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SHARES

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PLUS

WHY **STOCK MARKETS** AROUND THE WORLD PLUNGED LAST WEEK

SMITHSON LIVES UP TO THE HYPE AS THE **FUNDSMITH TRUST** TURNS ONE

HOW TO BUILD A **DIVERSIFIED PORTFOLIO** WITH JUST **THREE ETFS**

Getting your head round Greggs' share price slump

Everything was riding on another round of earnings upgrades… and they didn't happen

To be a good investor you must be able to understand why shares are moving in a certain direction. **Greggs' (GRG)** 12.5% share price drop on 1 October upon publishing a new trading update is a perfect example to study.

At first glance, the trading update looked very positive and so the large fall may have been difficult to comprehend. But once you obtained a better understanding of its situation and weighed that against its stock market valuation it was easy to see why the shares fell.

Greggs' shares have been fuelled by three things over the past year – earnings upgrades, investors happy to pay a higher rating for the stock and the company being one of the few ways for UK investors to play the fast-growing vegan theme.

The business has historically traded in a price-to-earnings range of 16 to 25-times but this valuation jumped up earlier in 2019 when the launch of its vegan sausage roll generated significant publicity and led to more people visiting its stores.

It wasn't a one-off boost either. Greggs continued to report strong trading as the year progressed, leading to a series of upgrades from analysts as they raised their future earnings estimates again and again.

This euphoria around trading strength resulted in investors being willing to pay a higher rating for the shares, thereby creating another catalyst for the share price in addition to earnings.

The accompanying chart shows how its price-to-earnings ratio jumped beyond the historic range this year. The data in the chart is based on historic earnings – you would normally need to focus on

forecast earnings to get a sense of what the market is thinking but the chart still provides a good illustration of how the valuation got out of kilter.

At the same time the vegan movement hit the mainstream and investors scrambled to find ways to invest in it. The UK stock market has very little on offer for this theme, meaning Greggs was the natural choice for many hoping to profit from increased demand for plant-based foods.

Taking all these factors into consideration you can perhaps understand why everyone wanted to own a slice of Greggs from an investment perspective.

It meant expectations were very high leading up to the trading update on 1 October. Everything was riding on the company once again beating expectations and Greggs saying there was still big interest in its vegan products.

Sadly neither happened so the shares quickly started to de-rate as investors were no longer prepared to pay such high earnings multiples given how some of the key catalysts had potentially played out.

The vegan angle arguably still has legs. Greggs is planning to launch vegan versions of its entire product range, according to reports. But the lack of earnings upgrades this time may ultimately see the shares struggle in the near-term.

Watch this **webinar** for more on Greggs' debate and what valuation ratios can tell you.

By **Daniel Coatsworth** Editor

Contents

VIEWING SHARES AS A PDF?
CLICK ON PAGE NUMBERS TO JUMP TO THE START OF THE RELEVANT SECTION

Why stock markets around the world plunged last week

There are specific reasons why billions have just been wiped off the value of pensions and investments

Last week was not a good one for stock market investors in pretty much every part of the world.

Big countries from the UK to India, Brazil to China, and the US to Japan, saw their main stock markets plunge amid concerned over the prospects for global growth.

Already fragile thanks to the threat of the US-China trade war going global, the world economy has taken a turn for the worse thanks to a large amount of bad data.

WHAT'S GOING ON?

A lot of important data was released last week which tells us how economies around the world are doing. Barely any of it was good.

Most of the bad stuff came from Purchasing Managers' Index (PMI) surveys in countries across the globe.

Every month, purchasing managers, namely the people who buy in the raw materials, goods and services required by a company, are asked a series of questions about their business to gauge how positive or negative they're feeling about the immediate future and about the longer-term outlook.

The questions include levels of manufacturing (how busy they are), levels of new orders (how busy their customers are), levels of inventory (how much stock they have) and levels of employment (whether they are hiring or firing people).

The questions are quite general and the replies are sorted into more positive than last month, less positive than last month, or no change on last month.

Each month the change in sentiment – whether it's positive because more managers gave positive responses or negative because there were more negative responses – is added to the previous month's index number to create a new number.

If every purchasing manager is positive month after month the index will only go up and if they are gloomy month after month it will keep going down.

The crucial level for the PMI is 50: a reading above 50 is taken to mean that manufacturing is expanding, a reading below 50 means it is contracting.

MAJOR MARKETS TAKE A BIG HIT

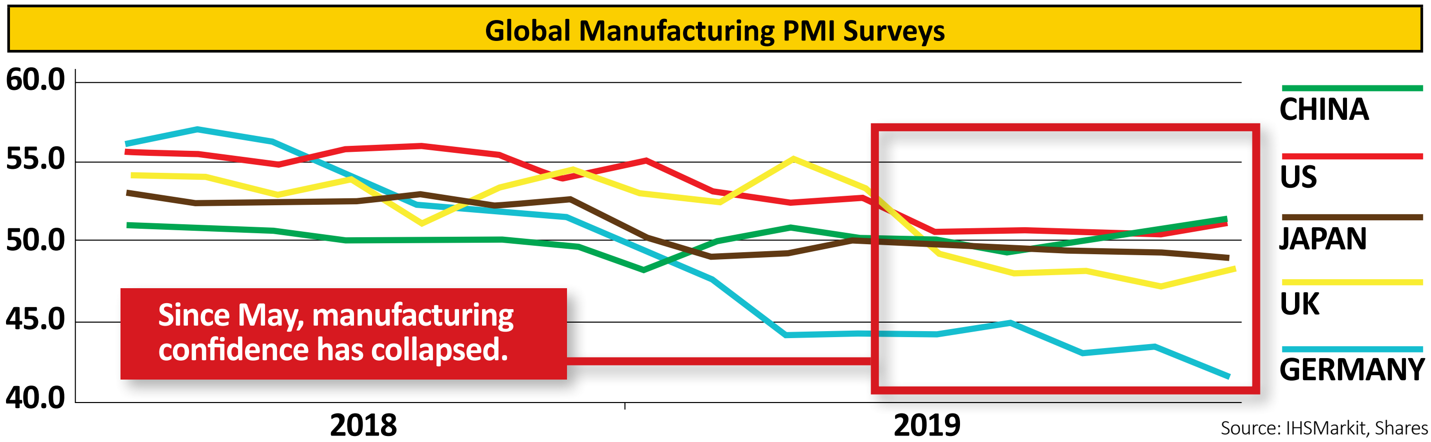
Name	1 WEEK CHANGE (%)
FTSE 100 (UK)	-3.7
S&P BSE 100 Index (India)	-3.2
DAX Xetra (Germany)	-2.3
CAC 40 (France)	-2.7
Russian Trading System Index (Russia)	-2.7
Bovespa Stock Index (Brazil)	-2.4
Nikkei 225 (Japan)	-2.1
Swiss Market Index (Switzerland)	-2.1
Hang Seng (Hong Kong)	-0.5
S&P 500 (US)	-0.3

Source: SharePad, Shares. Data 27 Sep 2019 market close to 4 Oct 2019 market close

WHAT IS THE DATA SAYING?

In the past month, three of the five biggest economies (the UK, Japan and Germany) recorded a score below 50 for their manufacturing PMI, the fifth time in a row according to data provider IHSMarkit.

While the US appears to be in positive territory, figures from another PMI data provider (ISM) give



a different picture on American manufacturing with a score of 47.8.

Manufacturing data is always closely watched despite the fact many developed countries are no longer driven by manufacturing.

This is because when manufacturers are confident they invest in their businesses. In turn this can lead to increased employment which leads to higher levels of consumer confidence and ultimately consumer spending, which accounts for the majority of most big economies.

WHY IS THE LATEST DATA IMPORTANT?

The data suggests economies around the world don't look like growing at the rate investors would've hoped for.

Disappointing PMI data from the US has worried investors because the ISM score of 47.8 for September is well below the 50.1 the market had expected. This puts the threat of a recession in the world's largest economy back on the table.

The figures also give major cause for concern over Germany given that its manufacturing PMI has collapsed, tumbling from the start of the year onwards to hit its lowest point in September since the financial crisis.

Germany's economic fortunes are closely watched by investors as it is the largest country in the Eurozone and the fourth biggest economy in the world.

Investment bank Liberum says: 'Without any financial crisis as in 2008, there has not been such a gulf between the performance, suggesting the structural pressures of auto, tariffs and outsized Chinese exposure may be taking their toll on Germany.'

WHAT'S HAPPENING TO STOCK MARKETS?

Stock markets plunged last week. The FTSE 100 recorded a huge drop, hurting the value of pension funds and investments. The main indices in Brazil, Germany, France, Japan, India, the US and Hong Kong also recorded sizeable losses over the week.

The big trigger was the disappointing PMI data from the US, while Germany's data also went down like a lead balloon.

All the negative manufacturing PMI scores from the world's biggest economies have got people in the market worried about the growth prospects for companies in these countries.

Therefore a significant chunk of investors have been selling their shares en masse, effectively trying to cash in now because they think things will probably get worse in the months ahead.

IS IT REALLY ALL THAT BAD?

The new week has so far been a somewhat different story, with stock markets cautiously regaining some ground on last week's losses.

But investors are still nervous over US-China trade talks and continued uncertainty over Brexit negotiations.

While this may not be good for your FTSE 100 tracker fund or ETF, it's not bad if you're a gold investor or invest in gold mining companies. The shiny metal seems to have found its base level at $1,500 an ounce in response to all the economic gloom hanging around the world.

It's worth highlighting that analysts at Liberum see things differently to the rest of the market.

They think the bad data from the US in particular signals a 'correction', so while things seem bad, the market before has been unsustainable and expectations are simply adjusting to the level where they should realistically be.

US trade war extends to European shores

Diageo escapes broad tariffs for now but risks remain

Last week the World Trade Organisation (WTO) gave the US the green light to impose billions of dollars of tariffs on European companies in retaliation for more than a decade of EU subsidies on large aircraft.

Specifically the WTO found 'that certain subsidies provided by the European Union and certain member States to the European large commercial aircraft manufacturer Airbus caused displacement and significant lost sales (to the US)'.

The EU tried to argue that the US had subsidised its own large commercial aircraft manufacturers but it was fighting a lost cause and the US walked away with the biggest arbitration award in WTO history.

Immediately the Office of the US Trade Representative (USTRO) announced that it would apply $7.5bn of tariffs on a range of EU goods beginning on 18 October, 'with the bulk of the tariffs being applied to imports from France, Germany, Spain and the UK – the four countries responsible for the illegal subsidies'.

The USTRO said it would 'continually re-evaluate these tariffs based on our discussions with the EU' but that it reserved the right 'to increase the tariffs at any time or change the products affected'.

Tariffs on large new non-military aircraft have been set at 10% while the UK has been singled out for 25% tariffs on most types of clothing including swimwear and nightwear, bed linen, sweet biscuits, books, pictures and prints, building machinery such as diggers, sausages, bacon, cheddar cheese, certain fruits, liqueurs and cordials.

However, in terms of export sales single-malt Scotch whisky is easily the biggest casualty with sales to the US worth $460m or over half the value of British products targeted according to the Scotch Whisky Association.

Fortunately for **Diageo (DGE)**, the biggest maker of Scotch whisky, large spirit categories such as blended whiskies, gin and vodka are exempt from the tariffs for now so its shares have been on a run alongside those of European spirit-makers Pernod-Ricard and Remy Cointreau.

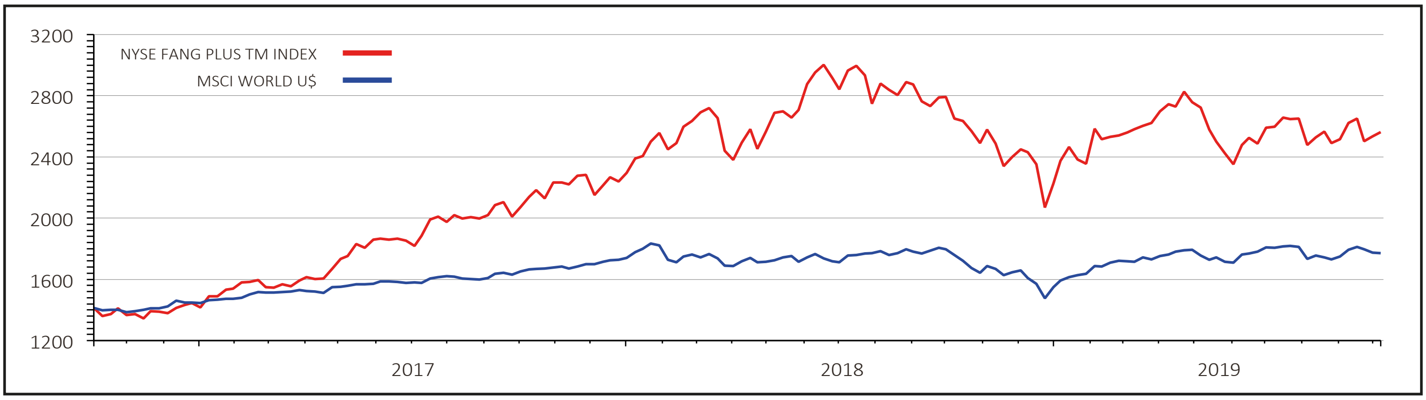
However it's worth reiterating that the US could introduce new tariffs on large spirit categories, as it has done with French wines, at any time.

