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# SHARES

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# FIRST-TIME INVESTOR

## HOW TO PLAN

## WHAT TO BUY

**PLUS**

INVESTORS LINE UP TO BUY **CUT-PRICE STOCK FROM WOODFORD**

**PART TWO OF OUR ESG GUIDE** + WE REVEAL OUR ESG FUND PORTFOLIO

**GOLD HITS SIX-YEAR HIGH** AND SENDS MINING SHARE PRICES SOARING

# Don't hitch a ride with newly-listed Trainline

The risk versus reward analysis does not favour buying the shares

Train and bus ticket seller **Trainline (TRN)** is the latest 'app' or 'platform' business to see its shares soar upon making its stock market debut. Investors appear to be treating Trainline as if it is the latest in a long line of modern, disruptive companies. This could be a mistake.

It isn't a new business in the same fashion as other stock market darlings like Beyond Meat and Slack. In fact, Trainline was founded in 1997 and began selling tickets online in 1999. It has essentially been doing the same thing for the past 20 years, albeit on a greater scale and adding a few extra services like alerts which tell customers when cheap advance tickets become available for specific journeys.

Four years ago it was valued at around £500m and was about to float on the stock market before private equity group KKR bought the company. A year later Trainline bought Captain Train to expand its position in Europe. The UK bit of the group makes a positive contribution to group earnings but the overseas interests are losing money.

Trainline's equity is now valued at £2bn. It made a £13.7m pre-tax loss in the year to 28 February 2019 on sales of £209.5m. Although losses are narrowing and sales are growing, investors are placing a lot of faith in significant public transport demand growth which seems ambitious.

Admittedly Trainline has benefited from growing adoption of mobile and tablet devices, and consumers becoming savvy at booking their travel needs online. However, price is very important in the battle for consumer spend and Trainline doesn't score that well versus its peers. The company is more expensive than train operators' own websites when you factor in booking fees.

Trainline is the market leader in the UK for selling transport tickets which explains why a lot of investors have been eager to own the shares. We spoke to a fund manager who took part in the IPO (initial public offering) and they said demand was huge for the stock because everyone wanted a slice of a market-leading digital platform.

But what if new competition threatened to steal large chunks of its market share? Trainline says in its prospectus that National Rail Enquiries, a journey planning and information service owned and operated by the UK rail carriers, could capture a material share of the market should it decide to start selling rail tickets directly. It also flags the risk of Google, Apple, Amazon or Facebook being a major competitive threat should they decide to enter the market, given the strength of their brands and customer reach.

We also note Uber now includes London public transport bus and tube times on its app, perhaps with a goal of becoming a one-stop-shop for transport needs. That's another headache for Trainline.

And finally, investors often buy shares in platform businesses as they can benefit from a network effect. For example, the more people selling items on auction platform Ebay, the greater the choice for buyers and the more appealing it becomes to use the service. With Trainline, it already offers widespread choice and greater customer numbers won't make its services more appealing from a network perspective.

While Trainline offers a decent service, the price is wrong from an investment perspective given the weak barriers to entry.

We are delighted to announce that *Shares* has been voted **CFA UK Publication of the Year** in the CFA UK Journalism Awards 2019.

The digital magazine was praised for its efforts in educating investors. CFA UK is a professional membership body for investors.

# Contents

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CLICK ON PAGE NUMBERS TO JUMP TO THE START OF THE RELEVANT SECTION

# Investors line up to buy cut-price stock from suspended Woodford fund

The restructuring of Woodford Equity Income Fund is gathering pace

The number of deals involving stocks being bought by third party investors from the troubled **Woodford Equity Income Fund (BLRZQ73)** is picking up pace.

Dealing in the fund is currently suspended while fund manager Neil Woodford restructures the portfolio, selling the most illiquid holdings and reducing exposure to many other stocks in an effort to raise cash to meet redemptions and be able to increase the weighting towards large cap companies.

Regulatory filings show that Woodford has already cut its positions in some of the fund's biggest holdings, including private equity specialist **Oakley Capital Investments (OCI:AIM)** where its stake has been reduced from 19.39% to below 5%.

The fund's position in housebuilder **Crest Nicholson (CRST)** has been trimmed from 15.08% to 9.83%; and its stake in payments group **PayPoint (PAY)** has gone from 15.73% to 10.98%. Other names being sold down from the Woodford fund include intellectual property incubator **IP Group (IPO)** and media group **Time Out (TMO:AIM)**.

Oliver Brown, fund manager at **MFM UK Primary Opportunities Fund (B8HGN52)**, says brokers are having a feeding frenzy as they know what Woodford holds and they are trying to put together blocks of investors to buy stock from the suspended fund.

Brown is among the institutional investors taking advantage of the situation, saying there is an opportunity to buy at a double discount.

The market knows what Woodford has to sell and so these stocks are being marked down in price because of the share overhang. Some of the stocks are also trading on low valuations because of discounts applied to UK stocks amid fears over the impact of Brexit.

'We're in the market for some **Eddie Stobart Logistics (ESL:AIM)** stock,' says Brown. 'Its shares have gone from 80p to 70p off the back of Woodford being the largest shareholder – the market knows he needs to sell.

'One broker has been trying to get stock for 50p and I'm sure Woodford has said no at that price. However, we're watching closely as we know he is a distressed seller.'

Brown says his goal is to buy Woodford-related shares below the current market price. He has already done a deal with Woodford for MFM UK Primary Opportunities Fund to buy some of its holding in leisure group **Ten Entertainment (TEG)**.

'The shares had drifted from 225p to 210p which we can only assume to be the Woodford effect. We bought at 212p from Woodford and the stock last week went back up to 230p.'

The suspension on the Woodford fund will be reviewed every 28 days but investors shouldn't expect dealing to resume at the next review, scheduled for 1 July. It could take many months to restructure the portfolio.

# Can Glencore shake off ESG backlash?

Analysts suggest the miner should consider segregating its coal cash flows

Under pressure on numerous fronts, not least on environmental grounds thanks to heavy exposure to coal assets, commodities firm **Glencore (GLEN)** is only just recovering from 12-month lows at 280p.

In February Glencore announced it would cap coal production but in a sign of the increasing relevance of ESG (environmental, social and governance) issues analysts at investment bank Jefferies believe more radical action is required to address this issue, with pressure on thermal coal prices also hurting the company.

They argue Glencore should commit to paying out 100% of its cash flow from thermal coal, in recognition of the fact that 'the multiple investors are willing to pay for thermal coal EBITDA (earnings before interest, tax, depreciation and amortisation) is likely to continue to decline as ESG becomes a more prominent theme'.

Although they concede that depressed coal prices mean this might not have a significant impact on capital returns they add that 'a strategy of explicitly segregating coal cash flows to return to investors would change the perception of Glencore's coal business and stabilise if not re-rate the Glencore (earnings) multiple'.

The company continues to face several other issues including its substantial borrowings, last reported at $14.7bn.

A US Department of Justice probe into alleged money laundering and a separate investigation by US regulators are expected to hang over the investment case for some time and the company has also been hit by a more onerous mining code in Democratic Republic of Congo.

## IQE feels smartphones squeeze from intensifying US/Chinese trade dispute

Complex supply chains and high fixed costs see analysts slash earnings hopes

ANALYSTS HAVE SLASHED earnings forecasts by more than half for compound semiconductor wafer technology designer **IQE (IQE:AIM)**. The Cardiff-based company last week warned of an escalating squeeze on orders as the fallout from the US ban on Huawei rumbles on.

This follows an increasingly sharp decline in smartphone handset volumes worldwide as the US and Chinese authorities lock horns over global trade and intellectual property rights.

Data from market researcher IHS Markit says smartphone display shipments plunged 20% sequentially during the first quarter of 2019, with further declines anticipated for the second and third quarters.

Peel Hunt analysts have slashed their earnings per share estimates for IQE by 53% for the full year to 31 December 2019, while Canaccord Genuity analysts went even further, cutting their own projections by 55%.

Shares in the company collapsed 25% to 53.8p on 21 June, their lowest in more than two years.

IQE is part of a complex semiconductor supply chain to smartphone and other electronics kit manufacturers, including providing laser-based technology widely believed to be used in iPhone face recognition technology.

# Funds industry looks for solution to liquidity dilemma

Investment Association responds after high profile fund suspensions

The Investment Association is planning to launch a new fund structure which could be a solution to the liquidity issues which hit property funds in the wake of the Brexit vote and more recently the suspended **Woodford Equity Income Fund (BLRZQ73)**.

The full blueprint for a so-called 'Long-Term Asset Fund' will be released later in 2019. Broadly this new class of collective would have the ability to invest in less liquid assets like infrastructure, property or private equity but, crucially, with a move away from offering daily trading in the units of the funds.

The IA also says this fresh type of fund will probably not be offered to ordinary investors without requirements for advice or appropriateness tests.

'It has become the norm for funds to offer daily trading and one of the challenges for the industry is going to be resetting customer expectations that they can sell their investments immediately,' says Ryan Hughes, head of active portfolios at AJ Bell.

'There will need to be effective education around why having a longer notice period for selling investments offers a degree of customer protection when investing in certain asset types. People accept it for certain savings accounts in return for a higher interest rate, so it is certainly possible for investments too.

Hughes says moving away from daily traded funds would allow fund managers to make genuine long term investments because they will have greater visibility of when they might need to sell underlying assets to meet customer redemptions.

'This has long been discussed for property funds but would suit all kinds of investments such as unquoted businesses, small cap stocks, infrastructure projects and fixed interest, especially high yield bonds,' he adds.

## FirstGroup sees off boardroom coup attempt

### Activist investor Coast Capital tried to remove six of 11 board members

BILLED AS AN existential dust-up between transport operator **FirstGroup (FGP)** and its biggest shareholder Coast Capital, it is the former who has won after seeing off an attempt by the activist investor to remove six of its directors.

The Wall Street hedge fund couldn't get the backing from 50% of voting shareholders that it needed in an extraordinary general meeting, despite reports that other top investors would vote in favour.

Coast had called for the removal of chairman Wolfhart Hauser and chief executive Matthew Gregory as well as four other of the 11 directors on the board.

Hauser's days could still be numbered after nearly 30% voted for his removal. Historically bosses with such votes against them have been pressured into resigning.

Coast and FirstGroup clashed over the company's strategy. Coast wants FirstGroup to get out of the troublesome rail sector and sell off its highly profitable American school bus division.

But FirstGroup would rather sell off the less profitable parts, like its coach service Greyhound, and argues the company's pension deficit would soar if it sold off the best bits.

SHARES AJBell

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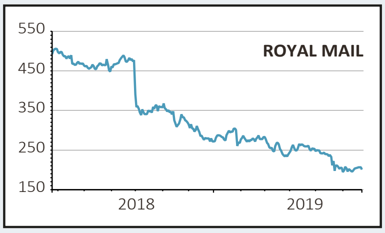
# The price is right: Royal Mail shares are now a bargain

The stock is too good to ignore at the current price despite a few headwinds

**ROYAL MAIL ↗ BUY**
(RMG) 197.95p
Stop loss: 150p

Market value: £2bn




Are you feeling brave and are happy to make a contrarian call? **Royal Mail (RMG)** looks like a very interesting 'buy' at the current price, albeit recognising this is a high-risk investment.

Shares in Royal Mail have fallen by 69% in the past year or so on worries about its shrinking legacy business. They now trade on 0.45 times tangible book value, the lowest in the London Main Market.

We think investors are being too sceptical because the company is now at an inflection point where the growth in UK parcels more than offsets declining volumes in UK letters.

In addition we find it noteworthy that company directors have spent more than £1m of their own money to buy shares since the company outlined its future strategy on 22 May.

Earlier this year analysts had been expecting a dividend cut, and we've subsequently had that confirmed by the company. It is now guiding for 15p per share (previous year: 25p) with possible additional payouts in future years with substantial excess cash flow.

Even if there aren't any supplemental payouts, the base level provides a yield of 7.6% at current prices, not insubstantial in a low interest rate world.

Royal Mail is targeting an improvement in UK productivity of 15% to 18% out to 2023-24. This should result in an improvement in operating margins to 4%-plus by 2021-22 and 5%-plus by 2023-24, compared with 3.9% today.

The company is making changes to production through a redesign of the Royal Mail network, with parcels automation increasing dramatically from 12% to 80%.

While supporting growth and automation changes, management want to keep a tight control of extra capital expenditures. They are aiming to spend £400 to 500m cumulatively over the next five years.

If the forecast operational improvements materialise, the incremental return on that expenditure will be an impressive 38%.

The jewel in the crown for the company is its Global Logistics Services (GLS) division, one of Europe's leading ground-based parcel networks. It has built its revenues from €300m a decade ago to €3.3bn today, a compound annual growth rate (CAGR) of 25%.

E-commerce growth continues to be the driving force, which has seen the size of the cross-border parcels market increase in value to more than $60bn. Royal Mail is targeting €4.5bn revenue for GLS by 2023-24, a CAGR of 6.4% per year.

Even if the company achieves half of its goals, it should be enough to change the negative sentiment towards the shares.

By **Martin Gamble**
Senior Reporter

# Kainos is at the forefront of a digital transformation

It has huge opportunities in helping government departments and companies

You won't find too many businesses and organisations refusing to bow to digital transformation and **Kainos (KNOS)** is there to help.

It is a built-in-Britain IT business that does three things. First, it helps typically large organisations transition their processes and operations into the 21st Century digital world.

Many UK Government departments employ Kainos, including the Cabinet Office, Home Office, Driver & Vehicle Licencing Agency (DVLA), Department for Transport, Land Registry and the NHS.

The company also provides implementation and testing for users of its Workday enterprise management tools.

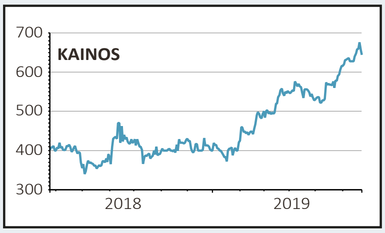
The third leg is Evolve, an NHS IT system that includes things like electronic medical records that help streamline the service the NHS can deliver to patients.

Evolve has been muddling along recently, hamstrung by widely reported NHS spending cuts although longer-term Kainos remains optimistic on the opportunity.

And the other parts of the business have been progressing at a blistering pace. In the year to 31 March 2019 its digital services drove revenue growth, up 69% to £132.6m, with momentum in both Workday implementation and on UK Government digital transformation despite Brexit concerns.

**KAINOS ↗ BUY**
(KNOS) 648p
Stop loss: 518p

Market value: £793m




Overall Kainos ended up beating original 2019 forecasts of £18.8m of pre-tax profit on £115m revenue by a huge margin, reporting £23.3m and £151.3m equivalent figures.

Kainos is also a very impressive cash machine, with cash matching the company's £24.4m of earnings before interest, tax, depreciation and amortisation (EBITDA) despite capital spend doubling to £2m. That left Kainos with £42.5m of net cash on the books.

Where Kainos has been clever is in picking and choosing the contracts it bids for and pursuing an organic Workday strategy rather than chasing acquisitions.

## IMPRESSIVE TRACK RECORD

Consensus estimates for the year to 31 March 2020 call for £27.5m EBITDA on £165m revenue, which would be its 10th straight year of higher revenue and adjusted pre-tax profit.

At face value this implies

slower growth this year but we take the view that Kainos is sensibly managing market expectations with a view to beating estimates, as it did last year.

So while the stock is not cheap, on a 2021 price-to-earnings multiple of about 35, we see multiple catalysts for forecasts to rise and the share price to grow into the rating especially as investors chase reliable growth firms to increasingly full valuations.

Analysts at Canaccord Genuity are convinced that Kainos has scope for several years of 10% to 20% organic revenue growth as an enabler of the digital transformation. We share this confidence.

By **Steven Frazer**
News Editor

THIS IS AN ADVERTORIAL

# Introducing AVI Global Trust

## Name change

We are pleased to announce that the British Empire Trust has been renamed to the AVI Global Trust (ticker: AGT), with effect from 28th May 2019.

AGT
AVI GLOBAL TRUST

Since incorporation in 1889 as the *Transvaal Mortgage Loan & Finance Company*, AGT's name has always made reference to the scope of its investment mandate. In 1906, the name was changed to the *British Empire Land Mortgage & Loan Company* to reflect an increasingly global focus, and in 1964 the more familiar name of *British Empire Securities & General Trust* was adopted.
Today, 130 years after being founded, the company has developed a truly global reach and we believe its new name will more accurately reflect where and how it invests.


## Investment Approach

Asset Value Investors (AVI) has managed the c. £1 bn AVI Global Trust since 1985. The strategy over that period has been to invest in asset-backed companies around the world, where we believe that attractive risk-adjusted returns can be earned through detailed research with a long-term mind-set.
Asset-backed companies is a broad category, and includes family-controlled holding companies, property companies, closed-end funds and, most recently, cash-rich Japanese companies. The approach is benchmark-agnostic, with no preference for a particular geography or sector.
AVI has a well-defined, robust investment philosophy in place to guide investment decisions. An emphasis is placed on three key factors: (1) companies with attractive assets, where there is potential for growth in value over time; (2) a sum-of-the-parts discount to a fair net asset value; and (3) an identifiable catalyst for value realisation.


Joe Bauernfreund, Portfolio Manager

A concentrated portfolio of c. 25* investments allows for detailed, in-depth research which forms the cornerstone of our active approach.
Once an investment has been made, we seek to establish a good relationship with the managers, directors and, often, families behind the company. Our aim is to be a constructive, stable partner and to bring our expertise – garnered over three decades of investing in asset-backed companies–for the benefit of all.
AGT's long-term track record bears witness to the success of this approach, with a NAV total return well in excess of its benchmark. We believe that this strategy remains as appealing as ever, and continue to find plenty of exciting opportunities in which to deploy the trust's capital.

DISCOVER AGT AT WWW.AVIGLOBAL.CO.UK

*One investment is the Japan Special Situations basket of 18 Japanese stocks.

## CARNIVAL
(CCL) £34.24

### Loss to date: 12.7%
**Original entry point:**
**Buy at £39.35,** 13 June 2019

WE REITERATE OUR buy stance on **Carnival (CCL)**, following a fall in the shares in reaction to the company lowering its full year guidance for earnings per share by 3% to 5% to between $4.25 and $4.35.

The bulk of the downgrade was down to propulsion issues at Carnival Vista, and a change to the US government's policy towards Cuba, both one-off issues which reduced revenue yields.

There was also a small impact from capacity increases in Germany and economic deterioration in France, although these were partly offset by lower fuel consumption and favourable foreign exchange movements. It should be noted that the second quarter results were ahead of prior guidance.

A change to annual earnings guidance of this magnitude does not hugely impact longer term earnings potential. For some perspective, it is always useful to keep in mind that equities are long duration assets, discounting 20 to 30 years of future earnings.

Analyst Greg Johnson of Shore Capital points out that Carnival's enterprise value-to-berth is currently less than $170,000. He says: 'A value of under $170,000 per berth has only previously been seen during periods of extreme stress, notably during the Gulf War, the Financial Crisis and the sinking of the Concordia.'


**SHARES SAYS:** ↗
**Disappointing but certainly no reason to abandon the trade. Stay positive.**

## TESCO
(TSCO) 226p

### Loss to date: 4.6%
**Original entry point:**
**Buy at 236.9p,** 23 May 2019

**Tesco (TSCO)** shares have lagged the FTSE 100 since May but we are sticking with our call after the first quarter trading update (13 Jun) and the recent capital markets day (18 Jun).

