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BT COULD **SLASH ITS DIVIDEND** BY 30%

THE KEY REASONS WHY YOU **NEED TO INVEST IN MICROSOFT**

THE DIFFERENT WAYS TO PLAY THE **US MARKETS VIA ETFS**

Thomas Cook investors in a spin as they brace for debt-for-equity pain

It is important to understand the impact of lenders deciding to take new shares instead of getting their cash back

Debt-for-equity swaps are rarely good news for shareholders despite potentially keeping the lights on in a business.

That matters for anyone owning stock in holiday seller **Thomas Cook (TCG)** as they are now facing this situation and therefore need to understand what debt-for-equity really means.

Shares in Thomas Cook halved in value on 12 July when the company outlined a £750m refinancing plan that would see major shareholder Fosun, a Chinese tourist group, gain a controlling stake in the package holiday part of Thomas Cook and a minority interest in its airline operations. The exact terms have yet to be published.

The proposed deal would also see much of Thomas Cook's bank and bond debt being converted into equity. Its lenders are essentially saying they would be happy to take new shares in Thomas Cook instead of having existing loans paid back in cash.

The alternative for them is to wait for the travel group to repay its borrowings. However, given the severity of the financial pressure the business is under, there would be a significant risk that Thomas Cook couldn't pay back its debt and so they lose out.

Going down the debt-for-equity route is seen as a last resort for lenders to try and claw back their money.

Lenders taking new equity creates a much greater pool of shares in issue and so existing shareholders would be heavily diluted. Imagine Thomas Cook was a cake with eight slices and eight shareholders. By swapping debt for new shares, Thomas Cook is essentially re-cutting its cake into much smaller slices per shareholder.

Companies often distribute some of their profits to shareholders in the form of dividends. If the pool of shares has got much bigger as a result of the debt-for-equity swap, it means any dividend payments have to be spread across a greater number of people and each investor's share could be tiny.

Thomas Cook suspended dividends last year and it is hard to see it paying them again in the near future, although the lenders accepting new shares will inevitably hope for such payments down the line.

Debt-for-equity swaps can also impact voting rights. Existing shareholders have a smaller voice following these deals because of the big equity dilution and the lenders taking on the new shares could become a dominant force in terms of voting on company actions.

Construction services group Interserve announced a debt-for-equity plan earlier this year that handed control of the business to banks. However, its largest shareholder, the US hedge fund Coltrane, voted against the plan and so the business went into administration and anyone owning its shares lost all their money.

It doesn't always end badly with debt-for-equity schemes. For example, Punch Taverns refinanced in 2014 and three years later was acquired for £1.8bn by Heineken and Patron Capital. However, shareholders did see a large amount of value wiped off in the preceding years when the pubs company was drowning in debt, and the subsequent takeover only clawed back a small fraction of this lost value.

By **Daniel Coatsworth** Editor

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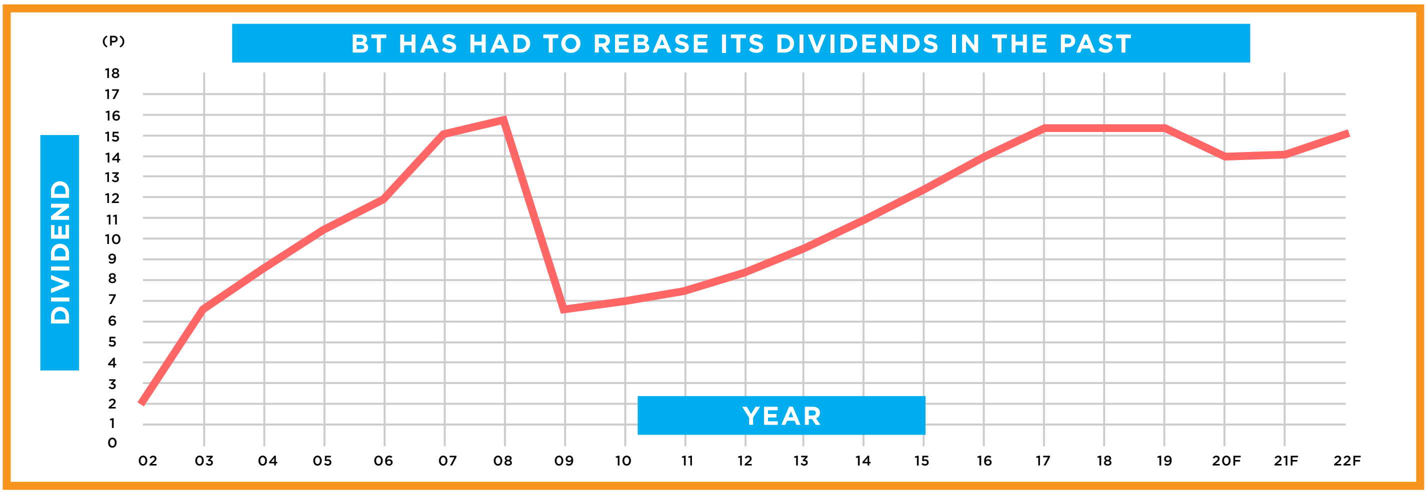
BT could slash its dividend by 30%

Rebasing looks inevitable as the company has other needs for its cash



Source: BT, Reuters (forecasts)- year to 31 March

UK telecoms giant **BT (BT.A)** appears to be softening up investors to a future cut to its £1.5bn a year dividend as it balances rising fibre roll-out investment.

BT's management estimate that it will cost an extra £400m to £600m a year to accelerate the roll-out of its fibre-to-the-premises network.

There are several potential levers to pull to free up additional funding, including deeper cost cutting or taking on more debt. However, BT chairman Jan du Plessis appears to favour rethinking shareholder payouts, hinting at as much during BT's shareholder meeting on 10 July.

In May BT raised its full fibre roll-out targets from 3m homes and businesses to 4m by March 2021. It currently serves full fibre to approximately 1.2m UK premises. Management has also pledged to extend its fibre-to-the-premises network to 15m properties by the middle of the next decade.

BT chief executive Philip Jansen, who was appointed to the top job in February this year, confirmed in May that the company would stick to its 15.4p dividend per share commitment for the 12 months to 31 March 2019, and gave a firm indication that a similar payout would be on the cards for the current financial year.

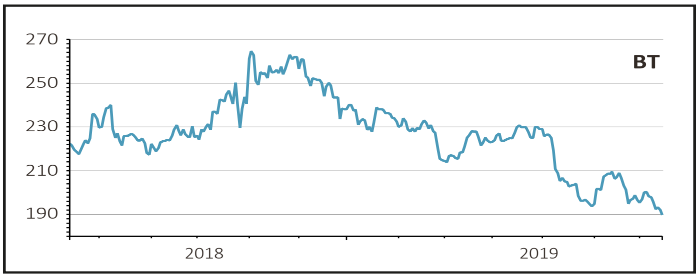
Investors have been dubious over the sustainability of dividends at this level for some time. BT's share price has largely stumbled lower over the past four years, pushing the income yield up to 8.1%, based on the current 189p share price.

Supportive analysts point out that BT has 'mended fences' with regulator Ofcom over Openreach, a BT subsidiary which controls its broadband network, by offering easy access for rivals to share the network.

BT has also been able to retire some of the risk associated with its multi-billion pound pension scheme, which is running with a £6bn deficit.

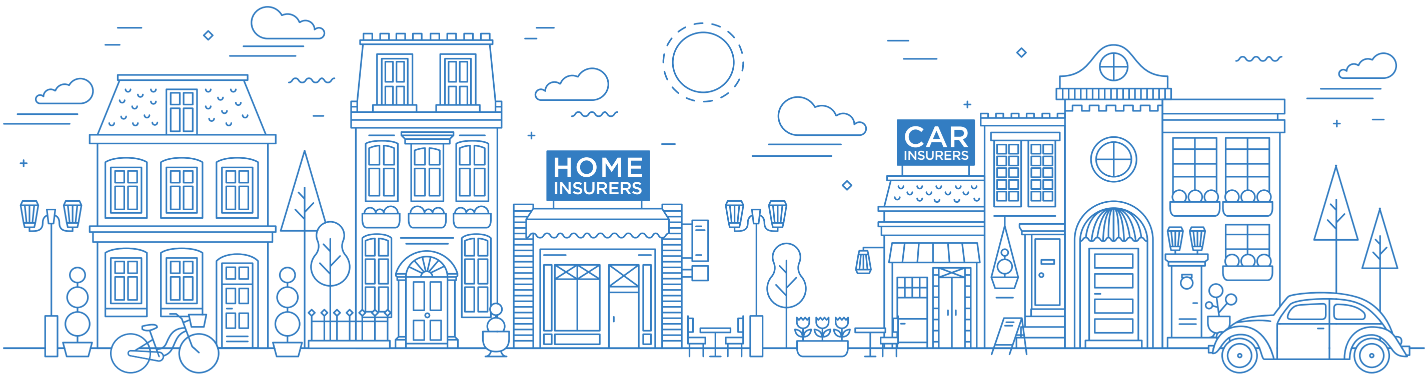
Yet BT is already in the middle of £1.5bn a year cost-cutting plan that includes shedding jobs, closing offices and selling property.

Analysts at investment bank Berenberg anticipate a 30% cut to the 2021 dividend to 10.8p per share, potentially slashing £500m off BT's annual dividend bill. That would still imply a 5.7% income yield at current share price levels, and allow scope to rebuild the payout in the medium-term.



Insurers dealt new blow after less favourable change to compensation rate

The industry was expecting a better outcome to lift some of the burden of claims inflation



UK car and home insurers are crying foul after the Lord Chancellor raised the discount rate on personal injury lump-sum compensation but left it short of the level the industry had hoped for.

Shares in **Admiral (ADM)**, **Direct Line (DLG)** and **Hastings (HSTG)** all sold off on the news.

The Lord Chancellor raised the personal injury discount rate – or Ogden rate as it is known – to minus 0.25% from the minus 0.75% set in 2017 but this is well below the level industry insiders were demanding.

LV Insurance's general insurance claims director Martin Milliner said the change 'doesn't go far enough' in replacing the 'absurd and fiscally irresponsible' decision to cut the rate to minus 0.75% two years ago.

'At this level we believe that claimants will remain over-compensated, thus undermining the common law principle of 100% compensation,' added Milliner.

According to an industry survey, around half of insurers were hoping that the rate would be increased to somewhere between 0.1% and 1%.

The rate is used to assess how much accident victims should be given as a lump sum to be used over their lifetime if they are seriously injured, for example in a car accident.

The decision to keep a negative interest rate, rather than set a positive rate, is good for accident victims and bad for insurance companies because it means the initial sum paid out has to be bigger.

Following the announcement of the new rate, Hastings said it would need to put aside an extra £8.4m in reserves, lowering its pre-tax profit for this year.

Analysts at Morgan Stanley and UBS see Admiral as the most exposed given that it assumed a 0% Ogden rate for reserving last year, and have cut their 2019 earnings forecasts for this stock by as much as 15%.

Partly as a result of the negative Ogden rate, which has increased the cost of personal injury claims, insurers are facing the highest level of motor claims inflation for many years. This could lead to lower levels of dividend growth than previously enjoyed, or even dividend cuts.

Other factors pushing up claims inflation are credit hire, fraud and soaring repair costs.

Due to the use of more sophisticated technology in modern cars, higher prices for parts from abroad due to the weak pound and rising labour rates, repair costs have helped push motor claims inflation well above 5% for most of this year.

A study this week by Confused.com shows that the industry has been fighting back by pushing through an average 5% increase in motor premiums in the second quarter, but analysts see insurers' margins shrinking further this year.

Hurricane Energy blows the market away

Production guidance uplift helps company bounce back from exploration disappointment

UK oil producer **Hurricane Energy (HUR:AIM)** is building on the significant milestone in June of first oil from its Lancaster field.

An investor day on 11 July revealed the company's early production system at Lancaster is performing better than expected with upgrades to production guidance.

While Hurricane held 2019 production guidance, it has upgraded forecasts for 2020 to 20,000 barrels of oil a day (bopd) from 17,000 bopd. The company believes it can generate cash flow of up to $240m from this output.

The company also dismissed fears that a recent exploration disappointment with its Warwick Deep well has negative implications for Lancaster or its Lincoln asset.

Hurricane is the first in the UK to produce hydrocarbons from so-called fractured basement reservoirs. These are bodies of rock beneath the earth formed more than 2 billion years ago.

In certain places these massive structures – located deeper than the sandstones which have traditionally been the focus of oil exploration in the UK – have been pushed up and violently fractured by earthquakes and other tectonic forces.

The hydrocarbons discovered by Hurricane are contained within the cracks in these formations.

Tracker fund criticised for misleading ESG credentials

The passive investment industry needs to have better defined methodology

LAST WEEK THE *Financial Times* reported that the $500m Vanguard ESG US Stock exchange-traded fund (ETF) had invested in oil services company Schlumberger, pipeline company Kinder Morgan and oil refiner Marathon Petroleum, despite its 'green' label.