The US makes up a third of Diageo's group sales and in the year to June sales of all types of Scotch were up 7% so a blanket tariff on imports of blended whiskies would be a blow.

Brewers look to be unaffected as exports of UK-brewed beer to the US are minimal. Over 80% of UK-brewed beer is consumed domestically according to the British Beer & Pub Association.

Investors won't have made much from FAANG stocks this year

A group of technology shares include Amazon and Netflix have underperformed the market



The leading US technology shares known as the FAANGs, an acronym for Facebook, Apple, Amazon, Netflix and Google, have led the stock market higher during the past five years, outperforming the MSCI World index by 139% since October 2014.

However on a relative basis the group has started to lag the broader market since peaking in June 2018 and has underperformed by 15%. This is based on analysis of the NYSE FANG+ index which also includes the shares of Alibaba, Nvidia, Tesla, Baidu and Twitter.

The biggest contributors to the weakness have come from shares in Netflix which has dropped by 35% since the index peaked last the summer, and Nvidia whose shares are down by 37%. The launch of streaming services by Disney and Apple haven't helped sentiment towards Netflix, especially given its sky-high stock rating.

Even Amazon has seen its shares fall by 16% since the index peak in 2018. The best performer of the bunch has been Apple, whose shares are around the same level as last year.

The waning appeal of technology has also been seen in the poor performances of new stock market flotations such as ride sharing app company Lyft which has seen its shares almost halve since listing this year, with bigger competitor Uber showing a 37% fall since coming to the market in May.

One limiting factor to the FAANGs' future performance is related to the sheer size of some of its constituents such as Apple with its $1trn market capitalisation. As companies get bigger the growth rate naturally tails off due to the fact that the base value of revenue and profit is larger.

There is a natural life cycle to the development of most companies. You could easily make the case that Apple's product cycle is entering the mature or mid-life stage, where growth opportunities are relatively limited.

For Apple, you could argue that its prospects are at least reflected in the undemanding rating of around 19 times forward earnings per share.

You could make the case that price action is finally catching up with the underlying rating of the FAANGs which peaked at 73 times one-year forward earnings per share five years ago and currently sit at 43.5-times according Ed Yardini research.

In that time the group's share of the S&P index in the US has grown from around 7% to close to 18% at the peak. Ultimately, the increased size of this much lauded group of stocks will act as an impediment to further relative progress.

Recruiters, insurers and the week's other big news

We look at the market's top risers and fallers

Recruitment firms were heavily under the cosh on 8 October with **Robert Walters (RWA)** and **Michael Page (PAGE)** falling by nearly 10% apiece as they cut earnings guidance.

Both companies attributed their struggles to political and economic uncertainty. PageGroup lowered its operating profit guidance for the full year to a range of £140m to £150m against market expectations of £150m to £160m, saying it has 'limited forward visibility' in its business. Robert Walters lowered its guidance for full year pre-tax profit to flat on last year instead of earlier expectations for a 6% increase.

INSURANCE WOES

Another sector under pressure was non-life insurance following the publication of an interim report on the industry's pricing practices by the Financial Conduct Authority (FCA).

Hastings (HSTG), **Direct Line (DLG)** and **Admiral (ADM)** all saw their shares fall on 4 October as the FCA signalled it would take action to stop customers effectively being penalised for staying loyal.

The full FCA proposals aren't expected until the first quarter of 2020 and the impact of any changes is yet to filter into forecasts but broker Canaccord Genuity believes Direct Line could be affected the most.

CEO CHANGES

Amid a growing exodus of FTSE 100 chief executives, Alison Cooper from tobacco firm **Imperial Brands (IMB)** and Bob Dudley from oil producer **BP (BP.)** have become the latest to hand in their notice.

Dudley will retire in 2020 having helped rehabilitate the oil major in the wake of the Gulf of Mexico oil spill. He arguably left on better terms than Cooper whose exit came just a week after a major profit warning from the company which suggested its strategy of looking to vaping to replace declining sales of traditional tobacco products could be in trouble.

Building products firm **SIG (SHI)** issued its own profit alert on 7 October amid a weak construction market. The company is taking action, agreeing to sell its air handling division to France Air Management for €222.7m (£198.3m) including debt. Separately, it has also agreed to sell its building solutions unit to Ireland's **Kingspan (KGP)** for £37.5m.

FTSE 350 MOVERS OVER THE PAST WEEK

BEST PERFORMERS		
STOCK	SHARE PRICE RISE	REASON
Sirius Minerals	13.3%	Takes action to preserve funds after failed financing + says strategic review on track
Bakkavor	6.7%	Recent positive broker comment
Sophos	4.7%	Generally bullish market sentiment

WORST PERFORMERS		
STOCK	SHARE PRICE FALL	REASON
SIG	-14.9%	Profit warning on weak construction markets, divestments announced
PageGroup	-13.5%	Warns on profit, blaming economic and political uncertainty
Hochschild Mining	-9.2%	Negative reaction to move into rare earths space

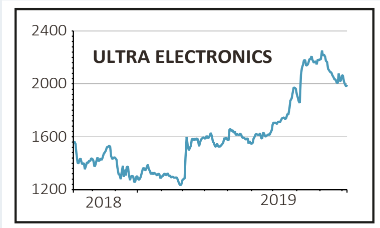
Source: Shares, SharePad. Data to 8 Oct 2019

Revamped Ultra Electronics is tougher and more focused

The defence firm is integrating a previously fragmented business model

ULTRA ELECTRONICS
BUY
(ULE) £19.79
Stop loss: £15.83

Market cap: £1.4bn



A slight pullback in the share price for defence firm **Ultra Electronics (ULE)** represents a good buying opportunity.

A 2019 price-to-earnings ratio of 16-times does not look demanding with scope for the company to beat earnings forecasts as the benefits of a revamp of the business come through.

Simon Pryce took over as chief executive in June 2018 after a tricky period for Ultra, reflected in the ousting of long-standing chief executive Rakesh Sharma in November 2017 and lots of institutional investors betting that the share price would fall. Pryce also had to issue a profit warning shortly after assuming the role.

Essentially Pryce's diagnosis was that the business was just too fragmented. In March, alongside the maiden full year results under his tenure, he observed that of around 130 capabilities offered by the company, 29 were responsible for 85% of its revenue.

Although this reveals the need for a more integrated approach, it also highlights that Ultra is a quality outfit with a weight of impressive intellectual property. The shares have started to recover this year but an update on the integration process could act as a further catalyst for the share price when unveiled early next year.

Many of its competencies are in areas being prioritised in global defence spending such as marine and cyber warfare. Investment bank Berenberg comments: 'Ultra's broad range of niche technologies and capabilities, including anti-submarine warfare and cyber security, are likely to remain high-priority areas for government spending.'

US defence spending increased for a fifth consecutive year in 2019 and is budgeted to increase by a further 3% in 2020.

At a time when there are concerns about global growth, Ultra's relative insulation from the gyrations of the global economy could provide some welcome ballast to portfolios.

Supported by this positive backdrop, Pryce has already achieved some significant milestones in his transformation of the group. A return to organic growth for 2018 was announced in March this year and half year results in August revealed an order book above the £1bn

threshold for the first time since 2011, underpinning forecasts for organic revenue growth of around 3% or higher.

It is worth noting this order book does not include positions on several longer term defence programmes, where firm orders are expected but are yet to be placed.

Risks for investors to weigh include continuing weakness in the UK defence market and an ongoing probe by the Serious Fraud Office into potential corruption in Algeria.

By **Tom Sieber**
Deputy Editor

Meet your fund manager over lunch.

Charles Luke
Investment Director
Aberdeen Standard Investments

If you are a shareholder in Murray Income Trust PLC, come and meet the people who run it on your behalf.

Murray Income Trust PLC invests in high quality companies, mainly listed on the UK stock market, with the aim to deliver an attractive income together with income and capital growth.

The Company will hold its Annual General Meeting (AGM) on Tuesday 5 November 2019. If you're a shareholder, you're warmly invited to:

- Come and watch a presentation by Charles Luke, Investment Director, Aberdeen Standard Investments – and ask questions about his investment approach and thoughts on markets.
- Meet the Board of Directors – responsible for ensuring the Company is run in your best interests.
- Vote on any resolutions that have been proposed.

Murray Income Trust PLC AGM
12.30pm, Tuesday 5 November 2019, London, EC4V.

Includes a buffet lunch.
Each shareholder may bring a guest.

For further information on how shareholders may attend, please email your name and whether you are bringing a guest to **murray.income@aberdeenstandard.com**

murray-income.co.uk

Please remember, the value of shares and the income from them can go down as well as up and you may get back less than the amount invested.

How Murray Income Trust PLC has performed

Year ending	31/08/19	31/08/18	31/08/17	31/08/16	31/08/15
Share Price	12.2	2.8	12.8	10.3	(6.4)
NAV[A]	6.7	4.6	11.6	14.6	(4.7)
FTSE All-Share	0.4	4.7	14.3	11.7	(2.3)

Cumulative performance (%)

	as at 31/08/19	1 month	3 months	6 months	1 year	3 years	5 years	10 years
Share Price	832.0p	(1.7)	1.2	10.7	12.2	30.1	34.3	153.2
NAV[A]	882.3p	(2.0)	3.2	9.3	6.7	24.5	35.9	153.4
FTSE All-Share		(3.6)	2.0	4.3	0.4	20.2	31.2	124.8

[A] Including current year revenue.
Total return; NAV to NAV, net income reinvested, GBP. Share price total return is on a mid-to-mid basis. 12 month returns to 31 August.

aic DIVIDEND HERO

Morningstar Sustainability Rating

Aberdeen Standard Investments

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3i Infrastructure is a great long-term investment

Its shares aren't cheap but its premium to NAV has halved from its 12-month high

The second and third quarters of this year have seen some chunky fundraisings by infrastructure and renewable energy funds.

In June, **Greencoat UK Wind (UKW)** raised €375m, **Sequoia Economic Infrastructure Income (SEQI)** raised £216m and **Aquila European Renewables Income (AERI)** raised £154m.

In September, Sequoia raised a further £139m, **IPP (INPP)** raised £234m in two separate funding rounds and **Renewables Infrastructure Group (TRIG)** raised £227m.

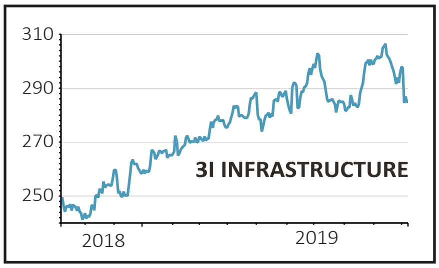
All of which goes to show that while investor appetite for stocks continues to wane, exposure to infrastructure via quoted vehicles remains very much in vogue.

With a market capitalisation of £2.3bn, FTSE 250-listed **3i Infrastructure (3IN)** has delivered consistent growth in net asset value (NAV) of 13% per year including dividends since listing in 2007, which is more than twice the total return of the FTSE 250 index over the same period.

The investment trust owns a portfolio of economic infrastructure businesses, which in turn own their physical assets in perpetuity. It has a portfolio of greenfield projects in the construction phase where it owns all or part of the ensuing concession.

The infrastructure portfolio makes up 88% of the group's assets and includes among other things telecom towers, power lines and metering, energy storage, and emergency rescue and response services.

3I INFRASTRUCTURE
BUY
(3IN) 286p
Stop loss: 229p



These assets typically employ between £50m and £250m in capital and generate annual returns of between 9% and 14%, and the company has a good track record of realising full value for its assets when the time comes to sell.

The main attractions of infrastructure as an asset class are that it offers diversification from equities as well as 'locked-in' long-term yields.

Infrastructure funds typically aren't cheap though, and like the rest of the sector 3i trades above net asset value which analysts at Stifel estimate was between 245p and 250p at the end of September. On that basis the trust is at a premium of 14% to 16%, well below its recent high but not cheap on an absolute basis.

There is conceivably a risk that the Labour Party might win the next general election and set about nationalising infrastructure assets but that seems unlikely in the short term.

Also the company is currently raising more money to pay down debt following a recent acquisition. While the deal is accretive to earnings, the issue of new shares is dilutive for existing shareholders.

As the company identifies more targets, so it will need to raise more finance or sell existing assets so there is a risk of further dilution.

By **Ian Conway**
Senior Reporter

TED BAKER

(TED) 459.2p

Stop loss triggered

Original entry point:

Buy at 912p, 22 August 2019

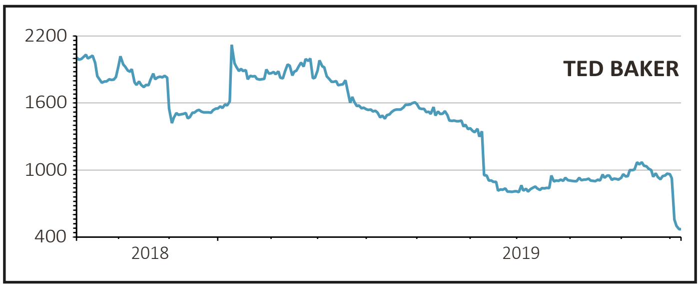
WE HAVE TO hold our hands up and say we got it badly wrong on British fashion brand **Ted Baker (TED)**. We felt a lot of negative news was already reflected in the share price but we didn't anticipate just how weak first half trading at the company would be.