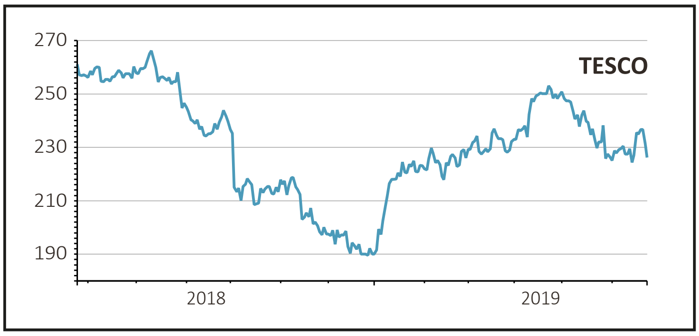
Despite a tough comparison with last summer, Tesco still managed to increase turnover by more than the market in the first quarter with a particularly strong performance in fresh food. Also the Booker acquisition is delivering growth as planned.

The comparison with 2018 will remain hard in the second quarter given that grocery sales are backward-looking and last summer's boost was still being felt in the numbers until October.

However, Tesco is focused on keeping hold of its customers, raising its revenue and trimming costs so that its margins and cash generation improve.

As well as working with its suppliers, it has a global sourcing alliance for household products with France's Carrefour which reduces costs considerably.

Other ways to improve profits include smaller local stores, the Jack's own-brand range and own stores, increasing use of technology including cashless payment and less expensive but more effective marketing.




**SHARES SAYS:** ↗
**Grocery sales are growing steadily and Tesco is the undisputed market leader. Investors are worried about tough comparisons with last year but the company is already planning for next year. Buy.**

# **Brexit three years on:** markets and the economy in five charts



*It's been three years since the UK voted to leave the EU. We look at what's happened to the economy and markets, and what's next for investors.*

By Sue Noffke,
Head of UK Equities

ON 23 JUNE 2016, the UK public voted on whether or not to stay in the European Union (EU). Many expected the UK to remain in the EU, but by a majority of 52% to 48% the Leave campaign won.

The UK was scheduled to leave the EU at 23:00 UK time on 29 March 2019. However, after the UK parliament failed to approve the Withdrawal Agreement, it was granted an extension with a new deadline set for 31 October 2019. Below is five charts showing how the UK economy and financial markets have fared over the past three years.

## WHAT'S HAPPENED IN MARKETS SINCE BREXIT?

### STERLING

Arguably the biggest barometer of Brexit is the value of the British pound. Since the vote to leave it has fallen more than 14% against the US dollar and 13% against the euro.

The strength or weakness of a currency is linked to the health of its country's economy and the stability of if its government.

**THE FALL (AND SOMETIMES RISE) OF STERLING SINCE THE BREXIT VOTE**


Source: Schroders. Refinitiv data for the USD/GBP and Euro/GBP exchange rates between 23 June 2016 and 10 June 2019. Correct as at 11 June 2019. CS1594

### FTSE VS STERLING

While the weakness in the pound has made traveling abroad more expensive for those who earn their money in pounds, it has provided a boost for UK stocks.

More than two thirds (70%) of the revenues of the companies listed on the FTSE All-Share index are generated overseas. When the profits from those revenues are converted from a strengthening currency back into sterling they are worth more.

The chart below shows how closely the fortunes of UK stocks have correlated with the fall (and sometimes rise) of the pound against the US dollar.

**HOW CURRENCIES HAVE MOVED THE FTSE ALL-SHARE SINCE THE BREXIT VOTE**


Source: Schroders. Refinitiv data for the FTSE All-Share and USD/GBP exchange rates between 23 June 2016 and 10 June 2019 correct as at 11 June 2019. CS1594

### STOCK MARKETS

In the immediate aftermath of the referendum the FTSE 100 and the FTSE 250 fell 9% and 12%, respectively. But since the close of the market on 23 June 2016, UK shares, as measured by the FTSE All-Share, have risen 28.1% as of 15 June 2019.

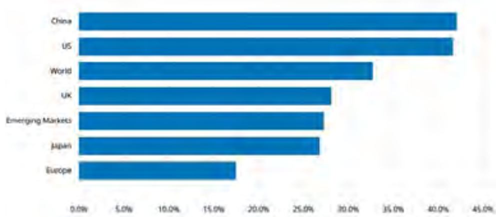
The relatively stable global economic backdrop has been helpful. Global investors have bought into the so-called Goldilocks scenario; a "not too hot, not too cold" combination of stable growth, benign inflation and low interest rates.

Support for the UK market and the economy came from the Bank of England (BoE), which has kept monetary policy loose, ensuring businesses and markets have access to funding.

However, the UK stock market has lagged global stocks. Since the Brexit vote, China shares have returned 42.1%, according to Thomson Reuters data; US stocks returned 41.6% and world stocks have returned 32.7%.

UK stocks have returned 28.1%, marginally outperforming emerging market and Japanese shares which returned 27.3% and 26.8% respectively. European stocks returned 17.5%.

**HOW GLOBAL MARKETS HAVE PERFORMED SINCE THE BREXIT VOTE**




Source: Schroders. Refinitiv data for the MSCI China, MSCI US, MSCI World all countries, MSCI UK, MSCI Emerging Markets, MSCI Japan and MSCI Europe between 23 June 2016 and 10 June 2019 correct as at 11 June 2019. CS1594

Of course, there are lots of other factors that have influenced UK and other markets during this period. The global nature of UK equities has led to international developments setting the tone for the market, and this continued to be the case since the EU referendum.

Some of the key international drivers over the past three years have included monetary policy decisions by the world's major central banks, global economic activity and, more latterly, US-China trade tensions.

## DOMESTIC VS INTERNATIONAL EARNERS

Although the UK stock market has held up relatively well, there has been a contrast between domestic companies which earn most of their revenue outside the UK versus those that earn most of their revenues internationally.

As the chart below illustrates, in the period from mid-2013 through to the end of 2015, the UK economy outperformed the global economy, sterling was strong and UK domestic companies outperformed UK overseas earners. Then, as Brexit fears set in and the UK voted to leave the EU, UK domestics significantly underperformed.

### UK DOMESTIC SHARES HAVE BEEN MOST OUT OF FAVOUR... AND SEEN A SIGNIFICANT DE-RATING

Source: Thomson Reuters Datastream. Data from 4 March to 11 March 2019.

Exchange rates were a major driver of this, as the market discounted the beneficial translational impact of weaker sterling for companies with significant overseas earnings. However, it was also in large part due to UK domestic companies suffering a "de-rating" amid fears the UK economy would grow at a lower rate going forward outside the EU.

Investors have indiscriminately shunned UK stocks as a consequence of Brexit, and the market overall has suffered a de-rating. Prior to the EU referendum, investors had been prepared to pay approximately 15x the UK stock market's expected aggregate earnings for the year ahead. Today, this multiple, or "rating" is around 13x, which compares very favourably to the global stock market, trading on approximately 15x expected 2018 aggregate earnings.

## UK STOCKS UNLOVED AND VALUATION AT 30-YEAR LOWS

The negativity of international investors towards UK equities is entrenched – global fund managers have been "underweight" the UK for three years, according to 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.

Valuations reflect the degree to which investors have shunned UK equities. The chart below tracks the UK market's valuation discount versus global equities based on the average of three metrics. The metrics used are:

**Price-to-book value (PBV) ratio** - The ratio used to compare a company's share price with its book value (the book value is the actual value of the company assets minus its liabilities).

**Price-to-earnings (PE)** - A ratio used to value a company's shares. It is calculated by dividing the current market price by the earnings per share.

**Price-to-dividends (PD) ratios** - A ratio that shows how much a company pays out in dividends each year relative to its share price.

### UK STOCKS UNLOVED: TRADE AT A 30% DISCOUNT TO GLOBAL PEERS TO A 30 YEAR LOW


Source: Morgan Stanley as at 31 March 2019.

Sue Noffke, Head of UK Equities, said near-term issues persist whilst Brexit remains unresolved but UK shares provide plenty of opportunities.

"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.

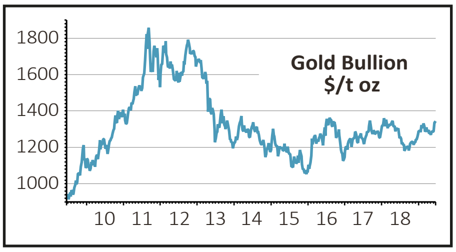
"If we do experience a recession in the near term, we would expect it to be local to the UK (possibly the result of a disorderly Brexit) rather than a global one, although we are in the latter stages of the economic cycle. This gives us a degree of comfort that the UK equity market's yield (currently around 4.5%) is sustainable as the large majority of UK stock market dividends derive from overseas.

"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."

# Gold hits six-year high and sends mining share prices soaring

Why the metal has rallied and different way to get exposure

The price of gold has hit $1,426 per ounce for the first time in six years. The precious metal has been in hot demand as a result of the weakening US dollar and America's central bank raising concerns over the health of the country's economy.



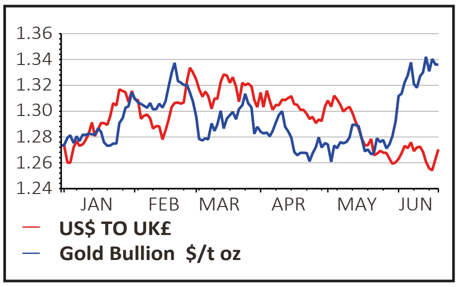

Gold typically does well when the stock market does badly, as investors see the relative stability of its price as a safe place to put their money.

It is called a 'safe haven' asset because it typically keeps its value even when the market is turbulent. Another safe-haven asset for example is German government bonds, because it's deemed highly unlikely Germany will go bust and default on its debt.

At its most base level, the idea of buying gold comes from the notion that the entire world system could one day collapse and therefore gold will become the default currency, so you'll be using it to buy your groceries. But *Shares* deems the likelihood of this happening to be almost zero.

### WHY THE RUSH?

The gold rush would suggest investors are getting nervous. People in finance like to use the term 'wall of worry' when there are a lot of market issues keeping them up at night.




At the moment there are concerns global economic growth won't be as good as people thought, and they're also worried about America's trade tensions with China and now Mexico getting out of hand.

In addition, the US dollar has weakened after the US central bank the Federal Reserve signalled it would resist pressure to cut interest rates.

It comes after another rush back in February as investors were again scared of a global economic slowdown, as well as a no-deal Brexit and the ongoing trade war.

In a research note earlier this month, analysts at UBS had forecast the gold price to reach $1,400 per ounce in the next year.

They said: 'We continue to advocate gold as an insurance asset, as we believe it can help shield investors from geopolitical flare-ups, macro data disappointments and sharp gyrations in financial markets.'

## CENTRAL BANKS SEEK SAFE HAVEN

It's not just investors hoping to make a quick buck who are piling money into gold. Further support for gold comes from central banks, who according to UBS have added over 145 tonnes to their reserves in the first quarter of this year, having added more than 651 tonnes last year, the most in 47 years.

Together with other factors, it's expected that central bank demand will help to continue pushing the gold price higher.

While there may be a rush now, the gold price has held relatively stable at around $1,200 to $1,300 per ounce for the past four years. This is why in times of market adversity people rush to snap up gold.

For example, when the FTSE 100 fell to a four-year low of 5,536 on 11 February 2016, gold had already been in a rising price trend for the previous four weeks and remained in an uptrend for some time after. It moved from c$1,100 per ounce in January that year to exceed $1,360 per ounce six months later.

## GOLD MINERS VS GOLD

Investors wanting to get exposure to gold can do so in several ways. In addition to buying gold coins or bullion, you can buy exchange-traded funds which track the gold price such as **iShares Physical Gold (SGLN)**, opt for investment funds which invest in gold miners like **BlackRock Gold and General (B5ZNJ89)**, or buy individual gold

**Resolute Mining (RSG)** last week floated on the London Stock Exchange, offering investors exposure to three mines in Australia, Ghana and Mali.

An approximate £450m market cap makes Resolute the sixth largest gold miner listed on the UK stock market. Read this **article** to learn more about the company.

**LONDON-LISTED GOLD MINERS: SHARE PRICES 2019 YEAR-TO-DATE**

| | |
|---|---|
| Trans-Siberian Gold | 122% |
| Serabi Gold | 108% |
| Petropavlovsk | 57% |
| Highland Gold | 48% |
| Shanta Gold | 32% |
| Pan African Resources | 28% |
| Polymetal | 19% |

| | |
|---|---|
| Centamin | 7% |
| Chaarat Gold | 5% |
| Fresnillo | 4% |
| Acacia Mining | 3% |
| Greatland Gold | -10% |
| Avesoro Resources | -60% |
| **AVERAGE** | **28%** |
| **GOLD** | **12%** |

>£40m market cap
Source: Shares, SharePad as of 25 June 2019

mining shares.

Gold miners can rise by a greater amount than an appreciating gold price – and also underperform when gold falls in value.

Year-to-date, gold miners worth more than £40m on the London Stock Exchange have risen by an average of 28%, compared to a 12% rise in the gold price.

The best performer is **Trans-Siberian Gold (TSG:AIM)**, which has seen its share price more than double this year as the company benefits from the rising gold price and from recent efforts to raise awareness about the business. Previously one to shun engagement with UK investors, the miner last year changed its approach and has been actively promoting its story.

The worst performer is **Avesoro Resources (ASO:AIM)**, down 60% year-to-date as a result of operational and financial setbacks.

It is important to note the risks of investing in gold miners. You have to consider geopolitical risks such as the government of the country where a miner is doing business deciding to remove licences or impose extra taxes; operational risk as mines rarely run smoothly; and financial risk as many miners take on considerable debt when building new projects.

While miners with some or all of these negative issues can still rise in value when gold is soaring ahead in price, their shares can crash when gold pulls back in value.

By **Yoosof Farah**
Reporter

# FIRST-TIME INVESTOR

## HOW TO PLAN WHAT TO BUY

TAKING YOUR FIRST steps with investing needn't be a frightening experience if you know what's involved.

We've created a step-by-step guide covering all the main points you need to think about, including whether investing is actually right for you.

Our guide also includes pointers for spotting the products most suitable to your needs, how much you might be able to make, and classic mistakes to avoid.

### 1. WHY SHOULD I INVEST?

Most people want to invest to make more money than they'd get from putting cash in a bank or building society account. But that doesn't mean investing is right for everyone.

Investing involves taking higher risks in order to obtain higher rewards. Investing in shares, in particular, comes with much greater risks than putting cash in the bank.

You can lose money with shares, potentially everything if the business goes bust. In contrast, cash in the bank is protected up to £85,000 per financial institution – under the Financial Services Compensation Scheme – and the only real threat to cash is the impact of inflation eating away at the true value of your money. Rising inflation means goods costs more and so each £1 you have will buy you less.

**IS INVESTING RIGHT FOR YOU?**

You should only invest money you can afford to lose. Anyone with a nervous disposition may not be suited to investing, nor someone who is reliant on their money not dropping in value over a specific time.

If you're still happy to proceed, you need to address these three points: your investment goals, time horizon and risk appetite.

An investment goal might be having a pot of money to pay for a house deposit, a holiday of a lifetime, a loft conversion or to supplement your pension in retirement.

The time horizon really matters as the longer you have to invest, the more time your money can be put to use in the markets. By reinvesting any dividend payments you own more fund units or shares and enjoy compounding benefits. Effectively you're receiving interest on the interest that's been paid.

Short time horizons come with the risk of a market correction and so you may not have enough time for the value of your investments to recover before you need to access the money.

**WHY RISK APPETITE MATTERS**

Risk appetite will help when deciding which investments to make. If you have a low appetite for risk you may prefer to invest in bonds rather than shares. You can invest directly or through funds holding that asset class. If you have a higher appetite for risk, you may want to look at shares, funds investing in shares, or potentially high-yield bonds.

The world of shares could even be split into different levels of risk such as medium risk for supermarkets or higher risk for oil producers or airlines.

The other thing to consider is whether you need to take a certain level of risk in order to hit a financial goal. If you need to make 10% a year for three years to hit a goal, for example, then a low appetite for risk would leave you in a pickle. You would either need to invest in higher risk products to realistically hit the goal, extend your investment period so as to only need a lower return each year, or reduce your goal.

## 2. HOW MUCH CAN I MAKE?

It is important to set appropriate expectations for potential investment returns. If you've only ever come across people talking about investing in films such as *Trading Places* and *The Wolf of Wall Street*, you may think 100% gains each year are normal. Sadly, they are not.

UK shares have achieved 4.7% average return each year over the past 50 years when adjusting for inflation, which is known as 'real returns'. This is according to a study by Barclays. So if inflation were running at the Bank of England's 2% target, you could feasibly make 6.7% return in a year on an unadjusted basis.

This figure is just an average and it is important to understand that some years you can make more – and some a lot less. For example, the inflation-adjusted return on UK shares was -3.5% a year between 1968 and 1978, finds Barclays, so you would have lost money. The following decade was much better with 12.4% annual inflation-adjusted returns.

Have a look at the table to see how shares

**REAL INVESTMENT RETURNS (% PER YEAR)**

| Years | Equities | Gilts | Cash |
|---|---|---|---|
| 1908-1918 | -3.5 | -7.4 | -4.8 |
| 1918-1928 | 10.3 | 7.0 | 6.9 |
| 1928-1938 | 3.6 | 6.7 | 2.4 |
| 1938-1948 | 3.9 | 0.8 | -2.6 |
| 1948-1958 | 7.1 | -4.5 | -1.8 |
| 1958-1968 | 11.0 | -1.4 | 1.9 |
| 1968-1978 | -3.5 | -3.3 | -2.7 |
| 1978-1988 | 12.4 | 5.8 | 3.8 |
| 1988-1998 | 11.1 | 8.7 | 4.7 |
| 1998-2008 | -1.5 | 2.4 | 2.4 |
| 2008-2018 | 5.8 | 2.7 | -2.5 |

Source: Barclays Research.
Returns adjusted for inflation.

have compared with government bonds (gilts) and cash over certain periods. UK government bonds are considered low-risk products because no-one thinks the government will default on the debt and fail to pay back your money. The returns from gilts have generally been better than cash, but not always by much.

If you're buying a fund, make sure you understand the different types of asset classes in its portfolio. For example, some funds only contain equities which is another word for stocks and shares – in this case it would be feasible to expect similar returns to owning individual company shares.

Other funds may contain assets such as shares, bonds and property and so the returns may not be as high as a share-only fund as it contains a mixture of higher and lower-risk assets.

## 3. HOW MUCH DOES IT COST TO INVEST AND IS THERE A MINIMUM AMOUNT?

In general it costs about £10 to buy or sell an exchange-traded fund (ETF), an investment trust (a type of fund) or a stock. You typically have to pay an annual or quarterly fee to the company you use to make investments, such as AJ Bell Youinvest, Barclays Stockbrokers, Interactive Investor or The Share Centre.

In AJ Bell Youinvest's case, it charges £9.95 to buy or sell in its ISA and then 0.25% of the value of the shares, gilts, investment trusts or exchange-traded funds (ETFs) in your account, capped at £7.50 per quarter. Funds classified as unit trusts or Oeics are cheaper to buy and sell, at £1.50, and ongoing charges are tiered depending on how much money you have invested. A portfolio of unit trust and/or Oeic funds worth less than £250,000 in value would attract a 0.25% annual fee.