According to the company's website, the fund seeks to track the FTSE US All Cap Choice index while excluding stocks screened for certain environmental, social and corporate governance (ESG) criteria.

Specifically the fund excludes investing in companies involved in adult entertainment, alcohol, tobacco, weapons, fossil fuels, gambling and nuclear power.

In response, Vanguard has said that it will update the description of the fund to better reflect the index methodology and exclusions. It apparently only excludes companies that own fossil fuel reserves and not oil services companies.

As *Shares* reported on 20 June, ESG funds are becoming increasingly mainstream, with figures from the Global Sustainable Investment Alliance showing global assets topped $30trn in 2018.

Without a well-defined methodology in place, the industry could easily be accused of labelling products in order to 'tap into' investment flows at the expense of transparency.

The combination of growing mass-market appeal and non-standardised benchmarks is a potentially toxic mix and the passive investment industry would be wise to address the issue sooner rather than later.

The investment industry has had its fair share of past mis-selling scandals; let's hope another one isn't brewing.

Burberry, Sports Direct, Ryanair and other big news

We look at the market risers and fallers from the past week

It's been a good week for British luxury brand **Burberry (BRBY)**, which added more than £1bn to its market value after better than expected first quarter results.

Its shares rose 12.7% to £22.44 following a 4% rise in comparable store revenues. The iconic brand has man of the moment Riccardo Tisci to thank. The Italian fashion designer, renowned for his work at French fashion house Givenchy, has produced a swathe of new designs for Burberry. And it is the increased availability of his products which has driven the company's improved results.

DELAYED RESULTS

Shares in **Sports Direct (SPD)** plunged 15% to 237p after it delayed publishing its full-year results. The sports retailer cited uncertainty around trading in its House of Fraser chain for the delays, as well as its auditor Grant Thornton facing increased scrutiny for working with Sports Direct.

Two firms who've also had a bad week are software company **Micro Focus (MCRO)** and recruiter **PageGroup (PAGE)**.

Shares in Micro Focus fell 17.3% to around £16.52 after executive chairman Kevin Loosemore sold £11.6m worth of personal shares in the business, casting a gloomy shadow over the firm's near-term prospects in the eyes of investors.

PageGroup tumbled 17% after it warned profits would be lower than expected because Brexit, trade wars and the Hong Kong protests have lowered the number of people being hired in its markets across the world.

AIRLINE TURBULENCE

Ryanair's (RYA) shares rallied despite cuts to routes and lowered growth ambitions as 737 MAX delays hit home. The low-cost Irish airline said it expected to get only 30 of the 58 jets it ordered from Boeing by May 2020, meaning it has had to scale back its anticipated growth next summer from 7% to 3% by lowering its number of flights.

The rise in the share price could have been a result of the airline tackling the issue by looking to make itself leaner, moves that could act as a defence mechanism for future profits.

Ryanair chief executive Michael O'Leary said as a direct result of the Boeing delays, the company is starting talks with airports to determine which of its underperforming or loss-making bases should receive cuts or closures from November 2019.

FTSE 350 MOVERS OVER THE PAST WEEK

BEST PERFORMERS

STOCK	SHARE PRICE RISE	REASON
Burberry	10.9%	First quarter results better than expected
Syncona	10.9%	Investor interest picks up following recent valuation weakness
John Wood Group	8.7%	Shares continue rally following bullish trading update in June

WORST PERFORMERS

STOCK	SHARE PRICE FALL	REASON
AG Barr	-27.1%	Profit warning relating to bad weather and brand challenges
Micro Focus	-17.3%	Chairman sells £11.6m worth of stock
PageGroup	-17.0%	Profit warning due to global economic uncertainty

Source: Shares, SharePad, data to 16 July 2019

Switch on to the underappreciated potential of eOne

Demand for content from streaming providers should benefit Entertainment One

The compelling investment case for TV and film business **Entertainment One (ETO)** has been obscured by concerns over its cash generation.

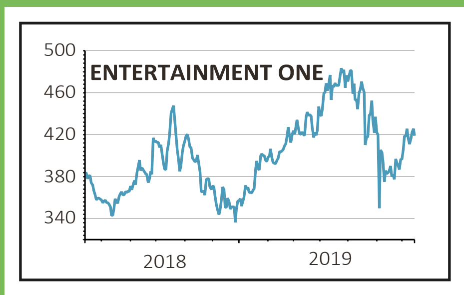
We think this situation is in the process of changing and believe investors should buy now before the market gives the company full credit for its ability to capitalise on growing demand for content – a trend driven by the increasing dominance of TV streaming.

The enduring potential in the dominant pre-school *Peppa Pig* brand as well as under-appreciated bits of the business, such as its music arm, give us further confidence in the outlook for the share price.

The valuation looks relatively undemanding on 16.1 times March 2020 forecast earnings per share.

ENTERTAINMENT ONE BUY
(ETO) 418.2p
Stop loss: 334.5p

Market cap: **£2.1bn**



VIDEO IN DEMAND

The increasing trend for people to sign up to subscription services offering a wide range of TV series and films to binge on has created a voracious appetite for content among these platforms. They need compelling material to attract new subscribers and hold on to existing ones. Clearly this benefits Entertainment One and other content creators.

A recent shift in the streaming space is seeing the likes of Disney and 21st Century Fox launch their own platforms, with a plan to limit their best shows and movies to these offerings.

This is likely to create a content gap for the likes of Netflix and Amazon Prime Video to fill, thus reinforcing Entertainment One's position.

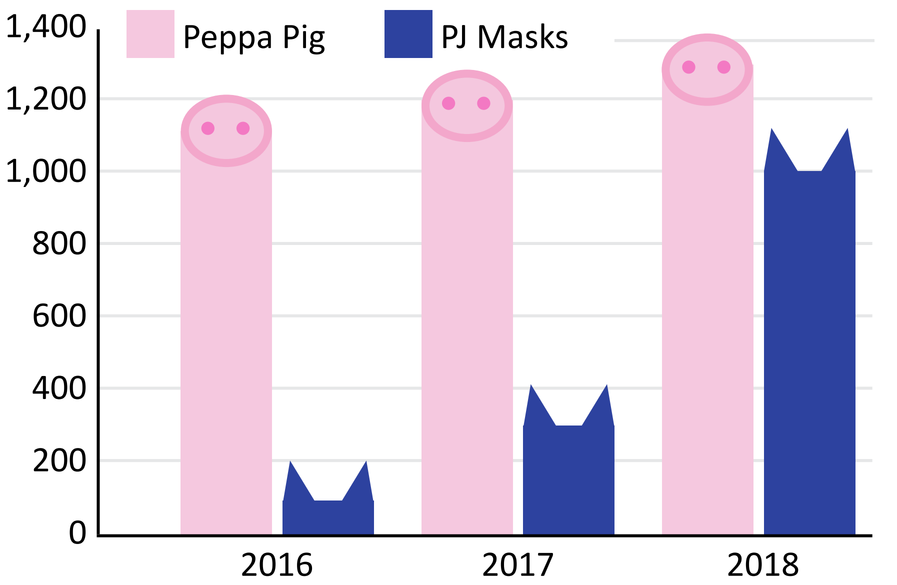
The jewel in the crown for the business is its ownership of *Peppa Pig* with the company benefiting from merchandising revenue and the animated series roll-out to new geographies, most notably China. *Peppa Pig* has helped the Family & Brands division to be the star of the show.

Theme park operator **Merlin Entertainments (MERL)** has plans to open 50 new *Peppa Pig* attractions worldwide which should benefit Entertainment One in terms of commission on ticket revenue as well as merchandise sales and increasing brand awareness.

NOT JUST ABOUT PEPPA

Fellow kids title *PJ Masks* has also been a winner for the company and helping to reduce its reliance on the cartoon pig. The forthcoming launch of new kids TV show *Ricky Zoom* will be a test of the company's ability to create a conveyor belt of hit children's titles.

RETAIL SALES REVENUE FOR PEPPA PIG AND PJ MASKS (US$M)



Source: Shares, Company data, Berenberg estimates

If Family & Brands has been a star performer, the television and film operations have been through a period of transition amid structural shifts away from DVD and cinema-led distribution. It has also been a victim of box office success being hoarded by big blockbuster movies, leaving producers of mid-market titles like Entertainment One out in the cold.

The diminishing reliance on the television and film arm, which has lumpy cash generation, should improve the overall cash flow profile of the business. There are also changes being made to the way the division is run, with a focus on producing its own content rather than acquiring and distributing third party productions.

IMPROVING CASH FLOW

The latter involved significant upfront costs from acquiring and then marketing content without any guarantee of success. By contrast the new approach with content production is to secure revenue commitments from a broadcast partner, thereby covering a large proportion of the associated costs.

The company's music business is profitable and has strong growth potential, particularly since the acquisition of music publishing business Audio Network for £178m in 2018.

The company's music label is a potential beneficiary on the royalties created from an explosion in music streaming as well as licensing its library of songs to third party film and TV producers and scoring its own in-house titles.

KEY MAN RISK

The key risk for a prospective investor in Entertainment One to weigh, and one which applies across its TV, film and music operations, is a failure to deliver hit content.

There is a lot of reliance on the company's chief content officer and industry grandee Mark Gordon. Reports he might be about to leave the business hampered the share price earlier in 2019.

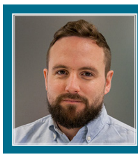
Berenberg says: 'We note that if Mark Gordon decided to leave Entertainment One before 2022, he cannot produce for any other company during this period. He also owns 8m shares in the company.'

A further element of downside protection is provided by the company's existing media library which Berenberg believes is worth 370p per share based on the latest independent valuation. The quality of this existing content could also make Entertainment One a takeover candidate.

IMPROVING CASH CONVERSION AT ENTERTAINMENT ONE

Year	Cash conversion
2018	38%
2019	41%
2020e	55%
2021e	57%
2022e	63%

March year-end. Source: Berenberg



By **Tom Sieber**
Deputy Editor

Tighter data laws will drive business for Restore

The office services firm has plenty of scope to grow organically

A £183m fine imposed on British Airways shows how seriously firms have to take the security of their customer data, whether it is online or in old documents that need to be disposed of securely.

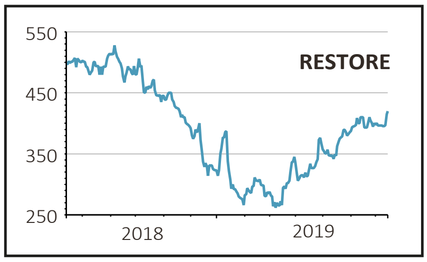
Increasing pressure on companies to better manage customer data should play to the skills of offices services firm **Restore (RST:AIM)** which is an expert in managing data for large organisations.

We're reviving our 'buy' rating on the stock after the shares de-rated and the firm appointed a new chief executive.

The business is in better shape and more firmly-integrated than it was a year ago, having de-geared itself after the acquisition of TNT Business Solutions and disposed of the printer cartridge business in exchange for a minority financial interest in the buyer.

RESTORE BUY
(RST:AIM) 420p
Stop loss:336p

Market value: £510m



STRONG CASH FLOW GENERATION

Restore's main business is UK document management which is divided into three streams: storage, scanning and shredding. All three generate strong, stable cash flows without needing high levels of maintenance spending.

Document storage is the biggest single business, accounting for around 45% of group revenue and 70% of profit. Restore provides storage and retrieval of hard copy documents, typically stored in cardboard boxes.

In total it manages over 20m boxes across 45 sites in the UK and its client list includes 90% of FTSE 100 companies, 90% of top 100 UK legal firms, 80% of top 50 accountancy firms and 80% of NHS trusts, which are typical of organisations which still generate and depend on paper documents.

The storage market is fairly concentrated with Restore vying for first place with Iron Mountain, followed by a long tail of smaller providers. This means that pricing is 'rational', in the words of new CEO Charles Bligh, while there is still scope to grow both organically and via small acquisitions.

Along with records management, Restore has a scanning business ('Digital') which saves stored documents in digital format so that customers can track and access them at any time, helping them to reduce their reliance on paper.

Revenues from Digital were 10% of the group total last year, including the scanning business acquired with TNT BS. Margins were down due to the TNT unit making losses initially but there is scope to improve pricing this year.

TRUSTED PARTNER

The third leg of Restore's document-handling business is on-site and off-site shredding and the secure destruction of documents, hard drives and identification, which is a logical fit with its other operations and generates around 20% of group turnover.

While many large clients already trust Restore with their

RESTORE: FINANCIAL METRICS				
	Sales	Pre-tax Profit	EPS	DPS
2011	£18.8m	£3.7m	4.3p	1p
2012	£43.3m	£6.2m	7.4p	1.5p
2013	£53.6m	£10.0m	10.5p	1.9p
2014	£67.5m	£12.0m	12.3p	2.4p
2015	£91.9m	£16.3m	15.6p	3.2p
2016	£129.4m	£23.0m	17.9p	4p
2017	£176.2m	£31.2m	22.5p	5p
2018	£195.5m	£37.5m	25.2p	6p
2019e	£213m	£42.7m	27.6p	7p
2020e	£221m	£45.1m	29.5p	8p

Source: Company accounts, Reuters Eikon (forecasts)

data security, there is huge scope to grow with small and medium-sized UK firms and build greater market share.