The statement was a real shocker. The company was already enduring a tough 2019 amid the departure of founder Ray Kelvin over allegations of inappropriate conduct and earlier profit warnings.

However, the market clearly didn't expect it to post a £23m pre-tax loss, with trading badly hit by weak consumer spending. Group revenue was down 0.7% to £303.8m, with retail sales in reverse in the UK and Europe, North America and the Rest of the World regions and licence income and e-commerce sales both falling. On top of that, the dividend was cut by more than half to 7.8p.

Perhaps most concerning was the outlook which flagged expectations for a weaker second half year-on-year.

While we did flag the risks facing the business in our original article, this situation is a reminder of the dangers of buying a stock that has issued lots of bad news as more could be in the pipeline.



SHARES SAYS:

A disappointing outcome. The company has plenty of work to do to repair sentiment. Stay clear.

HOLLYWOOD BOWL

(BOWL) 225p

Gain to date: 2.5%

Original entry point:

Buy at 219.5p, 20 December 2018

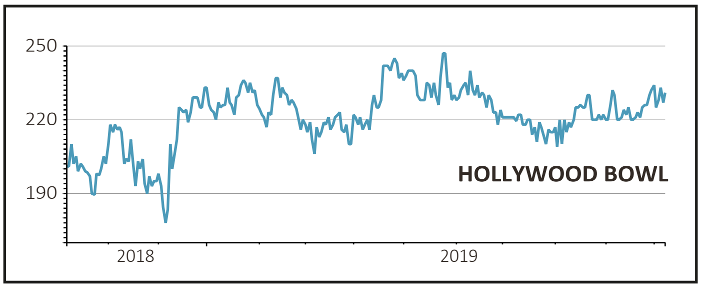
WE PICKED LEISURE group **Hollywood Bowl (BOWL)** as one of our top stocks for 2019 in the belief that it would be a resilient business and make money whatever the economic backdrop. That has proven to be the case.

Its latest trading update reveals total sales up 7.7% and like-for-like growth of 5.5% for the year to 30 September.

Promisingly the company also says it expects to report growth in pre-tax profit 'in excess of 10%' which is ahead of previous market expectations.

The company has seven new centres in the pipeline which are expected to be delivered by the 2023 financial year, in line with its guidance of two per year. In addition, the group is set to test three further golf centres, which are due to open in the current financial year.

Hollywood Bowl is considering returning additional capital to shareholders as it has done in the prior two years. Broker Shore Capital has pencilled in a 4.3p special dividend, worth around £6.5m, on top of the ordinary dividend of 6.9p, which together equates to a yield of 5% at the current share price.



SHARES SAYS:

The company's affordable pricing model and consumer preferences for spending on 'experiences' puts the business in a good position to capture growth and continue to deliver strong cash flow. Keep buying.

Looking at UK markets **differently**

Alex Wright, Portfolio Manager of Fidelity Special Values PLC, explains the benefits of contrarian investing.

In November 2019, Fidelity Special Values PLC celebrates its 25th birthday and, at that time, I will be only the third Portfolio Manager to have been responsible for the company. Since I took over the trust in 2012, I have continued to invest on behalf of the company's shareholders using the same value-focused, contrarian approach used since it was established under Anthony Bolton back in 1994.

As a contrarian, I'm drawn to unfashionable stocks that are out of favour and trade on cheap valuations. I'm looking for potential positive change that others haven't seen yet. I also look to invest in companies where I understand the potential downside risk, to limit the possibility of future losses.

Ideally, I want to invest in companies that are exceptionally cheap on relevant measures, or which have some kind of asset that should prevent their share prices falling below a certain level - this can be anything from inventory to intellectual property. From this, I then look for opportunities where I believe the market's perception can shift due to changes in the company's competitors or market, a new product line or an expansion into new business areas. I also impose a strict sell discipline on myself once the recovery has taken place.

Finding these types of overlooked and underappreciated opportunities is not easy and requires extensive research. Central to the long-term success of our approach has been the insight and expertise of our large team of analysts. Fidelity's philosophy is to base investment decisions on company fundamentals such as competitive position, management strength, growth opportunities, valuation and so on. Overarching trends in the economy play a supplementary rather than primary role in our investment decisions.

Looking at markets today, ongoing political uncertainty has created a challenging environment for UK equities. A cautious approach is needed, but attractive valuation opportunities are out there. Against this backdrop, I am increasingly finding attractive opportunities among stocks with defensive characteristics and the ability to control their own fate and drive positive change irrespective of the prospects for the domestic economy.

The UK market is a good source of defensive companies, both classically defensive and others with more hidden defensive qualities. Imperial Brands is an example of

the former. Valuations in tobacco companies have fallen significantly over recent years and I favour Imperial over competitor BAT due to its stronger balance sheet and its promising new vapour innovations which I believe are underappreciated by the market. Amongst the "hidden" defensives I have added to Pearson which continues its transformation from print to digital and is countercyclical; it performs well in a US economic downturn as education enrolment picks up.

On the flip side, I have been reducing the trust's exposure to economically-sensitive areas like banks over recent months. The significant move down in global bond yields will put major pressures on net interest margins and for most banks there are few avenues left to offset this pressure. At the company level, I recently moved to sell out of my holding in Lloyds. In line with our original thesis, the company was successful in cutting costs and driving efficiencies, but I now see limited upside at its current valuations. It has become a bellwether for the UK economy with its future performance tightly linked to the UK mortgage market and interest rate movements. By contrast, I continue to hold RBS as I see a more favourable risk-return profile - it is at an earlier stage of its recovery relative to Lloyds and still has room to go in its evolution towards becoming a high return bank with excess capital.

Important information

The value of investments can go down as well as up and you may not get back the amount you invested. Overseas investments are subject to currency fluctuations. The investment trust can gain additional exposure to the market, known as gearing, potentially increasing volatility. The trust invests more heavily than others in smaller companies, which can carry a higher risk because their share prices may be more volatile than those of larger companies. The shares in the investment trust are listed on the London Stock Exchange and their price is affected by supply and demand. This information does not constitute investment advice and should not be used as the basis of any investment decision, nor should it be treated as a personal recommendation for any investment. If you are unsure about the suitability of an investment you should speak to an authorised financial adviser. Reference to specific securities should not be construed as a recommendation to buy or sell these securities and is included for the purposes of illustration only. Investors should note that the views expressed may no longer be current and may have already been acted upon.

Smithson lives up to the hype as the Fundsmith trust turns one

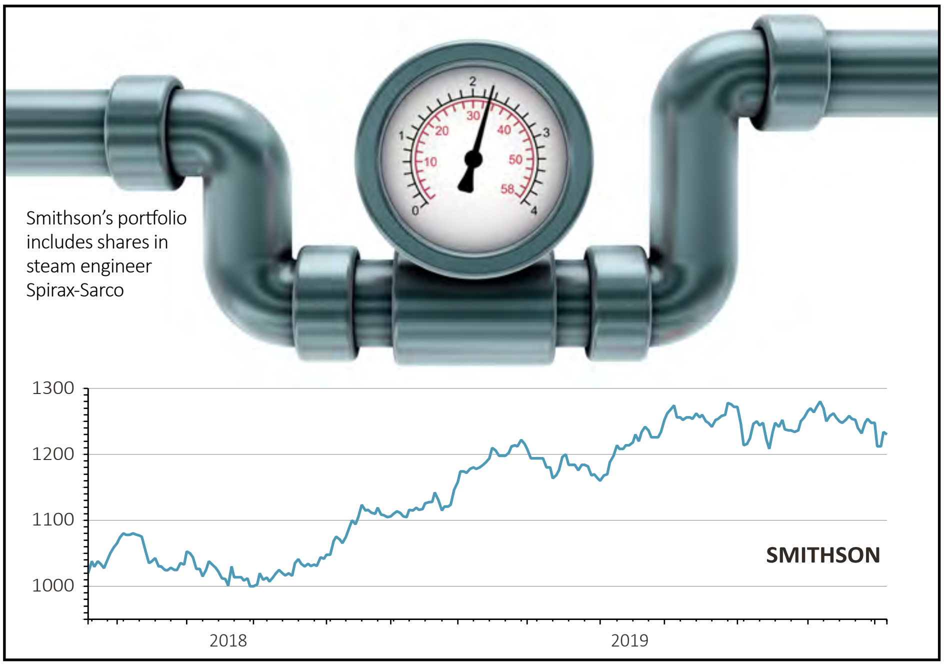
We explore how it has achieved nearly 19% return in 12 months

A year ago **Smithson (SSON)** became the largest ever investment trust launch, raising £822.5m to invest in quality small to mid-cap companies. Investors lapped up the shares in the hope they would deliver similar success to its sister fund, **Fundsmith Equity (B41YBW7)**.

Their faith has been rewarded with Smithson having achieved 18.8% return since launch on 19 October 2018 versus 19.7% from the flagship Fundsmith fund over the same period.

This great start will have certainly been helped by the timing of Smithson's launch which happened during a weak period for the stock market, thus valuations were lower for many companies. That's advantageous when trying to build a portfolio.

A good start will boost sentiment towards the trust but it will take several more years before you can truly start to judge its performance.



Smithson's portfolio includes shares in steam engineer Spirax-Sarco

FUNDSMITH EXTENSION

Smithson was created to take advantage of good companies that would be too small for Fundsmith Equity as the latter focuses on very large businesses. A team was assembled and they spent a year writing approximately 150 reports on stocks that matched the same criteria used for Fundsmith Equity, namely a focus on aspects such as free cash flow.

Many of these potential companies were subsequently rejected, leaving a much smaller investable universe which currently stands as 77 stocks. Of this universe, Smithson currently has positions in 29 companies.

A focus on quality is interesting as investors have been prepared to pay high multiples for seemingly top-notch businesses for many years on the stock market. Late August this year saw a sudden rotation where investors switched to buying value stocks, namely companies on very cheap valuations.

So far it looks like this could be a short-term switch. But if quality did go out of favour, it would arguably also leave Smithson out of favour given its quality focus.

Portfolio manager Simon Barnard insists such an event wouldn't prompt him to change his style as he believes any shifts in the market are 'irrelevant'. He comments: 'Our strategy is fairly clear – buy good companies, don't overpay, do nothing.

'Sometimes the market throws up opportunities, sometimes it doesn't. We aren't aiming to outperform in every period, we are aiming to outperform in the long term. It would seem crazy to change a long term strategy that

SMITHSON'S TOP HOLDINGS
Equifax
Masimo
Verisk Analytics
Rightmove
Sabre
Check Point
Ansys
Recordati
Halma
Cognex

AMONG THE TOP holdings is Verisk Analytics, a data provider for the insurance and natural resources industries. It has the world's largest database of insurance claims information. 'When you are doing anything in insurance – writing a contract, managing your claims, doing fraud detection – data is absolutely key,' says Morgan.

'Insurance companies buy the data from Verisk and generally do so via long-term subscription contracts. If an insurer goes to buy data from Verisk, they first have to also give them all their data.

'The bigger the data pool the better, so as they grow the barriers to entry keep getting bigger, like a network effect.'

works for a short term change in the market.'

THE VALUATION DEBATE

Barnard says he is looking for value, just not really cheap and potentially inferior businesses. The fund manager says he often gets asks by investors why he has invested in what look like very expensive companies such as **Halma (HLMA)** and **Rightmove (RMV)**. His answer is that investors may be looking at the wrong valuation metric.

'We focus on free cash flow yield. Rightmove generates a lot of free cash flow; when you look at it on that metric it is not that expensive compared to other things on the market.'

Assistant portfolio manager Will Morgan says at Smithson's half year stage (30 June 2019), the portfolio valuation was the same as the reference market which is the MSCI World Small and Mid-Cap index. 'We think we are getting at the same price much higher quality businesses that also grow about 1.5 times the rate of companies in the reference index,' he comments.

'If you were to look at the portfolio on aggregate, our companies on average have nearly four times the return on capital employed of the reference market. They tend to have much higher operating margins, significantly higher cash generation and much lower leverage so we can be fairly confident that the quality of the businesses we own are significantly ahead of that in the market.

'Even though the headline multiples might appear high to some, there is a difference between being highly rated and being expensive.'

TERRY SMITH'S ROLE

The tremendous success of Fundsmith Equity – which has delivered 18.6% annualised returns since launch in November 2010 – means that Smithson's fund managers were under pressure from day one to deliver equally strong returns. In particular, there was also the fact that Fundsmith Equity's architect and fund manager Terry Smith wouldn't be running Smithson.

'Expectations are high internally and externally,' admits Barnard. 'Ultimately all we care about is the performance.

'At the end of the day we are investing people's life savings.

The fact that we get to meet a lot of our investors helps to remind us of that – it is very motivating. We are very focused on executing the strategy to the best of our ability.'

Investors may find some comfort that Smith is still closely involved with Smithson despite not being behind the wheel. 'Day to day we just get on with it. On big issues like selling a position outright or making an investment in a company for the first time, we would always consult him in his role as Fundsmith's chief investment officer, but I as portfolio manager make the final decision,' clarifies Barnard.

BROAD EXPERTISE

Both Barnard and Morgan joined from investment bank Goldman Sachs where the former was a fund manager and the latter an analyst. They were recruited to launch Smithson, alongside Fundsmith analyst Jonathan Imlah, due to their expertise.

