STOCK SCREEN: THREE NEW SAFE-YIELD BUYS FOR OUR RACING-AHEAD PORTFOLIO

investors CHRONICLE

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A blueprint for housing
Hangover for the pubs sector
Barclays' new platform reviewed
Aim blocks the riff-raff

PROTECT YOURSELF FROM PROFIT WARNINGS

How to tell when it's time to get out



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SEVEN DAYS

THE EDITOR
Keep an open mind



I was delighted by the response to my editorial last week in which I expressed my niggling doubts about the future of the big oil exposure in my portfolio. "Oil producers will be around for a long time yet. We won't be seeing electric transport ships, passenger planes or lorries for a long while!" said one reader, and indeed the general feeling was that we don't have anything to worry about just yet.

That was the conclusion I too had reached, because like those commenting I understand how deeply oil is ingrained in the global economy, that cars only represent one aspect of the hydrocarbon distribution chain, and that the shift to electric vehicles will be slow. But I think it raises a wider point around how investors mentally engage with the shares they own. One reader suggested that oil companies will simply shift to become the largest investors in renewable energy, and thus maintain their stranglehold on the way we power our lifestyles. This is of course possible, but it is making a leap of intellectual faith that has so far not been backed up by evidence: just because a company is good at one thing does not necessarily mean it will be good at another, and incumbency is no guarantee of success.

In fact, there is plenty of evidence to the contrary: the list of incumbents in other industries battered by disruptive forces is a long one; just look at Amazon and its impact on high street retail; or the failure of Pearson to adapt to digital textbooks; or – in a scenario still playing out – the rise of pay-TV models such as Netflix and Amazon that threaten traditional TV models, not least that of the BBC which will no doubt face further pressure for reform of the licence fee regime after this week's publication of its top earners' salaries. I could go on, but the common feature is that businesses often find it hard to wean themselves off the revenue and profit streams they have relied upon for years. Often they are simply not organisationally flexible enough, unlike new entrants.

Nevertheless, Shell is, as our reader suggests, committing $1bn a year to renewable energy projects. But it seems like small change given $240bn a year is being spent globally on renewable projects, and even in contrast to Shell's own £30bn annual profits. Indeed, as Mark Robinson argues on page 52, the renewable race is still wide open, and a dominant force in renewable innovation could just as easily emerge from the smog-filled cities of China as the West. We must, therefore, keep an open mind and be ready to change it, because as investors we are all subject to cognitive biases, the most dangerous of which is known as confirmation bias. It's what, as Algy Hall notes in this week's cover feature, makes us stick with a share when evidence is mounting that trouble is brewing: we filter out facts we don't like and only pay attention to those that support a previously held view.

THE BIG STORIES

HS2 boost
Contracts awarded

Construction groups, including Costain (COST), Kier (KIE) and Carillion (CLLN), received a boost this week after the government announced they had been selected to complete work on the HS2 high-speed rail line between London and Birmingham. The news was particularly welcome for the latter, whose share price had fallen by a third the previous week when it issued a profit warning and announced plans to suspend its dividend. Its joint venture with French civil engineering group Eiffage secured two design and build contracts worth around £1.3bn.

Aviva streamlines
Lossmaking sale

Income Tip of the Year Aviva (AV.) has announced plans to sell Friends Provident International – which offers life assurance, pensions and investment products in Asia, the Middle East and Europe – to a subsidiary of International Financial Group for £340m. Management concluded that the business was not central to the life assurer's strategy and will book a £130m loss on the sale. However, it will provide a £100m boost to its solvency capital levels and will be beneficial to the dividend, management said.

Food to go
Reckitt disposal

Reckitt Benckiser (RB.) is continuing with its plans to become a global force in the consumer health and hygiene markets. It plans to sell its food business, which includes French's mustard and Frank's RedHot sauce, to McCormick & Company for $4.2bn (£3.2bn). The move follows the acquisition of Mead Johnson Nutrition earlier this year. The company will use the proceeds of the sale to pay down some of its debt, after it completes during the third quarter of this year.

THE NUMBERS

52m
The number of international subscribers to Netflix at the end of June, which has overtaken domestic US customers for the first time. Total subscribers reached 100m in April.