On top of the documents business, Restore is the UK market leader in commercial and workplace relocation moving the equivalent of 350,000 desks per year through its Harrow Green subsidiary.

Being the number one UK operator and the trusted partner of large firms such as news organisation Bloomberg, social media giant Facebook and fund management group Fidelity, means high levels of repeat business and market-leading operating margins.

Revenues from the relocation business were just under 20% of the group total last year thanks to a 'steady level of ongoing activity'.

FAST-GROWING TECH BUSINESS

Restore's final business, which is new and growing fast thanks to the size of the market and the fact that it compliments to the rest of the group, is the installation and recycling of IT equipment.

For its relocation clients, Restore already audits and tags IT assets prior to moving them into storage or to a permanent location. It also offers IT set-up and deployment, saving time getting the kit up and running exactly to the clients' specification.

Realising that clients also need to dispose of obsolete IT equipment, Restore offers collection and recycling of customers' kit with secure, fully-tracked destruction of data and environmentally-friendly recycling.

Restore offers a basic, free collection service where it remarkets or recycles the equipment for its own benefit, or for a fee it will remarket the kit and pay the customer a rebate. By taking care of these 'start-of-life' and 'end-of-life' processes Restore gathers in yet more revenues from its existing clients.

The technology installation and recycling business generated around 5% of group turnover last year and with the acquisition of another small recycler, Spinnaker, in August 2018 revenues are set to rise.

FOCUS ON ORGANIC GROWTH AND MARGINS

After a busy year of acquisitions and disposals under the old boss, the new boss is keen to let everything bed down, keep a lid on costs and focus on finding opportunities to cross-sell more of the firm's services to its clients.

No doubt there will be one or two small deals to build scale but the main aim for this year is to generate more recurring revenues from within the business rather than branch out into new areas.

Nor is the new chief executive interested in growing the business geographically: the UK market offers more than enough growth potential meaning empire-building abroad is not on the agenda.

By **Ian Conway**
Senior Reporter

WPP

(WPP) 964p

Gain to date: 12.9%

Original entry point:

Buy at 854p, 14 March 2019

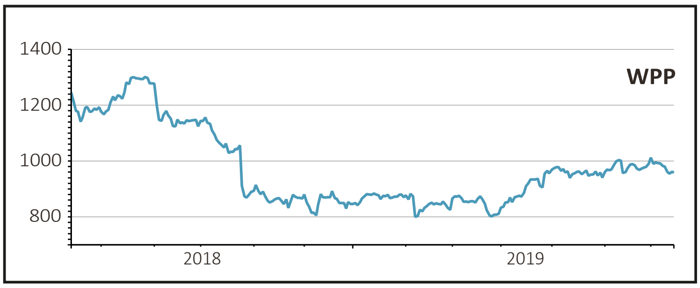
CHIEF EXECUTIVE Mark Read achieved an important first step in his revamp of the group with the sale of a 60% stake in **WPP's (WPP)** Kantar market research business to private equity firm Bain Capital.

Proceeds to WPP on completion after tax and continuing investment in Kantar are expected to be around $3.1bn. Some of this will be returned to shareholders but a good chunk will go towards paying down debt.

The flipside is some limited earnings dilution after the deal completes in early 2020.

Investment bank Liberum comments: 'The fact that this deal has been done without any drama and in line with expectations at pretty much all levels (price, return of proceeds, and in line with the stated timeframe) will not only be seen as a relief but should also increase the market's confidence in management's ability to execute its strategy.'

Read's leadership will next be under the scrutiny of the market when the company reports its first half results on 9 August.



SHARES SAYS:

This news increases our confidence in the repair job Read is doing at WPP. Keep buying the shares which are on an undemanding forward price-to-earnings ratio of 9.7 and yielding 6.2%.

A.G. BARR

(BAG) 653.6p

Loss to date: 20%

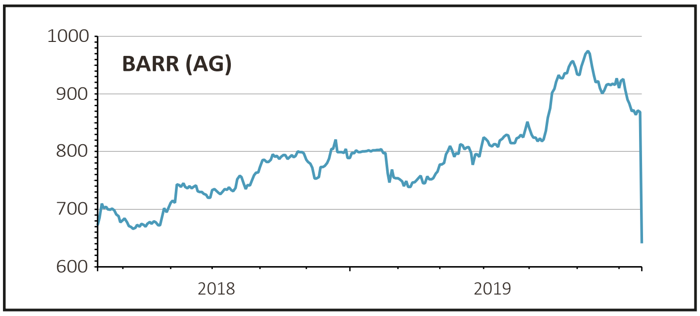
Original entry point:

Buy at 817p, 9 May 2019

SADLY, OUR RECENT 'buy' call on *Irn-Bru* maker **A.G. Barr (BAG)** has seen its 20% stop loss triggered following a profit warning. Naturally we are disappointed by the magnitude of the ensuing earnings downgrades, but we remain bullish on its long-term potential and would use the opportunity to buy more shares at the lower price.

A.G. Barr says trading is below expectations, partially due to a strategy shift from a heavy focus on driving volume last year back to prioritising value now. This has been exacerbated by some brand challenges, as well as disappointing weather.

Against a prior year comparative boosted by 2018's summer heatwave, A.G. Barr expects sales for the 26 weeks to 27 July in the region of £123m, roughly a 10% year-on-year decline. Due to operational gearing, full year profits are expected to drop by up to 20% and investors should also brace themselves for results marred by exceptional costs as A.G. Barr seeks to restore trading momentum.



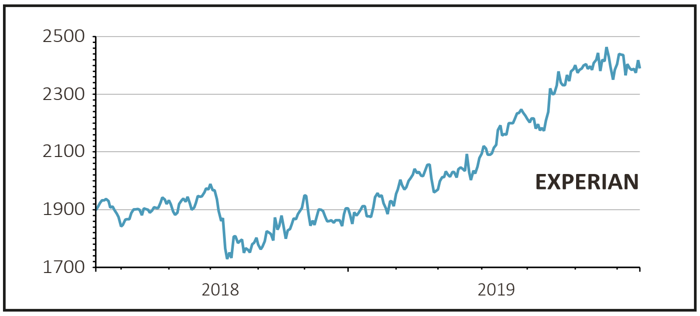
SHARES SAYS:

Downpour-induced downgrades are disappointing short term, yet A.G. Barr says it has addressed the specific brand-related issues and we remain convinced the *Irn-Bru* maker can continue to compound earnings on a long-term view. Investors prepared to show patience should view the sell-off as a buying opportunity.

EXPERIAN
(EXPN) £23.65

Gain to date: 26.5%

Original entry point: Buy at £18.69, 9 Aug 2018



THE FIRST QUARTER update from information services company **Experian (EXPN)** shows the company can still grow revenues at a respectable pace (6% organic, or like-for-like) despite strong growth in the same quarter last year following major contract wins.

North America continues to be the main driver with 8% organic revenue growth, helped by the recent acquisition of AllClear ID. Alongside the business-to-business (B2B) operations, the consumer side traded well with 9% organic growth.

Latin America had a strong start to the year with 9% organic growth thanks to strong demand in Brazil for both business and consumer services.

Europe and Asia saw a dip in organic growth due to a strong comparison with last year although India was a stand-out performer and total revenues rose thanks to the acquisition of Compuscan in South Africa.

The UK was a mixed picture with encouraging growth in data services but overall B2B revenues were flat and consumer revenues were marginally higher.

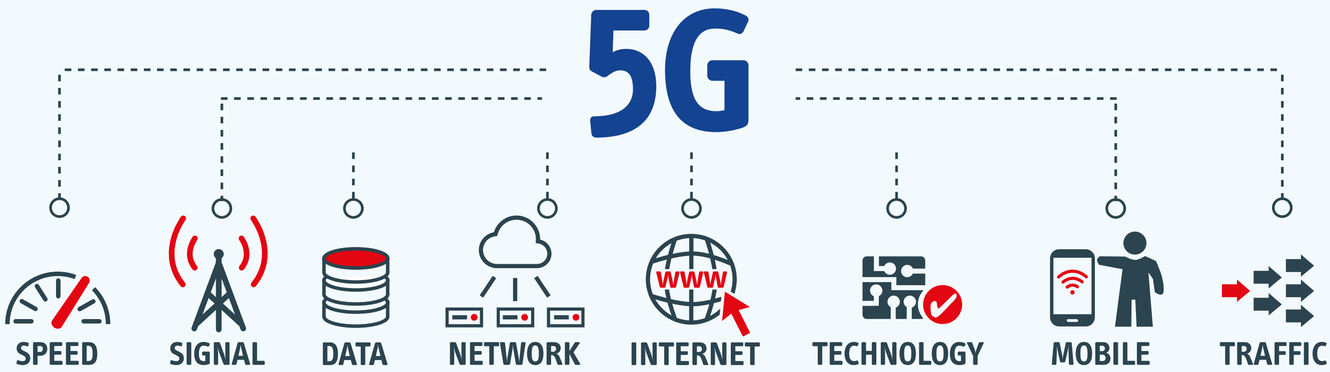
The company has confirmed its guidance for this year and we continue to like its ‘economic moat’ which allows it to generate organic growth and substantial free cash flows without substantial risk of new entrants coming into the market.

SHARES SAYS:

Experian’s shares are just off their all-time highs but we would stick with them and add on any weakness.

HOW REVOLUTIONARY IS THE 5G EVOLUTION?

POLAR CAPITAL



Source: Adobe Stock 2019

5G has arrived and while currently only available in a handful of cities (six at launch in the UK) it is estimated that 40% of the world's population will have 5G coverage[1] by 2024.

The fifth generation of wireless networks promises to provide users with better responsiveness, greater bandwidth and faster download speeds. It will give operators the ability to develop new products, applications and services and deliver them more cost-effectively. All this will allow consumers to access the internet faster, get quicker mobile connections, upload videos more quickly and stream movies more smoothly.

To give an idea of the step-up from 4G, according to Borje Ekholm, CEO at Ericsson: "No previous generation of mobile technology has had the potential to drive economic growth in the way that 5G promises. It goes beyond connecting people to the possibility of making the internet of things (IoT) and the fourth industrial revolution a reality. 5G has the ability to drive a digital society where everything that can benefit from being connected will be connected."

While the previous four generations have all been about delivering faster connectivity, 5G is much more enterprise and company focused. It will allow applications ranging from the IoT – anything with a chip in it such as an alarm clock, a vending machine or smart TV – to connected cars, autonomous trucks and cloud-based gaming. These are all genuinely cutting-edge innovations.

One of the key improvements of 5G is low latency, meaning a high speed of signal being sent and received, the speed an action follows an instruction – imagine playing Fortnite and there being a noticeable delay between moving the controller and moving your on-screen character. More broadly, low latency should enable the proliferation of the IoT, potentially challenging how data is created, stored and analysed in the future.

Another area to benefit is the radio access network (RAN), which is that part of the mobile telecoms system that sits between a device and a signal, connecting a device to a network. 5G will support a network upgrade in a market that has seen little if any growth, leading to greater capacity and efficiency for users.

This whole area is not without risks – witness concerns around Huawei technology's security, the arrest in Canada of its chief financial officer and the possibility of it violating Iran sanctions. The result has been that several countries, spearheaded by the US, have boycotted Huawei products.

Then there are the extremes of views on 5G. For example, Kaan Terzioglu, Turkcell's CEO, says: "I think this is the beginning of the fourth generation of the industrial revolution. 5G will be the platform linking billions of devices together". However, Ron Marquardt, Sprint's vice president of technology is more circumspect, saying: "I think a lot of the hype is where things are going to be 10 years from now with 5G, not what it will be at launch".

The answer is likely to be somewhere in between as while 5G remains in its infancy today, momentum is building nicely and we expect it to move from hype to reality over the coming years.

Fatima Iu
July 2019

Fatima joined Polar Capital in April 2006 and is a fund manager on the Polar Capital Technology Fund, Polar Capital Technology Trust and Polar Capital Automation and Artificial Intelligence Fund.

[1]Ericsson Mobility Report; January 2019

The case for and against share-based compensation

In theory aligning management and shareholders is a good thing. In practice it usually favours management

Following on from our discussion of the importance of corporate governance and business ethics, and how short-term reporting can distract management from focusing on long-term goals, this week we look at an issue which touches on both topics: share-based compensation for directors.

Executive pay and share-based compensation have been the subject of debate for years among academics, politicians and the media, with many people blaming the financial crisis in part on excessive levels of 'incentives' for management teams to boost short-term returns.

At the heart of the compensation debate is the issue that if the 'ownership' of a company and managerial control are kept separate, the interests of the managers may diverge from the interests of the shareholders, who are the ultimate owners.

Therefore many companies use performance-related pay to align the interests of management with those of shareholders, more often than not with a specific link to earnings per share or the price of the company's stock.

Linking executive pay to a company's operating performance isn't as simple as it sounds. There are myriad ways that a company can boost its performance to hit earnings or 'total shareholder return' targets.