Combined they have covered many different sectors which is handy as Smithson doesn't have a specific sector or geographic market focus.

For example, they are comfortable analysing and investing in **Spirax-Sarco (SPX)**, a UK steam engineer. 'Steam is used in the manufacture of almost any product you care to imagine,' says Morgan. 'Spirax has a highly skilled salesforce who are highly qualified engineers and who are embedded in their customers' businesses.'

The fact Smithson's investable universe is only 77 stocks at present means the fund managers can focus on those businesses and read large amounts of relevant material. 'Warren Buffett famously said you only need moderate intelligence to understand all of this; you just don't want to be making mistakes,' says Barnard. 'These are not complicated businesses (in the portfolio).'

It also helps that its portfolio companies are at a mature enough stage so the managers can have comfort in their business models. 'These are companies which are highly profitable and have good track records,' remarks Morgan. 'The numbers tell you something.

'If we were looking at speculative businesses or speculative technology, pre-revenue or pre-profit, then we might need some expertise to guess if the thing is going to work. That isn't a game we are going to play. We are looking at companies that have already won.'

DISCLAIMER: The author owns shares in Smithson

By **Daniel Coatsworth**
Editor

SHARES SAYS:
Smithson is certainly delivering for investors and it is always welcome to see a fund that is transparent about what it does and how it aims to make money. We rate this as a core holding for a diversified investment fund.

DEALING WITH PORTFOLIO DETRACTORS

SMITHSON'S PERFORMANCE is really impressive but like all funds there are weak spots. It recently sold US auto industry software provider CDK Global after a change in management and strategy left the fund managers lacking confidence in the firm.

The investment trust has also had to stomach recent share price weakness in Ambu which makes disposable endoscopes. 'So far the market has been reusable ones, but the problem is that they are expensive to buy in the first place and very expensive to clean. There is also a risk that the cleaning process is not adequate and therefore a high risk of contamination,' explains Morgan.

He says Ambu has developed a disposable endoscope which at the moment costs the same as it would do to clean a reusable one, with the added benefit of removing the risk and liability of contamination.

'It is in fairly early stage of what we expect to be long term growth. Ambu has had issues with timing of product launches and a change in CEO which has led to concerns that the long term market opportunity is not as big as people once thought. But we believe the opportunity is as big.'

WHY BONDS HAVE BEEN #1 THIS YEAR

FIXED-INCOME PRODUCTS HAVE SOARED IN POPULARITY

Investors have piled into bonds in 2019 at the expense of equities, with more than £8bn inflows into UK bond funds and over £4bn flowing out of equity funds in the first eight months of the year according to the Investment Association. Data from the US show similar patterns.

This might be caused by investors responding to fears about a slowing global economy amid fractious trade talks between the US and China as well as Brexit worries. But some of the trend might also be related to investors chasing performance.

One of the cornerstone assumptions underpinning capital markets is that investors behave rationally to maximise profit. But according to Bloomberg there's now around $17trn of bonds which, if held to maturity will result in owners losing money.

This fierce inflow of money into bonds has pushed up prices and pulled down yields.

Many investors are buying products where they could lose money if the bonds are held to maturity. They are buying these bonds for capital gains, hoping that the price will keep rising (and yields keep falling) so they can sell for a profit before the bond's fixed term matures.

In Europe 69% of the €8.18trn Eurozone government bond market has a negative yield (we elaborate on this concept later in the article), up from 40% at the beginning of the year, according to Tradeweb.

Roughly half of the €3.4trn of investment grade corporate debt has a negative yield, up from 12% at the start of the year.

HOW A BOND WORKS

Before we consider what's going on, it is worth a quick lesson to understand the world of bonds.

A bond is like an 'IOU' – a government or company borrows money from an investor by issuing bonds in exchange for cash. They then pay a fixed amount of interest over a specific time period; at maturity the investor cashes in the bond for its original face value (also known as 'par').

You often see people discuss bonds in terms of their yields. This can be confusing given that stocks are discussed in terms of share prices. You just need to understand that bond yields move in the opposite direction to the price. So when someone says a bond's yield is falling, the price is actually rising.

Investors can buy UK government bonds called gilts with various maturities from one year up to 30 years, paying fixed rates of interest (also known as a 'coupon'). The name 'gilts' comes from the fact that the original certificates had gilded edges.

NEGATIVELY YIELDING BONDS

If you buy a bond or gilt that is trading above par there are some important points to consider.

Let's say you buy at a premium to par at £140. On maturity you will only receive back par at £100 and therefore make a capital loss of 29%.

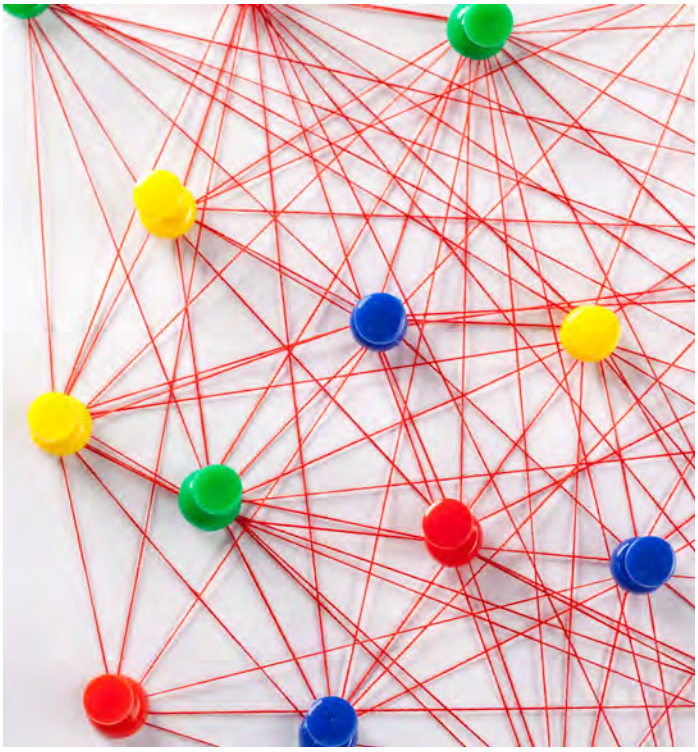
You need to account for the interest payments received over the life of the bond and if the yearly coupon were 2% that would be equivalent to 20% over a 10-year period.

In this example, even after adding back the interest payments, you would end up with an overall loss which is why this bond example would be called a negatively-yielding bond.

WHY WOULD AN INVESTOR DELIBERATELY LOCK IN A LOSS?

The answer turns out to be more nuanced than one might assume. As incredible as it sounds, it might mean that yields become even more negative (as prices keep going up).

Bond fund manager Mike Riddell of Allianz Global Investors says: 'Given that a five or 10 year government bond yield is essentially the market's expectations of where central bank rates are going in the next five or 10 years, then if central banks have further to cut,



bond yields can go much more negative, which would give bond investors a capital gain.'

Fund manager Andrew Mulliner at Janus Henderson is thinking along the same lines, commenting: 'Negatively yielding bonds are not a mystery at all, but a rational consequence of the European Central Bank's (ECB) negative interest rate policy as well as bank regulation.'

Since the financial crisis in 2008 central banks have embarked on quantitative easing (QE) to alleviate stress in the banking sector. That meant buying government bonds from banks which increased their reserves and encouraging them to make more loans. That was the theory.

The ECB decided it needed to go further and started charging banks that parked excess money with it in the hope that the banks would be incentivised to increase loans and provide credit to the economy.

All of these actions lowered interest rates on everything from mortgages to corporate debt. It also had the effect of pushing up the price of existing government bonds (and pulling down the yield).

BUYING AT ANY PRICE

Since the financial crisis banks have been forced by regulators to hold more capital against their loans, in case they went bad. The banks use a risk-weighted assets calculation to determine how much capital they need, which in turn determines how many loans they can make.

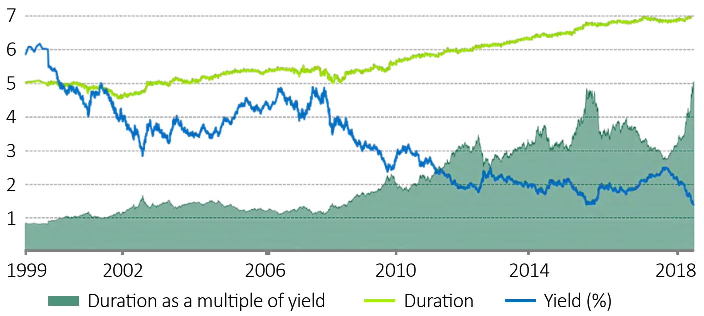
The riskiest assets such as corporate loans carry a higher weighting which increases the amount of regulatory capital that banks have to hold. Importantly, sovereign bonds are considered 'risk free'. This means that banks can lower their risk capital requirements by simply buying and holding government bonds. In other words, negatively yielding government bonds are very attractive to banks and they are not particularly sensitive to the price they are willing to pay.

Insurance companies are in a similar predicament in that they are mandated to hold enough capital to cover their obligations to policy holders for at least 12 months.

Given that the capital is needed to cover potential liabilities, it is normally held in the safest instruments. You guessed it, they have a preference for high quality, liquid assets and government bonds fit the bill.

Wherever an institution is required by a regulator to hold a minimum amount of capital or collateral, there is a demand for bonds that have a low or zero risk-weighting. This seems perfectly rational from the banks' and insurance companies' perspective.

NEGATIVE BONDS AREN'T NECESSARILY CHEAP

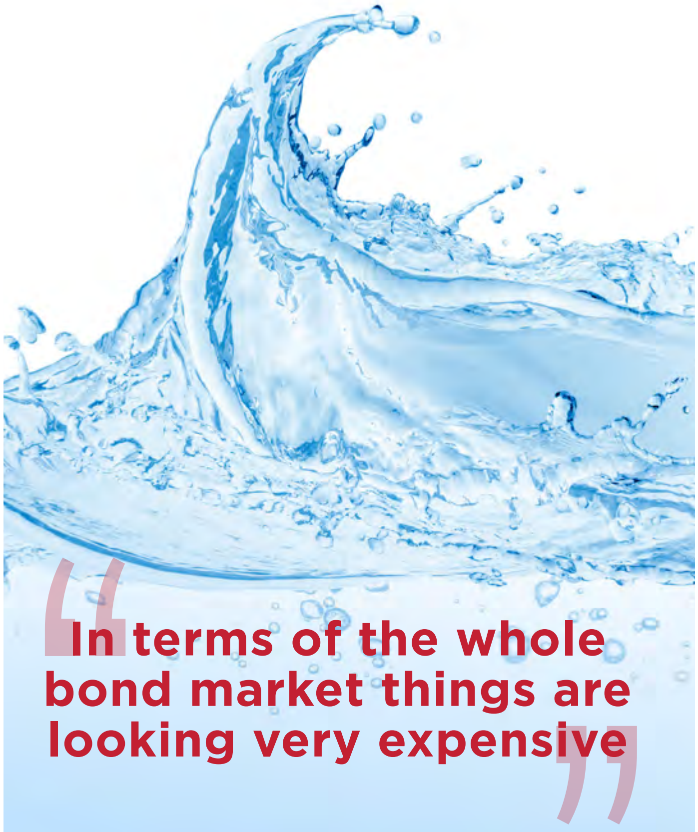


Source: TwentyFour

The risk of capital loss increases when yields fall because the price of the bond becomes more sensitive to a rise in interest rates. The blue line on the chart shows the bond yield for the total market. It has fallen from over 6% in 1999 to 1.5%.

The green line is the duration of the market, which is a measure of how long it takes to receive back the capital value of the bond. The lower yields go, the longer it takes to earn back the capital, which increases the duration, as seen on the chart.

The shaded area on the chart is the duration as



> "In terms of the whole bond market things are looking very expensive"

a multiple of the yield and implies that a 1% move up in interest rates will wipe out the equivalent of five years of interest payments, up from less than one year in 1999.

Chris Bowie, who manages bond portfolios at TwentyFour Asset Management, says 'the relationship between yield and duration is as stretched as it has ever been, so in terms of the whole bond market things are looking very expensive'.

He adds: 'In our corporate bond fund, we have more short-dated bonds than the benchmark, which means we have both a higher yield than the benchmark but also a lower duration. In our view this is the best way of producing a quality income without significant capital risks nor capital volatility.'

LOWEST YIELDING CORPORATE BOND EVER RECORDED

This may sound crazy, but central bank policy has distorted corporate credit markets so much that some companies have been able to borrow money for free.

At the end of August industrial conglomerate Siemens borrowed €3.5bn over two to five years by issuing bonds to investors that didn't pay any interest. You might think logically that demand would be slim. You would be wrong because demand from investors was very strong.

One fund manager even lamented that he didn't have enough cash at the time to place an order to buy the bond.

His rationale was that paying a company to lend to it for up to five years was a much better proposition than accepting negative yields on German government debt for 30 years. It was simply the 'least bad option'.

However there is an important difference between lending to Siemens or a large company like **Vodafone (VOD)** and lending to a government. The UK government, for example, can print money to meet its obligations, whereas a company has to 'earn' future cash flows to repay its debts.

In other words, as the name suggests, lending to corporations involves taking on credit risk which makes the activity more far more risky.

What are 'payment in kind' notes?