You may ask if there is a minimum amount of money needed to invest. While investment platforms may let you put a very small amount of money in a fund or buy a single share worth 50p, you must consider the impact of charges on the overall cost.

There is no point buying a share for 50p when the dealing cost is nearly 20 times this amount. You are better off feeding cash into your ISA or other investment account until it becomes a decent chunk whereby the dealing cost would only be a fraction of the overall transaction.

For example, saving up £400 is a more reasonable amount to buy shares or a tracker fund.

The rough £10 dealing fee would represent 2.5% of the investment which isn't too bad if you are thinking about holding the shares or tracker fund for many years. But clearly the higher the amount you invest, the lower the percentage the transaction costs represent.

### HOW TO CUT COSTS

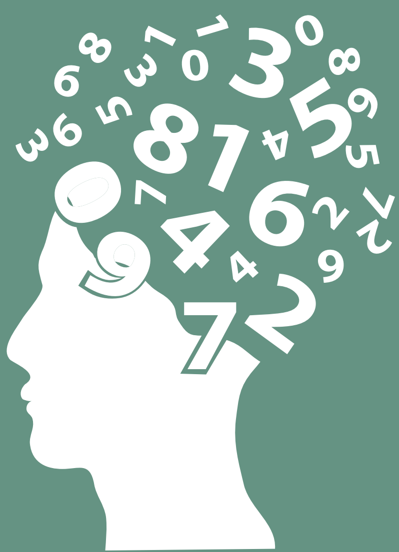
One way to reduce your costs is to use the regular investing services offered by most investment platforms which can cost as little as £1.50 for all asset classes including ETFs and shares.

Your order is pooled once a month with other investors' orders which helps to keep the

## HOW MANY FUNDS SHOULD I OWN IN AN IDEAL PORTFOLIO?

If you're new to investing and are picking diversified global funds then five to 10 funds would be a reasonable amount for a good investment portfolio.

Once you're more experienced and perhaps own funds that are more concentrated in nature – namely ones which invest in a much smaller number of assets, taking bigger bets – then 15 to 20 funds would be a reasonable amount for a portfolio. This assumes you have exposure to lots of different types of assets such as shares, funds, bonds and property.



overall transaction cost low. The downside is that you don't get to choose the day in which the order is made.

Before you splash the cash, you must first consider how much you can really afford to invest. We recommend you create a monthly household budget so you know how much money is coming in, such as from your salary, and how much your bills cost. Then you can see how much is left for casual spending and investing.

Make sure you pay off any large borrowings in the form of personal loans or credit cards first before investing, particularly if they come with large interest rates.

## 4. WHICH TYPE OF ACCOUNT SHOULD I USE?

ISAs should be your first consideration as these offer tax benefits and generally don't have the same access restrictions you get with pensions, although the latter do come with tax relief.

One exception is a Lifetime ISA which imposes a 25% penalty if you are withdrawing money for reasons excluding buying your first home, terminal illness or reaching the age of 60.

All capital gains – the extra money you make when an investment goes up in value – and dividend payments are free of capital gains tax or income tax for everything held inside an ISA wrapper.

### COMPARING ISA ACCOUNTS

| Types of ISA | Investment options |
|---|---|
| Cash ISA | Cash |
| Stocks & Shares ISA | Shares, funds, bonds, cash |
| Lifetime ISA | Shares, funds, bonds, cash |
| Help to Buy ISA | Cash |
| Cash Junior ISA | Cash |
| Stocks & Shares Junior ISA | Shares, funds, bonds, cash |
| Innovative Finance ISA | Peer-to-peer loans |

Adults can save up to £20,000 a year across all types of ISA apart from Lifetime ISAs which have a £4,000 limit, Help to Buy ISAs where you can save up to £1,200 in the first month and up to £200 per month thereafter and Junior ISAs which have a £4,368 annual allowance.
Lifetime ISAs include 25% government bonus on contributions. Help to Buy ISAs include 25% government bonus on total contributions between £1,600 and £12,000. Help to Buy ISAs are available to new savers until 30 November 2019. Bonuses must be claimed by 1 December 2030. There are further terms and conditions for ISAs so please read all the rules before you invest.
Source: Shares, HMRC

A dealing account should only be used if you've used up your annual ISA allowance which is currently £20,000. Here capital gains and dividends are subject to tax, although you do get certain allowances each year.

The other option is a SIPP which stands for 'self-invested personal pension'. Here you can run your own pension pot and benefit from tax relief.

## 5. WHAT SHOULD I PUT MY MONEY INTO?

Anyone new to investing should consider funds first. Here you benefit from instant diversification so if something goes wrong with one of the holdings in a fund, the other holdings should act as a cushion and prevent a large amount of damage to your wealth.

Owning just a handful of individual company shares puts you at risk of significant wealth destruction if something goes wrong with one or more of them.

Going down the funds route may mean you give up some of the potential returns you could get from having individual stocks, but that's not a bad price to pay if it means you smooth out the ups and downs from the market.

Your choices include passive funds such as ETFs which are low cost and track different indices. For example, you can get an exchange-traded fund which moves in line with the FTSE 100, an index of the 100 biggest stocks on the London Stock Exchange. If the FTSE 100 moves up by 2% in value, so does your ETF.

Passive funds come in various forms including ones tracking certain geographies; others can include specific sectors or styles such as dividend-paying assets.

Another option is an active fund where all the decisions about what is bought and sold are made by a fund manager.

Active funds come in all different shapes and sizes and cover the investment trust, unit trust and Oeic world. Some place big bets with concentrated portfolios, often only containing 20 stocks. Others offer much broader exposure such as through a portfolio of 100 or more stocks.

**RETURNS COME IN TWO FORMS**

You can make money in two ways with investing. One is through capital gains which is your investment rising in value. The other is through dividends.

Many funds give you the choice of buying an 'inc' or 'acc' version of their product. You buy the 'inc' version if you want to collect any dividend payments as cash or the 'acc' version if you want to roll-up any dividends into owning more units or shares in the fund.

The frequency of dividend payments varies from fund to fund. Not all funds pay them, but those that do have historically paid out twice a year. More recently frequencies have increased to quarterly or even monthly for some funds. Please note that investments do have the right to cut or suspend dividends, so you must appreciate they aren't guaranteed forms of income.

Once you've built up experience with investing, it is only natural to want to buy individual company shares. When you feel comfortable taking this step make sure you do thorough research and don't overpay for something.

Just remember that large companies such as those in the FTSE 100 aren't guaranteed to make you money.

Even the biggest businesses experience problems or go out of favour with investors. There are no guarantees that funds will make you rich, either. You can still lose money from them if the fund manager has made the wrong selections or the market you are tracking goes into decline.

## CLASSIC FIRST-TIME INVESTOR MISTAKES

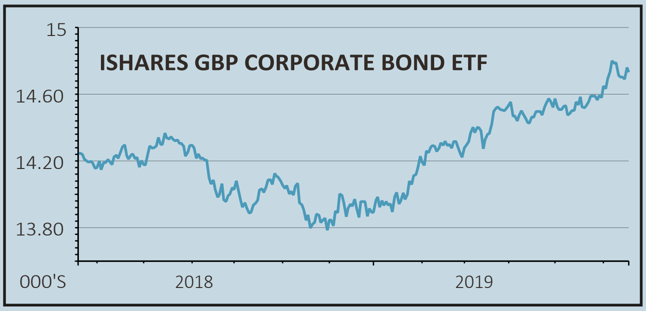
- Buying what's deemed to be 'hot' such as crypto-currencies or cannabis stocks
- Buying small stocks hyped by people on social media and underappreciating they are very high risk
- Not having enough patience and trading in and out of stocks or funds, thereby incurring lots of dealing costs
- Investing too small an amount so the overall transaction is dominated by dealing costs
- Not taking advantage of tax benefits – i.e. failing to use an ISA and using a dealing account instead
- Investing cash that's subsequently needed to pay bills

# FIVE FUNDS FOR FIRST-TIME INVESTORS

**We've picked five funds aimed at first-time investors. These are all considered to be lower-risk investments and ideal for beginners.**

**Approach your investment journey in stages and don't try to do too much at once. By taking small steps you can build up confidence and knowledge, and potentially take higher risks later on should you have the appetite.**

## ISHARES GBP CORPORATE BOND ETF (SLXX)




You may have been told by a friend or family to start your investing journey by putting money into government bonds. We think high quality corporate bonds might be a better place to start as the returns could be a bit better for only taking a small amount of extra risk.

The iShares passive exchange-traded fund tracks an index of bonds issued by high quality companies. Buying a bond effectively means loaning someone money in exchange for receiving regular interest payments over a fixed period of time.

When bonds mature you get your initial money back, assuming you bought at par value which is the price at which the bonds were first issued. If you bought above par then you would get back slightly less at maturity, or a bit more if you bought below par.

The iShares product currently invests in a range of bonds including some issued by banking group **Barclays (BARC)** and supermarket giant Walmart.

## BNY MELLON GLOBAL INCOME (B7S9KM9)

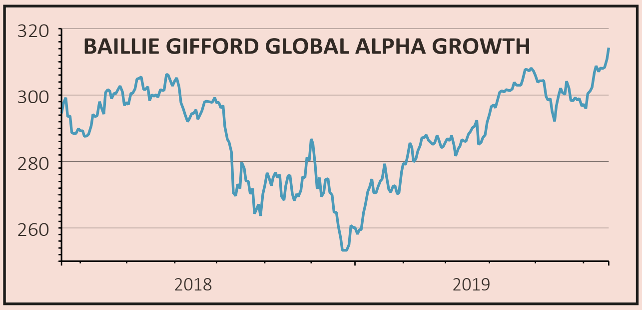

This is a great place to start if you're looking to invest in high quality companies around the world. The fund, which used to be called Newton Global Income, has stakes in such companies as soft drinks giant PepsiCo and technology conglomerate Cisco Systems.

Although this is an income fund, currently yielding 3.1%, you can buy a specific version of the fund if you want to use dividend payments to enhance the value of your holding in the fund. Buy the 'acc' version – which has the code **B7S9KM9** – and the fund will do all the reinvestment for you.

The alternative is to buy the 'inc' version – which has the code **B8BQG48** – and receive dividends as cash payments every three months.

Anyone who has time on their side and doesn't need the income should really buy the 'acc' version to enjoy the benefits of compounding over time.

# BAILLIE GIFFORD GLOBAL ALPHA GROWTH (B61DJ02)

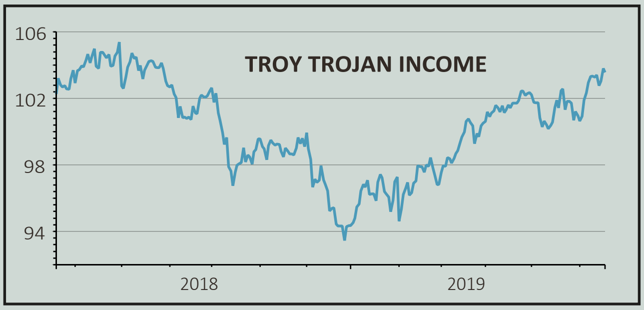



Many people would seek to buy the most popular fund on the market, believing it to be a favourite among a lot of investors because of its skills and performance.

**Fundsmith Equity (B41YBW7)** is arguably the most popular at the moment, but we believe the Baillie Gifford fund could be a better choice for a first-time investor for several reasons.

It is cheaper and more diversified than Fundsmith and also smaller in terms of the assets under management and therefore more nimble. It invests in companies which it believes offer above-average profit growth including life insurer **Prudential (PRU)** and payments network MasterCard.

# TROY TROJAN INCOME (BZ6CQ17)




This is an actively-managed fund with a focus on capital preservation. Don't be fooled into thinking the fund doesn't want to make money for you.

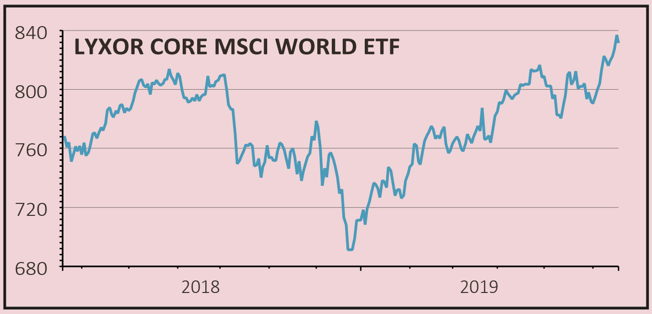
Its slow and steady approach has certainly been good over the years with the fund having generating 11.85% annualised returns over the past decade.

Its strategy is to be careful with how money is allocated and to not take wild bets on potentially iffy companies.

The fund invests in UK-listed stocks such as oil producer **Royal Dutch Shell (RDSB)**, catering group **Compass (CPG)** and credit agency **Experian (EXPN)**.

Troy Trojan Income invests in Royal Dutch Shell

# LYXOR CORE MSCI WORLD ETF (LCWL)




This is a passive exchange-traded fund and the ideal first investment as it provides exposure to a diverse range of companies around the world for a very low annual cost of 0.12%.

It tracks the MSCI World index which is a basket of more than 1,600 stocks trading on 23 different developed market countries. Among the names in the index are Microsoft, Apple, Johnson & Johnson and Nestle.


Microsoft is one of the 1,600 tracked stocks in the MSCI World Index

By **Daniel Coatsworth** Editor

# Now is not the time to invest in Lloyds Banking

Hopes of lower bad debts and a bumper buyback may be premature

The last 20 years have certainly been eventful for **Lloyds Banking (LLOY)**, a stock owned by a large number of retail investors thanks to a history of generous dividends.

From a sleepy high street also-ran it has grown through a series of mergers and acquisitions (M&A) into the largest UK-focused retail and commercial lender.

Given a relatively benign economic backdrop, analysts are predicting a significant recovery in profits in the coming 18 months and a large share repurchase programme.

Even so, we believe there are good reasons not to rush in and buy the shares just yet, particularly given the uncertainties over the outlook for a UK economy to which Lloyds' fortunes are heavily wedded.


## POTTED HISTORY

The current structure of Lloyds is the result of a decade of frenzied M&A in UK banking during the late 1990s and early 2000s.

In the five-year period leading up to the market peak in March 2000, Lloyds took over the Cheltenham & Gloucester building society, Trustee Savings Bank (TSB), Birmingham Midshires and life insurance group Scottish Widows.

At the same time, Halifax Building Society, one of the UK's biggest mortgage lenders with more than 7m account holders, demutualised and went on an acquisition spree of its own, taking over the Leeds Permanent Building Society and life assurance company Clerical Medical.

In 2001 Halifax bought Bank of Scotland to create the ill-fated HBOS. This 'new force' in British banking set out to become the UK's largest savings and mortgage provider.

However HBOS expanded so rapidly that by the time the financial crisis struck in 2008 the problems with its loan portfolio were so extensive that it had to be rescued. By acquiring HBOS, Lloyds instantly became the largest retail lender in the UK and today the group has over 25m retail customers.

## WHERE DOES IT MAKE ITS MONEY?

As well as retail and commercial banking, which includes niche businesses such as agricultural mortgages (via AMC), credit cards (MBNA) and motor finance (Black Horse and Lex Autolease), Lloyds offers insurance and investments through Scottish Widows and its newly-formed Schroders Personal Wealth unit.

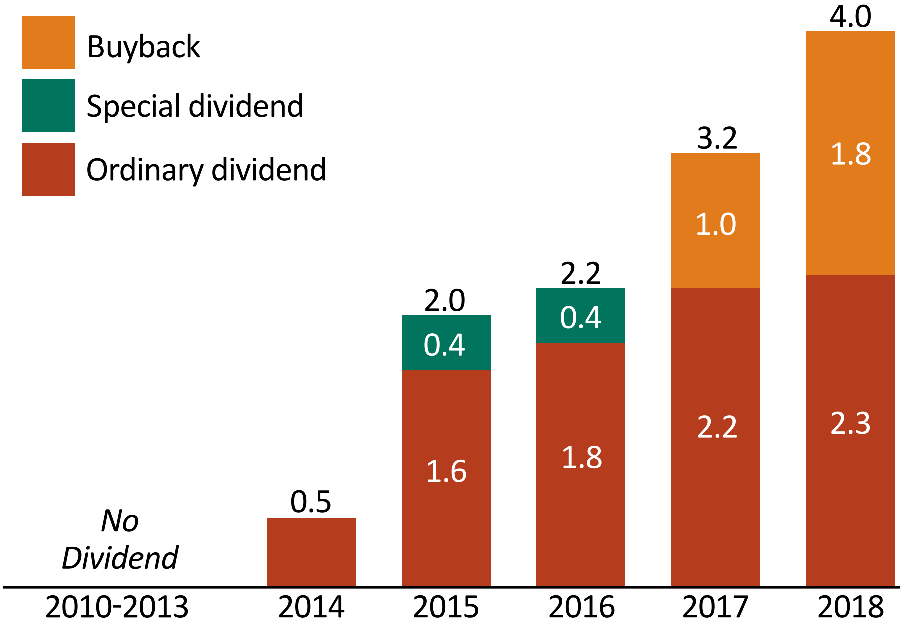
Retail banking in its various guises accounts for 36% of total revenue, commercial banking accounts for 28% and insurance and investments make up the remainder.

As of 31 March 2019, Lloyds had £441bn of loans and advances – a slight decrease on December 2018 – and £417bn of customer deposits, also slightly down on last December.

Its net interest margin – the

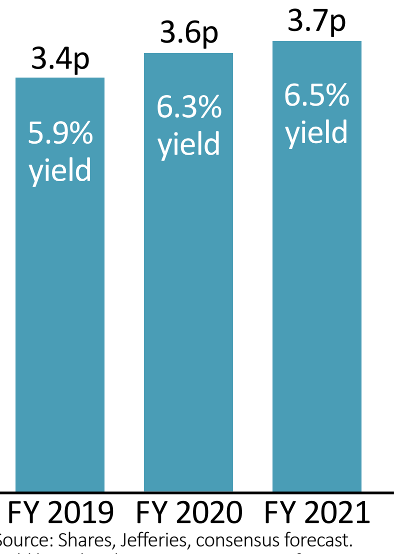
## TOTAL SHAREHOLDER RETURN

Total capital return to shareholders, £bn




Source: Lloyds Banking

## HOW MUCH COULD LLOYDS PAY IN FUTURE DIVIDENDS?




Source: Shares, Jefferies, consensus forecast.
Yield based on latest price 57.2p, as of 24 June 2019

difference between what it makes on lending money out and what it pays customers on their deposits – was just 2.9%, which shows how narrow the margins are on its core business.

### EARNINGS TO RISE, BAD LOANS TO FALL?

Given that Lloyds has the most exposure of all the high street banks to UK consumer and business sentiment, which is holding up for now thanks to a 40-year low in unemployment, analysts are predicting that charges for bad loans should fall sharply this year and next year.

Combined with lower operating costs and lower charges for PPI mis-selling, they argue that pre-tax profit should rise considerably allowing the bank to buy back more than £4bn of shares, equivalent to 10% of its current market value.