As Howard Marks, the founder of Oaktree Capital Management, puts it, the stewards of a company should be 'purer than Caesar's wife' and resist the temptation to do business in a way which moves a little extra money from shareholders' pockets into their own.

> WHEN PROFIT MAXIMISATION IS EXALTED TO EXCESS, ETHICS AND RESPONSIBILITY CAN GO INTO DECLINE
>
> HOWARD MARKS

NICE LITTLE EARNER

Due to widespread opposition to company bosses receiving huge salaries, the majority of executive pay tends to be in the form of performance-driven share awards or bonuses. In the US as much as 90% of executive pay can be performance-related.

When executives are incentivised to increase a company's earnings, dividends or share price (or all three together in the case of total shareholder returns), it is no surprise that executives start chasing short-term performance.

To quote Marks again: 'When profit maximisation is exalted to excess, ethics and responsibility can go into decline. The pursuit of short-term profit leads to actions which are counter-productive for others, for society and for the long run.'

At their worst, skewed

incentives and short-termism can lead to over-leverage and poor risk management, generating asset bubbles. The bigger and more complex the business, the more obstacles to monitoring and regulating executive pay.

At the same time, investor expectations have changed over time. Private investors, who used to dominate the shareholder registers and took a passive, long-term view, have given way to big institutions who typically push for high returns in a shorter time.

INVESTORS HAVING A LOUDER VOICE

The good news is that investors, helped by groups such as Pensions & Investment Research Consultants (PIRC) and Institutional Shareholder Services (ISS), are getting bolder in blocking excessive share-based pay awards.

Last week a quarter of shareholders voted against B&Q owner **Kingfisher's (KGF)** outgoing chief executive's bonus payment of £522,000. Veronique Laury, who was paid almost £1.8m last year, up from £1.6m in the previous year, resigned from the firm without having met her target of improving profits by £500m by 2021.

Kingfisher has agreed to discuss the payment with its investors and provide a response within six months. Meanwhile other investors withheld their vote on the pay of the whole Kingfisher board.

Shareholder pressure and public outrage saw housebuilder **Persimmon's (PSN)** former chief executive get a trimmed-down bonus – although £75m is hardly penny-pinching – and eventually the boot last year, while the most public spat over management pay has to be at media giant **WPP (WPP)**.

Despite repeated shareholder revolts during his tenure, WPP's chief executive and founder Martin Sorrell is estimated to have pocketed well over £200m in executive pay, including share-based compensation, between 2012 and 2018 when he left the firm. Even his leaving package was opposed by shareholder groups.

By **Ian Conway**
Senior Reporter

HOW HUMANA GAMED THE SYSTEM

In late 2014, when US health insurer Humana reported worse than expected quarterly results, it sweetened the pill with a $500m accelerated share buyback.

What investors didn't realise was that the buyback, which instantly reduced the number of shares in issue, increased earnings per share (EPS) by the 2c it needed for the firm to beat its $7.50 quarterly profit target.

That meant that even though earnings were short of forecasts, the chief executive was able to trouser a $1.7m bonus on top of his salary for 2014.

Humana had already changed its calculation of EPS in 2014 by omitting losses from paying down debt, to try to bring earnings as close as possible to its target level of $7.50.

Without the buyback however, which didn't need shareholder approval, it wouldn't have got over the line.

The moral of the story is the next time a company in which you own shares proposes a buyback, look and see how much the management stand to benefit.

LIVE LONG AND PROSPER!

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

A longer life

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

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

A longer income

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

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

Invest long-term and prosper slowly

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

Contrariwise

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

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

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

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

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

As at 15 June 2019

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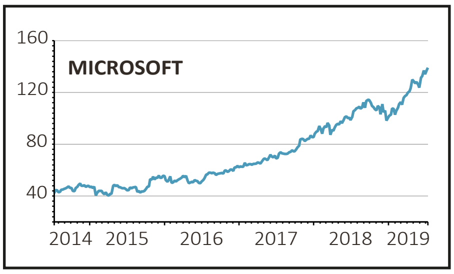
The key reasons why you need to invest in Microsoft

The world's largest company is highly attractive on so many measures

While everyone will know Microsoft as a brand, the inner workings of its business are perhaps less well known among investors even though it is widely held, either directly through shares or via investment funds.

No company did more to seed the personal computing explosion in the 1980s and 1990s, and it is today the world's largest listed business, worth $1.06trn. Windows and Excel spreadsheets are as familiar to most of us as the BBC news or PG Tips, and Bill Gates' pullovers are legendary.

With Microsoft forecast to report nearly $125bn in revenue for the year to 30 June 2019, we now look at its growth opportunities, business challenges, dividend prospects, and the valuation investors are expected to pay for the US-listed shares.



MICROSOFT REINVENTED

This is not the company that it once was, emerging as a great example of how a fine business can lose its way and then reinvent itself, becoming stronger than ever.

Its modern success is largely down to visionary chief executive Satya Nadella who has been in the top job since 2014.

Today the company operates via several major divisions which can be split roughly into three segments; Productivity and Business Processes, Personal Computing and Intelligent Cloud.

Nadella's crucial triumph has been to transform the company into a cloud-based software-as-a-service model,

Microsoft-owned Minecraft is the second biggest selling game of all time, second only to Tetris

MICROSOFT'S 2018 SALES BREAKDOWN

Business area	Sales	% of group sales
Office	$28.3bn	25.7%
Microsoft Azure	$26.1bn	23.7%
Windows	$19.5bn	17.7%
Gaming	$10.4bn	9.4%
Search ads	$7.0bn	6.4%
Enterprise services	$5.8bn	5.3%
Linkedin	$5.3bn	4.8%
Devices	$5.1bn	4.7%
Other	$2.8bn	2.5%

Source: Microsoft

streamlining the user experience and building a vast pool of recurring revenues.

Such a transformation was a difficult process, dragging on revenue and lowering margins as profitable servicing and maintenance income slowed – and the transformation is arguably still ongoing today.

But down the line this will mean much greater visibility, increasingly sticky users as well as slashing the cost of distribution. Software updates can be rolled out across the vast user base centrally, while upgrades and up-sales are more seamless for customers, which should drive margins in time.

Subscription-type revenues make up about a third of Microsoft's annual sales and are headed for 50% by 2022, according to the company. Its Azure cloud platform is now seen as its chief growth lever.

AHEAD IN THE CLOUD

In its last earnings report, the third quarter to 31 March, commercial cloud revenues (Azure, plus Office 365 and Dynamics 365) increased 41% year-on-year to $9.6bn, putting it in line for $38.4bn of annualised revenue. Azure revenue alone jumped 73%.

That compares to $30.6bn of revenue overall, up 14%. Cloud gross margins increased from 58% to 63%, underlining the profitability expansion potential we mentioned earlier.

To put this into perspective, Microsoft Azure is already the world's second biggest cloud analytics and applications platform, behind only Amazon's AWS. Yet experts believe that cloud computing has decades of growth ahead with mainstream adoption still in its early days and with new services and applications emerging all the time.

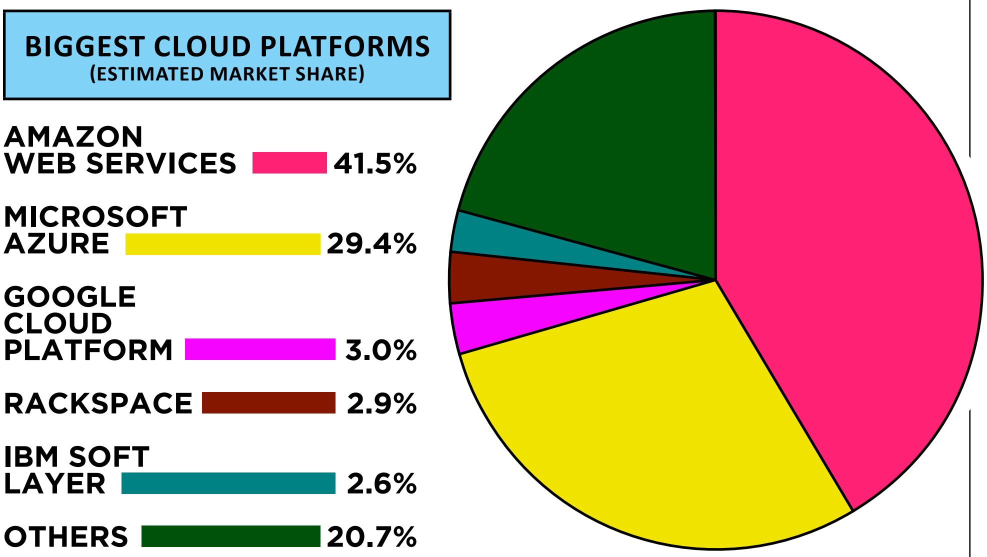
Crucially, this means that Azure growth should remain rapid without Microsoft having to eat Amazon's AWS lunch.

INVESTMENT TRUSTS WITH MICROSOFT IN TOP HOLDINGS

Trust	% of portfolio in Microsoft
Manchester & London	11.6%
Polar Capital Technology Trust	8.8%
JPMorgan American IT	6.6%
Henderson International Income	4.8%
Brunner Investment Trust	4.5%
Personal Assets Trust	4.4%
JPMorgan Global Growth & Income	3.4%
Allianz Technology Trust	3.1%

Source: FE

BIGGEST CLOUD PLATFORMS
(ESTIMATED MARKET SHARE)



Source: Skyhigh Network

UNIT TRUSTS AND OEICS WITH MICROSOFT IN TOP HOLDINGS

Fund	% of portfolio in Microsoft
L&G Global Technology	14.4%
Janus Henderson Global Technology	9.6%
UBS US Growth	9.4%
L&G Global 100 Index	8.0%
Morgan Stanley Global Brands	7.5%
AXA Framlington American Growth	7.4%
Investec American Franchise	7.3%
Investec Global Quality Equity Income	7.2%

Source: FE

Microsoft is a company with rock solid and growing revenues, expanding margins and a solid balance sheet.

As of December 2018, Microsoft had $73.2bn of debt offset by a bulging bank account with $127.7bn cash, resulting in a $54.5bn net cash position which Morningstar calculates to be worth about $7 per share.

Net income in the June 2016 financial year was $22.3bn and, if analysts are right, that will top $35.5bn for 2019, and hit $44.7bn by 2021. Encouragingly, analysts flag Microsoft's nifty habit of consistently beating analyst earnings and revenue projections.

CRUNCHING THE NUMBERS

At $138.99, Microsoft is trading close to all-time highs yet the shares are not overly expensive. On Reuters consensus estimates, the stock trades on a next 12 months price-to-earnings (PE) multiple of 26.6, versus 24.3-times for peers (Oracle, Apple, SAP among them).

The PE ratio falls to 24 on 2021 forecasts. Investors are also likely to get a near-$2 per share dividend over the next year, implying a decent 1.4% yield for what remains essentially a growth stock.

Microsoft Azure is already the world's second biggest cloud analytics and applications platform

> **"AS OF DECEMBER 2018, MICROSOFT HAD $54.5BN NET CASH"**

MICROSOFT'S MAIN INTERESTS

- **Productivity and Business Processes** – includes Office and Dynamics product lines, and LinkedIn platform
- **Intelligent Cloud** – encompasses server products, cloud services and enterprise services offerings
- **Personal Computing** – includes Windows licensing, Xbox-related gaming and revenue from its Surface family of products and PC accessories

SHARES SAYS: ↗

The question should not be whether you should own Microsoft (the answer is 'yes') but how you should own it.

If you own any sort of global or US equities tracker then you own a bit of Microsoft. This will also be the case for investors that have actively-managed technology funds or investment trusts in their portfolios.

For many that may be enough, particularly for those wanting to avoid the extra complexity of W-8BEN tax forms that need to be filled out by UK investors buying US stocks.

The alternative of directly owning Microsoft shares looks like a very sensible option given the technology giant's growth, income and all-round financial muscle. Creating growth opportunities in the highly competitive tech space requires proactive management and that's exactly where Microsoft's strengths lie.

By **Steven Frazer**
News Editor

STAR FUND MANAGERS:
Success doesn't always last forever

By James Crux

Recent years have encouraged the cult of the 'star' investment manager, usually built on the long-term investment records of high-profile stock pickers. Yet in the wake of the Neil Woodford fund suspension, the very notion of the star fund manager is being called into question, especially when it comes to revered money managers going it alone.

Having their own name above the door can feed already huge egos and there is the danger that a star manager's views go unchallenged, potentially leading to costly blunders.

Usually when a manager with a lengthy and much-lauded track record strikes out on their own there is accompanying industry fanfare. This includes speculation about what they might do differently, whether loyal investors will follow the manager to their new fund house and which 'best buy' lists the new portfolio may appear on.

This happened when Julie Dean launched Sanditon Asset Management, Richard Pease set up Crux Asset Management and when Neil Woodford set up Woodford Investment Management.

Yet analysis of past performance data suggests investors should proceed with caution when stock pickers with stellar reputations 'go solo', since they usually suffer a drop in returns after leaving their former employer.