On 25 September luxury car maker **Aston Martin Lagonda (AML)** issued $150m of debt at an interest rate of 12% plus another $100m which would only be triggered if the company sold at least 1,400 units of its new DBX car in the next year.

What's different and toxic about these bonds is that half of the interest is deferred until the bonds mature in 2022. These are known as 'payment in kind' bonds because the interest isn't paid each year but added back (as a payment in kind) to the principal loan.

If investors are demanding a 12% interest rate when the overall junk bond market is yielding 2.8%, one has to question the chances that Aston Martin will be able to repay the loan. Worryingly, payment in kind notes were very popular leading up to the 2008 financial crisis.

MINI BUBBLE?

One part of the corporate credit market which receives relatively little attention is the high yield bond market, sometimes known as the junk bond market.

Companies that issue junk debt have a high chance of defaulting on their interest payments and going bust. This reflects a combination of poor business fundamentals and a high cost of servicing debts.

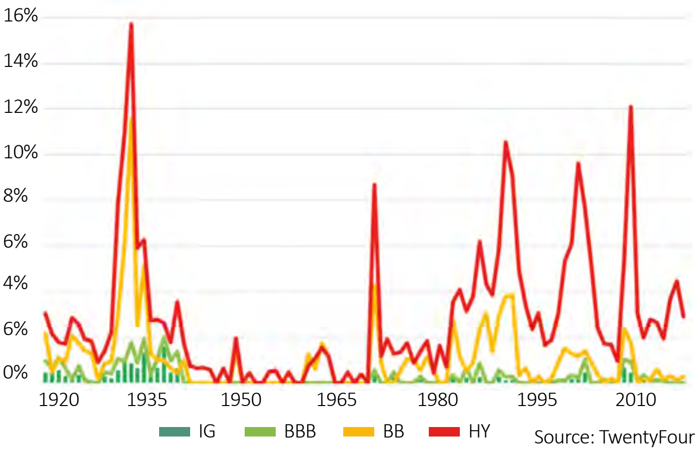
Historical default rates (weighted across the whole high yield universe) were as high as 15.8% during the great depression in the 1930s while in the financial crisis of 2008 they reached 12%.

For comparison high quality investment grade bonds saw less than 2% of companies going bust in the 1930s and even fewer went under, around 1%, during the 2008 banking crisis.

To reflect very high risks of default, junk bonds usually pay a high rate of interest to compensate. Rates were as high as 24% at the height of the financial crisis while 20% yields were on offer during the bursting of the tech bubble in 2001.

One of the historical benefits of owning government bonds is that they tend to move in the opposite direction to stocks, which gives a portfolio some protection when equities fall

Junk bonds have not been immune to the low interest rate environment. Today the interest rate on the Bank of America Euro High Yield index is an incredibly low 2.8%. This level implies there won't be any future bankruptcies in the high yield market, surely a case of hope over experience. We believe now is not the right time to own high yield bond funds.



Source: TwentyFour

PORTFOLIO PROTECTION

One of the historical benefits of owning government bonds is that they tend to move in the opposite direction to stocks, which gives a portfolio some protection when equities fall.

Part of the reason for the so-called 'uncorrelated' action is that government bonds are seen as safe relative to equities and in periods of stress investors dump some of their stocks for bonds, pushing up the price of the latter.

The bond fund managers questioned by *Shares* believe that bonds will continue to offer protection in a falling stock market. That's partly because governments that have their own currency can print money to pay for its future obligations if required.

This view does present a conundrum in a zero interest rate world because it looks very much like the 'greater fool theory' at work.

The idea being that investors don't really care about the price of an asset because they assume that at some point in the future there will be another investor (fool) willing to pay an even higher price.

That may very well be the case because such a downward spiral in rates and upward spiral in bond prices is potentially infinite. The current mind-set is reflected in how that poor fund manager felt about missing out on buying the negatively yielding Siemens bond.

While bond yields could fall further, boosting prices and flows, given the rising risks it seems prudent to focus on bond funds which have a wider mandate to search out global opportunities and relative value. We suggest you look at **Artemis Strategic Bond Fund (B2PLJR1)** and **M&G Global Macro Bond Fund (B78PH60)**.

By **Martin Gamble** Senior Reporter

ADVERTORIAL

PUTTING FUNDAMENTALS FIRST

Lucy Isles, joint-manager of the High Yield Bond Fund, explains how the fund's genesis has resulted in a forward-looking research approach our genesis has resulted in a forward-looking research approach, focusing on fundamentals first. The focus on fundamentals before valuation allows us to achieve the right balance of risk and reward and helps us to avoid costly mistakes. Our approach to high yield has been born out of our roots as a long-term equity house, which is unique within the market.

The value of an investment in the fund, and any income from it, can fall as well as rise and investors may not get back the amount invested.

We seek to identify a diverse range of under-appreciated resilient businesses that will adapt to our changing world. We define resilience as comprising three factors – a durable competitive position, good governance and a sustainable approach (synonymous with Environmental, Social & Governance) and an appropriate capital structure. Resilience, however, is not static, so we have developed rigorous monitoring tools to inform position sizing and our sell discipline. We think about risk differently, taking active positions in companies who face very different risk profiles. Knowing our holdings well is our first risk control, diversity is our second. We currently lend to 73 issuers from 15 countries in 18 sectors.

The combination of all these factors allows us to invest for the long term, with a three to five-year investment horizon, resulting in low turnover – a further differentiating characteristic of the fund. We allow time for fundamentals to assert themselves over fluctuating market sentiment and avoid unnecessary trading in what is a costly asset class. In doing so, we believe our investments are better placed to capture the opportunities of today and the future, to deliver long-term income, not short-term yield.

The result is top quartile performance in all timeframes, one, three, five and ten-year and since inception, 18 years ago. We deliver this outperformance by investing in bonds we consider to be resilient and then rigorously monitoring our holdings. This allows us to determine how the businesses are responding to our capricious world, and whether the initially identified resilience remains or we need to consider selling the bonds. We have delivered this top quartile performance with an 18-year track record for some of the lowest, if not the most competitively priced fees in the industry, with total charges for the fund of 0.37 per cent, with no entry or exit fee.

In doing so, we believe we remain true to Baillie Gifford's principal goals - to add value to clients, support companies and benefit society through thoughtful long-term investment.

ANNUAL PAST PERFORMANCE TO 30 JUNE EACH YEAR (%)					
	2015	2016	2017	2018	2019
Baillie Gifford High Yield Bond Fund (B Inc Shares)	-0.7	0.9	12.6	1.7	6.7
Investment Association Sterling High Yield TR	-0.7	0.7	10.4	1.0	5.1

Past performance is not a guide to future returns

Source: FE. Single pricing basis, total returns. Sterling.
The manager believes this is an appropriate comparison for this fund given the investment policy of the fund and the approach taken by the manager when investing.

What is the repo market and why is it behaving oddly?

We debate why the repo rate spiked and banks found themselves short of ready cash

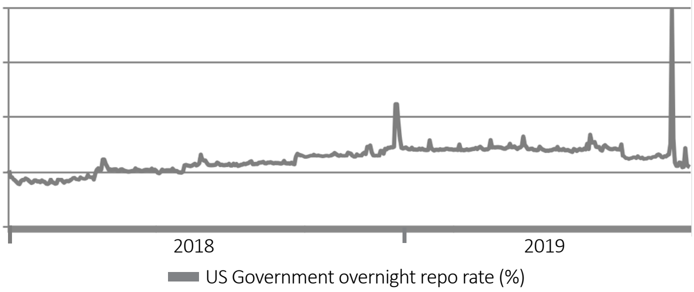
By **Russ Mould**
AJ Bell Investment Director

Real film buffs will remember *Repo Man*, a 1984 science fiction film directed by he UK's Alex Cox but it is the repo rate that investors need to be watching closely right now.

The repo rate is the level at which banks lend to each other overnight, or central banks lend to the banks.

It provides banks with immediate liquidity if they happen to need it and enables the lender to make a financial return pretty much without risk, given the extremely short time horizon involved and the collateral that backs them.

US OVERNIGHT GOVERNMENT REPO RATE SPIKED SUDDENLY LAST MONTH



Source: Review, AJ Bell

It is usually a quiet, uneventful market that forms an important, if unsung, part of the financial markets' plumbing and tends to run smoothly. And that is why recent events in the repo market require scrutiny.

In fairness, if you had blinked you would have missed it. The repo rate has since come back down. But late September's surge was not the first spike in this overnight lending rate. There have been four of five of them since late 2017, when the US Federal Reserve launched quantitative tightening (QT) and began to shrink its balance sheet.

SHARP SPIKE

Several theories have been put forward as to why the repo rate suddenly spiked and the banks found themselves a little short of ready cash. The most-widely fingered culprits have been corporation tax payments and the sale of lots of new Treasury bonds by the US government, whose budget deficit has continued to surge thanks to the Trump tax cuts.

Yet both of these would have been scheduled events, so it was odd that they caused such a scramble for cash.

An article on *Reuters* even went so far as to name JP Morgan as the bank that needed the money because it had run down the amount of cash on deposit with the US Federal Reserve and acquired US Treasuries to try and eke out some extra returns on its capital.

That meant JP Morgan, usually a big provider of liquidity to the repo market, actually needed to access it and had to pay up for the privilege.

This is not to say JPMorgan is in any financial difficulty, as it continues to meet all regulatory capital and liquidity requirements with ease. But, assuming *Reuters'* report is correct, it does suggest that JP Morgan and other banks did not have any excess liquidity to hand, because they had invested their cash and thus could not contribute to the overnight interbank market.

In other words, quantitative tightening was working as planned and the Fed was draining away liquidity in an attempt to retreat from the unorthodox, emergency policies launched in 2008 to tackle the financial crisis.

POLICY PIVOT

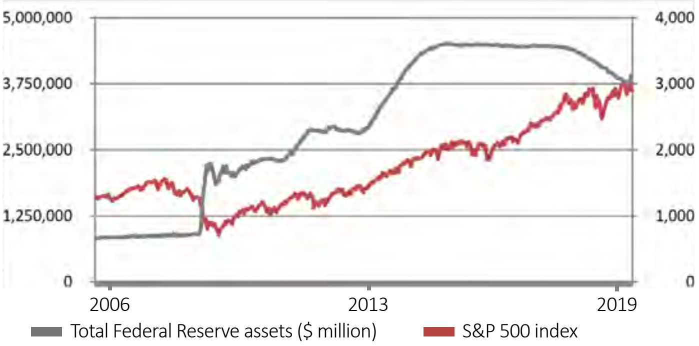
The Fed has already backtracked. It stopped QT in July and thanks to several direct interventions to provide liquidity to the repo market its balance sheet has started to gently swell again, adding further monetary stimulus to the pair of interest rate cuts already pushed through.

This has several implications:

- The financial markets and the US economy struggled without their fix of cheap Fed liquidity, in the shape of record low interest rates.
- The Fed is expanding its balance sheet with hardly anyone noticing. It may not take much to prod the central bank toward more rate cuts and an official return to quantitative easing (QE) if even minor policy tightening gums up the financial markets' plumbing.
- This could be good for risk assets, if markets decide more cheap cash is coming their way. One of the favourite charts of US equity market bulls is the one that runs the benchmark S&P 500 index against the expansion of the Fed's balance sheet during the QE era. Oddly enough this chart almost disappeared from view when QE was halted and then QT began.

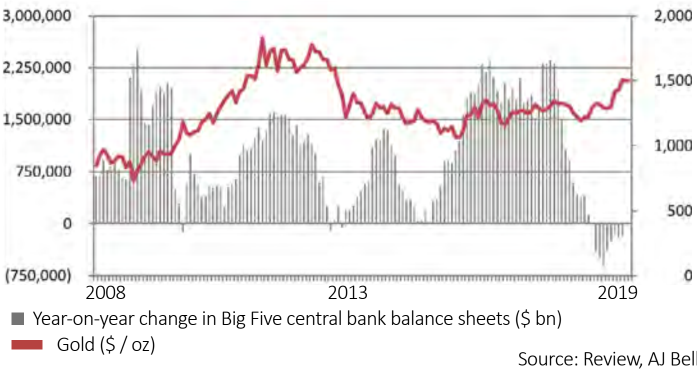
It could be good for gold but bad for risk assets if markets decide any return to unorthodox policy is the result of the very same policies' prior failure to deliver the desired returns (growth and inflation). Gold did well when investors felt central banks were losing control (2007-11) and less well when they took the view the authorities had matters in hand (2012-18).

S&P 500 HAS FEASTED OFF CHEAP FED CASH



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

GOLD HAS PERFORMED WELL WHEN DOUBTS OVER CENTRAL BANK POLICY HAVE GATHERED



Source: Review, AJ Bell

BACK TO THE FUTURE

We must accept that the past is no guarantee for the future but little incidents such as the repo ructions need watching, especially if they become more frequent.

Add them to the WeWork fiasco; the high coupons demanded by investors before they funded **Aston Martin (AML)** and **Metro Bank (MTRO)**; and bitcoin's 25% plunge in the past month and you can construct a case that either liquidity is getting tighter or markets' confidence is wobbling a little or both.

Our top picks in the UK supermarket sector

We look at the different business strategies and investment products offering access

While last year saw grocery spending lifted by high temperatures, World Cup fever and a Royal Wedding, the big supermarket chains haven't had much to celebrate this year with consumer confidence wobbly due to continued Brexit uncertainty and tough comparisons with last year's sales bonanza.