40%
The decline in revenue reported by Goldman Sachs during the three months to June, underperforming its peers. Chief financial officer Martin Chavez said the performance of its commodities, currency and fixed income businesses had been subpar.

$1.2bn
The amount BHP Billiton plans to invest in its US shale assets during the next year. That's despite calls from investors, including activist Elliot Advisers, for the business to be sold or spun-off into a separate company.



GOOD WEEK FOR: RPC P47

BAD WEEK FOR SAFESTYLE P10

Pressure piled on

Reports of tightening regulation around consumer credit products have scarcely left the pages of the IC during recent months. Now the government has announced plans to ban surcharges on credit and debit card payments from January. Customers spent £473m on such charges during 2010 alone, according to estimates by the Treasury. Take-away food apps have among the highest charges, with companies including Just Eat (JE.) and Hungry House adding 50p to the bill for card payments, although this is sometimes paid by the restaurant. The change follows a European Union directive to ban surcharges on Visa and Mastercard payments, although the government plans to extend this to PayPal and American Express.

"The apparent myopia among many politicians is because they know that the property market drives much of the economy. Upset it and a recession becomes more likely."

NO FREE LUNCH, PAGE 20



Strategic delivery

Improved pension offer

Royal Mail (RMG) may be close to removing one of the thorns from its side. Following a long-running pensions dispute with workers unions, the group has put forward an improved offer to members of its defined-benefit pension scheme, which will close to future accrual in March. Management has proposed offering members a choice between a defined-benefit cash balance scheme and a defined-contribution scheme. Letter volumes were down 6 per cent during the three months to June. However, an increase in parcel sales meant overall revenue inched up 1 per cent.

GSK surprise

Horlicks sale

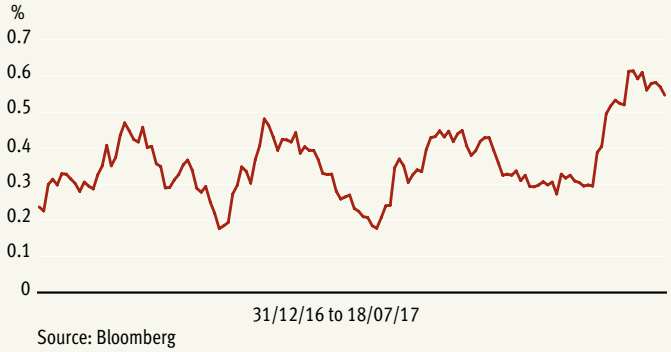
We've long noted GlaxoSmith-Kline's (GSK) shift from pharmaceutical company to more of a manufacturer of consumer healthcare goods, with the latter producing a considerable amount of like-for-like earnings growth in recent years. That's why the group's latest update makes for odd reading. Glaxo intends to sell its Horlicks brand in the UK and is proposing to close the associated manufacturing site in Slough, where it is made. In addition, the group intends to sell the MaxiNutrition brand in the UK and is exploring options to divest some other smaller non-core nutrition brands. Conversely, the group plans to invest more than £140m at several of its sites between now and 2020 to support the expansion of manufacturing for respiratory and HIV medicines.

Trump stumbles

Healthcare replacement dropped

Donald Trump faces another obstacle to his plans to overhaul the US healthcare system, after Republicans abandoned plans to replace Obamacare. Instead, the administration will only repeal the system put in place in 2016. Senate majority leader Mitch McConnell said he would repeal Obamacare, but with a two-year delay, which they hope will give them time to come up with a replacement. It's certainly a high-risk strategy that could leave a void once occupied by Obamacare.

Chart of the week: 10-year bund yields fall back



Source: Bloomberg

Expectations that the European Central Bank's (ECB) quantitative easing programme could soon end abruptly were subdued by weaker US economic data and dovish commends from the Fed this week.

German 10-year government bond yields fell back from their 14-month high (see chart), ahead of the central bank's meeting. Yields have been trading at heightened levels since ECB president Mario Draghi made bullish remarks about the health of the Eurozone economy at the end of June.

The ECB's quantitative easing scheme expires at the end of the year.