Analysis by investment bank Investec – which rates Lloyds a 'buy' – contrasts the initial expectations of Lloyds' bad loan charges for 2017 and 2018 just after the Brexit vote in 2016 with the actual outcomes.

Immediately following the vote, analysts were forecasting charges of £1.8bn for both 2017 and 2018. By mid-2017 those estimates had fallen to £1bn for 2017 and £1.6bn for 2018. The actual impairment charges were £795m for 2017 and £937m

### COULD BANKS ULTIMATELY BECOME REDUNDANT?

The most interesting recent development in finance has been the apparent 'coming of age' of crypto-currencies.

While Bitcoin accounts for over half of the estimated $285bn global 'coin' market and most of the column inches in the press, it's the emergence of so-called 'stablecoins' backed by real-world assets and their potential to disrupt the mainstream of commerce and finance which is really significant.

There is no question that Facebook's launch of Libra, which is backed by established payment providers including Mastercard, Paypal and Visa, is a genuine competitive threat to the current payment system dominated by the banks.

In time, if Facebook's suppliers and its 2.7bn customers establish a trend for using crypto-currencies, the traditional role of banks could shrink much faster than anticipated.

for 2018.

Looking ahead, Investec and others argue that the level of bad loans, currently just 0.25% of Lloyds' total assets, should fall over the next two years rather than rise, allowing it to reduce the level of charges.

## LOWER COSTS COULD MEAN BIG SHARE BUYBACKS

Even if revenue is flat for the next two years, Lloyds' cost of funding has fallen sharply while its operating cost-to-income ratio – which is already the lowest in the industry – is set to fall from 49% to the low 40s by 2020 according to the bank's own forecasts.

Meanwhile payments for PPI mis-selling are falling ahead of the expiry date for claims this August, and analysts argue that the bank may not need to use the full £1bn worth of provisions left on its books.

In this scenario, as well as offering a prospective dividend yield of 5.9% rising to 6.3% in 2020, the bank would be so over-capitalised that it could afford to return £2.75bn this year and possibly £1.75bn next year through share buybacks.

## HIGH SENSITIVITY TO BAD LOANS

In contrast to this rosy scenario, analysis by investment bank Jefferies – which also rates Lloyds as a 'buy' – shows that the size of its loan portfolio and the ratio of bad loans are the biggest factors driving the share buyback and valuation arguments.

Jefferies' current base case, on which it believes the bank is worth 99p per share or 73% above today's price, sees bad loans rising to 0.34% of total assets by 2021 while revenue grows very slightly and costs fall very slightly.

A slight positive tweak to bad loans, revenue and costs sees the valuation rise to 113p or 98% above today's price.

However a slight downward tweak to revenues, an upward tweak to costs and a bad loan ratio of 0.53% of total assets sends the valuation down to 52p or 9% below today's price.

### LLOYDS: BULL VERSUS BEAR POINTS

**THE CASE FOR**

- Lower bad loan & PPI charges
- Lower operating costs
- Dividend yield/valuation
- Potential for large share buyback

**THE CASE AGAINST**

- Weak housing market/ Brexit to impact confidence
- Small change in nonperforming loan forecasts equals a big drop in valuation
- Increased capital requirements/regulation
- Crypto-currencies become mainstream

## BUSINESS TO BECOME MORE CHALLENGING

It's worth flagging that Lloyds' core lending business is likely to be less profitable and more heavily regulated going forward.

The Bank of England has warned the banks that the current mortgage market is 'dysfunctional' and that it is watching their capital levels 'like a hawk'. It is unhappy with the current high loan-to-value and loan-to-income ratios on new mortgages and is concerned that not enough capital has been put aside if values suddenly fall.

With the central bank pushing for lenders to have higher capital ratios when bad debts are low – and they are at historic lows right now – the hoped-for buyback of £4bn-plus shouldn't be taken as a given in our view.

Meanwhile the RICS survey still paints a grim picture of the housing market with most chartered surveyors downbeat about the outlook for prices and transactions and analysts are starting to grow concerned that the new housing market may be weaker than they have forecast.

At the same time, the Government is giving the Competition and Markets Authority (CMA) new powers to fine banks which have overcharged customers on mortgages and insurance firms which have overcharged or misled customers. The CMA believes that up to 1m mortgage customers and 12m insurance customers may have been wrongly treated.

By **Ian Conway**
Senior Reporter

# Why Russia has outperformed

Further rate cuts could support a Russian stock market which has enjoyed a resilient performance

Russian growth has proved to be fairly robust of late despite the pressure from volatile oil prices, international sanctions and structural issues in the economy.

The country's flagship Russian Trading System (RTS) index has outperformed both the US S&P 500 and the UK's FTSE 100 over both a one-year and three-year time period.

### WHAT IS THE RTS?


This index includes the 50 largest stocks on the Moscow Stock Exchange, with the list of shares reviewed quarterly. More than half of the index is represented by oil and gas companies.

With the Central Bank of Russia (CBR) potentially poised to press the trigger on further interest rate cuts, having reduced its policy rate to 7.5% at its last meeting on 14 June, Russian stocks could be set to continue their strong run.

Consultant Capital Economics comments: 'The statement (accompanying the latest rate cut) struck a dovish tone – the CBR seems less concerned about inflation.

'We think that the key rate will be lowered to 7.25% by the end of this year and 6.75% by end-2020.' The CBR has the leeway to pursue this course of action thanks to a more stable inflation backdrop.

In valuation terms Russian equities compare favourably with other emerging markets and those in the developed world. According to Germany's Star Capital, Russia trades on a price-to-earnings ratio of 5.5-times and offers a dividend yield of 6.5%.

Amid state pressure, Russian companies are increasing their generosity to shareholders. This was reflected in energy firm Gazprom's recent decision to hike its dividend twice in the space of a week to 16 rubles.

This move was the catalyst for a double-digit increase in a share price which had tracked sideways for months, if not years.

### RUSSIA OUTPERFORMS UK AND US

| Index | One-year performance (%) | Three-year performance (%) |
|---|---|---|
| FTSE 100 | -2.46 | 23.2 |
| Russian Trading System Index | 24.6 | 48.9 |
| S&P 500 | 5.62 | 40.9 |

Source: SharePad, 19 June 2019

# Emerging Markets: Views from the Experts

Three things the Franklin Templeton Emerging Markets Equity team are thinking about today

## 1. NEW TARIFFS

Market sentiment turned negative in May, when concerns emerged of an escalation in the US-China trade war.

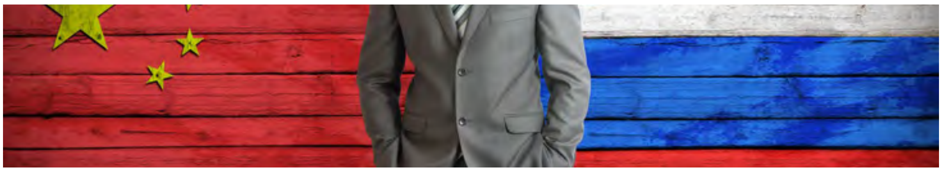
Undoubtedly, the increase in tariffs will impact many Chinese producers, with some companies already shifting manufacturing to other countries. However, China is becoming less dependent on trade—at present about a third of its gross domestic product (GDP) comes from foreign trade compared to almost 65% more than a decade ago.

Instead, the key underlying drivers of China's growth have been shifting toward innovation, technology and consumption. If China's rebalancing efforts result in an economy that is more sustainable, it would almost certainly continue to be a structural growth driver for emerging markets (EMs) in the decades to come.

## 2. MSCI REBALANCING

MSCI's semi-annual rebalancing, which was accompanied by the inclusion of Saudi Arabia in the MSCI Emerging Markets Index and the reclassification of Argentina from frontier market (FM) to EM status, took place on 28 May.

MSCI also increased the inclusion factor of China A-shares to 10% from 5%, doubling its index weighting to just under 2%.



MSCI's decision to upgrade Saudi Arabia to emerging markets status puts it firmly on the radar of international investors and is a positive step for the Middle East region's transition into mainstream EM investment.

## 3. RUSSIA

Russia remains one of the most undervalued markets globally, despite very strong performance over the past three years. Many international investors have avoided this market because of economic sanctions against the country.

Russia's fairly self-sustained economy has limited the impact of sanctions. While the economy has proven to be resilient, many companies have taken steps to adapt and flourish in the current environment. In some cases, restricted access to Western technology has spurred Russian companies to invest in building their own ecosystems, which contributes to more sustainable growth.

Moreover, corporate governance in many Russian companies has improved significantly. For example, many companies have increased dividend payouts and undertaken share buybacks to improve shareholder value.

**TEMPLETON EMERGING MARKETS INVESTMENT TRUST (TEMIT)**

**Porfolio Managers**

**Chetan Sehgal**
Singapore

**Andrew Ness**
Edinburgh

TEMIT is the UK's largest and oldest emerging markets investment trust seeking long-term capital appreciation.

# EXPLORING THE 'G' IN ESG:

## WHY GOVERNANCE IS VERY IMPORTANT TO INVESTING

When you buy a share in a company you are actually obtaining a portion of a business, thus making you a part owner.

And as an owner you want to have confidence that you are getting the full picture of a company's performance and prospects, decisions are being made in your interests, and that money is being put to good use. You don't want to see it frittered away on value-destroying acquisitions or ill-fated business ventures.

The key is corporate governance, which is the system through which a business is directed and controlled.

**IMPACT ON INVESTMENT RETURNS**

A piece of research published in 2003 by Harvard academic Paul Gompers looked at the performance of US companies in the 1990s. It found an 8.5% better return per year from public firms with the best corporate governance on its measures compared with those which scored worst.

This makes sense as without good governance the risks of investing in a company are significantly higher. Think back to any of the big corporate scandals of the past decade, such as the cheating on emissions tests at Volkswagen to Facebook's misuse of data and **BP's (BP.)** Gulf of Mexico oil spill. Governance failings are likely to be at the heart of them.

**In the second part of our two-part series on ESG investing we examine the issue of governance and unveil an ESG portfolio to help develop investment ideas which tap into this increasingly mainstream theme.**

All these examples saw significant damage wrought on the respective companies' share price and investing in just one company with inadequate governance can do significant damage to your investment portfolio.

Under pressure from regulators and other stakeholders, companies have got better at talking the talk in this area but not all businesses are walking the walk.

**Governance**

- **Shareholder rights**
- **Executive diversity**
- **Accounting**
- **Business ethics**
- **Scrutiny of key directors**

Foxy Bingo.com's owner GVC has seen rebellions against executive pay

## PAYING LIP SERVICE TO GOVERNANCE

Advisory group PIRC recently cited the example of gambling group **GVC (GVC)** where there have been consistent rebellions against executive pay followed by acknowledgements of the need to listen to shareholders.

Ahead of GVC's latest annual shareholder meeting on 5 June, PIRC said: 'In the run-in it has stressed its engagement with shareholders and willingness to listen to their concerns about executive pay. On an entirely different subject, in 1971, The Who sang: "I'll get on my knees and pray we don't get fooled again".'

Sure enough, when the meeting arrived 40% of shareholders voted against the remuneration report and GVC was yet again promising to listen.

While regulators and major shareholders can play a part in the stewardship of a company, the board of directors are the ones with the responsibility for corporate governance and for this reason it's important to have a diverse board with strong independent directors.

Sacha Sadan, director of corporate governance at Legal & General Investment Management, says: 'This doesn't just mean things like gender diversity, which are important; I'm often asking questions to companies like "why are there only financial people on the board when you are a customer service business?". You need directors who can challenge businesses to make better decisions.'

Sadan says this requires a split of the executive function between chief executive and chairman, with a company's chair ultimately playing the most crucial role in a company's governance.

## HAVE YOU READ PART ONE OF OUR ESG GUIDE?

**Follow these links to read about 'E' and 'S' of ESG**

## WHY THE CHAIRMAN MATTERS

The chairman should have responsibility for the hiring and firing of CEOs and Aviva Investors' chief investment officer for equities David Cumming says this is still an area where there is significant room for improvement.

'Companies are still slow to exit underperforming CEOs. As a shareholder there is plenty of evidence of CEOs doing damage for too long. (Boards) often take the right decision in the end but it takes too long.

'The Kingfisher CEO said they were stepping down, (after) there was a long period of underperformance; the boss of BT has gone, you could argue they should have gone sooner; and the Kier CEO went recently and should probably have gone sooner.'

He adds that Aviva Investors, like other institutional investors, will often seek to apply pressure in private but there are occasions where a lack of response forces matters into the open.

## GETTING VOCAL

Cumming was vocal about **Unilever's (ULVR)** thwarted attempt to shift its primary stock market listing and headquarters out of the UK. 'They lost, and it did quite a lot of damage. That was an example of a company not listening to shareholders and there were consequences for that,' he says.

Failure to properly hold chief executives to account puts them in an overly dominant position. These can be particularly acute when the CEO is also the founder, with recent examples including the misconduct allegations facing Ray Kelvin at **Ted Baker (TED)** and the acrimonious departure of Martin Sorrell at **WPP (WPP)**.

Cumming notes that a chairman can themselves often be more difficult to fire and adds that 'if you have a weak chairman and CEO then it can be

The £100m bonus awarded to Persimmon CEO Jeff Fairburn was the catalyst for chairman Nicholas Wrigley's departure

## OUR TOP ESG PICKS

**Are you looking for our ESG portfolio of funds? Click here to jump to the article**

difficult to effect corporate change'.

He also says ESG issues and the extent of the changes in the last 18 months to two years are still underappreciated at board level.

### TACKLING EXCESSIVE PAY

When board failings saw Jeff Fairburn, the former chief executive of housebuilder **Persimmon (PSN)**, trouser a £100m bonus (later trimmed to £75m), it was chairman Nicholas Wrigley who first fell on his sword. He stepped down in December 2017, months before Fairburn eventually departed.

Cumming says despite progress on executive remuneration, this is still a big issue. 'At Ryanair, for example, does O'Leary deserve £100m if things work out when he's been very hawkish on employee pay?'

Legal & General's Sadan notes bonus schemes solely linked to adjusted or core earnings per share 'where all the bad stuff has been taken out' are particularly concerning.

This type of situation can encourage management to focus too heavily on short-term earnings performance and potentially to massage these figures to paint them in a more positive light.

An extreme example of this situation can be with café chain Patisserie which involved alleged criminal activity on the part of finance director Chris Marsh.

Patisserie did run a bonus scheme linked to earnings per share targets, and in February 2018, both Marsh and then-chief executive Paul May exercised options granted in 2014 and immediately sold the shares acquired for a total profit of £2.9m.

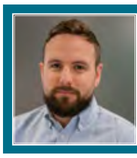
The good news according to Sadan is that the lion's share of businesses are attempting to implement sound governance.

'Most companies are good, not great. When you don't know what's going to happen with domestic politics, for example, it's not always easy to make the right decisions but most companies are at least trying.'

**A RECORD 226 GLOBAL COMPANIES WERE TARGETED BY ACTIVISTS IN 2018 ACCORDING TO ASSET MANAGER LAZARD**

And for the businesses which fall short, there is growing pressure from activist investors, who buy large stakes in a business to drive a change in strategy which they hope can deliver an improvement in the share price.

Institutions may play a different role but Sadan says Legal & General would not be afraid to back activists if their interests are aligned.



By **Tom Sieber** Deputy Editor

# Shares' ESG portfolio: seven funds to buy now

We pick a mixture of active and passive funds, investment trusts and ETFs to play the ESG theme

There are now a multitude of investments offering exposure to ESG themes as investors seek to benefit from environmental, social and governance strategies. Having researched the space for our two-part series on ESG investing, we've pulled together a portfolio of active and passive funds which specialise in certain areas or give you broad exposure to the ESG universe.

You can either buy all of the funds, choose between the active or passive ones, or cherry pick one or two funds to sit alongside other investments you may already have in this space.

## SHARES' ESG PORTFOLIO

**ACTIVE**

| THEME | FUND | OCF |
|---|---|---|
| ENVIRONMENTAL | Impax Environmental Markets Trust (IEM) | 1.04% |
| SOCIAL | BMO Responsible UK Income (B4NKFT8) | 0.80% |
| GOVERNANCE | First State Asia Focus Fund (BWNGXJ8) | 0.90% |
| ETHICAL | Rathbone Ethical Bond (B77DQT1) | 0.67% |
| SUSTAINABLE DEVELOPMENT | Stewart Investors Worldwide Sustainability (B7W3061) | 0.89% |

**PASSIVE**

| THEME | FUND | OCF |
|---|---|---|
| SOCIAL | iShares MSCI USA SRI UCITS ETF (SUAS) | 0.3% |
| ALL-ROUNDER | iShares MSCI World ESG Enhanced UCITS ETF (EEWD) | 0.2% |

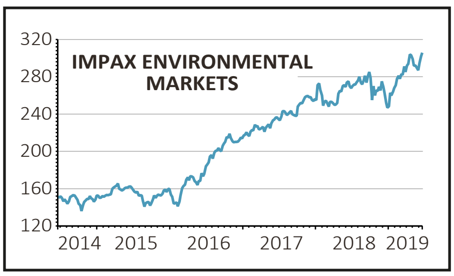
OCF = ongoing charges figure, All data Morningstar/AJ Bell

## ACTIVELY-MANAGED FUNDS

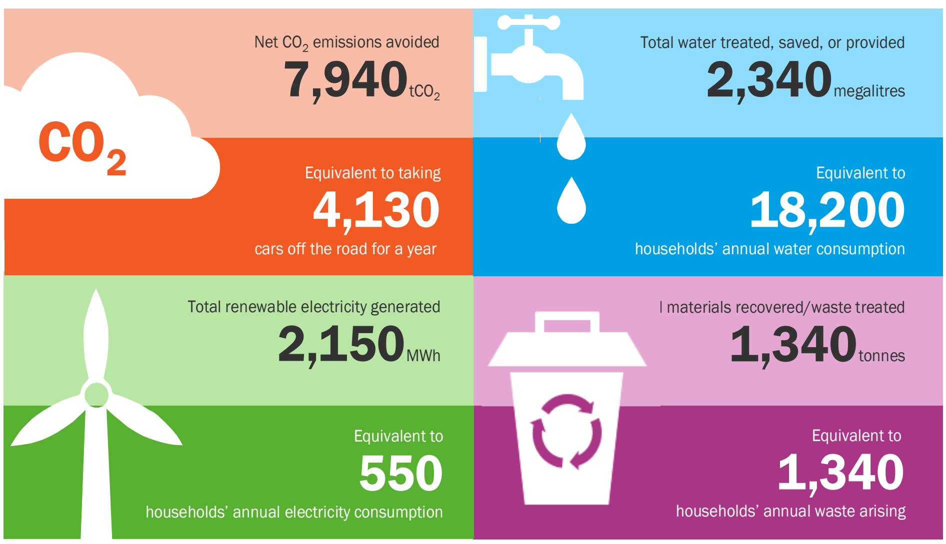
### ENVIRONMENTAL

### Impax Environmental Markets (IEM)

Launched over 17 years ago, the fund was one of the first to offer retail investors the chance to benefit from growth in the markets for cleaner or more efficient delivery of energy, water and waste services.




**IEM plc - environmental impact of £10m investment**




Source: Impax Asset Management

Part of the fund invests in companies which mitigate issues such as climate change, including renewable energy and energy efficiency stocks.