Yet despite these headwinds, shares in **Tesco (TSCO)** – the biggest of the three mainstream London-listed supermarkets by market value and by market share, and *Shares*' pick of the bunch – have performed well this year, racking up a 26% gain.

The market hasn't been as kind to Tesco's rivals, with shares in **WM Morrison (MRW)** down 8% year-to-date and **Sainsbury (SBRY)** down 19% after the failure of its planned merger with arch-rival Asda.

SALES FIGURES SHOW PRICE IS KEY

Shares has analysed the past five years of UK grocery sales figures from market research firm Kantar Worldpanel and a clear trend emerges.

It may seem obvious but the data clearly shows that when grocery prices are falling, volumes tend to increase as we all add a few extra items to our baskets. Conversely when prices consistently rise by 2% to 3% for a sustained period, we tend to buy less.

The 'golden period' for UK supermarkets was late 2016 to late 2017, which saw a combination of sharply rising prices after two years of intense competition and average volume growth of around 1%.

At their peak during the summer of 2017 supermarket sales were growing by as much as 5% on an annual basis before continued price increases eventually choked off demand.

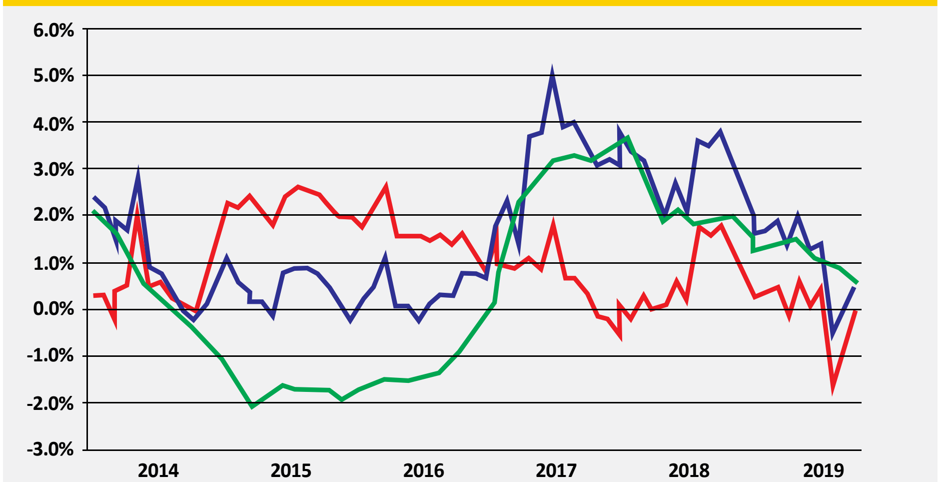
Interestingly the spike in sales last summer thanks to the heatwave was driven half by pricing and half by a recovery in volumes as we lapped up as much beer and ice cream as we could to keep cool.

The latest data from Kantar shows total sales by value increased by just 0.5% in the 12 weeks to early September, more in line with the pre-2017 average, with volumes picking up from their recent slump as price increases fade.

WINNERS AND LOSERS

Naturally there are winners and losers in the fight for market share, and the big winners are the German discounters Aldi and Lidl who in the past three years alone have grown

UK GROCERY MARKET SALES TRENDS 2014-2019



Sales trends in the 12-week period leading up to date shown. Source: Kantar Worldpanel, Shares their combined market share from 10% to over 14% thanks to aggressive store opening programmes and canny marketing.

To put this in perspective, each 1% increase in market share is worth about £1.2bn in annual sales according to Kantar.

The discounters – or limited-assortment grocery stores as they prefer to be known – successfully shed their 'down-market' image some time ago and are seen as combining quality, variety and value, resulting in a steadily rising share of shoppers' weekly food spend.

They haven't had it all their own way, however. Although each of the Big Four supermarkets has lost market share in the last three years, figures from Kantar suggest that Sainsbury's has been particularly effective at fighting back, especially in the run-up to Christmas.

FIGHTING BACK

Following its botched attempt to merge with Asda over the summer, Sainsbury's has gone back to the drawing board to find ways to win customers both in-store and online in a market with 'low to no underlying growth' as chief executive Mike Coupe put it.

Mimicking Tesco, it has reduced its 'value', entry-price product range and introduced what it calls 'owned brands' like J. James in meat, fish and poultry, and Stanford St in prepared foods, which have much more visual appeal and give the impression of heritage.

This has not only attracted new customers but existing customers are trading up from its 'commodity' products, meaning fewer low-value sales.

It has also reined in its level of promotions. According to Kantar, in the year to 8 September just 34% of Sainsbury's sales were promotional against 40% at Tesco and 45% at Morrisons. Only Asda had a lower percentage of sales from promotions (33%).

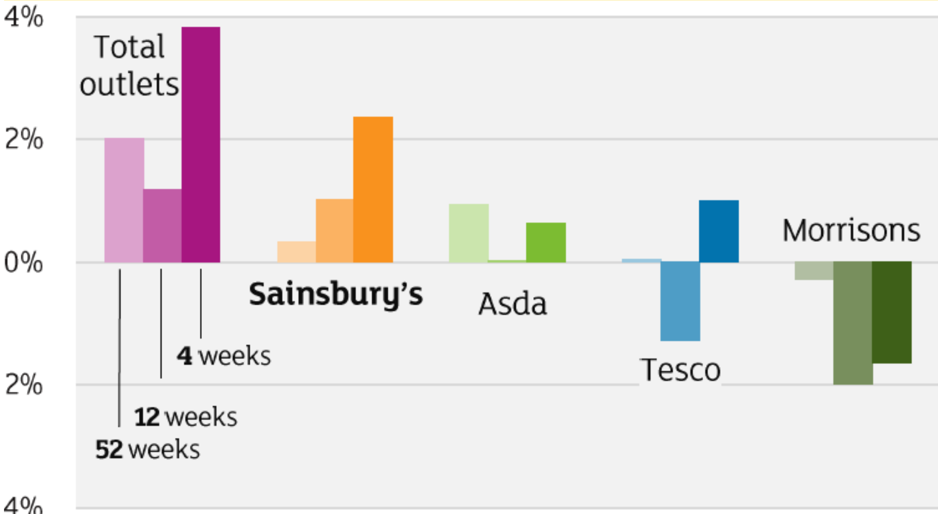
While like the rest of the 'Big Four' it is gradually losing grocery market share to the discounters, there is still a sizeable 'pie' left to squabble over and Sainsbury's has actually been outperforming its major rivals both in value and volume terms over the past four and 12 week periods.

WHOLESALE AMBITIONS

Tesco has racked up considerable success with its 'owned brand' Farm Foods products and its Exclusively at Tesco range with total own-brand grocery sales of £17.7bn in the 12 months to June.

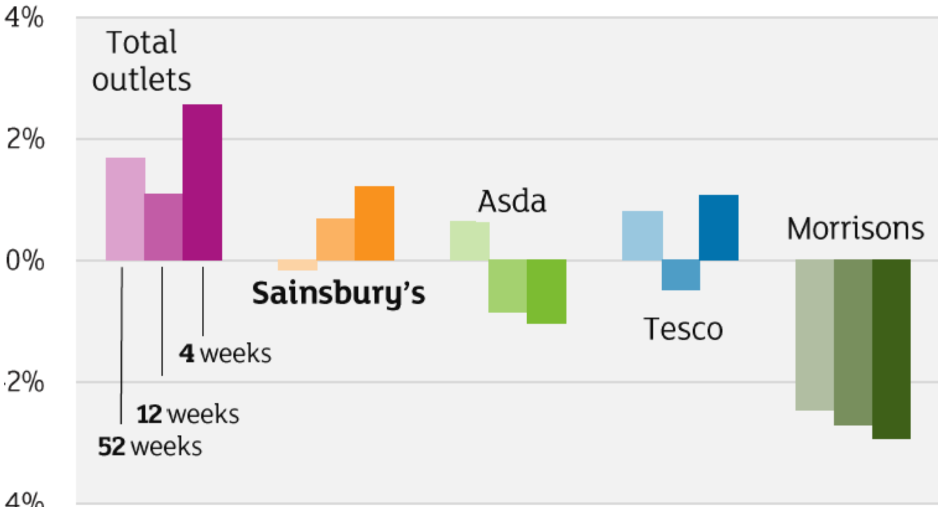
However its attempt to launch its own-brand discount store concept, Jack's, has been less successful. After a big media launch and a promise to open 10 to 15 outlets by the end of this year, ambitions appear

SALES VALUE GROWTH



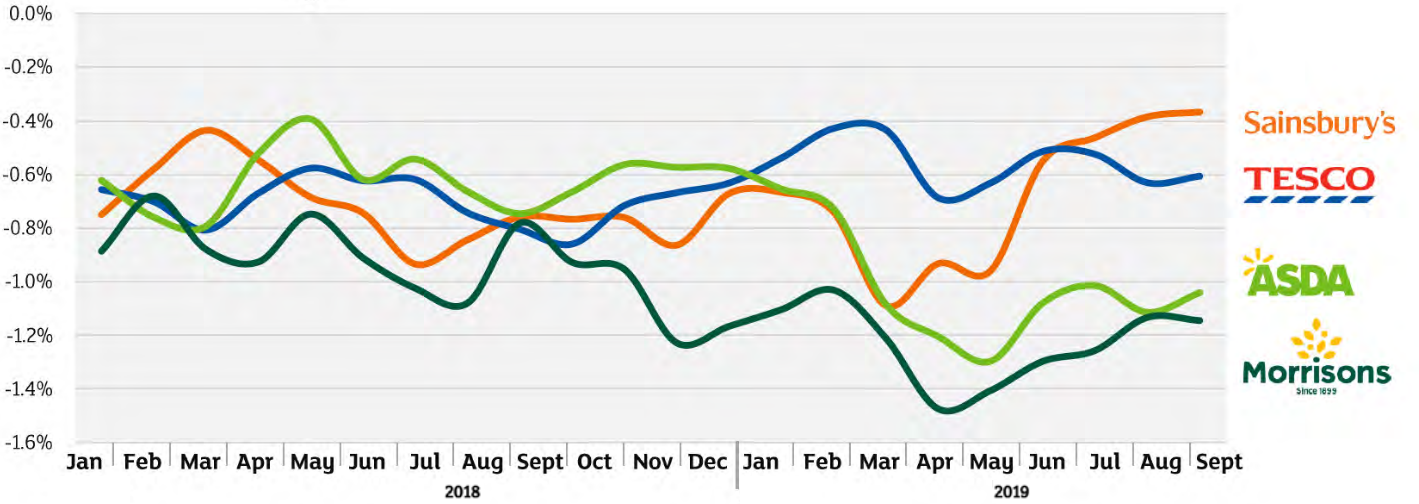
Source: Nielsen Panel, Total FMCG, 4, 12 and 52 weeks to 07 Sept 2019- Market Universe: Total Outlets.

SALES VOLUME GROWTH



Source: Nielsen Panel, Total FMCG, 4, 12 and 52 weeks to 07 Sept 2019 - Market Universe: Total Outlets.

REDUCED SWITCHING LOSSES TO DISCOUNTERS



Source: Nielsen Panel, Total FMCG, Market Universe: Total Outlets, 12wkly data to 07 Sept 2019 vs 08 Sept 2018, Spend switching as a% of total sales

to have been scaled back.

The flagship 40,000 Rawtenstall store is closing and will reopen as a Tesco superstore, while just three new Jack's are scheduled to open in the next six months. Whether the concept will ever move the needle in terms of contribution to sales is moot.

What has been a big success is the acquisition of the Booker wholesale business, which has taken Tesco into the convenience store and food-on-the-go market. In the first half results to the end of August, virtually all of the sales growth came from Booker.

It's no surprise that Tesco is pushing further into wholesale with the acquisition of Best Food Logistics. For 'a nominal consideration', and subject to review by the competition watchdog, the deal could add £1.1bn of additional foodservice revenues. Best Food customers include sandwich chain Pret a Manger and fast-food stalwarts KFC and Burger King.

ANYTHING YOU CAN DO…

Like Tesco, Morrisons has upped its promotional activity in the retail channel and expanded in the wholesale channel with a raft of new deals this year.

Retail prices were 'significantly reduced' on hundreds of lines in the first half and the company says that 'while this is having a deflationary impact relative to the market we have been pleased with the volume uplift'.

Even with this volume increase, Morrisons' like-for-like sales in pounds and pence were down 2.4% in the second quarter after a 0.2% gain in the first quarter.

In wholesale, while like-for-like sales were lower than a year ago due to lapping last year's

aggressive roll-out to McColl's stores, they were at least up by 0.5% in the second quarter.

Wholesale revenues topped £700m in the first half and are 'on track for £1bn in due course' thanks to an expansion of the relationships with Amazon and Rontec and a new deal to supply Harvest petrol station forecourt shops.

THE BATTLE MOVES ONLINE

Morrisons' deal with Amazon allows Prime Now customers to order 'a full Morrisons shop online', which is picked in-store then delivered by Amazon drivers with the option of one-hour delivery being rolled out across more major cities.

This brings Morrisons into direct competition with **Ocado (OCDO)**, its former partner in online grocery shopping and the former landlord of its Erith customer fulfilment centre.