Risers and fallers (%)

▲ Lonmin	+38.91
▲ Premier Oil	+35.14
▲ Weir	+9.86
▲ RPC	+9.42
▲ Vesuvius	+8.23
▼ N Brown	-4.84
▼ Pearson	-3.82
▼ Moss Bros	-3.06
▼ Sky	-3.01
▼ Amec Foster Wheeler	-2.73

Week to 18 July 2017

For more market data go to page 8

UK stock market

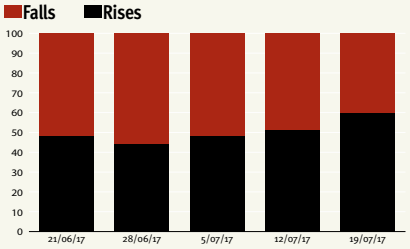
Index	18/07/17	1-week change (%)	1-month change (%)	1-year change (%)	Year high	Year low	PE	Dividend yield (%)
FTSE 100	7,390.22	+0.82	-0.98	+10.38	7,547.63	6,634.40	29.2	3.80
FTSE 250	19,613.38	+2.07	-1.02	+16.28	20,024.92	16,906.26	22.5	2.68
FTSE All-Share	4,046.36	+1.04	-0.95	+11.68	4,130.15	3,603.96	27.7	3.58
FTSE Aim	4,790.08	+0.18	-1.48	+38.44	4,969.33	3,482.10	41.8	1.30

FTSE 100 rolling 30-day



Source: Thomson Datastream

Share performance



IC ONLINE

For more UK market data, see http://markets.investorschronicle.co.uk

Other major markets

Index	18/07/17	1-week change (%)	1-month change (%)	1-year change (%)	Year high	Year low	PE	Dividend yield (%)
Eurofirst 300	1,502.96	+0.83	-1.61	+12.32	1,558.02	1,296.32	23.97	3.43
CAC 40	5,173.27	+0.64	-1.71	+18.71	5,432.40	4,321.08	19.15	3.20
Dax 30	12,430.39	-0.05	-2.53	+23.52	12,888.95	9,981.24	19.97	2.70
Dow Jones	21,574.73	+0.77	+0.89	+16.41	21,637.74	17,888.28	18.83	2.31
S&P 500	2,460.61	+1.45	+1.13	+13.55	2,460.61	2,085.18	21.68	1.98
Nasdaq Comp	6,344.31	+2.44	+3.13	+25.49	6,344.31	5,036.37	34.50	1.11
Nikkei 225	19,999.91	-0.97	+0.28	+21.23	20,230.41	16,083.11	19.11	1.72
Hang Seng	26,524.94	+2.50	+3.51	+21.66	26,524.94	21,574.76	14.37	3.34
Australia ASX All Ords	5,738.10	-0.53	-1.20	+3.60	5,976.40	5,238.30	20.27	4.11

Key emerging markets

Index	18/07/17	1-week change (%)	1-month change (%)	1-year change (%)	Year high	Year low	PE	Dividend yield (%)
Brazil iBovespa	65,337.67	+2.36	+6.02	+15.67	69,052.00	56,162.38	17.58	3.00
Russia RTS	1,038.45	+3.69	+4.43	+7.13	1,195.61	903.04	7.24	5.07
India CNX Nifty	10,178.05	+0.54	+2.60	+17.29	10,268.75	8,093.89	23.18	1.32
China SE Comp	3,187.57	-0.48	+2.06	+4.73	3,288.97	2,953.39	17.37	1.90
Thailand SET	1,571.52	+0.15	-0.32	+5.33	1,591.00	1,406.18	16.03	3.30
Turkey ISE 100	105,718.30	+2.46	+7.66	+37.37	106,217.00	71,594.94	11.28	2.53
Argentina Burcap	59,253.73	-4.67	+0.78	+31.18	62,932.77	42,155.36	na	0.92

Economic indicators

Indicator	UK	US	Germany	Japan
Inflation (Index Jan 87=100) Change on year	272.3 (Jun) +3.5%	245 (Jun) +1.6%	109.1 (Jun) +1.5%	99.8 (Jun) +0.1%
Unemployment Change on year	0.81m (Jun) +4.6%	6.98m (Jun) -10.5%	2.55m (Jun) -5.5%	2.05m (May) -3.3%
Industrial production Change on year	104.1 (May) -0.3%	105.2 (Jun) +2%	114.1 (May) +4.9%	100.1 (May) +4.7%'
Average earnings Change on year	£473 (May) +2.2%	$9.28 (Jun) +0.9%	109.8 (Apr) +3.7%	101.4 (May) +0.6%
Retail sales volume Change on year	115.1 (May) +0.9%	$479,358m (May) +4.4%	112.4 (May) +4.9%	¥11,766bn (May) +2.1%
Current account Actual change on year	-£16.9bn (Q117) +£8.83bn	-$116,781m (Q117) -2%	+€17.29bn (Jun) -3.5%	+¥1,400.90bn (May) -8.6%
Money supply – M1 Change on year	£82.4bn (Jun) +6.3%	$3,498.6bn (Jun) +7.7%	€2,813.3bn (May) +5%	¥712,525bn (Jun) +7.6%