Another part of the fund invests in companies which enable people to adapt to environmental challenges, such as water infrastructure and 'smart' power grids.

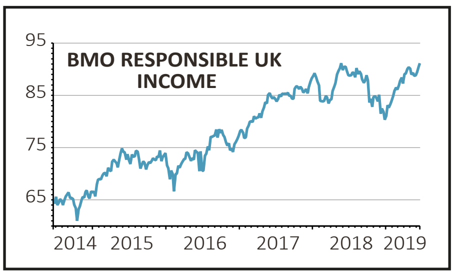
Its share price has doubled over the past five years.

## SOCIAL
### BMO Responsible UK Income (B4NKFT8)

Run along strict ethical guidelines, the fact that BMO looks beyond financial gains to focus on community benefits and more when measuring performance is an important point to make for potential investors.

An investment policy that has been called 'dark green' by some – effectively ruling out investing in anything with a weapons, gambling, booze or tobacco slant, which covers a fair slug of the FTSE 100 – the fund expands its investment universe into the mid cap and smaller companies space where it regularly grills company bosses on their environmental and social strategies and how they might impact long-run returns.

This policy means the fund pitches itself as a medium risk



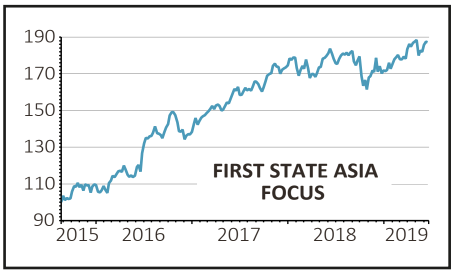

ESG-style fund option. About 30% of the portfolio can be aimed at bonds for safety, while cash and hedging levers can be pulled when equity markets are under pressure.

## GOVERNANCE
### First State Asia Focus (BWNGXJ8)

We've selected this fund for the way First State Stewart Asia – an autonomous investment management team within First State Investments – pays particular attention to governance issues. It only invests in companies where it perceives the management operates the business effectively and in the interest of all stakeholders.

It says: 'Companies that do not look after their customers, employees, suppliers and the larger community are unlikely, in our view, to be rewarding long-term investment.'

This approach is embedded into the fund's broader focus on ESG. The team seek out quality companies defined by the




strength of their management, financials and franchise.

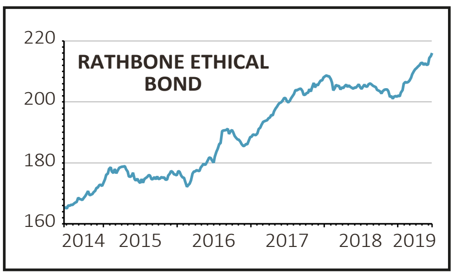
'The pursuit of immediate gains through short-sighted strategy, reckless conduct, or the exploitation of labour, tax loopholes, legislative arbitrage or the environment runs contrary to this definition of "quality",' it adds.

The funds invests at least 80% of its money in shares which are based in, or do business in, the Asia Pacific region including Australia and New Zealand but excluding Japan. It is allowed to invest up to 20% of its money in companies around the world.

You're getting exposure to mid and large-sized companies – at least $1bn in size. The portfolio includes Indian financial group HDFC Bank and Australian biotechnology group CSL.

## ETHICAL
### Rathbone Ethical Bond (B77DQT1)

Income investors skittish about toppy equity markets and seeking shelter in the form of investments with an ethical



bent might look to this socially responsible investment (SRI) fund, which has handsomely outperformed the IA Sterling Corporate Bond sector over the past 10 years.

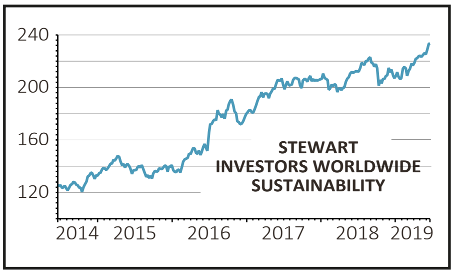
The quarterly dividend-paying fund provides a regular, above-average income by putting money to work with a range of bonds and bond market instruments meeting strict ethical and financial criteria.

Steered by Rathbones' head of fixed income Bryn Jones and deputy manager Noelle Cazalis, the fund focuses on high quality, investment grade bonds and aims to deliver a high 5% to 7% yield.

The ethical overlay, provided by a dedicated research team, provides an extra level of investment diligence and helps the managers to spot problems that might affect bond performance at the earliest stage.

## SUSTAINABLE DEVELOPMENT

### Stewart Investors Worldwide Sustainability (B7W3061)




> **'IT'S NOT LIKELY TO OUTPERFORM IN FROTHY BULL MARKETS, BUT IT SHOULD HOLD UP WELL WHEN MARKETS FALTER'**

Not a pure ESG fund in the strictest sense, Stewart Investors Worldwide Sustainability is known for putting socially important and sustainable business models front and centre of its stock selection process.

Typically holding 40 to 60 stocks drawn from all over the world, it seeks proven management, strong balance sheets and long-run earnings potential from medium-sized companies.

Headed by manager Nick Edgerton, the fund puts great stock in the strength and talent of its team with individuals bringing particular expertise in niche areas thanks to original and independent research.

Absolute returns remains the goal rather than beating a particular benchmark. 'It's not likely to outperform in frothy bull markets, but it should hold up well when markets falter, a feature we saw in 2018 pleasingly,' says Morningstar analyst Ronald van Genderen.

'It's admirable that Stewart Investors encourages alignment with shareholders by paying good parts of the team's bonus into the funds.'

## PASSIVE FUNDS

## SOCIAL

### iShares MSCI USA SRI UCITS ETF (SUAS)

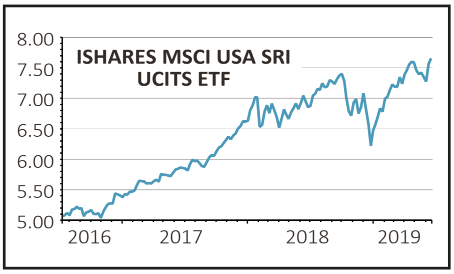
This exchange-traded fund (ETF) is a cheap way to get exposure to the big US companies, but without the possibility of inadvertently putting money into firms raking in shedloads from dodgy activities.

The fund negatively screens companies, so it excludes them if they are involved in any of the following activities: biological and chemical weapons, nuclear weapons, uranium weapons, landmines, civilian firearms, tobacco, cluster bombs, and violation of the UN Global Compact.

The likes of Boeing, Lockheed Martin and General Dynamics are out; and in are names such as Microsoft, Proctor & Gamble and Walt Disney.

It's important with this ETF to think what socially responsible means to you, as the likes of McDonald's and Pepsi are in the fund's top 10 holdings and some people may think fast food and fizzy drinks are no good for society.


McDonald's is surprisingly included in iShares MSCI USA SRI UCITS ETF's portfolio



## ALL-ROUNDER

### iShares MSCI World ESG Enhanced UCITS ETF (EEWD)

One of six ETFs BlackRock launched earlier this year to give investors exposure to the ESG space at a low cost, this ETF invests in a wide range of large and mid-cap companies across 23 developed markets.

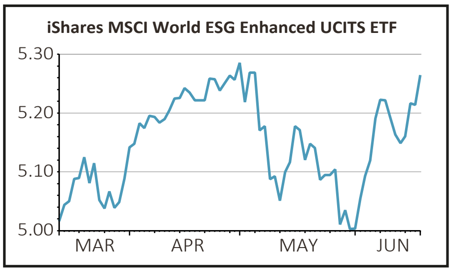
It provides diversified exposure to more than 1,300 companies, skewed heavily towards the US which makes up 61.5% of the fund's geographic exposure.

The ETF reweights stocks to maximise ESG scores while remaining close to benchmarks, but aims to hold companies that will produce 30% less carbon emissions than the benchmark.

It also screens out companies with exposure to controversial and nuclear weapons, tobacco, civilian firearms, coal and oil sands, and those mired in big controversies.

But it's important to note the fund does still hold oil companies such as ExxonMobil, Chevron and BP as these businesses are active in renewable energy and electric vehicle infrastructure developments which means they can can score positively from an ESG perspective.

ExxonMobil is included in the portfolio due to its renewable energy and electric vehicle activity




By **the Shares team**

# How to cut both funeral and burial costs

There could also be a clampdown in the industry on excessive pricing

It's getting more expensive to die. The cost of having a burial in the most expensive part of the UK (unsurprisingly in London) has hit almost £12,000, while the average cost across the UK is just shy of £4,000.

The figures from Royal London show that Kensal Green, in north-west London, is the most expensive place to have a funeral, with an average cost of £7,489. In comparison, Belfast in Northern Ireland is the cheapest place to die, with an average funeral cost of just shy of £3,000. The costs include collection/care of the deceased, a basic coffin, a hearse, and a simple service.

But funeral costs have been rising far higher than incomes in recent years, with the most recent figures showing a 6% increase in costs between 2017 and 2018. It means more people are taking on debt to help pay – Royal London estimates one in 10 took on debt to pay for a funeral, with the average debt being £1,744.

### DIG-IT-YOURSELF

It also means a rising number have decided to take the DIY approach. You can take on many of the tasks that a funeral director usually carries out, often for minimal hassle – and for a large cost saving.

It will surprise many that you can actually bury a body in your

**Most/least expensive locations for a funeral in the UK**

| Most Region | Average cost of a burial funeral | Average cost of a cremation funeral | Average funeral cost |
|---|---|---|---|
| Kensal Green (London) | £11,857 | £3,121 | £7,489 |
| Enfield (London) | £8,902 | £3,384 | £6,143 |
| Beckenham (London) | £7,730 | £3,541 | £5,636 |
| Southgate (London) | £7,307 | £3,346 | £5,327 |
| Golders Green (London) | £7,215 | £3,233 | £5,224 |
| Wandsworth (London) | £7,168 | £3,070 | £5,119 |
| Morden (London) | £6,936 | £3,041 | £4,989 |
| Manor Park (London) | £6,696 | £3,269 | £4,982 |
| Leatherhead (Surrey) | £6,310 | £3,541 | £4,925 |
| Islington (London) | £6,753 | £3,081 | £4,917 |
| East Finchley (London) | £6,753 | £3,081 | £4,917 |

| Least Region | Average cost of a burial funeral | Average cost of a cremation funeral | Average funeral cost |
|---|---|---|---|
| Belfast (Northern Ireland) | £3,050 | £2,851 | £2,950 |
| Paisley (Scotland) | £3,245 | £2,982 | £3,114 |
| Glasgow West (Scotland) | £3,245 | £3,007 | £3,126 |
| Alford (Lincolnshire) | £3,164 | £3,106 | £3,135 |
| Bridgwater (Somerset) | £3,017 | £3,286 | £3,152 |
| Amersham (Buckinghamshire) | £3,261 | £3,066 | £3,164 |
| Burton on Trent (Staffordshire) | £3,244 | £3,151 | £3,197 |
| Abingdon (Oxfordshire) | £2,975 | £3,421 | £3,198 |
| Wellingborough (Northamptonshire) | £3,055 | £3,370 | £3,213 |
| Swindon (Wiltshire) | £3,086 | £3,351 | £3,218 |

Source: Royal London

## GOVERNMENT HELP IS AVAILABLE

PEOPLE ON CERTAIN benefits can claim Government help for paying for funerals, which will then be reclaimed from any money you receive from the deceased's estate.

The amount varies but will help to cover the costs of burial or cremation fees, transport and death certifications, as well as up to £700 for flowers, the coffin and funeral director's fees. The money will either go into your bank account directly or to the funeral director.

If your spouse or civil partner dies you could get Bereavement Support Payment from the Government. To be eligible you must be under state pension age, and it's based on the National Insurance contributions your partner made.

There are two rates: the higher of a £3,500 lump sum and £350 monthly payments for 18 months is for those eligible for child benefit. Otherwise you get the lower rate of £2,500 and £100 a month payments for 18 months. You must claim within three months of the death to get the full amount. More details can be found here.

back garden or any private land (subject to some conditions), you don't need to pay for a plot and a formal service. You can also cut out the cost of transporting the body, and do it in your own car or a taxi.

Other things that are easy and quick to arrange yourself are posting death notices in newspapers, and ordering a coffin or casket. While this route isn't for everyone, some people do a DIY funeral not to save costs but also to make the funeral more personal. You can also choose a 50:50 approach, where you take on some tasks to cut costs and the funeral director does others.

Another option is the low-cost 'direct cremation' approach, which typically costs around £1,000 and includes transporting the body, a private committal and return of the ashes in an urn. The family can then scatter the ashes at a significant place for them.

### GOVERNMENT CRACKDOWN

The rising cost of funerals has not escaped the eye of the Government, with the Competition and Markets Authority (CMA) launching an investigation into the space, which has often been referred to as a 'Wild West' market.

Funeral directors have been criticised for being opaque on their fees, making it hard for customers to compare between providers, while others have said they exploit people at an emotional and vulnerable time.

Last month the CMA launched a full market investigation into the space, aiming to look at the reluctance of firms to publish clear prices, the difficulty for new crematoria firms to enter the market and the high year-on-year price rises across the funerals space.

Andrea Coscelli, chief executive of the CMA, says: 'People mourning the loss of a loved one are extremely vulnerable and at risk of being exploited. We need to make sure that they are protected at such an emotional time, and we're very concerned about the substantial increases in funeral prices over the past decade.'

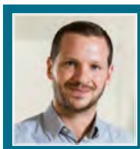
Earlier this month the Financial Conduct Authority announced it would regulate the pre-paid funeral plans market, after finding that customers were losing out. Research last year found customers were subject to high-pressure selling and misleading sales tactics. It is now consulting on what the final rules will be.

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

# 'How can the self-employed boost their retirement savings?'

AJ Bell pensions expert Tom Selby has the answers

*I read a lot about the savings options for people in work (auto-enrolment, etc) but little about the alternatives for self-employed people like me. Given I miss out on matched employer contributions is there anything I can do to boost my retirement savings?*
***Martin***



**Tom Selby**
AJ Bell
Senior Analyst says:

While self-employed workers miss out on auto-enrolment, there are various options available to boost your retirement.

Let's start with the obvious ones. Pensions like SIPPs are an attractive retirement savings vehicle for most people, including the self-employed.

If you pay £80 into a SIPP it will be topped up to £100 automatically through tax relief, while you can also claim a further £20 through your tax return if you're a higher-rate taxpayer and £25 if you're an additional-rate taxpayer.

Most people can pay in £40,000 a year (note you can't contribute more than your income in any given tax year), although this may be lower if you are a very high-earner or have already accessed your pension flexibly.

If you invest your money you'll have the opportunity to benefit from compound growth over time too – particularly if you reinvest those dividends.

You also benefit from tax-free investment growth and total flexibility over how you take money out from age 55, with a quarter available tax-free and the rest taxed in the same way as income. On death SIPPs benefit from generous tax treatment too and can be passed on tax-free if you die before age 75 (and at your beneficiaries' marginal rate if you die after 75).

Lifetime ISAs are an interesting, more flexible retirement savings alternative which may appeal to you. If you're aged 18 to 39 you can save up to £4,000 a year in a Lifetime ISA and the Government will automatically add a 25% bonus (the same as pension tax relief if you're a basic-rate taxpayer), up to a maximum of £1,000 annually.

You can take your money out at any age to buy your first home worth £450,000 or less, or if you become terminally ill. Otherwise any withdrawals before you turn 60 will incur a 25% Government exit penalty, meaning you might get back less than you put in.

If you own your own business you might also want to consider paying your salary directly into your pension. This would no longer count as profit and so could reduce your corporation tax bill as well as being free of income tax.

However, HMRC may question if your total salary and benefit package is excessive, so it's worth speaking to a financial adviser or accountant before going down this route. Note this option isn't available if you're a sole trader, although you can still make personal pension contributions.

## 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.

# What rate cuts could mean for your portfolio

## Examining why central banks are (still) looking to monetary stimulus

With virtually every other central bank in the world taking a softer line in 2019 it is no great surprise to see our very own Bank of England doing the same.

A 20 June Monetary Policy Committee vote of nine to zero to leave policy unchanged is perfectly in keeping with the concerns that the Bank of England continues to express about the economic implications of Brexit but also wider concerns over global growth and inflation (and why we are not seeing enough of either).

Australia, New Zealand, Chile, India and Russia have all cut interest rates this year, the European Central Bank is considering further monetary stimulus and the US Federal Reserve is laying the groundwork for its first interest rate cut since December 2008.

The chances of the Bank of England looking to join Norway and the Czech Republic among those who have increased interest rates in 2019 look pretty slim, especially as any unexpected tightening of policy could give sterling a boost and perhaps hamper exports at what remains a delicate time for the UK economy.

Investors must now address two issues. First, why are central banks readying themselves to play fast and loose with monetary policy once more? Second, what are the implications for portfolios?

### MONEY MAKES THE WORLD GO ROUND

What appears to concern central banks more than anything else is their inability to stoke inflation (unlike the 1970s, when they made very heavy weather of slowing it down).

This is reflected in US five-year forward inflation expectations. The market thinks that inflation in America will be 1.8% in five years' time, below the Fed's 2% target, below the post-1948 average of 3.5% and barely above the 1.6% average of the past, post-crisis decade. Since inflation is in many ways about perception, this is a big thumbs down to 10 years of unorthodox monetary policy in the form

**MOST RECENT MOVES IN MAJOR CENTRAL BANK INTEREST RATES**

**2019**

| Last move up | | Last move down | |
|---|---|---|---|
| Czech Republic | 1.75% | Russia | 7.75% |
| Norway | 0.75% | India | 6.00% |
| | | Chile | 2.50% |
| | | New Zealand | 1.75% |
| | | Australia | 1.50% |

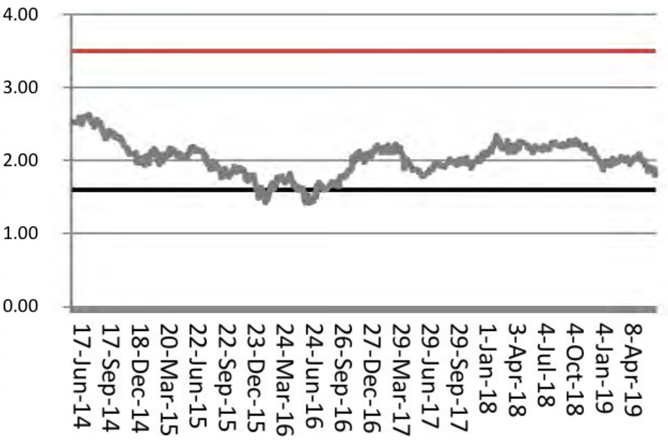
**2018**

| Last move up | | Last move down | |
|---|---|---|---|
| Turkey | 24.00% | Brazil | 6.5% |
| Mexico | 8.00% | China | 4.35% |
| South Africa | 6.75% | | |
| America | 2.50% | | |
| South Korea | 1.50% | | |
| Canada | 1.50% | | |
| UK | 0.75% | | |
| Israel | 0.10% | | |
| Sweden | (0.50%) | | |

Source: Refinitiv

of zero (or negative) interest rate policies (ZIRP and NIRP) and quantitative easing (QE).