For its part Ocado saw close to 10% growth in sales in its first half, but the really big news was the creation of a 50:50 joint venture in grocery with **Marks & Spencer (MKS)** which comes into operation next year.

M&S has struggled with its own online offering for years and the tie-up with Ocado – where it replaces Waitrose – makes a great deal of sense strategically as the profiles of customers at both firms are very similar. Both are relatively affluent and are willing to pay extra for what they perceive to be good-quality products.

According to market researchers Mintel, online sales of groceries in the UK hit £12.3bn last year, up 9% on the previous year, and are forecast to reach almost £20bn in 2023, a further 60% increase.

While younger customers are happy to shop for groceries online, the big trick for the grocers is to get the older generations, 45 and above, to do their weekly shop online.

Again, given their complementary customer profiles the Ocado-M&S tie-up looks sensible and could see sales grow faster than the overall market if it can succeed in attracting enough older, affluent shoppers.

HOW TO INVEST IN THE SUPERMARKET SECTOR

Five supermarkets are listed on the London Stock Exchange: Tesco, Sainsbury's, Morrisons, Ocado and Marks & Spencer.

An alternative way to get exposure to the sector is through investment fund **Supermarket REIT (SUPR)** which invests in UK real estate used to house supermarkets. It makes money by charging rent to tenants which are principally Tesco, Sainsbury's, Asda and Morrisons.

While there are no investment funds or exchange-traded funds offering a single way to access the operating businesses of the main supermarkets, there are a few funds which have one or more of the UK companies in their top 10 holdings. This would provide exposure as part of a broader diversified portfolio. Examples include (according to data from FE):

- **Aurora Investment Trust (ARR):** 6.76% of its portfolio is in Tesco
- **TM Sanditon UK (BXRTP05):** 4.07% of its portfolio is in Sainsbury's
- **Schroder Income (B3PM119):** 3.71% of its portfolio is in Morrisons
- **Baillie Gifford UK Equity Alpha (0585819):** 5.00% of its portfolio is in Ocado
- **RWC UK Equity Income (BG34129):** 5.00% of its portfolio is in Marks & Spencer

For investors happy to own individual company shares, our top two picks are Tesco and Ocado.

TESCO

Tesco has the financial might to continue investing in prices if needs be, to see off the threat of the discounters (who are seeing their operating losses mount).

However, if the pricing environment were to improve its market-leading position means it would be the biggest beneficiary of grocery price inflation.

At the same time its diversification into wholesale brings a new customer base and exposure to the food-on-the-go market which is growing faster than its core grocery business.

OCADO

Ocado offers direct exposure to online grocery shopping which is growing faster than in-store sales.

If successfully executed, the joint venture with M&S could see earnings rise faster than the market expects.

However the game-changer is the 'smart platform' which provides online retail solutions to six international players including France's Casino, Australia's Coles, Kroger of the US and Sobeys of Canada (combined sales last year of over $200bn).

Fees from these and other partners could grow sharply if Ocado's software is more widely adopted by food and non-food retailers – and that is what the stock market is principally focused on.

By **Ian Conway**
Senior Reporter

How to turn your dream of early retirement into reality

Fancy ditching work and joining the FIRE movement?

The FIRE movement sounds nothing like a retirement planning strategy, but it's a movement where people are saving their cash and retiring young.

Financial Independence, Retire Early (or FIRE) in a nutshell involves maximising your income and reducing your spending while you're in work in order to be able to retire early – 40 is often the target age.

Fans of the movement say it means you're not tied to a job and can enjoy time out of work for longer, with small life changes that aren't too arduous. Critics say that you end up penny-pinching throughout your life in order to retire on a frugal income.

HOW IS IT ACHIEVEABLE?

In order to achieve FIRE people will target saving anywhere between 50% and 75% of their take-home pay each month. By saving this money and investing it (often in low-cost funds) they aim to hit a target savings pot and then be able to retire. The idea is that you've got used to more frugal living during your working life, so you're able to live more frugally in retirement.

Mark Bishop, aged 50, retired seven years ago after deciding that going into the office

everyday wasn't something he wanted to do forever. 'While I enjoyed some aspects of work I never really liked the obligation to turn up every day and there were many other things I wanted to do with my life,' he says.

Rather than feeling like he missed out on anything in order to save to retire early, Bishop says he just avoided 'over-consumption' or borrowing too much money, particularly if it was just to buy things like the latest car, to 'appear affluent'.

His only extravagance that he regrets is buying a boat in his early 30s, which he went on to sell for a loss. 'Also I regret moving home so much when I was younger and not keeping the properties and renting them out. The 1990s were a golden age for property purchase,' he says.

But Bishop, who is co-founder of the Financial Independence UK Facebook group, insists the FIRE movement isn't just for bankers and City types, and is achievable for those on a 'reasonable but unspectacular income'. In short, he says, people can just follow his path, where he 'maximised income, minimised expenditure, used tax breaks wisely, [and] invested well'.

RETIRING AT 39

Steve Powley, 59, is another person who focused on saving

> "It means you're not tied to a job and can enjoy time out of work for longer"

his money to retire early. He previously worked at a software company, but freelanced and saved money so he could ditch working life early. He retired at 39 and now splits his time between the UK and Spain.

'My epiphany was when I had got off the train at London Waterloo and followed a guy down the platform. He was, I guess, mid-60s, his suit was crumpled and creased, shoes scruffy, and he just looked tired and miserable. I resolved that day not to end up like that,' he says.

His strategy was a mixture of saving well, not borrowing too much and taking on more lucrative work. 'I never stretched myself with a mortgage, never bought flash cars, and generally saved prudently. Then I did a few lucrative freelance contracts abroad – not many people have that option so I was fortunate.'

Another key aspect for Powley was to start investing his money. He took the dicey move of risking his £200,000 savings by teaching himself how to invest in shares, in order to boost his savings pot. He admits he was in the fortunate position that if he lost it all he knew he could go back to work and make more money.

However, he doesn't think FIRE is for everyone: 'Making enough money in shares isn't easy at all. It's worth a try if you fancy it but you need to have skills that would allow you to return to work easily – and I think you'd find it really tough with kids.'

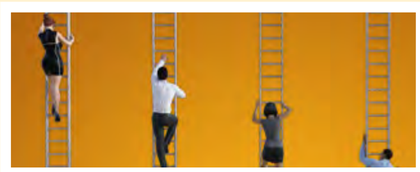
Even if I don't want to achieve FIRE, what can I learn from it?

1. **Cut back each month:** Most people who sit down and look critically at their spending will see areas where they could cut back without it affecting their lifestyle. It's a good idea every six months or a year to look at where you're spending money, areas where your spending has gone up, and any easy wins you can make to save money, such as switching energy or internet providers, or moving to a cheaper supermarket.

2. **Think hard before borrowing:** Lots of people in the FIRE movement attribute their success to not taking on lots of borrowing, so think before you do. Do you really need that loan to get a new car, or will your current vehicle suffice? Do you need to upsize your house or are you keeping up with the Jones? Even if you decide to go ahead, it's always good to challenge yourself on these decisions.

3. **Maximise your saving (and investing):** While the target of saving 50% or even 75% of your salary each month feels out of reach for many, could you be saving more of your cash? Putting money away on payday can help, as can having a budget (even if you don't stick to it rigidly each month). Also, if you know the money isn't going to be used in 10 years or more, think about investing it to get higher returns.

4. **Ditch the rat race (partly):** If the part of the FIRE movement that appeals most is doing away with the 9-5 job, can you make that a reality? Could you cut your hours and maintain your standard of living? Or cut your hours to make money from a side-hustle or hobby that you enjoy more (and don't have to do from behind a desk in the office).

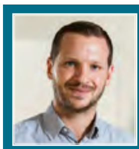


By **Laura Suter**
AJ Bell Personal Finance Analyst

Should I use pension funds to buy commercial property?'

Tom Selby responds to a small business owner considering using his SIPP to upgrade his business premises

I am a small business owner with a SIPP worth just under £300,000. I'm currently looking to expand into larger premises and was told I can potentially use some or all of my fund to buy commercial property. What are the risks and is it something I should consider?
Devraj



Tom Selby
AJ Bell
Senior Analyst says:

You can invest in commercial property via your SIPP, but there are strict rules governing how this can be done. Investing in residential property is not permitted under HMRC rules.

Investing in commercial property can be quite a complex process with significant costs and risks involved, so speaking to a regulated financial adviser is an absolute must. The below should therefore be viewed as a basic introduction only.

THE BASICS

Investing in commercial property might be attractive to self-employed investors who want to use their SIPP to help buy their business premises.

For those looking for indirect exposure to commercial property, there are various funds and trusts in which you can invest on an advised or non-advised basis.

If you invest directly in commercial property through your SIPP, you can borrow up to 50% of the value of your plan to help buy the property. It is also possible to pool your SIPP with those of other SIPP investors.

When you use SIPP funds to purchase commercial property to be used as your own business premises, you'll be required to pay rent at a commercial rate to the SIPP. This rent will be an allowable business expense and so could reduce your corporation tax bill.

RISKS AND COSTS

There are a number of risks your adviser will talk you through if you are considering using your pension to invest directly in commercial property.

One of the central tenets of retirement investing is diversification. By investing in a commercial property linked to your business, you are tying your retirement fortunes to the performance of that business (through the rent you receive) and the property market.

If the business struggles or the property market tanks, your retirement plans could be in trouble as well. Given the size of your fund, there's a decent chance you'll need to use the majority – if not all – of it to pay for a commercial property, so your exposure will be significant.

In addition, because commercial property is a specialist area there are likely to be extra fees involved. As well as paying a financial adviser, you will also need to cover costs of professional services, such as legal advice and valuation, as well as ongoing property management.

In summary, using your SIPP to invest in your own business premises is legitimate but there are risks involved which should not to be taken lightly.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

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

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

Build a diversified portfolio with just three ETFs

We look at how investors can gain broad exposure to different markets and asset classes using trackers

One of the great things about exchange-traded funds (ETFs) is that they are often widely diversified, replicating major indices which consist of many individual securities.

From an investor's point of view, this means you can hold fewer of them to get a wide-ranging portfolio.

But can you really get enough diversification with just three ETFs? Yes. In fact, some experts say you could even have a well-diversified portfolio with just two products.

TRULY DIVERSIFIED?

First you need to think about what sort of diversification you actually want, and select your funds accordingly, says Vanguard's head of ETF product management Mark Fitzgerald. 'If you're trying to get access to global equities and global bonds, the question is do you want developed and emerging markets, or do you want to span the globe completely?

'There are number of ways you could go about it but, in theory, an investor could choose two or three ETFs and get most of the exposure they need.'

He points to the Barclays Global Aggregate benchmark which is vast with around 23,700 fixed-income securities, for example, so an ETF tracking that index would offer wide bond market exposure. You could then take a global all-cap approach to equities with something like an ETF-tracking the MSCI World index to get a very broad, highly diversified exposure.

> "I think it is possible to use a small number of ETFs to deliver a balanced portfolio view"
>
> Deborah Fuhr, ETFGI

Equities and bonds are not the only asset classes though, so what about alternatives, gold or property? Wouldn't you miss out on these if you held just a few ETFs in your portfolio? Fitzgerald explains that you would get exposure to these asset classes through the major indices anyway: you might hold stocks or bonds from gold miners, refiners, or even fashion companies that buy gold.

An example of a Three-ETF portfolio

ETF	Ticker	Currency	Weight	OCF*	Bid-Offer Spread*
HSBC MSCI World	HMWO	GBP	55%	15	12
iShares Core MSCI Emerging Markets IMI	EMIM	USD	10%	18	6
iShares Core Global Aggregate Bond	AGBP	GBP (Hedged)	35%	10	28
Weighted Average				**13.55**	**17**

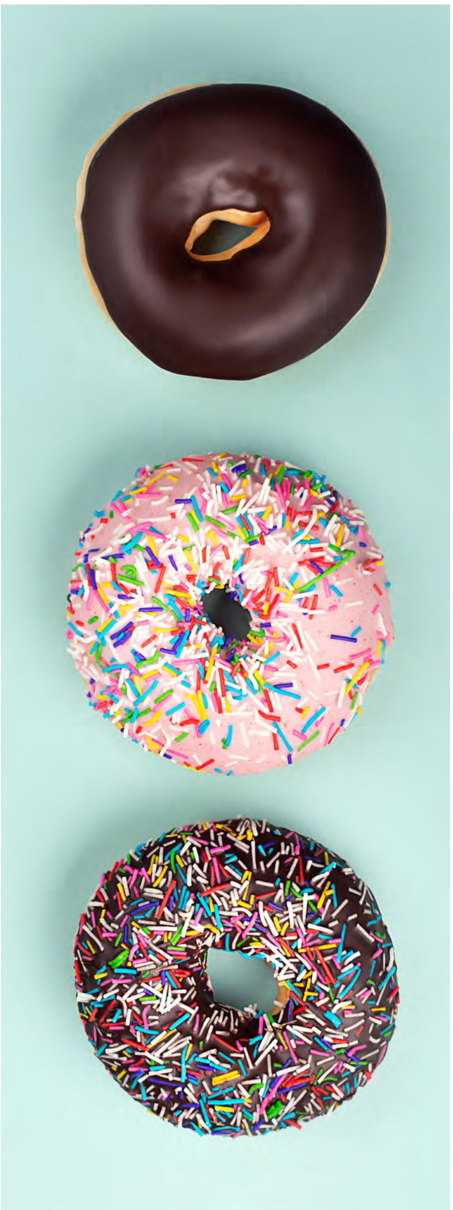
Source: All ETFs are London-listed. Source: Tilney. OCF = ongoing charges figure. *Basis points

For property, you might have exposure to listed real estate investment trusts, property developers, companies that own airports, even supermarkets such as **Tesco (TSCO)** which owns a lot of retail space, he says.