Commodities

	18/07/17	Year high	Year low
Dow Jones UBS Comm. Index	329.07	347.28	302.10
Brent Crude $/barrel	48.76	57.06	42.09
Comex gold $/ounce	1,242	1,367	1,127
LME three-month copper	6,007	6,106	4,607
Cocoa £/mt	1,531	2,455	1,390
Coffee Brazil ¢/lb	129.58	170.90	115.39

Currencies

	Rate	1 year max.	1 year min.
US$ vs £	1.30	1.34	1.21
Euro vs £	1.12	1.20	1.11
Yen vs £	145.57	147.75	126.09
SFr vs £	1.24	1.31	1.19

MORE ONLINE

For more cross rates and a currency convertor, see http://markets.investorschronicle.co.uk

Official interest rates

	Rate (%)	Since
UK Bank rate	0.25	4/08/16
ECB Repo rate	0	16/03/16
US Fed Funds	1.00-1.25	14/06/17
Japan	-0.1-0.1	29/01/16

Government bonds

Govt bond yields	%	Year high	Year low
UK: 10-year gilts	1.27	1.51	0.61
US: 10-year Treasuries	2.26	2.61	1.46
Germany: Bunds	0.50	0.57	-0.22
Japan: JGBs	0.07	0.11	-0.30

MORE ONLINE

For more global bond data, see http://markets.investorschronicle.co.uk

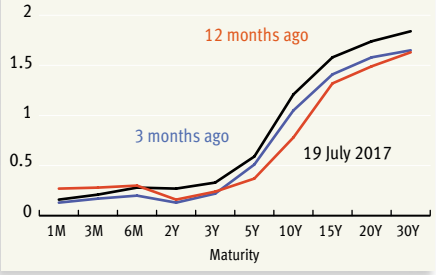
Corporate bond indices

	18/07/17	Yield (%)	Year high	Year low
Investment grade	97.16	1.16	99.75	96.42
High yield	119.94	2.80	120.33	116.54

MORE ONLINE

For prices of popular corporate bonds and Pibs, see www.investorschronicle.co.uk/bonds.

UK yield curve



NEWS

REAL ESTATE INVESTMENT TRUSTS

British Land looks good value ahead of buyback

Buying back its own shares represents better value for shareholders than chasing expensive acquisitions

JONAS CROSLAND

British Land (BLND) plans to spend up to £300m buying back its own shares, in a move indicating management frustration with the deep discount to net asset value the shares currently show. The buyback is also the result of continued strong demand in the investment market, which has made it more difficult to acquire assets offering an attractive return.

However, that strength has made it highly lucrative to dispose of certain assets. Since its full-year results were announced in May, British Land has sold off its share of the Leadenhall Building for £575m, while other disposals raised £135m, and there are further assets under offer worth £88m. During the three months to the end of June continued strong demand meant completed lettings and renewals reached a total 370,000 sq ft, 7.8 per cent ahead of estimated rental value. A further 870,000 sq ft is under offer. That included 310,000 sq ft of office space at 1 Triton Square, which the company will be committing £200m to develop. However, despite this and the share buyback, the disposal programme means there will not be any material change in the loan-to-value ratio.

At 1 Finsbury Avenue, which is part of the Broadgate Campus, work will start in August on a refurbishment programme at a cost to British Land of £35m. This will add more retail space, a new cinema and a roof terrace. And around 78,000 sq ft, or just over a quarter of the total, could be taken by technology company Mimecast, with exclusive discussions already under way. And at 2 Finsbury Avenue



British Land sold its share of the Leadenhall Building, known as 'The Cheesegrater'

– as part of the first-phase roll-out of Storey – the flexible workspace brand, 25,000 sq ft has been leased to Kingfisher Digital. Despite the buyback programme, British Land retains significant resources to fund its pipeline of development opportunities.