**INFLATION EXPECTATIONS CONTINUE TO SLIDE LOWER IN THE US**




Source: FRED – St. Louis Federal Reserve database

But central banks are also worrying about growth in a world when America and China are at daggers drawn over trade and tariffs are becoming the order of the day. Bond markets are responding to this by anticipating rate cuts and reflecting the failure to generate inflation.

As the table shows, 10-year benchmark government bond yields are lower than they were a decade ago, as we emerged from the financial crisis, and lower than when the Greek crisis was at its height in 2012. Again, this can be seen as a big raspberry to central banks and their growth and inflation policies.

**GOVERNMENT BOND YIELDS ARE LOWER NOW THAN THEY WERE A DECADE AGO**

| | Jun-09 | Mar-12 | Jun-19 |
|---|---|---|---|
| US | 3.90% | 2.01% | 2.01% |
| UK | 3.81% | 2.07% | 0.86% |
| Germany | 3.44% | 1.80% | (0.29%) |
| France | 3.85% | 2.80% | 0.05% |
| Italy | 4.47% | 4.82% | 2.11% |
| Australia | 5.86% | 4.07% | 1.35% |
| Spain | 4.27% | 5.02% | 0.42% |
| Portugal | 4.44% | 13.69% | 0.56% |
| Greece | 5.24% | 48.60% | 3.17% |
| Japan | 1.43% | 0.97% | (0.14%) |

Source: Refinitiv

## POLICY PICKLE

The issue that investors must ponder now is whether central banks can succeed by trying more of the same monetary medicine that has singularly failed to galvanise their patient economies (at least on a sustained basis) since 2009. The experiences of this century would perhaps suggest not, according to the bond market at least since yields on 10-year government paper have consistently trended lower since 2000 (if not the mid-1980s).

Not that this seems likely to stop them from trying and this is the hard bit for investors when it comes to portfolio construction and asset allocation.

Is the (renewed) slide in bond yields down to fears of deflation, or at least the abandonment of hope that central banks can stoke growth and inflation?

Or is it that bond market participants are just anticipating more NIRP, ZIRP and QE and doing their buying before the central banks do theirs?

In either of these two cases it is possible to argue that US 10-year Treasuries still look good value, even with a yield of around 2%. Markets are putting an 84% chance on the Fed's target interest rate coming in below 2% by April 2020.

But what happens if inflation does come back and central banks simply refuse to give in, cutting rates to zero (or beyond) and unleashing more QE? Government bonds would then be a horrible place to be, given where yields are right now.

By **Russ Mould**
AJ Bell Investment Director

# Wide dispersion of discounts and premiums among private equity trusts

We explain why the sector is behaving in an unusual way

There is an unusually wide spread between the premiums and discounts in the private equity-focused investment trust space. We would normally expect such products to trade below the value of their underlying assets yet the sector currently has some trading on discounts as wide as 40% and premiums of more than 26% to net asset value (NAV).

Investment bank Stifel argues there should be a natural discount rate of 10% to reflect illiquid portfolios and long holding periods of typically five years. Of the eight private equity investment trusts trading at a discount, all of them are trading in excess of this 10% figure. Bucking the trend are **HgCapital Trust (HGT)** which trades on a 1.8% premium to NAV and **3i (III)** which commands a remarkable 26.6% premium.

### WHY ARE MOST TRADING ON WIDE DISCOUNTS?

The recent suspension of **Woodford Equity Income Fund (BLRZQ73)** highlights the perils of a liquidity mismatch, which is why investment trusts are a more appropriate vehicle for illiquid investments as they are closed-ended funds.

Even so the knock-on impact on investment trust **Woodford Patent Capital Trust (WCPT)**, where the discount has blown out to 30%, emphasises how investor sentiment can impact the levels of discount.

In addition to the illiquidity issue is the fact that the assets in a private equity trust do not have a daily price like publicly quoted stocks. Outside of any business sales (realisations) that occur, management will provide an estimate, sometimes every quarter, or maybe once a year.

Investors are sometimes sceptical of reported net asset values. In recent years it appears that most assets in the sector have been valued conservatively.


**PRIVATE EQUITY INVESTMENT TRUSTS**

| Fund | Premium/ Discount to NAV% |
|---|---|
| 3i | 26.6 |
| HgCapital Trust | 1.8 |
| BMO Private Equity | -11.0 |
| HarbourVest Global PrivEq | -13.6 |
| Princess Private Equity | -15.6 |
| Standard Life Private Equity | -17.3 |
| ICG Enterprise | -17.7 |
| Pantheon International | -20.1 |
| NB Private Equity | -24.6 |
| JZ Capital Partners | -40.5 |

Source: Winterflood, Data as of 19 June 2019

### PERFORMANCE MATTERS

Performance and length of tenure of the managers seem to be the most important factors in explaining the dispersion of returns. Delivering better performance is not a guarantee, but it is a very effective way to shrink any discount or even push the shares to a premium.

We conducted a simple correlation calculation, looking at those trusts with five-year performance data, excluding those products which invest in other funds and discovered a 93% correlation. That is to say, long term performance in the growth rate of the net asset value explains almost all of the differences in the levels of price discount.

It should be noted that there are only a handful of trusts in the sample, so it may not be statistically significant. Even if we remove 3i from the sample, due to the fact that it is eight times larger than the next largest trust, the correlation is still 73%.

Interestingly, in the funds-of-funds segment, we didn't find any correlation between long-term performance of the NAV and the level of price discount/premium.

This seems to be due to the apparent anomaly of **HarbourVest Global Private Equity (HVPE)**, which has produced by far the best returns but trades in line with the sector average discount. Therefore, it might be worthy of further investigation.

## OTHER FACTORS IMPACTING DISCOUNTS

The size of a trust and whether it has a long history of reporting net asset values conservatively, i.e. subsequent maturing assets in the fund are realised at valuations above the carrying book values, increases confidence in the sustainability of a trust, potentially reducing the discount.

This could further explain why 3i trades at a large premium to its peers. 3i also has the benefit of a well-recognised brand and invests around 20% of its assets in infrastructure projects, differentiating itself from peers.

Corporate governance is an area which on closer scrutiny might lead to wider discounts, especially where the voting structure is not transparent or where the manager enters into a number of related transactions with the trust.

## IMAGE PROBLEM

Despite all the reasons that might help explain why most investment trusts trade at a discount, ironically, performance shouldn't be one of them. The sector five-year average NAV return, excluding 3i, has been 82.6% which compares favourably with the FTSE All-Share index return of 30%.

HarbourVest Global Private Equity owns stock in Staples

It does seem that the managers of private equity trusts have an image problem which reflects a lack of investor confidence in the sustainability of future returns.

We spoke to various analysts and managers and they all pointed to the fact that the sector is still suffering from the long shadow of the financial crisis of 2008. They insist that 'lessons have been learned' and the sector is a far different beast today. It appears that the bad old image of private equity being a highly leveraged, high beta play on public markets, isn't so accurate anymore.

The underlying assets in trusts today are more mature, which means they are cash generative with a number of trusts paying a dividend. Other differences with the past include the unfunded commitments and leverage employed being lower, even on a look-through basis. That's taking into account the amount of debt employed by the investee companies as well as at the fund level.

The average gain on book value has been in a 25% to 40% range over the last five years, according to HarbourVest. In simple terms that means the exit valuations of companies in the portfolio have been in excess of the 'carrying value' of the investments on the books.

## RISING CONCERNS

On the other side of the debate are those who are worried about the amount of unutilised cash slopping around, estimated to be $1.2trn globally, which increases competition for deals. There is a risk that managers overpay for assets in the future, thus lowering returns.

In a bizarre way, a heightened appetite to deploy cash also means that today there are more ready buyers of assets, making exits appear 'easier' and more frequent. It could explain the high average realisations that have been reported over the last few years.

By **Martin Gamble**
Senior Reporter

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# Micro-cap funds caught up in Brexit and Woodford liquidity fallout

Most funds in this space have lost investors money over the past 12 months

Many micro-cap funds are struggling as investors shun the very bottom part of the UK stock market. Weaker sentiment towards illiquid stocks in the wake of the Woodford fund suspension also doesn't help matters.

The fund managers targeting this space remain confident there is value to be generated from buying select smaller companies. They look for valuation anomalies where stocks trade at a discount to intrinsic worth. A successful micro-cap investment can produce significant returns – but success doesn't always come overnight.

Many micro-cap funds invest in stocks which are cheap because they've experienced financial or operational problems and where the fund manager sees a potential solution. Patience is therefore needed if you are going to invest in this space.

**MICRO-CAP FUNDS HAVE GENERALLY STRUGGLED IN THE PAST YEAR**

| FUND | 1 year performance |
|---|---|
| Miton UK Microcap (MINI) | -24.0% |
| Downing Strategic Micro-Cap (DSM) | -23.6% |
| River & Mercantile UK Micro Cap (RMMC) | -14.7% |
| Octopus UK Micro Cap Growth (BYQ7HN4) | -4.9% |
| Marlborough UK Micro Cap Growth (B8F8YX5) | -4.0% |
| Gresham House UK Micro Cap (BV9FYS8) | -1.7% |
| Gresham House Strategic (GHS) | 22.1% |
| **INDEX** | |
| FTSE ALL SHARE | 10.2% |
| FTSE 100 | 10.2% |

Source: SharePad, Morningstar, data as of 24 June 2019

## WHY ARE MICRO-CAPS OUT OF FAVOUR?

Micro-caps can suffer from very little trading on the market and so liquidity can be a major problem.

A lack of analyst coverage on very small companies means a lot of stocks are drifting downwards as mainstream investors are simply unaware of a lot of the names. This is the opposite situation to large cap stocks where the benchmark FTSE 100 index has risen by 10% in value this year.

Miton's Nick Greenwood and Charlotte Cuthbertson, who run **Miton Global Opportunities (MIGO)**, say another key reason why micro-caps are out of favour is structural.

Consolidating fund management groups have become so big (managing bigger pots of money) that companies worth less than £150m no longer 'move the needle' for portfolios, leaving micro caps out in the cold in terms of valuations.

And because the big fund management groups won't buy them, their valuations keep falling, which means larger competitors can swoop in and buy them on the cheap.

## THE BREXIT FACTOR

Gervais Williams, who manages **Miton UK Microcap Trust (MINI)** and **LF Miton UK Smaller Companies (B8JWZP2)** alongside Martin Turner, says many investors are shunning UK stocks because of Brexit fears.

'This trend has been even more adverse within UK micro caps,' he adds. 'As Brexit has become ever closer in 2019, investors have been particularly reluctant to increase their UK micro-

The Woodford debacle has reignited the debate about illiquid stocks being better suited to a closed-end fund structure

cap holdings.

'Once the shape of Brexit is known, we believe there will be renewed capital allocation given the UK valuation differential. If this is accompanied by an appreciation of sterling, then companies with significant domestic exposure will be better placed. For both of these reasons we believe that UK micro caps are well placed going forward.'

## WOODFORD GATING FALLOUT

The suspension of **LF Woodford Equity Income Fund (BLRZQ73)** – in order to give fund manager Neil Woodford time to sell his illiquid holdings – has put the spotlight on liquidity.

It has reminded investors that they cannot always sell their investments exactly when they want to. It has also served to remind investors that investment funds come with liquidity risks. That's served to widen the discount to net asset value on several investment trusts targeting the micro-cap space.

Williams says: 'Unfortunately, there is some terminology ambiguity here in the stock market which is really unhelpful. Specifically, the term "illiquid" can extend from private, unlisted heavily loss-making stocks where their valuation is somewhat subjective, to small, publicly listed companies that are profitable, cash-generative with a valuation that is determined by shareholder transactions.

'The danger is that anxieties about private loss-making companies may end up adversely influencing investor behaviour regarding micro-cap and small cap listed companies, which subsequently impedes their ability to raise capital and drive up future UK productivity, employment growth and tax take.'

## OPEN-ENDED FUNDS

The Woodford debacle has reignited the debate about illiquid stocks being better suited to a closed-end fund structure, so the fund manager isn't forced to conduct a fire-sale of assets when investors want to take their money out.

However, Williams takes the view that a well-managed portfolio of small and micro-cap companies can operate well within an open-ended fund structure.

Judith MacKenzie, manager of investment trust **Downing Strategic Micro-Cap (DSM)**, says the Woodford scenario points to a more pertinent point. 'I think the size of some funds has become a detractor from ability to actively fund manage, particularly smaller cap positions,' she says.

MacKenzie prefers to run concentrated portfolios and have a limit on how much money is being managed. She targets 25 to 30 positions in a portfolio with circa £30m to £50m funds under management. 'I'd get very nervous managing liquidity in a fund bigger than that investing in this space.'

## BUCKING THE NEGATIVE TREND

One of the better performers in the micro-cap funds space recently is **Gresham House Strategic (GHS:AIM)**, run by Graham Bird who applies private equity style techniques to construct a high conviction, concentrated portfolio with value characteristics.

It is currently trading on a 14.3% discount to net asset value despite having delivered 22.1% share price gains over the past year.

Gresham House Strategic is also one of a number of micro-cap trusts that sit in the portfolio of Miton Global Opportunities, an investment trust which invests in other funds.

Relevant trusts in the Miton portfolio including Downing Strategic Micro-Cap, **River & Mercantile UK Micro Cap (RMMC)** and **Henderson Opportunities Trust (HOT)**, the latter not specifically badged as a micro-cap fund but still offering exposure to the theme.

The managers of Miton Global Opportunities have been taking advantage of double-digit discounts to NAV on the grounds that the out-of-favour micro-cap asset class is set for a re-rating.

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

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# INDEX

**KEY**

- **Main Market**
- **AIM**
- **Investment Trust**
- **Fund**
- **Exchange-Traded Fund**













# KEY ANNOUNCEMENTS OVER THE NEXT WEEK

## Full year results

**2 July:** Cohort, Imimobile. **3 July:** Purplebricks, Theworks.co.uk. **4 July:** Superdry.

## Half year results

**2 July:** St Modwen.

## Trading statements

**3 July:** Sainsbury's, Topps Tiles.
**4 July:** Associated British Foods, Persimmon.


**WHO WE ARE**

**EDITOR:** Daniel Coatsworth @Dan_Coatsworth

**DEPUTY EDITOR:** Tom Sieber @SharesMagTom

**NEWS EDITOR:** Steven Frazer @SharesMagSteve

**FUNDS AND INVESTMENT TRUSTS EDITOR:** James Crux @SharesMagJames

**SENIOR REPORTERS:** Martin Gamble; Ian Conway @SharesMagIan

**REPORTER:** Yoosof Farah @YoosofShares

**CONTRIBUTORS** Russ Mould, Tom Selby, Laura Suter

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

**CONTACT US:**
support@sharesmagazine.co.uk

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Designer: Matt Ely

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THIS WEEK: 15 PAGES OF BONUS CONTENT

MKANGO RESOURCES
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POWER METAL RESOURCES

# SHARES SPOTLIGHT

*Mining, oil and gas*

INCLUDES COMPANY PROFILES, COMMENT AND ANALYSIS

JUNE 2019
ISSN 2632-5748

# Introduction

Welcome to *Spotlight*, a bonus magazine which is distributed eight times a year alongside your digital copy of *Shares*.

It provides small caps with a platform to tell their stories in their own words and this edition is dedicated to the natural resources space. The company profiles are written by the businesses themselves rather than by *Shares* journalists.

They pay a fee to get their message across to both existing shareholders and prospective investors.

These profiles are paid-for promotions and are not independent comment. As such, they cannot be considered unbiased. Equally, you are getting the inside track from the people who should best know the company and its strategy. Some of the firms profiled in *Spotlight* will appear at our investor evenings in London and other cities where you get to hear from management first hand.

Click here for details of upcoming events and how to register for free tickets.

Previous issues of Spotlight are available on our website.

# Meeting the oil and gas exploration challenge

On 17 June **Reabold Resources (RBD:AIM)** and **Union Jack Oil (UJO:AIM)** marked a potential milestone for oil and gas exploration in the UK as they claimed the largest ever onshore discovery after drilling on their West Newton site in the North East.

UK oil companies often explore for hydrocarbons in more exotic parts of the world and in this article we will discuss how they meet the challenges associated with this high-risk and high-reward activity

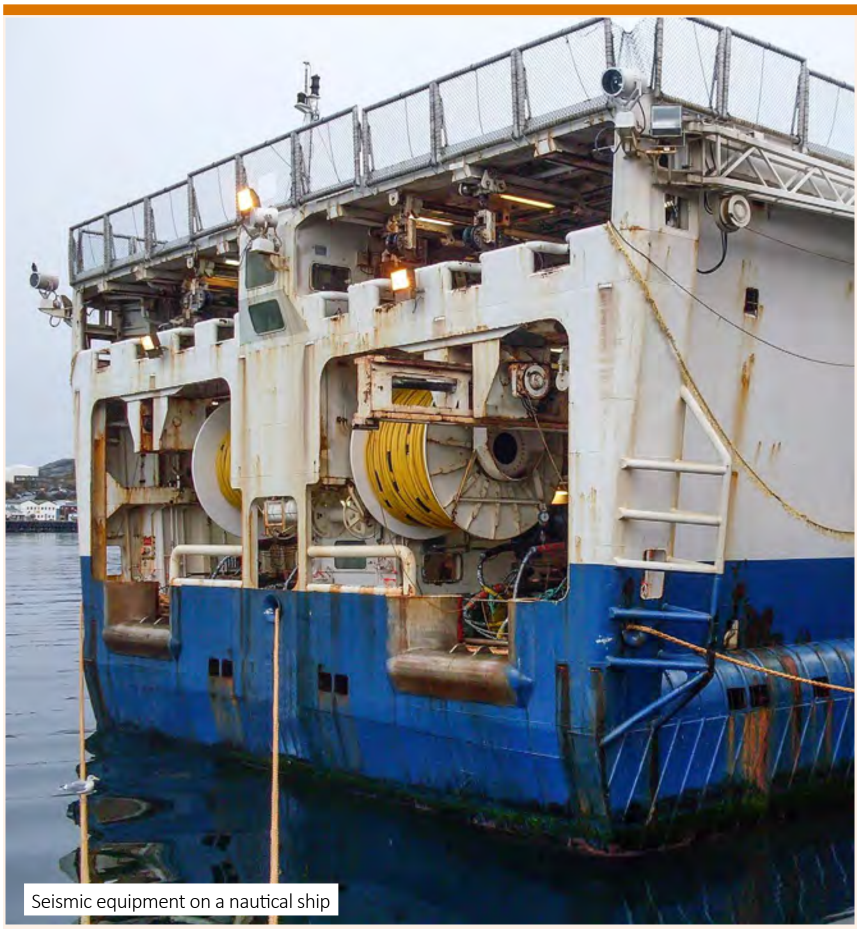
**RISK VERSUS RETURN**

There is little doubt exploring for oil and gas is an inherently risky activity. Distilled to its essence it involves sticking a hole in the ground and hoping to produce hydrocarbons from it. With this risk comes the potential for considerable reward.

While drilling in mature regions, such as the US Gulf of Mexico or North Sea, may be lower risk, companies also reduce their chances of discovering material deposits of oil and gas. The big discoveries, in most cases, having been made years or even decades before.