PROS AND CONS

So what are the pros and cons of a three-ETF portfolio? 'Many people own way too many funds', says Deborah Fuhr, founder and managing partner of research provider ETFGI. 'Own 10 to 15 active equity mutual funds and you are usually getting less diversification and paying higher fees because many of the funds own the exact same security. So even holding two ETFs could work, you just have to pick the ones that make sense to you.'

She notes a simple bond and equity split in two products would reflect a typical 'Global Balanced' portfolio: 'If you go back in time, one of the most typical portfolios for investors was Global Balanced – just equities and bonds. If you were to buy a global equity ETF and a global bond ETF that would likely



deliver better returns than trying to select active managers across the world.

'So I think it is possible to use a small number of ETFs to deliver a balanced portfolio view.'

Ben Seager-Scott, head of multi-asset funds at financial planner Tilney, says the major advantages of this approach are simplicity, ready diversification, and reducing your rebalancing costs when it's time to review your asset mix.

However, holding fewer funds means you have less control over your overall exposure compared to a more granular portfolio. 'The downside is that you can't control your underlying exposure so you are somewhat constrained by your market-cap weights so you can end up with dominance by individual country, and underlying costs can be higher for large countries than if you bought a set of individual cheaper ETFs,' he says.

CRUNCHING THE NUMBERS

Let's compare two model portfolios to see how the costs stack up for a three-ETF portfolio

An example of a Nine-ETF portfolio

ETF	Ticker	Weight	OCF*	Bid-Offer Spread*
iShares Core FTSE 100	ISF	12%	7	3
Vanguard FTSE 250	VMID	5%	10	14
Vanguard S&P 500	VUSA	18%	7	4
Xtrackers S&P Europe ex-UK	XUEK	10%	9	15
iShares Core MSCI Emerging Markets IMI	EMIM	10%	18	6
Vanguard Developed Asia Pacific ex-Japan	VAPX	5%	22	18
iShares Core MSCI Japan IMI	SJPA	5%	15	8
iShares Core Global Aggregate Bond	AGBP	25%	10	28
iShares Core £ Corp Bond	SLXX	10%	20	19
Weighted Average			**11.65**	**14.08**

Source: All ETFs are London-listed. Source: Tilney. OCF = ongoing charges figure. *Basis points

versus a larger one. Here we've gone for a 65%/35% split between equities and bonds. We've chosen examples of funds following the MSCI World and MSCI Emerging Markets indices for our equity exposure, and for bonds an iShares product which replicates the investment grade Barclays Global Aggregate Bond index.

What we see is that the ongoing charges figure (OCF) or the fees associated with the relevant ETFs are actually two basis points higher on the three-fund portfolio. The bid/offer spread, the difference between the price at which you can buy and sell an ETF, is also slightly higher.

Seager-Scott suggests this is because some of the most liquid ETF regions such as the UK and US have lower costs. 'The ETFs are very large so you get the benefits of scale and ease of execution. Even though the same constituents are in the global funds, they also have all of the other regions in there as well, and need to be optimised.

'The ETFs themselves aren't quite as large, so the result of that greater complexity and being mixed in with other regions makes the weighted average cost slightly higher.'

Although the OCF is higher, where this smaller portfolio would save you money is in trading costs, assuming you review your asset allocation regularly. Rebalancing regularly is important to make sure your risk is in line with your life stage and financial goals.

Most investors pay a flat fee per trade so if, for example, you paid £9.50 per trade and rebalanced your three-ETF selection quarterly, you would pay £114 a year in trading costs, £228 less than you would pay on a nine-ETF portfolio.

By **Hannah Smith**

Why India could deliver better returns after big tax changes

Funds to play the Asian powerhouse as it enjoys a big earnings catalyst

Within the global investment universe, the Indian growth story is among the most exciting. An Asian powerhouse home to over 1.3bn people, a population size second only to China, India boasts highly favourable demographics with an average age of 29, implying an enormous potential market for growth for years to come.

Recent tax changes could help renew investors' faith in India and in this article we will look at some of the ways you can play the country via investment funds.

STATE OF PLAY

Economic growth has slowed and the stock market de-rated over the past year, with a major contributor to economic and stock market weakness being a liquidity crisis.

The non-banking financial system was impacted by last year's default of lender IL&FS, a large infrastructure-focused non-banking financial company.

Liquidity has proved hard to access and companies that have failed to meet expectations have been hammered by the market.

Also weighing on sentiment is a reawakening of fears over prime minister Narendra Modi's authoritarianism and embrace of Hindu nationalism, not to mention tensions with neighbouring Pakistan.

The Indian government led by Modi has taken decisive action to rejuvenate the economy via a giant cut to corporation tax from 30% to 22%, meaning the effective rate will fall from around 35% to around 25%, equivalent to a $20bn injection into the economy.

Taxes on new manufacturing investment were slashed to 17%, making India more competitive versus tax rates in Vietnam, Indonesia and Bangladesh at a time when rising US-China trade tensions are reconfiguring global supply chains.

David Cornell, fund adviser to the **India Capital Growth Fund (IGC)**, says the tax changes underscore Modi's belief the corporate sector will create jobs and increase spending, both key to a revival in confidence.

'We believe these measures will lead to an across the board 9% boost to the (profit) of corporate India. But…more needs to be done to resolve bad debt issues and especially confidence in the financial and power industries.'

Besides this welcome economic stimulus, India bulls point out equity valuations have fallen to attractive levels, especially in the mid and small cap sectors largely ignored by large institutional investors. Indian stocks have begun to rebound since August.

INVESTMENT OPTIONS

Investors can access India via dedicated open-ended funds including **Jupiter India (B4TZHH9)**, **Matthews Asia-**

India (B3SWSK4) and **Liontrust India (B1L6DV5)**.

Regionally-focused collectives with material allocations to the country include **Stewart Investors Asia Pacific Sustainability B (B0TY6V5)**, **First State Asia Focus (BWNGXJ8)** and **Bailie Gifford Pacific (0606323)**.

Investors also have the option of looking at several low-cost ETFs including **Xtrackers MSCI India Swap ETF 1C USD (XCS5)** and **iShares MSCI India ETF USD Acc GBP (IIND)**.

Investment trusts with significant India exposure include **Scottish Oriental Smaller Companies (SST)**, **Fidelity Asian Values (FAS)** and **Templeton Emerging Markets (TEM)**.

Another option is **Fundsmith Emerging Equities (FEET)**. Its biggest geographic allocation is India at 41.3% compared with a 10.7% allocation to Hong Kong, 6.1% to Egypt and 4.6% to China.

There is also a quartet of closed-ended country specialists, including **Aberdeen New India (ANII)** on a 13.5% discount to asset value (NAV) discount, its larger counterpart **JPMorgan Indian Investment Trust (JII)** on a 9% discount, and **Ashoka India Equity (AIE)**, the outlier on a 2.3% premium to NAV.

The other India specialist is India Capital Growth, which is on a steep 17.2% discount to NAV. It focuses on the small and mid caps that have been hit disproportionately by the sell-off, although this highly concentrated, low turnover portfolio can and does invest in large caps where the managers believe long-term capital appreciation will be achieved.

INDIAN FUNDS - PAST PERFORMANCE

Fund	Annualised return over past 10 years
Stewart Investor Indian Subcontinent Sustainability Fund A GBP	13.26%
Aberdeen New India	11.11%
AS SICAV I Indian Equity A Acc GBP	10.66%
JPMorgan Indian	7.97%
Jupiter India	6.38%
Liontrust India C Acc GBP	5.69%
India Investment GBP	5.12%
India Capital Growth	4.87%

Source: Morningstar, to 30 Sep 2019

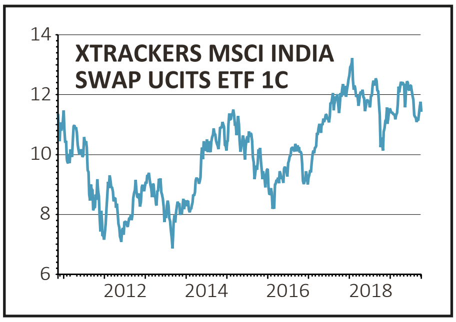
Ocean Dial duo David Cornell and Gaurav Narain manage the trust. The former points out that the portfolio traded on roughly 12 times estimated earnings for the year to March 2021 at the end of August. When it last dropped to that level back in August 2013, India Capital Growth went on to deliver a 197% return (in sterling) over the ensuing three years.

BOUNCING BACK

Results for the six months to 30 June 2019 were disappointing, NAV falling 4.6% and underperforming the BSE Midcap TR Index by 2.1%. As of the end of August, there were just 34 holdings with the top 20 speaking for 69.2% of the portfolio, so this is a book of concentrated best ideas.

'The country is taking a lot of painful medicine,' concludes Cornell, 'and it is having a very uncomfortable impact on the market and on the economy. It is a cleansing process which the government is fully supportive of. So companies are going bust, companies are defaulting on their credit and the housing finance sector has been worst hit and we've felt that in the portfolio.'

Yet he insists: 'As India comes out of this process of self-flagellation, we think we're going to go through a period of stronger, more sustainable economic growth with low inflation and that is a great environment for the kind of stocks in our portfolio to do well.'



By James Crux
Funds and Investment Trusts Editor

SHARES INVESTOR EVENINGS

14 NOV 2019

Radisson Blu
Hotel Edinburgh
EH1 1TH

Sponsored by AJBell Youinvest

Anexo Group
Speaker: Nick Dashwood Brown, Head of Investor Relations
Anexo Group is a specialist integrated credit hire and legal services group focused on providing replacement vehicles.

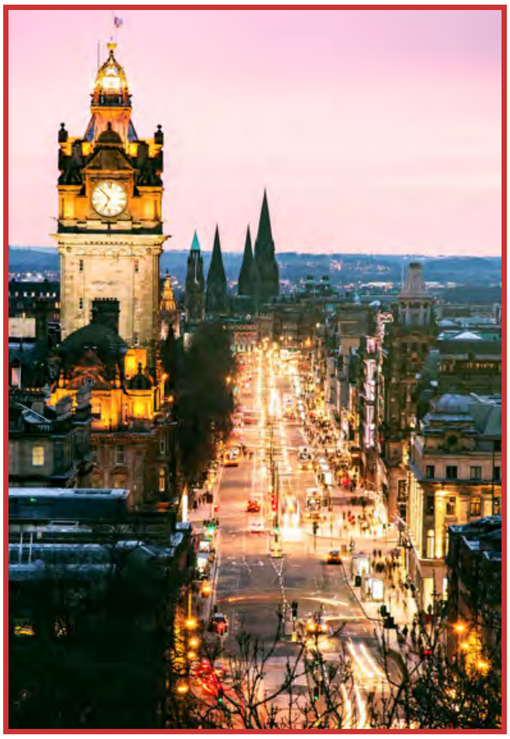
Cambridge Cognition
Speaker: Matthew Stork, CEO
Cambridge Cognition is a neuroscience digital health company specialising in the precise measurement of clinical outcomes in neurological disorders.

Coro Energy
Speaker: Andrew Dennan, CFO
Coro Energy is an oil and gas exploration company focused on delivering long-term production of natural gas.

Equals Group
Speaker: James Hickman, CCO
Equals Group is a leading challenger in the financial services sector catering for both business and retail customers operating under an e-money licence.

Scotgold Resources
Speaker: Richard Gray, CEO
Scotgold Resources is primarily focused on the development of its high grade Cononish gold and silver Project in the Scottish Highlands.

Trinity Exploration & Production
Speaker: Bruce Dingwall CBE, Executive Chairman
Trinity Exploration & Production is one of the largest Trinidad and Tobago-focused independent exploration and production companies.



During the event and afterwards over drinks, investors will have the chance to:

- Discover new investment opportunities
- Get to know the companies better
- Talk with the company directors and other investors

Event details

Registration 17.30
Presentations to start at 18.00
Complimentary drinks and buffet will be available after the presentations

Register for free now
www.sharesmagazine.co.uk/events

Contact

Lisa Frankel,
Events Operations Manager
Lisa.Frankel@sharesmagazine.co.uk
020 7378 4406

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KEY

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

Full year results

15 October: Bellway. **16 October:** Applied Graphene Materials, ASOS, Nanoco. **17 October:** WH Smith.

Half year results

15 October: LiDCO, Walker Greenbank.

Trading statements

11 October: Jupiter. **15 October:** Hays, Marston's, Merlin Entertainments, Rio Tinto, Schroders. **16 October:** BHP, Mediclinic, Segro. **17 October:** Domino's Pizza, Moneysupermarket.com, National Express, Rentokil Initial, Unilever

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, Hannah Smith, Laura Suter

ADVERTISING

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

CONTACT US: support@sharesmagazine.co.uk

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PRODUCTION

Head of Design Darren Rapley

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