Many investors will follow a successful fund manager when they leave on the assumption they'll stick to their investment knitting and continue to outperform. However, as the Woodford affair demonstrates, investors are now doubting whether they were right to follow the manager as he went solo.

ISOLATED INCIDENT?

Woodford suffered such a sharp reversal in his investing fortunes since leaving Invesco that dealing has been suspended in his **LF Woodford Equity**

Income (BLRZQ73) fund. The saga provides a salutary warning to investors not to plough cash into a star manager's fund on name alone.

That said, it is important to stress that any manager can go through a bad patch. We remain supportive of many well-known names in the industry and certainly do not believe that the Woodford situation should put you off star managers completely.

Instead, it should act as a lesson to better understand your exposure and as a reminder that someone being famous doesn't guarantee they will produce excellent results indefinitely.

If you've backed a star manager, or are considering doing so, make sure you understand what's in their portfolio and their strategy. If you are not comfortable or simply don't understand it, then steer clear. And never put all of your money in a single fund as diversification works to your advantage with both assets and fund managers.

THE CONCEPT OF STAR MANAGERS

Annabel Brodie-Smith, communications director at the Association of Investment Companies, says to become a star manager the individual will have overseen a period of stellar performance and will have built up a strong reputation which attracts other investors. 'There is no guarantee that a star manager's strong performance can be sustained and they can underperform and fall from favour.'

Brodie-Smith says star managers are under more scrutiny which can be a positive but also exacerbate problems when they underperform.

'Star managers of open-ended funds generally manage big funds, which can be a benefit in terms of scale and influence but can compromise the managers' investment selection. Some funds are co-managed by two or more managers or a team of managers. This approach leads to a diverse range of skills and experience, healthy debate and allows for succession planning for the future.'

STATUS ISN'T EVERYTHING

Thomas McMahon, senior analyst at Kepler Trust Intelligence, a research group, believes the concept of a star manager is actually unhelpful.

He says: 'It is important not to make an investment

ANTHONY BOLTON: THE STAR WHO FELL TO EARTH

Pre-Woodford, the star manager famed for falling to earth with a bump was contrarian value investor Anthony Bolton. He previously held the title of Britain's most famous stock picker.

His **Fidelity Special Situations Fund (B88V3X4)** returned 19.5% per year from December 1979 to December 2007, relative to 13.5% for the FTSE All-Share. A £1,000 investment would have turned into a staggering £147,000 over that glorious period.

Bolton retired as a full time fund manager in 2007, but he then surprised investors by returning to manage the **Fidelity China Special Situations (FCSS)** investment trust in 2010. He stepped down in 2015 following a disappointing performance which reflected his apparent misunderstanding of Chinese business culture and a bias to small and mid-cap companies that didn't fare well in the years following the global recession.

The trust's level of gearing (borrowing) only served to amplify losses. The lesson from Bolton's foray into China? Just because an investment strategy worked in one market at a particular time does not mean it will translate into a different market at a different time.

decision based on a fund manager's name, but to investigate how and why a particular fund or trust has been successful and consider whether those factors are likely to continue in the future.

NEED FOR RELEVANCY

McMahon stresses no strategy or style will do well in all environments. 'And while there may well be a skill element to fund management, a skilful player of darts may not be a skilful player of croquet.

'This is important to consider when a fund manager sets up on their own: do they have a track record in what they are trying to do? If not, then their track record may be essentially irrelevant to their chances of success and should not feature in the investment decision much at all.'

He also flags the danger of 'style drift', where a manager deviates from the formula that made his or her reputation.

'This is potentially a major red flag and needs serious investigation,' adds McMahon. 'Fund managers should be able to tell a coherent story about how their approach should lead to success, and its drawbacks too. If they can't, or if their actions don't match up to their words, that is the time to reconsider.'

QUESTION THE TRACK RECORD

Seasoned investor Colin McLean, managing director of SVM Asset Management, says that even when a cult is built on the long-term investment record of a money manager, the precise basis of a record may not be questioned by investors.

'There is a certain amount of randomness that the industry is good at creating narratives around,' he informs *Shares*.

McLean warns that the result of the star manager cult can be 'monster funds' that become victims of their own success. Raising huge chunks of money provides a short-term win for an asset management firm as they collect fees, but does it always mean this is good for investors?

The Scotsman also points out that despite public perception of the 'lone star manager', few investors work alone and so the performance track records are often the result of a team effort.

Aside from the now humbled Woodford, the best-known fund managers in the UK today are Terry Smith, the former analyst and City CEO turned fund manager who launched **Fundsmith Equity (B41YBW7)** fund in 2010, and Lindsell Train's Nick Train.

Smith puts money to work with high-quality companies that can sustain a high return on operating capital employed. While Fundsmith Equity has performed very well, the returns from **Fundsmith Emerging Equities Trust (FEET)** haven't been as impressive and Smith recently stepped back from the day-to-day running of this particular trust.

Other feted names in the market include James Anderson at Baillie Gifford's popular **Scottish Mortgage Investment Trust (SMT)** and Francis Brooke at **Troy Trojan Income (BZ6CQ39)**.

Less well-known names with the potential to become higher profile in the future include Man GLG's Henry Dixon, JOHCM's Alex Savvides, Evenlode's Hugh Yarrow, TwentyFour Asset Management's Chris Bowie, Janus Henderson Investors' Laura Foll and Invesco's James Goldstone.

WHY MANAGERS STRIKE OUT ALONE

Star managers decide to strike out alone for a variety of reasons. Some have long-held ambitions to establish their own investment firm with their name above the door. Others feel their investment strategy is compromised by a house view or become irked by an over-zealous compliance team.

But running a fund is very different to running a business and the performance of these managers seems to take a hit when they go it alone.

John Monaghan, head of research at Square Mile, cautions that the day-to-day running of a business is different to the day-to-day running of a fund.

'Remember that when they set up their own business, myriad factors can distract a star manager – previously they had the support of large research teams, analysts, sales departments and marketing teams, but after striking out alone, they'll have to operate in a leaner environment,' he adds.

WHO HAS GONE IT ALONE?

The most recent star to strike out on their own is Alexander Darwall, who is leaving Jupiter to set up his own outfit, Devon Equity Management.

Other examples in recent history include legendary emerging markets manager Mark Mobius, who retired from Franklin Templeton, then stunned the market by launching his own asset management boutique. He also poached Carlos Hardenberg and Grzegorz Konieczny, two of the American firm's most well-known portfolio managers, to help him manage the **Mobius Investment Trust (MMIT)**.

Paul Marriage made his name at Cazenove and Schroders, most notably with **Schroder UK Dynamic Smaller Companies (B5VQ012)**, where he generated average annual outperformance of 8.32% according to AJ Bell's research.

He left Schroders in 2017 and together with former colleague John Warren set up Tellworth Investments, launching **LF Tellworth UK Smaller Companies (BDTM8B4)** at the end of November 2018. This £92m portfolio follows the same investment process as they used at Schroders and, since launch, has returned 11.25% versus 3.88% for its benchmark.

Nick Train

Lindsell Train

Best known for: Lindsell Train Investment Trust, Finsbury Growth & Income and Lindsell Train UK Equity Fund.

Style: He's a near 40-year veteran of the markets and is known for having a buy-and-hold approach, often going a long time between adding new names to his portfolios. He focuses on high-quality businesses with strong cash generation to underpin growing dividends.

10 year annualised return: 19.5% (for Finsbury Growth & Income Trust, source: Morningstar)

Terry Smith

Fundsmith

Best known for: Fundsmith Equity

Style: Revered for his buy-and-hold approach to investing and focus on firms with strong barriers to competition. Smith made his name as an analyst uncovering companies' creative accounting techniques in the seminal 1990s tome '*Accounting for Growth*'.

5 years annualised return: 23.0% (for Fundsmith Equity, source: Morningstar)

SIX RISKS OF USING A STAR MANAGER

1. History suggests star managers struggle to maintain previous success if they set up shop on their own
2. Fame can attract too many assets and make funds hard to run
3. Many star managers typically have no-one to answer to
4. Solo star managers could be at a disadvantage by not operating in a team structure
5. There is a risk they lose focus
6. Fame can fuel egos and lead to poor decision making

'In his previous years at Invesco on the income fund Neil Woodford delivered annualised "alpha", which is outperformance of the index, of 4.3%. Since setting up alone he has underperformed the index by an annualised 7.2%,' says Laura Suter, personal finance analyst at AJ Bell.

'The trio of managers who set up Sanditon Asset Management are another example, with Julie Dean and Chris Rice outperforming their relevant indices at Schroders, but significantly underperforming in the following years.

'While some fund managers have outperformed the index after going it alone, such as Richard Pease at CRUX Asset Management and Barry Norris at Argonaut, they still haven't managed to generate as much alpha as they did at their previous company.'

The only person to buck this trend is Nick Train, who underperformed the index on an annualised basis when he ran money at M&G, before having sterling outperformance in the subsequent years.

Suter notes that he has been running money at Lindsell Train for far longer than he was at M&G, meaning he has benefited from investing through different market cycles.

Hugh Yarrow

Evenlode Investment Management

Best known for: Evenlode Income Fund

Style: Yarrow steers **TB Evenlode Income Fund (BD0B7C4)** with co-manager Ben Peters. He seeks out sustainable real dividend growth through a focus on asset-light companies with high returns on capital and strong free cash flow.

5 year annualised return: 12.7% (for Evenlode Income, source: Morningstar)

Alex Savvides

JO Hambro Capital Management

Best known for: JOHCM UK Dynamic Fund

Style: Savvides believes the market's misunderstanding of corporate change – typically new management teams with new strategies – regularly throws up opportunities for patient, disciplined and unemotional investors.

This approach typically leads him to high quality, unloved and under-researched UK companies, often in out-of-favour areas of the market.

5 year annualised return: 8.0% (for JOHCM UK Dynamic, source: Morningstar)

FUND MANAGERS GOING SOLO: PERFORMANCE SINCE START OF RUNNING FUND*

Manager	Fund name	Fund	Bench-mark	Average annual outperformance
Neil Woodford	**Previous:** Invesco Income (UK)	864.02%	364.49%	4.27%
	Current: LF Woodford Equity Income	-5.46%	34.84%	-7.24%
Neil Woodford	**Previous:** Invesco High Income (UK)	2403.65%	989.59%	3.58%
	Current: LF Woodford Income Focus	-23.82%	10.26%	-16.10%
Richard Pease	**Previous:** Henderson European Special Sits	58.62%	29.80%	4.28%
	Current: FP CRUX European Special Sits	80.95%	61.09%	1.72%
Richard Pease	**Previous:** Janus Henderson Euro Growth	207.60%	104.63%	3.32%
	Current: FP CRUX European	41.54%	50.30%	-1.82%
Nick Train	**Previous:** M&G UK Select	29.70%	30.46%	-0.65%
	Current: LF Lindsell Train UK Equity	370.29%	116.63%	6.54%
Nick Train	**Previous:** M&G Global Select	51.79%	63.26%	-5.80%
	Current: Lindsell Train Global Equity	122.02%	76.74%	7.13%
Barry Norris	**Previous:** Neptune European Opps	61.03%	33.82%	8.91%
	Current: FP Argonaut European Alpha	265.71%	193.81%	1.68%
Julie Dean	**Previous:** Schroder UK Opportunities	364.25%	198.10%	4.23%
	Current: TM Sanditon UK	-6.50%	26.91%	-7.77%
Tim Russell	**Previous:** Schroder Core UK Equity	119.98%	120.00%	0.00%
	Current: TM Sanditon UK Select	-11.82%	12.31%	-7.34%
Chris Rice	**Previous:** Schroder European Recovery	223.88%	175.81%	1.67%
	Current: TM Sanditon European	38.20%	58.52%	-2.18%
Richard Buxton	**Previous:** Schroder UK Alpha Plus	246.94%	129.30%	4.16%
	Current: Merian UK Alpha	44.21%	45.96%	1.62%
Paul Marriage	**Previous:** Schroder UK Dynamic Smaller Companies	430.12	119.97	8.32%
	Current: Tellworth UK Smaller Companies	11.25%	3.88%	7.37%

*Data for old fund runs up until manager left

Source: AJ Bell

10 ways to check you're happy with your investment funds

Lessons to be learned from the Woodford fund suspension

The news of Neil Woodford suspending withdrawals from his flagship fund has dominated the media. But what can investors learn from the situation to help hone their portfolios?

Investors trapped in the Woodford fund are understandably concerned about their money. While there's nothing they can currently do about that money, they can use some lessons from the situation to check that the rest of their portfolio is ship-shape.

Here are 10 questions to ask yourself about your funds:

1 How liquid are my funds?

A big issue for Woodford was that he had built up a large proportion of the fund in smaller companies, which are more illiquid, meaning they are harder to sell quickly.

You need to understand how liquid the funds are that you own, and accept that if you want exposure to illiquid assets, you may not be able to get your money when you want it. As Woodford has shown, just because a fund says it offers daily dealing, it doesn't mean it always will.