**FINAL FRONTIER**

This explains the appeal of frontier exploration – drilling in far flung parts of the world



Seismic equipment on a nautical ship

**EXPLORATION & PRODUCTION – THE PROCESS**

- Desk study: identifies area with favourable geological conditions
- Aerial survey: if favourable features revealed, then
- Seismic survey: provides detailed information on geology
- Exploratory drilling: verifies the presence or absence of a hydrocarbon reservoir and quantifies the reserves
- Appraisal: determines if the reservoir is economically feasible to develop
- Development and production: produces oil and gas from the reservoir through formation pressure, artificial lift, and possibly enhanced recovery techniques, until economically feasible reserves are depleted.

ANOTHER WAY FIRMS CAN LIMIT RISK IS TO HAVE PLENTY OF 'SHOTS AT GOAL' BY LINING UP A SERIES OF DRILLING TARGETS


Setting off explosions for a seismic survey

where the potential is untested and there are still massive finds to be made. Arguably it is only by taking on the risks associated with this activity that smaller companies can gain access to material deposits of oil and gas.

What tools do the technical teams which identify these prospects have at their disposal? Most will try and detect and determine the location and extent of deposits using several techniques which could be grouped together under the term exploration geophysics.

The most prominent of these techniques is seismology which involves creating shock waves that pass through hidden rock layers and interpreting the waves that are reflected back to the surface.

These shock waves are typically created over water using compressed air guns or controlled explosives while land surveys are conducted using explosives or thumper trucks to slam heavy plates into the ground.

This technology has developed and many companies now make use of 3D seismic surveys that allow them to build up a detailed picture of the earth's sub-surface in three dimensions. The resulting information is interpreted to help determine where companies should drill.

Typically firms will employ contractors to carry out this work – often subsidiaries of large oil services companies such as Schlumberger.

Seismic data may help companies to identify structures which could contain hydrocarbons but the only true test is to drill.

**DIVERSIFICATION**

Another way firms can limit risk is to have plenty of 'shots at goal' by lining up a series of drilling targets. If a company has just one exploration prospect in its portfolio and fails to make a discovery it essentially renders itself defunct.

Just as companies look to build up an extensive list of prospects, investors can increase their chances of scoring a success with their investments in oil and gas exploration by buying a selection of explorers based in different parts of the globe. That way, if just one makes a significant discovery the portfolio should generate a handsome profit.

**FUNDING AND RIG AVAILABILITY**

The obstacles faced by many smaller exploration companies in building up a diversified programme of exploration include a lack of financing and a shortage of available rigs. Debt is not usually an option unless a company has discovered reserves which banks will lend against and raising cash on acceptable terms in the equity markets is difficult in the current risk-averse environment.

It is worth examining in more detail how an explorer can realise value from a prospect. One option is to farm-out part of its interest ahead of drilling. This can help fund planned activity as well as highlighting previously unrecognised value in a portfolio.

The logical extension of a farm-out agreement is for a company to be bought out entirely – though this is more likely to occur once a company has made a discovery.

# Get to grips with the potash sector


Potash is used in farm fertiliser

'AS WELL AS BEING ONE OF THE MOST IMPORTANT TYPES OF FERTILISER IN THE WORLD, WHEN COMPARED TO THE NET PRESENT VALUE OF THEIR PROJECTS, THE POTASH SECTOR ALSO HAS SOME OF THE MOST UNDERVALUED COMPANIES WITHIN MINING.'
-CHARLES GIBSON, EDISON, DIRECTOR OF MINING

Potassium-heavy potash, used for various chemical processes in the pre-industrial world, gets its name from the practice of soaking plant or wood ash in a pot. Chemically speaking, potash made up of potassium chloride (also known as muriate of potash, MOP), potassium sulphate (sulphate of potash, SOP) and potassium nitrate.

**What is potash used for?**
As the once-expensive material became widely available after industrialisation, its use as a fertiliser soon became common. Today over 90% of potash is used as fertiliser.

Since industrialisation, potash has been mined from potassium-rich evaporite minerals or synthesised chemically.

Evaporite minerals come from salt-heavy bodies of water that have evaporated and formed deposits. Of these minerals, sylvite, carnallite, kainite, polyhalites and langbeinite are mined most often.

**Why do we produce potash?**
Potash contains high concentrations of potassium, which is sought after by the agricultural industry and is essential for all life. In plants potassium regulates the opening of stomata, tiny pores in plant tissue that handle gas exchange, increasing carbon dioxide uptake and growth.

It also triggers enzyme synthesis, including growth enzymes and adenosine triphosphate, a molecule acts as a carrier for photosynthesised energy in plants. And it helps regulate the uptake of water through the xylem, a vascular system for plants, and its release through stomata.

Counterintuitively most agricultural soil contains enough potassium for crops. However, this potassium is typically insoluble, locked into the ground and difficult for plants to absorb via osmosis.

By contrast, the potassium in the two most common types of potash, MOP and SOP, is readily water soluble. MOP and SOP are absorbed by plant roots with ease, so they are effective fertilisers.

**What are SOP and MOP?**

MOP is typically mined from evaporite minerals then ground down to crystallised salts or processed into solid fertiliser. Potash mines extract evaporite through conventional mining, solar evaporation or solution mining.

In solution mining, water is injected into a deposit through a well to dissolve salts. The solution is then retrieved and the potash recovered from the dissolved salts. It can also be produced through solar evaporation similar to lithium brine production.

Although relatively cheap to produce, MOP has one fundamental flaw: its high level of chloride. In low-chloride environments, this is a boon. But many plants, especially high-value crops such as fruits, vegetables, nuts and tea, are chloride sensitive. In these cases SOP is often used, despite being more expensive.

In contrast to MOP, the majority of SOP is chemically synthesised from raw materials rather than mined directly from the earth. This inevitably increases its cost and ensures it is used only when necessary. As a result, SOP holds a small percentage of the market, c10%, to MOP's 85%.


A potash flotation tank

**How is SOP produced?**

SOP is most often produced using the Mannheim process, where a furnace is used to mix potassium chloride and sulphuric acid together.

The other common method of SOP production uses solar evaporation, concentrating sulphate-and potassium-rich salts from lakes into brines. The salts are then processed to create SOP.

SOP can also be created as a by-product of salt production. When salt is concentrated via solar evaporation and retrieved, what remains is rich in sulphate and potassium, which can then be processed into SOP. The Mannheim process accounts for roughly 50% of all SOP production, solar evaporation another 30%.

**Which companies are heavily involved in potash?**

Of the most prolific producers, Nutrien, created from a merger of PotashCorp and Agrium in 2018, is one of the world leaders, along with the Mosaic Company. Both Nutrien and the Mosaic Company are highly involved in the world's largest potash reserve in Saskatchewan, Canada.

Elsewhere, Uralkali maintains five mines and seven milling plants in Russia. Uralkali and Belarusian state-owned miner Belaruskali were once partners, but Uralkali broke the partnership in 2013. However, Uralkali remains a large player.

Based in Germany, K&S is another giant, while Israel Chemical has a significant presence in potash in addition to its bromine business. There are also a number of smaller companies breaking into the potash market. Among them, BCI Minerals is continuing with its Mardie salt and SOP project (solar evaporation potash facility) on the west coast of Western Australia, alongside its fully functioning royalty-type interest in an iron ore mine, Iron Valley.

Kalium Lakes is also active in Western Australia, with its Beyondie Sulphate of Potash exploration, as is Salt Lake Potash with its Goldfields Lake sites. Meanwhile, Sirius Minerals is developing a polyhalite resource in North Yorkshire and Kore Potash is focused on its Kola project in the Republic of Congo.

*This article is based on a report produced by Edison Investment Research other Edison Explains research is available here*

# Mkango Resources
## Uniquely positioned for the rare earths renaissance

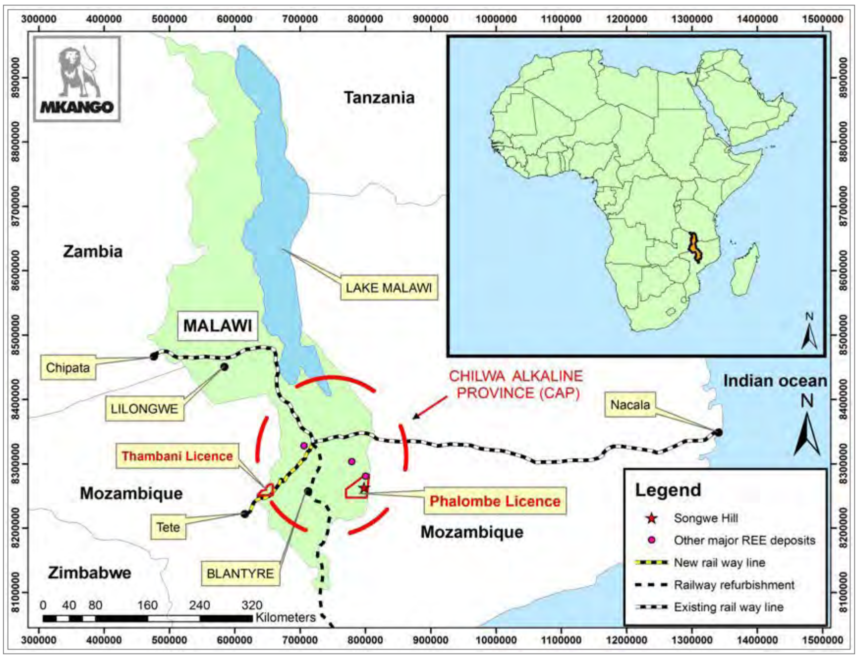
### Website: www.mkango.ca/s/home.asp

Mkango Resources (MKA:AIM / TSXV) is focused on the development of the Songwe Hill Rare Earths project in Malawi, one of the very few advanced stage rare earths projects outside China, and well positioned to become a leading new sustainable source of neodymium and praseodymium (NdPr), critical raw materials to fuel accelerating growth in cleantech markets, such as electric vehicles.

### FULLY FUNDED BANKABLE FEASIBILITY STUDY UNDERWAY

A bankable feasibility study (BFS) for Songwe is underway, targeted for completion in 2020 and fully financed by strategic partner Talaxis Limited, a subsidiary of Noble Group, which has an extensive market network throughout Asia and beyond.

## INTRODUCING MKANGO RESOURCES
### A PROSPECTIVE RARE EARTHS MINER WITH A PROJECT IN MALAWI



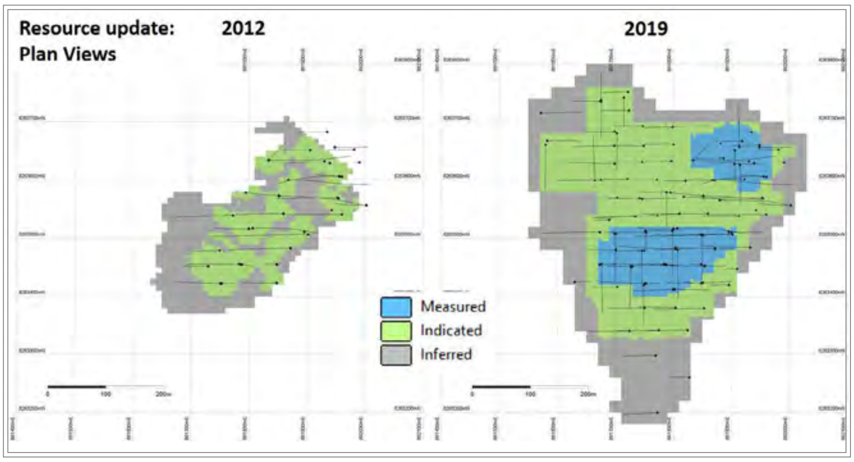

Talaxis has invested £12m in the project to date for a 49% interest. A pre-feasibility study (PFS) for Songwe was completed in 2015, resulting in an NPV of US$345m and an IRR of 37%, with capital expenditure of US$216m including an integrated processing facility in Malawi.

Following completion of the bankable feasibility study, Talaxis has an option to finance project development, which would leave Mkango with a 25% carried interest in the project, funded all the way through to production by Talaxis.

This stepwise financing arrangement significantly de-risks the project from a financing perspective and minimises dilution at the public company level. Mkango had a consolidated cash position of US$11m as at March 31, 2019 with subsequent warrant exercises bringing in an additional £1.2m cash.

### RARE EARTHS RENAISSANCE GATHERING MOMENTUM

Rare earths are used in everything from computer hard disk drives to wind




turbines and electric vehicles, but it is the latter where an industry transforming level of growth is anticipated. This is expected to lead to a doubling of NdPr demand in coming years.

China has dominated production of rare earths in recent years, but now end users both within and outside China recognise that new sources of supply are required to feed the exponential growth in electric vehicle demand and that a more diversified supply base is required to support development of a healthy market.

On the supply side, there are only a handful of advanced stage projects outside China, and the US-China trade war has highlighted the paucity of alternative sources of supply, with China effectively threatening to withhold rare earths supply to the United States. This has refocused market attention on rare earths versus recent market favourites, cobalt and lithium, the latter ultimately having the same demand growth drivers.

## WHAT DIFFERENTIATES MKANGO?

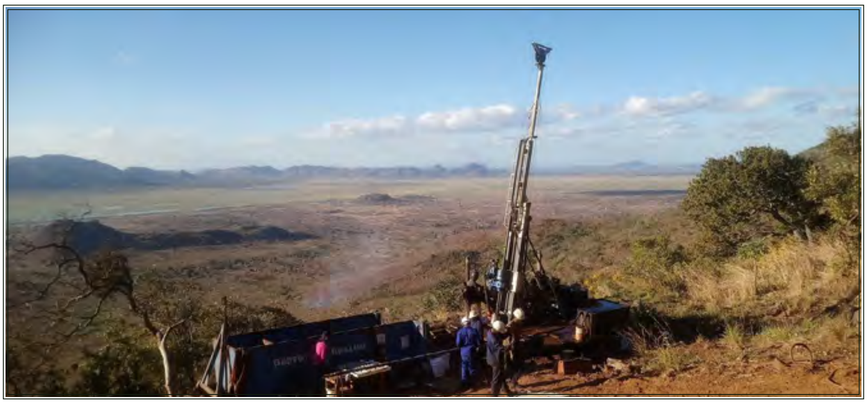
As the only focused rare earth company listed on AIM in London, together with a dual-listing on the Toronto Venture Exchange, Mkango differentiates itself with a well-defined and large scale NI 43-101 compliant Measured and Indicated resource at Songwe. This was increased by 60% to 21m tonnes following a 10,900 metre drilling programme in 2018, with broad zones of open pittable mineralisation, underpinning a long mine life with low cost bulk mining operations.

Coupled with the major rail, road and power developments in Malawi and a strong financing partner, Talaxis, this supports the development of large scale, processing and purification plant in Malawi to produce a purified mixed rare earths product, in contrast to producers of an impure mineral concentrate, the latter attracting a large discount and limiting marketing and downstream processing options.

Mkango's strategy will enable access to markets not only in China, Japan and elsewhere in Asia, but also Europe and North America. As part of the feasibility study, Mkango is also evaluating options to produce separated neodymium and praseodymium, which will further add value and increase marketing flexibility.

'Having financed and advanced the project through the very significant rare earth downtown which followed the 2010 speculative boom, and then into the beginnings of the ongoing rare earths renaissance, we believe this is a more sustainable overall strategy, maximising opportunities to create long term strategic and economic value and to access the capital required to develop a long life, large scale and sustainable low cost operation,' says Will Dawes, Mkango chief executive.

Mkango also differentiates itself with the 2018 establishment of subsidiary, Maginito Limited, which is also financed by Talaxis and focused on downstream opportunities relating to the rare earths supply chain, in particular neodymium alloy powders, magnet and other technologies geared to accelerating growth in the electric vehicle market. Magnito is looking to grow its portfolio of technologies and is evaluating a number of opportunities.



## MALAWI - THE 'WARM HEART OF AFRICA'

Malawi is known as the 'Warm Heart of Africa' – English speaking and a former British Protectorate, it is a rare earths mineral province that was the first country in Africa where carbonatites, the host rock for most major rare earth deposits, were identified.

Songwe, in addition to other rare earth deposits in Malawi, was drilled by the Japanese Government groups, JICA and MMAJ, in the late 1980s. What has changed since are the very significant infrastructure developments, which are key for a value-added development strategy, such as Mkango's.

'Over the last 10 years that we have been working in Malawi, we have seen huge progress, including a new and refurbished railway linking to a deep-water port at Nacala and a much expanded paved road network. Southern Malawi is a rare earths mineral province and this infrastructure will unlock the mineral development potential.'

'A number of our founding shareholders and many of our new investors have actually been to Malawi, both for business and on holiday – anyone who's been to the country comes away with a very positive impression. It's a fantastic place to work with some major investment opportunities, but remains under the radar for many investors,' says Alexander Lemon, Mkango president

## A LEADER IN SUSTAINABILITY AND CORPORATE SOCIAL RESPONSIBILITY IN MALAWI

Mkango leads the way in Malawi in terms of Corporate Social Responsibility (CSR) and is held up as an example of best practice in the Malawi mining sector by both Government and NGOs. CSR is integral to the vision of Mkango and will continue to be a major focus for the company.

CSR programmes have included the running of training programmes, educational and sporting equipment donations, syllabus painting on classrooms, in collaboration with local NGO Bongo Worldwide, an extensive scholarship programme, construction and refurbishment of water boreholes, bridges and roads, wheelchair donation, and construction of two kitchens and four dining rooms at local Primary Schools in partnership with Zero Hunger with Langar, a Birmingham based charity, which is currently providing one meal a day for approximately 2,500 children.

## BOARD AND MANAGEMENT

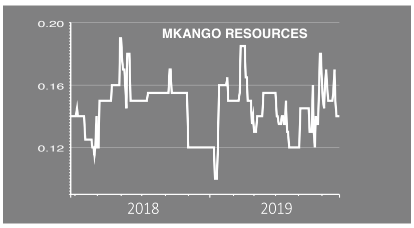
Mkango is led and was co-founded by William Dawes, Chief Executive and Alexander Lemon, president, both graduates of the Royal School of Mines, Imperial College, with longstanding industry experience.

'We have been leading the project since inception and that makes a very big difference in terms of continuity of relationships in Malawi and elsewhere, rare earth industry knowledge and our network. It is a close knit, technically led team, supported by a tier 1 team of rare earths specialists and a highly experienced board,' says Will Dawes, Chief Executive.

In a 2018 Board restructuring, Mkango brought in three new experienced board members: Susan Muir, formerly VP investor communications at Barrick Gold; Sandra du Toit, currently executive vice president with Standard Bank; and Shaun Treacy, a senior advisor with previous positions in JPMorgan, Lehman Brothers, Nomura and UBS.

Other board members include chairman, Derek Linfield, previously Managing Partner at Stikeman Elliott, and Adrian Reynolds, former Randgold executive.

'We have the right project, team and strategic partner to develop a major new sustainable source of rare earths in Malawi, spearheading development of Africa's foremost rare earths mineral province,' says Will Dawes, Chief Executive.



# Para Resources has golden ambitions

## Website: www.pararesourcesinc.com

The original premise of **Para Resources (PBR:TSX)** was to take advantage of what management perceived as 'good timing'.

This resource sector and the gold mining business in general is a cyclical one. At its last peak, capital was easily available and cheap and the sector was in favor. The majors over-spent on acquisitions and developments of risky projects. When the cycle turned down in 2011-12 mining equities were punished as balance sheets were over-leveraged.

