects.

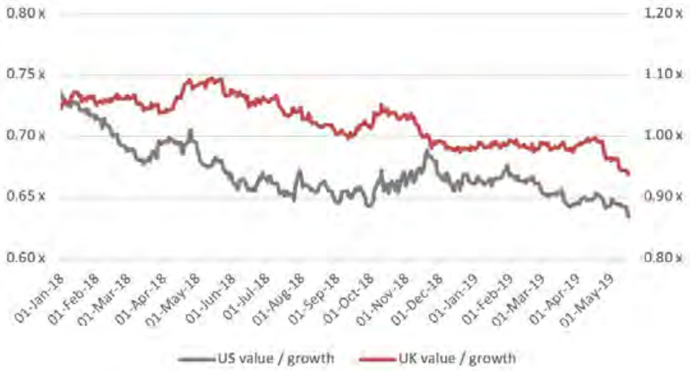
It encourages – or even obliges – investors to take more risk in search of a return on their money. This may make them more willing than usual to back companies that are growing their customer base and revenues but may still be in the red (and could remain there for a while yet) as there is less of an opportunity cost involved.

Discounted cash flow (DCF) valuations for growth companies' equity are boosted by low interest (discount) rates.

The combination of these two provides a deep pool of capital which start-ups can tap should it take longer to reach profit than expected and alleviates the pressure to hit it big straight away.

The next chart divides the value of the value index by the value of the growth index. If the line is rising then value is outperforming. If the line is falling, then growth is outperforming.

GROWTH STOCKS HAVE RALLIED HARD IN 2019



Source: Refinitiv. *UK data based on MSCI UK Value and MSCI UK Growth indices. **US data based on S&P 500 Value and S&P 500 Growth indices.

Growth stocks wobbled in the second half of 2018 as the Federal Reserve forced through a quartet of interest rate increases last year and value stocks began to briefly outperform. However, no sooner had the Fed backtracked in January – inspiring monetary policy pauses everywhere from the UK to the EU, Canada, Australia and New Zealand – than growth stocks took flight again.

RECIPE FOR CHANGE

Sharp-eyed investors will note from the first chart that the NYSE Fang+ index has failed to recapture last year's high and begun to slide again. This is not, however, offering succour to value-seekers, especially in the UK, where the MSCI UK value index trades below its summer 2007 peak.

What is probably really needed for value to come into fashion may be some good, old-fashioned GDP growth with a dose of inflation thrown in. This would help unloved cyclical firms boost profits, generate extra cash and pay down debt or increase dividends. It would also mean that growth is easier to find, at least in nominal terms, and imply that the scarcity premium attached to the Fang+ names is no longer merited.

A study of the past decade suggests that value names do show more signs of life when inflation is accelerating. With oil prices staying firm, central banks now discussing letting inflation run above target for a while and politicians leaning away from austerity and toward fiscal stimulus, the eventual return of inflation may not be quite as fantastical as it sounds today.

AN ACCELERATION IN INFLATION HAS SEEMINGLY HELPED VALUE STOCKS PERFORM...

Source: Refinitiv. *UK data based on MSCI UK Value and MSCI UK Growth indices. **US data based on S&P 500 Value and S&P 500 Growth indices.

...IN BOTH THE UK AND US SINCE THE GREAT FINANCIAL CRISIS

Source: Refinitiv. *UK data based on MSCI UK Value and MSCI UK Growth indices. **US data based on S&P 500 Value and S&P 500 Growth indices.

By **Russ Mould**
AJ Bell Investment Director

HOW I INVEST:

Decades of hard saving to fund a happy retirement

James from Sussex has squirreled away money throughout his working life

Retirement can be a liberating experience as finishing work gives you the freedom to enjoy life, learn new skills and embrace a wide range of hobbies.

This can come at a cost as individuals may need to have saved hard through their working lives to ensure they have adequate savings and enough income to fund their desired lifestyle in older age.