2 Has the fund got too big?

Be wary of funds that have accumulated masses of assets.

There's no hard and fast rule on the appropriate size of a fund, as it depends on what it's investing in. A fund invested in FTSE 100 companies can amass more assets than one investing in micro-sized UK start-ups.

Woodford Equity Income Fund (BLRZQ73) peaked at over £10bn, which doesn't look to have been appropriate considering his focus on smaller companies.

While it is always tempting to follow other investors into big funds, be careful and try to understand whether this size may actually be detrimental to long-term performance or liquidity.

3 Has the fund been a victim of investment drift?

Most managers are good at sticking to a well-defined investment approach that sees them invest in a particular type of company. And this is why investors buy into a fund – to access that fund manager's expertise and experience.

However, managers sometimes drift away from what they're good at and start investing in companies away from their core competence.

This can be a fund manager moving from investing in large companies into smaller ones, or it can be a manager changing their style of investing (typically because theirs is out of favour). This ultimately changes the fund into something different to what most investors originally thought they were buying.

4 Are too few investors controlling the fund?

It's important to be wary when a few investors control a large proportion of fund assets. If someone owns a large chunk of the fund and then decides to sell it can cause serious problems for the fund manager, particularly if they are investing in more illiquid assets.

It is always worth finding out what proportion of the fund the top five investors own – you can ask the asset manager for this information or find it in the annual report and accounts.

5 Have you just followed a 'star'?

No fund manager has the secret recipe to outperforming the market in all conditions and you should expect everyone at some point to have a period of bad performance when their investing style or process is out of favour. If someone has a good long-term track record, don't just assume it will continue.

6 Do you understand the fund manager's style?

It's vital to understand how a manager invests before you give them any cash, as it can be very painful to learn with your own money. Careful due diligence is rarely wasted.

Things you should make sure you know are: in what market conditions will they do well or badly, what type of companies do they invest in, and how many different holdings do they usually have? This will help you to determine whether the fund performance is in line with your expectations or not.

7 Have you looked beyond the fund name?

Just because two funds say they invest in UK equities doesn't mean they have the same risk or indeed can be compared.

Both may sit in the same sector but you could be comparing apples with pears. For example, a fund investing in large well-known UK companies can be very different to a fund investing in small and medium-sized UK companies. You should look beneath the bonnet, and beyond the fund name, to understand what it's investing in.

8 Have you spread your eggs across different baskets?

You don't want to put all your eggs in one basket, so make sure that one fund manager isn't running too much of your overall investment portfolio.

You should go through your investments and check that you have a good spread across different funds or regions, and re-balance your portfolio each year so you don't end up too concentrated.

9 Have you just followed the herd?

A worrying number of people invest in funds because their friend has done so or someone told them they made a lot of money from the manager – but you should always do your own research.

The same goes for following investment platforms' best buy lists – you should use them as a guide or a starting point, but make sure you do your own research so you understand the fund, how it invests and why you're buying it.

10 Have you checked cross holdings?

If a manager is running more than one fund, how many of the stocks are held across both funds?

If a manager has to sell in one portfolio, it may cause the price to fall in the other. Therefore, look not just at the fund you are interested in, but other funds run by the same manager.

You should also make sure that you don't have too much doubling up in your investment portfolio – for example, you don't want to own four funds that all have the same company in their top 10 holdings.

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

Should I pick a manager's fund or trust?

New research shows an interesting performance trend when a manager runs different products with similar strategies, writes Laura Suter

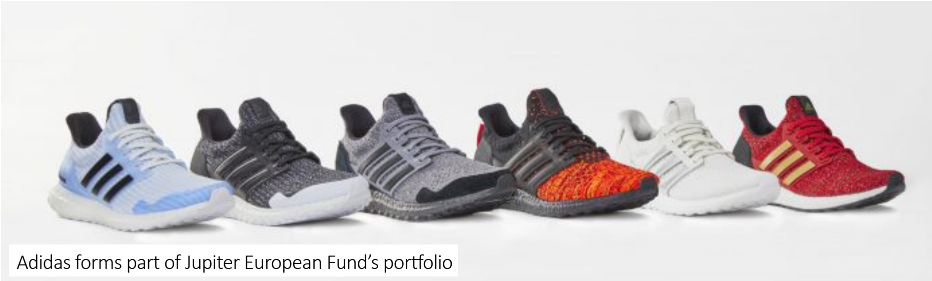
Fund managers who run both an investment trust and a fund to a similar strategy will usually outperform on the trust.

A number of fund managers run both an investment trust and a fund, with many having the same strategy and a big overlap between their holdings. But how can investors work out which to buy? Research from AJ Bell shows that the investment trust is far more likely to outperform than the fund.

The research looked at 49 'dual managers' who run a similar trust and fund, and compared fees, performance over 10 years and volatility.

In 75% of cases the investment trust outperformed the fund, on a total return basis over a 10-year period. What's more, in 60% of the pairings the trust was the cheaper vehicle, with a lower ongoing charges figure (OCF). On average the funds in the group cost 0.97% while the trusts cost 0.91%.

However, investors shouldn't just jump for the trust. They don't get this extra performance for free and they have to be prepared for a bumpier ride. This is because investment trusts have the ability to borrow money, or 'gear', where funds do not. It means that when a trust is doing well its returns can be supersized, which helps to account for some of the outperformance.


Adidas forms part of Jupiter European Fund's portfolio

On the flipside, it means that when their investments are falling in value these losses could be amplified. This shows in the figures, and a whopping 90% of the time the trust is more volatile than the equivalent fund.

WHICH MANAGERS FEATURE?

One of the more famous dual managers is Nick Train, who runs both the £7.1bn **Lindsell Train UK Equity Fund (B18B9X7)** and the £1.8bn **Finsbury Growth & Income Trust (FGT)**. The fees on the funds are almost identical, as are the top 10 holdings and the investment strategy. Despite this the trust's performance has outstripped the fund, returning 498.6% over 10 years compared to 432.8% for the fund.

However, over time the trust has been slightly more volatile, likely due to the gearing that the trust has, which is currently low at 1.2%. It means that if investors know they can stand the slightly bumpier ride, historically they would have been better off invested in the trust.

Alexander Darwall runs **Jupiter European Fund (B5STJW8)** and **Jupiter European Opportunities Trust (JEO)**. This is an example where the trust is cheaper than the fund, with an OCF of 0.9% compared to 1.02% for the fund. Over 10 years the performance difference is stark, with Jupiter European returning 364% compared to 567.9% for the trust, with the lower fees also likely playing a part. However, there is quite a dramatic difference in volatility between the two, with the trust being a third more volatile.

One pairing that bucks the trend of trusts being cheaper is Alex Wright's **Fidelity Special Situations (B88V3X4)** and **Fidelity Special Values (FSV)** investment trust, where the latter is pricier than the fund, costing 1.05% compared to 0.91%.

Despite this potential fee drag, the trust has outperformed the fund by almost 50% more over 10 years, returning 268.5% compared to 187.8%, although Wright hasn't run the fund for that entire time.

Fund manager	Fund name	Investment Trust name	Which is cheaper?	Fund - 10-year performance	Trust - 10-year performance	Which outperformed over 10 years?
Adam Avigdori, David Goldman	BlackRock UK Income	BlackRock Income and Growth	Fund	153.34%	168.36%	Trust
Alex Wright	Fidelity Special Situations	Fidelity Special Values	Fund	187.77%	268.51%	Trust
Alexander Darwall	Jupiter European	Jupiter European Opportunities	Trust	364.02%	567.89%	Trust
Andrew Brough	Schroder UK Mid 250	Schroder UK Mid Cap	Trust	203.09%	276.27%	Trust
Andrew Rose	Schroder Tokyo	Schroder Japan Growth	Fund	158.58%	205.77%	Trust
Austin Forey	JPM Emerging Markets	JPMorgan Emerging Markets	Trust	161.69%	199.47%	Trust
Ben Ritchie	Aberdeen UK Equity Income	Dunedin Income Growth	Trust	163.17%	189.25%	Trust
Ben Rogoff, Nick Evans	Polar Capital Global Tech	Polar Capital Technology	Trust	587.83%	661.14%	Trust
Chern-Yeh Kwok	Aberdeen Japan Equity	Aberdeen Japan	Fund	175.03%	204.48%	Trust
Ciaran Mallon	IP Income & Growth	Invesco Income Growth	Trust	171.69%	180.73%	Trust
Douglas Brodie	Baillie Gifford Global Discovery	Edinburgh Worldwide	Fund	536.50%	472.00%	Fund
Ed Kuczma	BGF Latin American	BlackRock Latin American	Trust	80.07%	65.70%	Fund
Evy Hambro, Olivia Markham	BGF World Mining	BlackRock World Mining Trust	Trust	16.51%	46.35%	Trust
Ewan Markson-Brown, Roderick Snell	Baillie Gifford Pacific	Pacific Horizon	Fund	269.97%	218.49%	Fund
Francesco Conte, Edward Greaves	JPM Europe Smaller Companies	JPMorgan European Smaller Comp	Fund	269.40%	306.82%	Trust
Francis Brooke, Hugo Ure	Troy Trojan Income	Troy Income & Growth	Trust	186.07%	273.47%	Trust
Georgina Brittain, Katen Patel	JPM UK Smaller Companies	JPMorgan Smaller Companies	Fund	281.82%	377.24%	Trust
Harry Nimmo	SLI UK Smaller Companies Inst	Standard Life UK Smaller Co.	Fund	404.73%	488.14%	Trust
Hugh Young	Aberdeen Global Asn Smllr Coms	Aberdeen Standard Asia Focus	Fund	218.65%	393.87%	Trust
Hugh Young	Aberdeen Asia Pacific Equity I	Aberdeen New Dawn	Trust	183.31%	211.02%	Trust
Hugh Young	Aberdeen Global Indian Equity	Aberdeen New India	Trust	256.23%	241.50%	Fund
John Bennett	Janus Henderson European Focus	Henderson European Focus Trust	Trust	226.35%	240.83%	Trust
Jonathan Brown	IP UK Smaller Companies	Invesco Perpetual UK Smaller	Fund	350.29%	472.87%	Trust
Mark Barnett	Invesco Income UK	Edinburgh Investment	Trust	129.54%	184.79%	Trust
Mark Barnett	IP UK Strategic Income	Perpetual Income & Growth	Trust	137.61%	144.89%	Trust
Matthew Brett	Baillie Gifford Japanese	Baillie Gifford Japan	Fund	262.52%	457.77%	Trust
Michael Kerley	Janus Henderson Asian Div Inc	Henderson Far East Income	Fund	194.10%	154.67%	Fund
Neil Hermon	Janus Henderson UK Smaller Coms	Henderson Smaller Companies	Trust	413.34%	575.28%	Trust
Nick Mustoe	IP Global Equity Income	Invesco Perp Select Glo Eq Inc	Trust	242.75%	216.42%	Fund
Nick Train	LF Lindsell Train UK Equity	Finsbury Growth & Income	Trust	432.75%	498.59%	Trust
Oleg Biryulyov, Habib Saikaly	JPM Russia	JPMorgan Russian Securities	Trust	103.87%	175.14%	Trust
Ollie Beckett	Janus Henderson European Smr Coms	TR European Growth	Trust	364.45%	246.11%	Fund
Peter Hewitt	BMO Multi Man Invest Trust	BMO Managed Portfolio Growth	Fund	194.30%	185.71%	Fund
Praveen Kumar	Baillie Gifford Japan Small Co	Baillie Gifford Shin Nippon	Fund	482.38%	789.22%	Trust
Richard Newbery, Alistair Whyte, Euan Macdonald, Keith Muir, Chris Watt, Peter Shaw, Jeremy Hall	Aberforth UK Small Companies	Aberforth Smaller Companies	Trust	233.72%	274.80%	Trust
Samuel Morse	Fidelity European	Fidelity European Values	Trust	191.01%	239.16%	Trust
Shoichi Mizusawa, Nicholas Weindling	JPM Japan	JPMorgan Japanese	Trust	235.63%	278.12%	Trust
Simon Gergel	Allianz UK Equity Income	Merchants Trust	Trust	154.69%	195.48%	Trust
Steve Davies	Jupiter UK Growth	Jupiter UK Growth	Fund	151.97%	144.83%	Fund
Thomas Moore	SLI UK Equity Income Uncons	Aberdeen Standard Equity Income	Trust	206.16%	165.39%	Fund

Source: AIC/AJ Bell/FE. Data is on a total return basis.

European trust sharpens proposition in fight against passives

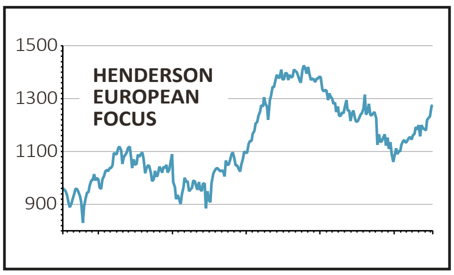
Henderson European Focus Trust increases portfolio concentration to take bolder bets

Fund managers are increasingly sharpening their proposition in the fight against competition from lower-cost tracker funds. Among them is John Bennett of **Henderson European Focus Trust (HEFT)** where the investment trust has amended its structure to give it capacity to make greater bets by holding fewer companies.