British Land owns or manages assets worth over £19bn, which are split almost evenly between regional and local multi-let retail assets, and office space in central London as well as a 46-acre plot at Canada Water. At 622p, the 31 per cent discount to net asset value reflects concerns that the central London office market could suffer as a result of the UK leaving the EU on unfavourable terms. However, demand for quality space is holding up a lot better than many expected, and the extent of the discount now looks hard to justify. We upgrade to buy. *JC*

RPC aiming to win hearts and minds

Shares in RPC (RPC) were on the rise after the packaging group effectively offered a sop to both its critics and shareholders via an AGM trading update.

The group revealed that first-quarter revenues of £960m were well ahead of the corresponding period last year, helped along by the contribution of acquired assets and positive currency translations. Reported and adjusted margins were ahead of management expectations, with the impact of higher polymer prices offset by the aforementioned foreign exchange impact.

We've highlighted the group's appetite for bolt-ons in what remains a highly fragmented plastic packaging market. However, RPC's determination to scale up and broaden its capacity – or at least the speed at which it has set about achieving these aims – attracted criticism earlier this year, most notably from Northern Trust Capital Markets. The criticism knocked nearly a third off the share price at the time, although it has largely retraced subsequently.

In a Damascene moment, the group now says it doesn't anticipate making any "significant acquisitions" in the current financial year, but would be looking to increase its organic growth. It has also ordered a review of management incentives, while announcing a £100m share buyback programme.

Last time out, we ventured that RPC was "suffering from a lingering crisis of credibility". That may have been a little unfair, particularly as we see the strategic sense of the group's acquisitive drive. But we think the change in tack is a tacit admission that more attention needs to be lavished on the ongoing integration process. Still a buy at 875p.

Mark Robinson



Things look gloomy at windows and doors specialist Safestyle

AIM: GENERAL RETAILERS

Safestyle: things aren't getting better

Windows and doors specialist Safestyle has warned that second-half profits will also fail to meet market expectations

HARRIET RUSSELL

Just one week after our interview with company bosses at windows and doors specialist **Safestyle (SFE)**, the group has issued a profit warning stating that second-half revenues and profits will not meet market expectations. That's down to "uncertain market conditions and weaker consumer confidence", thus managers think it prudent to expect "only modest revenue growth" again in the second half of the year. This follows a May warning, as part of the group's AGM statement, which warned that the first half had been weaker than expected.

It seems conditions are worsening across the windows and doors market, with more volatility in trading patterns than previously expected. According to industry regulator FENSA, statistics for the five-month period to the end of May 2017 show market volumes falling more than 10 per cent. Order intakes at Safestyle are up by 2 per cent over the course of the first half, suggesting that the company has done well to offset wider market challenges, but it won't be enough to defend annual forecasts – particularly at the bottom line.

On that note, the group is anticipating a continuation of the current market environment, and going on the defensive. According to chief executive Steve Birmingham, the company has already taken "firm action" to reduce operating costs, something that should be made more achievable now that work is complete on the new production facility, which came in on time and within budget. Mr Birmingham was also keen to stress that the company has continued to build its market share despite growing levels of competition.

Analysts at N+1 Singer have reduced their FY2017 and FY2018 pre-tax profit forecasts by 7 per cent to £20m and £21.5m, respectively, equating to EPS of 19.7p and 21.3p.

The negative share price reaction on the day of the profit warning was significant. Shares fell by around 12 per cent, suggesting the market was as surprised as we were by the news. True, management was reserved when questioned about consumer confidence just a week earlier, but we wouldn't have suspected a full profit warning to follow so soon. At 228p, the stock's valuation may look more compelling following this subsequent de-rating, but we believe it's a correction that adequately reflects near-term prospects for the sector. Given our current loss of faith here, we're getting out. Sell at 220p.

MEDIA

ITV investors hopeful as easyJet boss grabs top job

MEGAN BOXALL

Carolyn McCall's biography on the **easyJet (EZJ)** investor page proudly announces that under her tenure the airline has reached the landmark of carrying 70m passengers an year. **ITV's (ITV)** shareholders will no doubt hope she can obtain similar customer numbers in her new role. Britain's biggest commercial broadcaster has appointed Ms McCall as its new chief executive following Adam Crozier's departure in June.