James from Sussex knows all about this challenge as he is in the final stages of his working career and is making sure his portfolio is robust enough to support a happy retirement.

In his early sixties and married with no children, James has built up an investment portfolio worth approximately £450,000 and also has occupational pensions to help fund his retirement.

The Government service worker admits he has a couple of expensive habits – namely running a boat and going on holidays – and he certainly doesn't want to give them up.

'My investment strategy is long term, intending to build a capital base which will yield enough income, added to my pensions, to fund my lifestyle indefinitely,' says James.

TAKING ADVANTAGE OF TAX BENEFITS

His current investment pot is the result of years of hard work. James has been saving into various tax-efficient wrappers since the early 1990s, namely PEPs (personal equity plans), TESSAs (tax-exempt special savings accounts) and ISAs (individual savings accounts). Initially James opened lots of accounts but has now consolidated them into three accounts to make life simple.

There is also a SIPP (self-invested personal pension) into which he has saved money for the past two decades to take advantage of tax relief and have a pot of money to complement occupational pensions.

STARTING RELATIVELY EARLY

James bought his first home at age 28. Once repayments became more manageable and he had spare cash after paying the bills, at age 35 he started to dip his toes into the world of investing.

'My father had been very thrifty and always took care to invest over many decades, so I probably learned from his example,' he remarks.

And now James has found himself on the other side of the table where he is helping other family members to get the most from their finances.

He runs his mother's investment portfolio, described as being 'substantial', with the goal of making it last as long as possible while paying her care home fees.

'I also advise my family members when they ask, which is often, although I am conscious that everyone's resources and risk appetite are different.'

50% IN SHARES

Half of his portfolio is held in individual company shares, often split into silos as a play on what he believes to be 'predictable long term sectors'.

Examples include **Sainsbury's (SBRY)** as a play on basic foods; **Ashtead (AHT)**, **Hill & Smith (HILS)** and **Castings (CGS)** for the infrastructure theme; and **William Hill (WMH)** for exposure to the gambling sector.

James' portfolio also includes numerous utility companies such as **Severn Trent (SVT)**, **United Utilities (UU.)** and **National Grid (NG.)**; as well as insurers **Aviva (AV.)** and **RSA (RSA)**.

'Nearly all my companies have done well – decent regular dividends and they've held up their book values – over decades, which is why I keep them. I favour yields of around 4% and am happy with that,' he comments.

ADDING FUNDS TO THE MIX

A fifth of James' portfolio is in funds with the investor selecting products for exposure to areas where he feels he doesn't have adequate knowledge.

His preferred funds include four unit trusts from Fidelity to play the Far East and Europe regions and special situations. The latter is a term used to describe investing in companies based on specific situations rather than underlying fundamentals. For example, this might be a business trading below its intrinsic value or one where an activist investor is trying to enforce change.

The largest fund holding in his portfolio is **Mercantile Investment Trust (MRC)** as a way of accessing UK small and mid-sized companies. James also has 7% of his investments in five venture capital trusts and another 20% in fixed-rate bonds and preference shares.

LEARNING THE HARD WAY

Despite building up a large portfolio of diversified assets, James admits it hasn't always been an easy ride. 'I have made mistakes and suffered disappointments,' he says. 'I usually sell holdings in those companies, preferably once share prices recover to what I feel is reasonable.'

He gives the example of packaging group **MPAC (MPAC:AIM)**, previously known as Molins. 'It got into difficulties, stopped its dividend and I felt the shares no longer suited me, so I sold my substantial (£30,000) holding in batches, all for higher prices than I had originally paid.'

Several years trading commodities also taught James the mental discipline of accepting significant losses now and then 'as well as appreciating the good times without hubris'.

By **Daniel Coatsworth**
Editor

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All chart data sourced by Refinitiv unless otherwise stated

PRODUCTION
Head of Design: Darren Rapley
Designer: Matt Ely

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.