The trust has cut the minimum number of holdings it can have in the portfolio, with the so-called 'floor' of the fund going down from 50 to 45.

Bennett would like to lower the threshold further as the trust aims to become less like its FTSE World Europe ex-UK benchmark index. That would require approval by the board of directors and the trust's shareholders.

By having a more concentrated portfolio, the fund would experience a greater benefit when its holdings enjoy good news as there would be less diversification to dilute the



overall performance. However, this approach can work both ways and the fund could experience more pain if one of its holdings goes through a bad patch.

SPOTTING OPPORTUNITIES

Bennett doesn't appear to be a person who is afraid of taking bold bets. After all, he welcomes negative economic news as it can present a good opportunity to invest in the market.

That attitude is fortunate given his focus on Europe where the economic headlines are particularly gloomy at present. 'I say recession is a good thing because in recession you get bargains. You don't get bargains when everyone says come on in, the water's warm,' he remarks.

Typically a value investor, Bennett's portfolio is focused around finding high quality, Europe-based companies with share prices that are undervalued by the market.

Anyone buying this fund is getting exposure to companies that are listed in Europe but are actually active in more parts of the world.

Bennett's message is: 'Don't buy Europe, buy the globe'. You may think that sounds a bit odd from someone in charge of a European fund, yet there is logic in his thinking.

The fund manager's expertise is the European stock market and this presents his universe from which to find global companies, hence how the fund is differentiated from others labelled as more generic global products.

His view is that Europe's economic data is not what dictates the success of companies listed in the region, and so in his opinion poor figures from countries such as Germany this year aren't relevant to the success or failure of a business based in the continent.

BIG COMPANIES, LOW PRICES

Henderson European Focus' top holding is Swiss firm LafargeHolcim, the world's biggest cement company, which made up 5.9% of the fund as at 31 May 2019.

Since the two cement companies Lafarge and Holcim merged in July 2015, the combined company's share price has fallen from around CHF70 at the time of the merger to around CHF48 today, with its bigger size effectively holding it back from being able to grow.

Bennett says he has 'never liked cement, never liked Lafarge and never liked Holcim'. So why is it his biggest holding? 'It's not because it's cement. It's actually because one of the finest CEO and CFO teams I've ever met in my career are now at the helm there,' he explains.

Under the leadership of chief executive Jan Jenisch, who joined in September 2017, the company is moving away from being a so-called 'empire builder' and is tilting the focus of the business away from cement and into higher growth, higher margin areas of the building materials market.

Bennett thinks the business has been damaged by being in too many countries and markets, but that there should be a turnaround in performance as it gains a narrower focus.

He adds: 'Far too many European household names – Daimler, Siemens, Phillips and the banks – became empire builders. That is usually damaging to shareholders. Focus is usually what makes shareholders money.'

CUMULATIVE PERFORMANCE (%)

	10 Year	5 Year	3 Year	1 Year
Share price (total return)	205.9	32.5	28.7	-2.3
Net asset value (total return)	213.0	46.0	34.8	-0.4
Benchmark (total return)	146.1	40.6	39.4	1.8

Source: Janus Henderson, as at 31 May 2019

IDIOSYNCRATIC STOCK PICKING

Bennett highlights two companies which epitomise the trust's idiosyncratic view to stock picking, focusing more on a company's merits than the home country it is based in.

One is German manufacturer Knorr-Bremse, which makes train and truck brakes. Bennett calls it the 'classic epitome' of the German Mittelstand, the small and medium-sized enterprises (SMEs) which make up the backbone of the German economy.

A large number of such SMEs typically operate in niche parts of the manufacturing industry, and many have become global leaders in their respective markets.

Knorr-Bremse is one of those companies, and Bennett says its focus on two products and high market share mean it's primed to capitalise on growth in the markets where it sells its products, and that's not in Germany.

He says: 'When China invests in rail (for example), there are fewer bigger beneficiaries, certainly in the listed world, than Knorr-Bremse.'

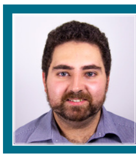
Since it listed in October 2018, the company's share price has steadily risen from €80 to around €93 today.

The other stock Bennett highlights is Spanish pharmaceutical company Grifols, one of only a few companies in the world making blood plasma-based products.

He describes the company as a 'very unique listed asset' which epitomises his fund and says there are about only three to four others in the world doing what Grifols does.

'That's a high growth niche with high barriers to entry, which happens to be listed in Spain. That's the type of company to me that epitomises the real European opportunity.'

While growth in its share price has been modest in the past year, the longer track record is different with the shares rising from around €6 in 2012 to currently hovering around the €27.50 mark.



By **Yoosof Farah**
Reporter

The different ways to play the US markets via ETFs

We look at the range of exchange-traded funds which follow American stocks

The US stock market is the largest in the world and encompasses shares in household names such as McDonald's, Disney and Facebook.

It has also been an extremely strong performer in recent years. On 10 July the S&P 500 index hit a new record high above the 3,000 level, just five years after attaining the 2,000 mark.

It is also the geographic market with the largest selection of London-listed exchange-traded funds from which you can achieve low-cost exposure.

There are several different indices tracked by US ETFs and it is worth a prospective investor being fully aware of the differences between them and what they are actually buying when they settle on a product.

TRACKING US LARGE CAPS

Although investors are probably most familiar with the likes of the S&P 500 and the Dow Jones Industrial Average indices, several ETFs actually track the MSCI USA index including **Xtrackers MSCI USA (XMUS)** which has an ongoing charge of 0.07%.

This index encompasses some 643 companies accounting for more than 80% of the total market value of US shares. The likes of Microsoft, Apple, Johnson & Johnson and others are all present and correct.

In that sense it is fairly similar to the S&P 500 which, as its name suggests, includes 500 of the largest US firms.

However, there is an interesting feature of the S&P 500 which distinguishes it from other indices. Companies can only be included in the index if they have delivered a profit over the previous year.

Like MSCI USA, the S&P 500 covers about 80% of the US stock market, however, it excludes companies such as Tesla and Uber as they do not make consistent profits.

Therefore investors buying a product tracking the S&P 500 are effectively getting a modest bias towards quality stocks given the profitability rule.

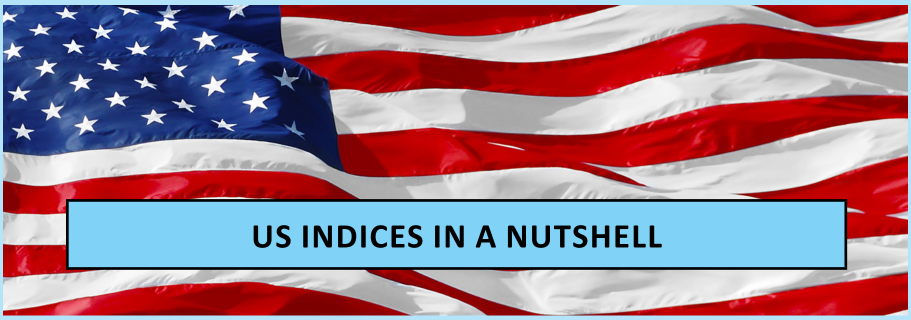
NEW CHEAPER PRODUCTS

In addition to offering exposure to the S&P 500, several providers are bringing new ETFs to the market tracking alternative indices from the likes of Morningstar and Solactive.

These are good lookalikes for the S&P 500 and because the index providers charge less, it enables the ETF issuer to charge investors less.

Examples include **L&G US Equity (LGUG)** and **Lyxor Core Morningstar US (LCUS)** which have ongoing charges of 0.04% and 0.05% respectively.

It is also worth considering



Index	Description
Dow Jones Industrial Average	Includes 30 large US-listed companies
S&P 500	Takes in 500 of the largest profitable US firms
NASDAQ 100	The top 100 businesses on the technology heavy NASDAQ index
Russell 2000	The main US small cap index

Source: Shares

WHAT IS IN THE S&P 500?

Information Technology	21.5%
Health Care	14.2%
Financials	13.1%
Consumer Discretionary	10.2%
Communication Services	10.2%
Industrials	9.4%
Consumer Staples	7.3%
Energy	5.0%
Utilities	3.3%
Real Estate	3.1%
Materials	2.8%

Source: S&P


Array Biopharma is currently being taken over for $10.6bn

the costs associated with trading the products, not just those levied by your platform provider but also the bid/offer spread which is the difference between the price at which you can buy and sell the shares.

As some of these new instruments are less widely held the spread can be higher and for this reason investors may want to stick with the larger and more widely traded ETFs which track the S&P 500. Examples include **iShares Core S&P 500 (CSP1)** and **Vanguard S&P 500 (VUSA)** which both have ongoing charges of 0.07%.

WHAT ABOUT THE DOW?

There are several ETFs which follow the Dow Jones Industrial Average, including **iShares Dow Jones Industrial Average (CIND)**. The Dow is a price-weighted average of 30 actively traded blue-chip stocks.

Price-weighted means their weighting on the index, and therefore the influence over how the wider index trades, is determined by share price rather than market valuation.

The means by which companies get into the Dow Jones Industrial Average is a bit vague. The companies tend to be leading operators in their respective industries and are very large.

It is quite rare for the Dow to keep changing names as it takes an important change in a company for it to be removed by the committee which runs the index.

In July 2018 the final original constituent of the index, General Electric, was ejected and replaced by the Walgreens Boots Alliance drugstore chain following a period of turmoil for the industrial conglomerate.

OTHER WAYS TO PLAY THE US

Another US index followed by ETFs is the NASDAQ 100 which is dominated by big technology stocks like Microsoft, Apple and Amazon. For example, ETF **Invesco NASDAQ 100 (EQQQ)** follows this index and has an ongoing charge of 0.3%.

The Russell 2000, tracked by several ETFs including **SPDR Russell 2000 US Small Cap (R2SC)**, includes a group of smaller US stocks whose fortunes are typically more closely tied to the domestic economy.

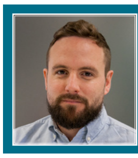
For the most part these are still relatively large companies. The median market cap of stocks on the Russell 2000 is $791m and the largest stock, Array Biopharma, is currently being taken over for $10.6bn.

While only a few constituents would be well known on this side of the Atlantic, Build-A-Bear Workshop may perhaps resonate with parents of small children given its UK high street presence.

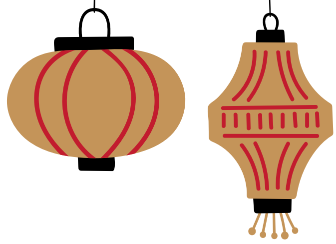
SPECIALISED EXPOSURE

For investors who want more specific exposure, there are numerous ETFs which track different sectors as well as products which filter the US market to identify stocks with specific attributes. These range from sustainability factors to financial metrics.

For example, **Invesco High Dividend Low Volatility S&P 500 (HDLV)** uses screens to identify higher dividend-paying members of the S&P 500 and may therefore be of interest to investors seeking a source of income.


By **Tom Sieber**
Deputy Editor

Why China still needs a trade deal



Economists and investors are concerned about the pace of growth in the country


Beijing

China's second quarter GDP growth figure of 6.2% year-on-year appears to be the source of some market angst, not least because it represents the slowest rate of increase since 1992, which is as far back as Beijing's records go.

It is possible to argue that such a rate of advance is remarkable for what is the world's second largest economy. If China were to maintain that growth rate for all of 2019, then its economy would, based on World Bank data, grow by $844bn this year. That is more than the entire output of Saudi Arabia, the world's eighteenth-largest economy.

And yet economists and investors alike seem concerned. The degree of worry among the latter can be easily measured by using the Shanghai Composite as a benchmark: the index trades no higher now than it did in January 2007.

The benchmark even stands some 10% below its

CHINESE EQUITIES ARE TREADING WATER AGAIN

Source: AJ Bell, Refinitiv

April high, thanks in no small part to how $7.4bn flowed out of Chinese equities in May. That was the biggest monthly outflow since June 2013, according to data from the Institute of International Finance.

Yet this bad news could be good news. The prevailing nerves about the economic outlook may persuade patient contrarians to think there is some value to be had, with Chinese equities trading on around 14 times forward earnings.

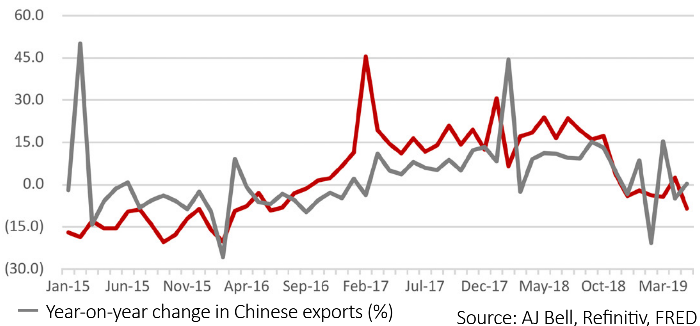
ECONOMIC JITTERS

All the same, three charts make it easy to see why economists and asset allocators are a bit nervous.