As a result, financings dried up and equity and asset values fell. Over the last 8 years, the majors have sold non-core assets, curtailed exploration spending and sources of capital for junior mining companies has dried up. To exacerbate this trend, the TSXV, the usual source of venture capital for the Junior Mining sector, has focused on cannabis stocks, to the detriment of resources.

### A BUYING OPPORTUNITY

Para Resources believes that this nexus created an excellent buying opportunity. Believing in the cyclicality of the resource and gold sectors, management

developed a strategy to acquire and develop gold assets at, or near, the bottom of the current cycle. The criteria for the acquisition of assets was based on several key elements:

- Acquire mining assets which were fully permitted
- Acquired assets to be in production or near-term production

## INTRODUCING PARA RESOURCES

### A JUNIOR GOLD MINING AND EXPLORATION COMPANY

- Investment in acquisition and re-habilitation to be less than $20m
- AISC to be low enough that the operations were profitable at $1,050 gold
- Return on invested capital is not dependent on exploration success
- Exploration potential in adjoining properties to be funded from cash flow

The company has acquired two projects with highly prospective exploration potential where there are existing mining and milling operations that can generate cash flow to support the exploration cost. The purchase of the existing and fully permitted mines and facilities dramatically reduces risk as the cash generated by these operations ensures a return on capital even if the exploration programs, which are inherently risky, are not successful.

Both of the Para projects have exploration programs planned, targeting multi-million-ounce deposits.

## SEEKING OTHER OPPORTUNITIES

Management and ownership continue to like the market dynamics and are seeking other opportunities that meet the criteria as they see Para as a platform company to continue to accumulate world class assets at dramatically below replacement cost. The reduction in risk is one of the paramount drivers of the strategy as evidenced by the investment of over $30m in Para by the two largest shareholders.

The typical indicators that the cycle has reached its bottom is industry consolidation and an increase in M&A activity. This is occurring now as the majors (Barrick and Rand Gold, Newmont and Gold Corp) have begun to realize that the lack of focus on exploration has resulted in a steady decline of gold reserves.

This is not a sustainable long-term trend. Para believes that asset and equity values will begin to rise in the near term as it is presently cheaper to increase reserves through M&A than through exploration.

Para's management team is seasoned and proven, having discovered, built, managed and sold several different mines over the last 40 years.

**Gold Mining Stocks Are Incredibly Undervalued Relative to Broader Equities**


***Note:** Data from May 2009 to April 2018. One cannot invest in an index
Past performance does not guarantee future results. **Source**: Bloomberg, U.S. Global Investors

## THE GOLD ROAD MINE, ARIZONA, USA

In August 2017, Para, through its 94% owned subsidiary Gold Road Mining Corp., acquired the Gold Road Mine, including patented claims and a mill and processing facility, located in the historic Oatman Mining District in Northwestern Arizona.

The Oatman District is the largest primary gold producing district in Arizona with a historical gold production including Gold Road of more than 2.1m ounces from two sub-parallel vein systems all of which is owned or optioned by the company. The distance between these veins and the Gold Road Mill is less than one kilometre on a paved road. The historic mines on these veins stopped production while still mining high grade ore.

In February 2018, Para published a NI 43-101 Technical Report on the Gold Road Mine and in April 2018, a NI 43-101 Technical Report on the Oatman Gold Mining District for the Tr-Ue vein. Both reports recommend multi-year exploration plans that together target an additional 1.6 to 2.15m ounces to be quantified over a two to three-year exploration program.

All mineralization in the district is in epithermal quartz, calcite, adularia veins containing cyanide leachable gold, and silver. The absence of environmentally sensitive constituents (RECRA metals) and acid-generating minerals significantly reduces permitting and reclamation issues.

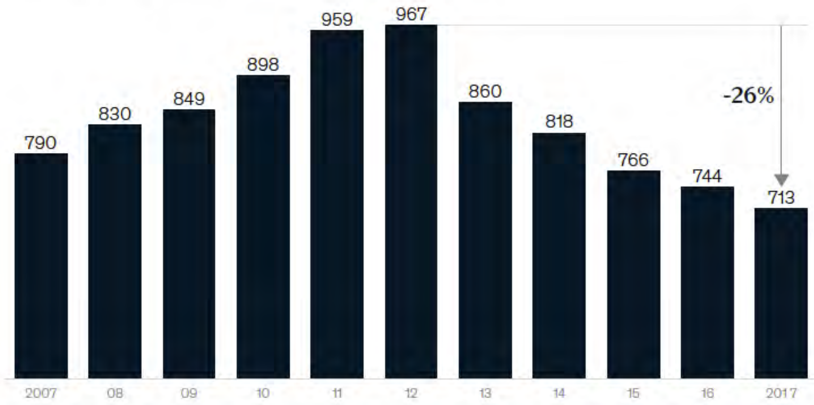
The Gold Road mill is a modern 500 tonnes per day (tpd) cyanide leach facility designed specifically to treat the Oatman-type mineralized material. Historical recoveries have been in excess of 95%.

The facility is fully permitting allowing Para to increase production from 500 tpd mill to 1,000 tpd. The mine is currently fully permitted to restart, including a recently updated tailings disposal site that has the capacity for 1,750,000 tonnes (10 years at 500 tpd). The tailings are dry stacked.

In May of 2018, Para published a NI 43-101 Preliminary Economic Assessment on the Gold Road Mine by RPA Global, to demonstrate robust financial results for the case of restarting the mine.

**Reserves by major gold companies has declined 26% since 2012 and are now below 2007 levels**

Reserves by major gold companies[1], 2007-17, million ounces Au




1 Agnico Eagle, AngloGold Ashanti, Barrick, China National, Freeport-McMoRan, Gold Fields, Goldcorp, Harmony, Kinross, Navoi Mining and Metallurgy Combinant, Newcrest, Newmont, Nord Gold, PJSC Polyus, Polymetal International, RandGold Resources, Shandong Gold, Sibanye-Stillwater, Yamana Gold, Zijin Mining

Source: S&P Global Market Intelligence

Some of the key highlights include: a $81.3 NPV at a 5% discount with $1,200 per ounce gold price, initial capital of $5.7m, and a seven-year mine life with 1.1m tonnes of material recovering 214,000 ounces of gold with an average diluted grade of 6.5 grammes per ton.

The NI 43-101 Technical Report authors believe the resource at Gold Road can be increased by over 700,000 ounces through an underground drilling program.

The mill has been re-commissioned and fully tested including doré production. A contract miner has been mobilized to site, rehabilitation work complete, and development and construction work is underway. Commercial production at 500 tpd is expected in Q4 2019.

In parallel prospect drilling is currently underway on the Tr-Ue vein system. This drilling is to confirm historical data and establish the basis of exploration drilling and resource delineation on the Tr-Ue vein, with anticipated start in Q3 2019.

## EL LIMON MINE

Para bought the El Limon Mine in 2016 and has invested $12m to upgrade and rehabilitate the mill and underground operations. In addition, Para acquired 22,000 Ha of mineral rights surrounding the Mill site. The exploration prospective on these properties is evidenced by the presence of hundreds of small artisanal miners who are working the surface or the near surface of the vein system.

This is the same vein system that is being mined at El Limon. There are a series of parallel veins that run for 12 km across the company's property. The El Limon mine is successfully mining that vein system at a depth of 450 metre and the system is open at depth. The average diluted head grade from the underground operation is seven to 10 grammes per tonne.

The feed for the El Limon mill will come from the El Limon underground mine and from other small mines on the property that are run by Para.

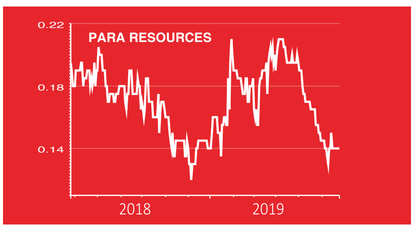
The Colombian government, in an effort to end the use of mercury and to bring these small miners into the formal economy, has a programme that allows the mineral rights holder (Para) to formalize these previously illegal operations, thus creating alternative sources for the El Limon mill. This system prevents the gold that is on the company's mineral concessions from being sold outside of the company's control.

Para upgraded the mill's capacity to 225 tpd by adding a second ball mill and installing new floatation and cyanide circuits. In June 2018, both mills re-started operations to confirm throughput, recoveries and metallurgical balance and mining was restarted with four separate areas, and an upgrade of the main hoist.

In July 2018, the mill received the first shipments of material from formalized miners on Para's properties. A steady ramp-up of production continues at the mine. The 2019 production target is 6,000 ounces and 10,000 ounces in 2020.

To achieve the ramp up, three new mine mouths are under development, one at the El Limon mine and the other two with formalized miners with the financial and technical assistance of the company. These three mines are expected to supply 70% of the mill feed tonnes and ounces next year.

Para will continue to take advantage of current market conditions to acquire and develop additional highly economic, near-term production assets that have strong exploration and development upside.



# Power Metal Resources going big in Africa

## Website: www.powermetalresources.com

**Power Metal Resources (POW:AIM)** is the new name for African Battery Metals.

After restructuring and refinancing the business in February 2019, the company has undertaken a full operational review of the existing project portfolio in Cameroon, the Democratic Republic of the Congo (DRC) and the Ivory Coast (ongoing) and has simultaneously acquired strategic interests in potential large-scale mineral opportunities in Botswana and Tanzania.

### KEY PROJECT IN BOTSWANA

In May 2019, POW acquired an interest in the Molopo Farms Complex (MFC) - 100% owned by Kalahari Key Mineral Exploration (KKME). With earn in agreements, POW have an option to increase this to a 50.96% effective economic interest.

Covering an area of 2,725 square kilometres in southern Botswana, the MFC project offers POW an advanced stage opportunity to explore large targets in elephant country for Ni-Cu-PGM deposits in one of the best mining jurisdictions in the world. 17 potential targets for mineralisation have been identified by a recent airborne survey.

### DEVELOPMENT IN DRC

POW's main focus in the DRC is the 52.6 square kilometre license containing the 70% owned Kisinka Copper Project. A systematic termite mound sampling programme was recently undertaken across the Kisinka license area.

Analysis of the sampling data has identified a 7 km long anomalous zone of copper mineralisation which is spatially related to the undifferentiated Roan horizons within the license area. Roan horizons of central Africa are host to the world's largest and highest-grade sedimentary rock-hosted copper-cobalt deposits in the Copperbelts of Zambia and the DRC.

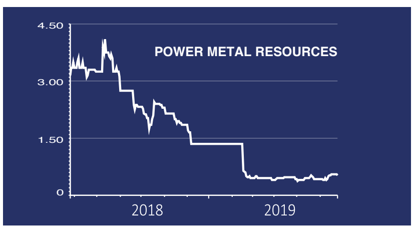
### TARGETING NICKEL IN TANZANIA

In May 2019, POW acquired a 25% interest in the Haneti Nickel Project – (75% owned by **Katoro Gold (KAT:AIM)**. POW have a 12-month option to increase their interest by a further 10% to 35%.

The Haneti Project comprises tenements covering an area of circa 5,000 square kilometres. Historical exploration identified Nickel Sulphide and PGM drill targets with the key target an 80 kilometre long ultramafic belt with grades of up to 13% Nickel and 2.33 grams per tonne of Palladium and Gold.

Recent geophysical interpretation work has identified significant extensions to Nickel Sulphide target areas with further identified potential for lithium pegmatite and associated elements of niobium and tantalum.

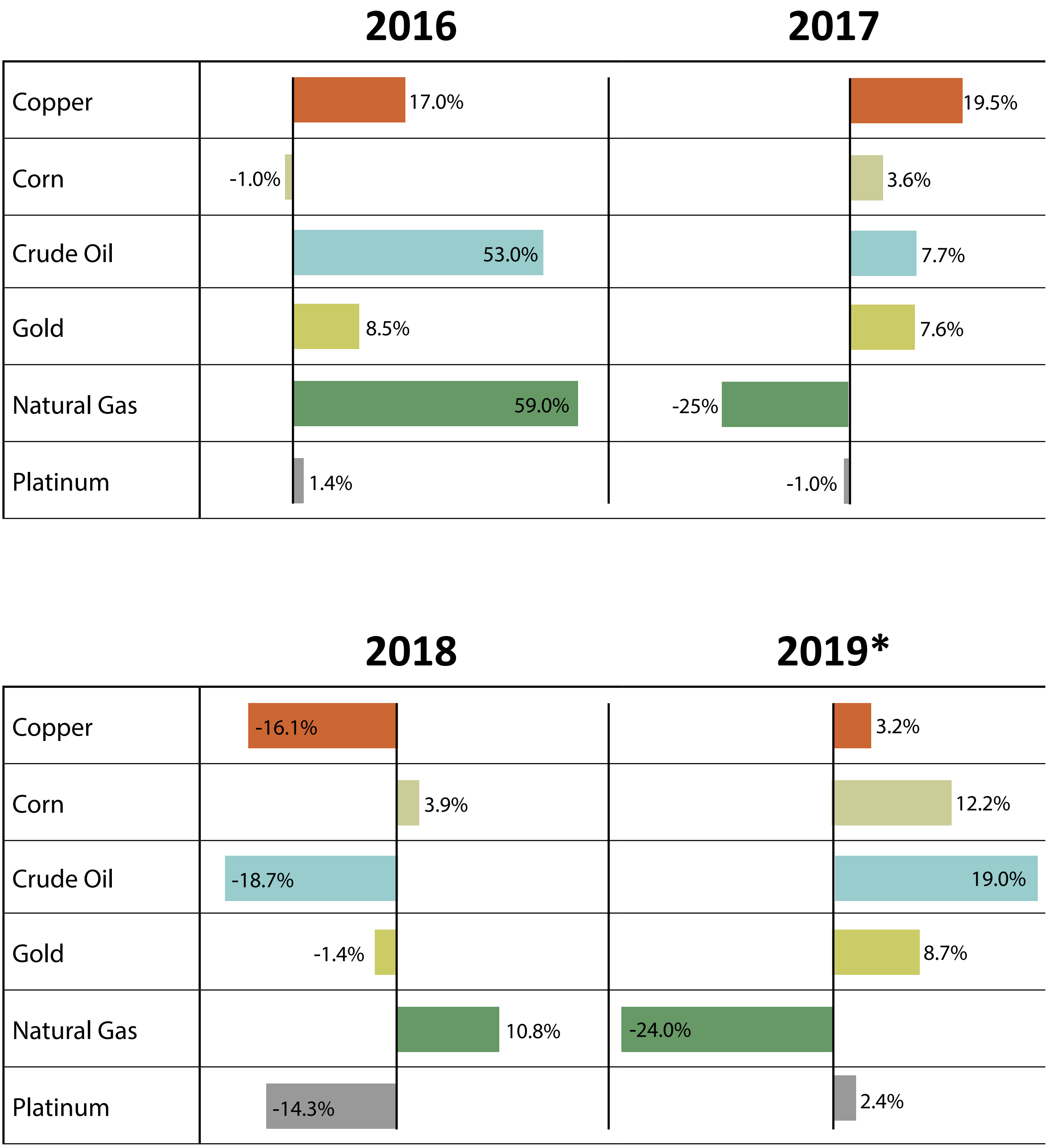
The company believes these are exciting times for Power Metal Resources and its shareholders as it pursues a strategic drive to discover large scale mineral resource deposits.




**INTRODUCING POWER METAL RESOURCES**

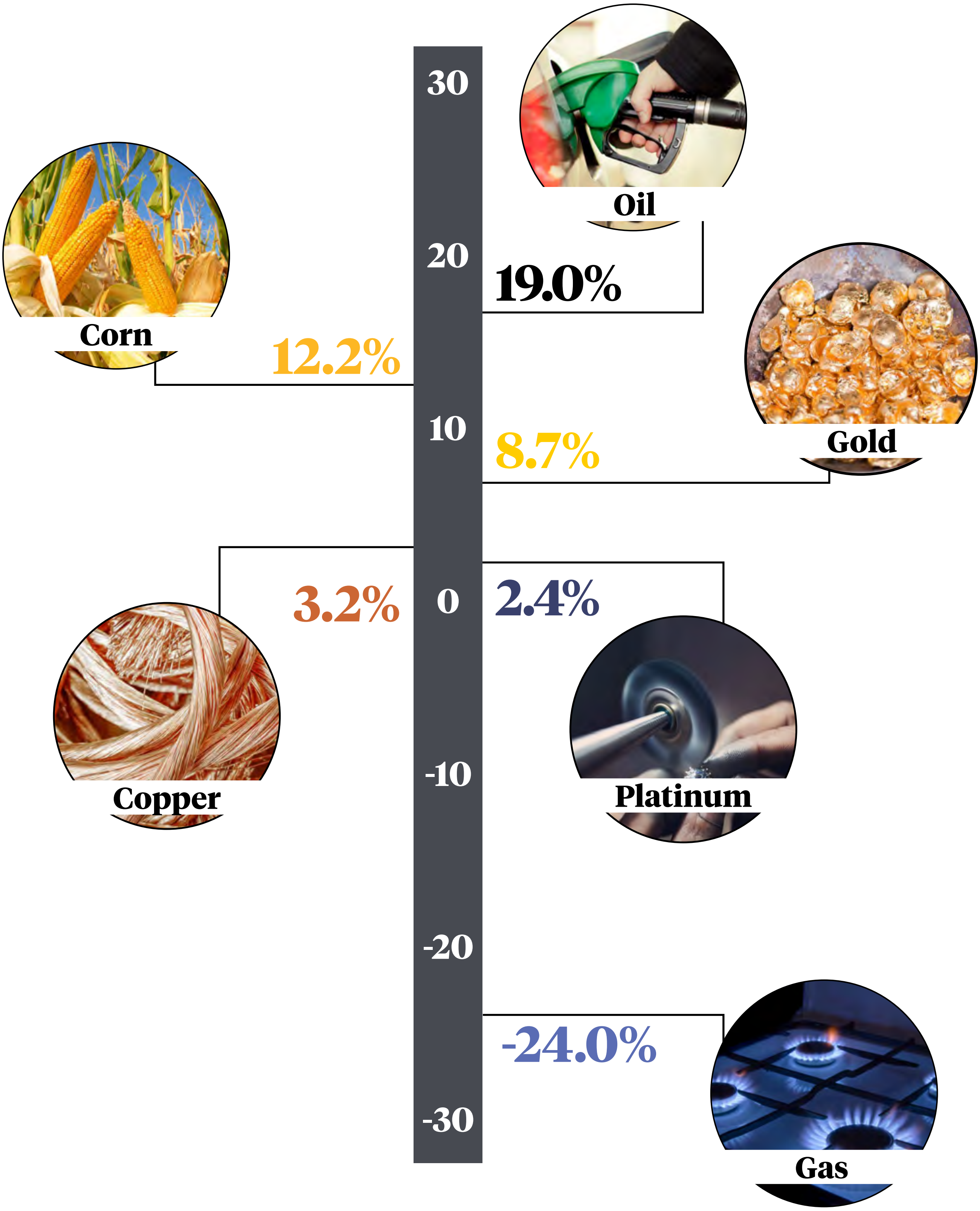
**EXPLORING IN ELEPHANT COUNTRY FOR LARGE-SCALE MINERAL DEPOSITS IN AFRICA**

# **Databank** – Commodity price performance 2016-2019




Source: Refinitiv. *Data to 24 June 2019

# **Databank** – Gain / loss so far in 2019




Source: Refinitiv