The first is the marked slowdown in Chinese export and import activity. Imports have fallen year-on-year five times in the last six months and in May exports grew just 0.3% year-on-year.

The former may reflect domestic softness, the latter slower global growth but also the impact of the trade dispute with America, where there seems little sign of an immediate resolution despite the hopes raised by President Donald Trump at June's G20 meeting in Osaka, Japan.

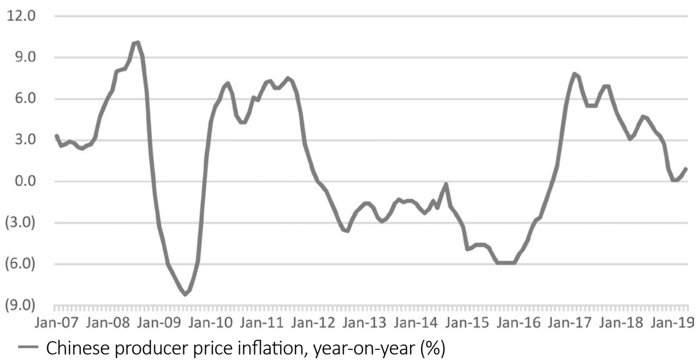
CHINESE IMPORT AND EXPORT GROWTH HAS SLOWED DOWN IN 2019



Source: AJ Bell, Refinitiv, FRED – St. Louis Federal Reserve database

The second may be a spill over from the trade slowdown. Chinese producer price inflation has slowed down, raising fears that the country's manufacturers may be sliding into some sort of supply-side glut or even a deflationary bust. Similar concerns did a huge amount of damage to the

PRODUCER PRICES MAY BE SLIDING TOWARD DEFLATIONARY TERRITORY



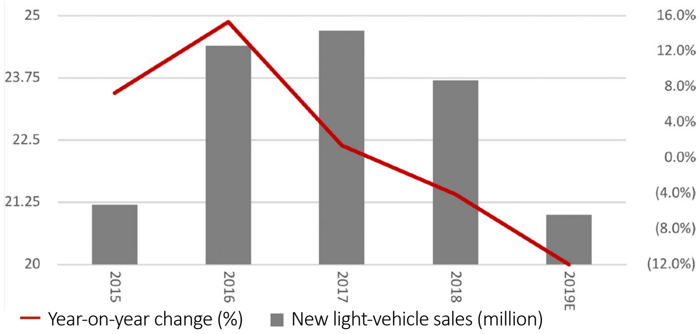
Source: AJ Bell, Refinitiv, FRED – St. Louis Federal Reserve database

Shanghai Composite in 2015-16.

The third is car sales. China is trying to pivot away from making stuff for export and building bridges to nowhere, or at least properties where no-one lives, and toward consumption.

A slide in the auto market suggests this plan may be hitting a speed-bump with volumes set to fall for the second straight year.

CHINESE CAR SALES APPEAR TO HAVE HIT A WALL



Source: AJ Bell, Chinese Association of Automobile Makers (CAAM), Organisation Internationale des Constructeurs d'Automobiles (OICA)

POLICY RESPONSE

President Xi and the Communist Party are not just letting events unfold around them. The government has increased export rebates, cut corporate pension contribution requirements and trimmed taxes.

The People's Bank of China has also done its bit in the form of interest rate cuts and a decrease in the reserves that banks are required to hold, in a bid to boost lending.

China's government debt is relatively low at $6.5trn or 48% of GDP so there looks to be plenty left in the tank when it comes to potential stimulus. But add in financial sector debt, household debt and soaring corporate debt and those figures rise to around $40trn or nearly 290% of GDP, which

looks less comfortable.

As such, the authorities in Beijing have a tricky balancing act, as they encourage growth with cheap cash and fiscal stimulus yet at the same time stop debt-fuelled housing and financial markets from becoming too bubbly. Although in this respect it could be argued that China is no different from the US, UK, Canada, Australia or Sweden, for example.

Growth could take on more of a stop-start pattern than previously, as stimulus boosts the economy (as per 2016), only for its effect to start to wear off (as per 2018) and the authorities to then step in again (as per 2019).

But of the three issues which held back Chinese equities last year, two now look less problematic. Oil has retreated to $60 a barrel, which helps since Beijing is a net buyer of crude. The dollar may have peaked, using the DXY ('Dixie') trade-weighted index as a guide, as the Fed prepares to cut rates and the White House talks down the buck.

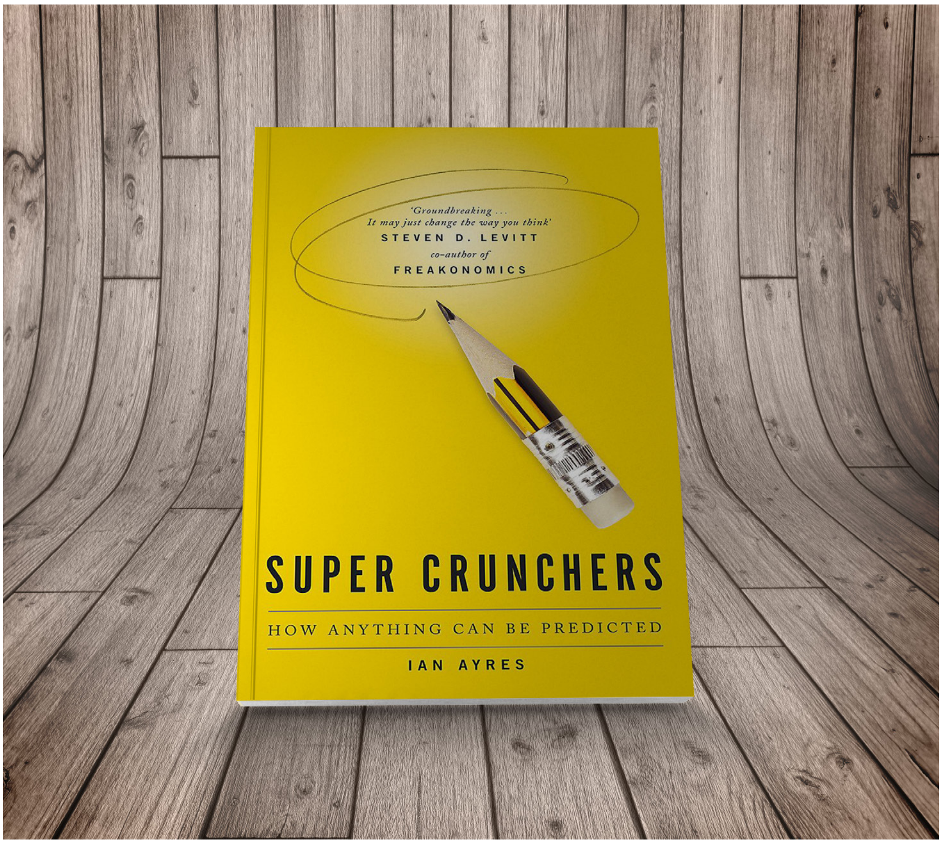
That still leaves the third issue – trade. Financial markets are working on the principle that both Presidents Trump and Xi need a deal so one will be done. The intertwined issue of technological supremacy unfortunately means that reaching an agreement may be a lot less simple than it looks, although Chinese stocks are still discounting a negative outcome from the negotiations with Washington.

Any trade deal with the US, assuming there is one, could therefore be a step on the road to a more sustainable recovery for the Shanghai stock market.

By **Russ Mould**
AJ Bell Investment Director

Super crunching sweeps the business world

Being able to predict trends by data mining is the key to success



In a break from reviewing 'self-help' books on investing and market histories, this month we look at a *New York Times* bestseller which investigates the use of big data, regressions and randomisations to solve puzzles.

If you've ever watched *Who wants to be a millionaire?* you may have noticed that 'Ask the Audience' option has a better record of getting the right answer than 'Phone a Friend'. In fact, asking the audience produces the right answer more than 90% of the time while phoning a friend produces the right answer less than two thirds of the time.

The reason for this is that the *average* guess or estimate of a group of people is more likely to be closer to the right answer than any individual estimate, as the author James Surowiecki showed in his 2004 book *The Wisdom of Crowds*.

In *Super Crunchers,* author and Yale law professor Ian Ayers takes this idea of collective wisdom further and dives into the world of data crunching to show how statistical analysis is displacing traditional experts and how this is affecting our everyday lives.

Super crunching isn't just changing the way that decisions are made, it's changing the decisions themselves.

DINNER IS ON THE HOUSE AND LOVE IS IN THE AIR

For every customer who goes to a Harrah's casino and picks up a 'Total Rewards' swipeable card, Harrah's knows on a hand-by-hand or slot-by-slot basis how much each customer is winning or losing in real real-time.

It combines this data with other information like the customer's age and the average income in the area where they live to predict how much that customer can lose and still enjoy the experience enough to come back.

It calls this amount the 'pain point'. If a customer gets close to that point, a manager from Harrah's approaches with commiserations and the offer of a free steak dinner for them and their partner in the company's steak-house. The pain of losing gives way to a pleasurable experience, and Harrah's data shows that this is often enough to encourage the customer to return.

One of the most active super crunchers is eHarmony which uses statistics rather than peoples' conscious and articulated preferences to find a compatible match.

At the heart of its match-making process is a regression model which takes raw historical data and estimates how various factors influence one single question or variable. In eHarmony's case the single variable is how compatible a couple is likely to be.

The raw historical data is comprised of decades of information on married people to see what types of personalities are *actually* happy together rather than how long people who just *think* they are compatible stay together.

The firm keeps its model and its data to itself but its ability to predict a match is remarkable. So much so that it claims that 70% of men and women will meet their spouse on eHarmony within a year.

WHAT'S IN YOUR WALLET?

US credit card provider Capital One, which used the phrase above in its marketing several years ago, combines regression analysis with randomisation to drive its business.

For more than a decade, Capital One has been running thousands of experiments every year for new products, new advertising approaches and new contract terms.

It regularly sends different groups of prospective customers different offers – for example a low introductory rate or a limited-time offer – to see which has the highest success rate.

Because each group is over 50,000 people, at which point the distribution of each group is almost identical, the difference in their responses can only be down to the offer they receive.

Sometimes price isn't everything. In one experiment, adding a photo of a smiling woman to the corner of an offer letter raised the response rate of male customers by the same amount as dropping the interest rate by nearly 5%.

GETTING IN ON THE GAME

Unsurprisingly, US companies are well ahead of their UK and European counterparts when it comes to super crunching.

Two of the few UK companies to really mine their customer data are **Tesco (TSCO)** and **ASOS (ASC:AIM)**.

Thanks to its Clubcard scheme, which was set up over 20 years ago, Tesco knows the shopping habits of 19m households or 60% of the UK population.

Together with the data from its mobile telephone and banking services, Tesco knows who are its most valuable customers and how to keep them spending.

ASOS is successfully using 'machine learning' – essentially computers crunching masses of data, running regressions and randomisations – to predict which products and styles its customers will like.

Companies which rely on consumers for their business need to get ahead and start crunching data now or risk losing out to rivals who better understand the value of data and are better at forecasting what customers are likely to want in the future.

> "For more than a decade, Capital One has been running thousands of experiments every year for new products, new advertising approaches and new contract terms"

By **Ian Conway**
Senior Reporter

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Martin talks about the past year and how Diurnal has managed to become one of the few listed biotech companies to have taken its product from concept, through development into commercialisation and generating revenue.

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James tells the story of how Equals, previously called FairFX, started from humble beginnings to become a business with £2bn+ turnover.

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LoopUp's co-CEO explains its cloud-based software solutions to conference calls and remote meetings while illustrating how its strategy differs from other companies in the market.

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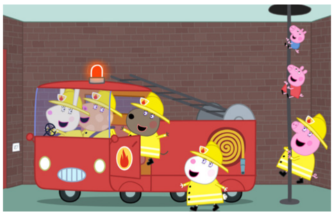
KEY

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



KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results

22 July: Tungsten. **23 July:** Carclo, Cohort, IG. **25 July:** Diageo, Fuller's.

Half-year results

23 July: PZ Cussons, Synectics, Unite. **24 July:** Croda, Drax, GlaxoSmithKline, Hammerson, Informa, ITV, Segro, Tullow Oil. **25 July:** Anglo American, Acacia Mining, AstraZeneca, Bodycote, Burford Capital, Capital & Counties, Howden Joinery, Inchcape, Lancashire, Morgan Advanced Materials, National Express, RELX, Unilever, Vesuvius, Wizz Air.

Trading statements

22 July: Petra Diamonds. **23 July:** ASOS, Paragon. **24 July:** Brewin Dolphin, Britvic, Marston's, PayPoint. **25 July:** AJ Bell, CMC Markets, Compass, Daily Mail and General Trust, Intermediate Capital, Sage.

DISCLAIMER:
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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

All chart data sourced by Refinitiv unless otherwise stated

PRODUCTION
Head of Design Darren Rapley
Designer Matt Ely

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