The change at the top comes at a time of rising pressure in the media world. Demand for TV advertising space – at one time ITV's biggest revenue contributor – has plummeted in recent years, as companies turn increasingly to online ad platforms such as Google and Facebook. Mr Crozier has done his bit to leave the company in good shape. During the past few years, he has dramatically reduced the company's reliance on TV advertising by bulking up its portfolio of production companies and investing in the online ITV Hub.

But the future still looks uncertain. In May, ITV predicted that net advertising revenue in the first half – the financial results of which are due to be announced next week – could fall by 9 per cent. Broker Numis expects 2017 pre-tax profits to drop 5 per cent to £805m due to that decline and the investment demands of running multiple production companies.

But Ms McCall is no stranger to corporate challenges. Her first six months as the boss of easyJet saw airlines grounded due to a volcanic ash cloud, a massive spike in the oil price and an airline traffic controller strike. Today, with a market capitalisation of £5.7bn, easyJet is £4.1bn larger than when she joined in 2010.

Ms McColl's experience atop a major UK media company seems to have served her well in obtaining the ITV role. Earlier, she was chief executive at Guardian Media Group and led the paper's major rebranding in 2005.

We have been impressed with Mr Crozier's diversification strategy and think Ms McCall is inheriting a strong company, well positioned to manage the future challenges of broadcasting. Although takeover speculation has been allayed following the appointment of such a high-calibre chief executive, we still think ITV's shares look materially undervalued at 11 times forward earnings. At 175p, buy.

MINING

Gold creeps up on mixed US economic data

Three factors helped to lift gold prices this week

ALEX NEWMAN

A dovish Fed, weaker-than-expected inflation figures, and forecasts for a weaker dollar were cited as the three triggers for a rally in gold prices this week, as markets lowered their forecasts for tighter US monetary policy. Having touched a three-month low at the beginning of July, the news sent the yellow metal quickly back towards $1,250 (£958) an ounce. Silver followed suit, nudging past $16 an ounce.

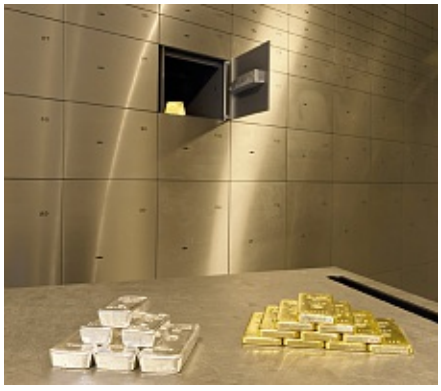
In the run-up to her testimony to US congress earlier this month, Federal Reserve chair Janet Yellen had been expected to deliver a more a hawkish tone; that is, a renewed commitment to raise interest rates and start shrinking the country's balance sheet before the end of 2017. In the event, Yellen and her Fed colleagues sounded less determined in their bid to wean the US economy away from easy money supply, despite data suggesting the country is approaching full employment.

'Gold investors should always focus on stocks that offer a good combination of low costs and realistic shareholder returns'

Theoretically, gold investors should fear the prospect of tighter monetary policy from the world's most powerful economy. Interest rate hikes are designed to calm inflationary pressures and increase the value of the greenback, which competes with gold as a store of value. That's the logic, anyway; recent history is more complicated. Some analysts see a greater threat to gold prices comes when the metal's physical supply outpaces new money supply. This is of course complicated when loose monetary policy funnels cash into asset markets – such as equities and bonds – rather than consumer goods.

According to HSBC, physical demand for gold is currently mixed and global supply "toppy". However, paper demand continues to pick up whenever there is a dip in gold. ETF Securities saw strong inflows into precious metals funds, reversing outflows seen earlier this summer.

Then there is the threat of geopolitical unrest, against which gold has long been seen as a cushion. Following the Brexit and US presidential votes in 2016, market prognosticators had understandably trained their eyes on further populist victories in the ballot box, suggesting rising protectionism would lead to increased safe-haven demand for gold. Major electoral shocks have eluded 2017 so far, but that doesn't mean political risks have receded.



Let off: the Fed's decision not to raise interest rates should be good news for gold investors

International markets have largely shrugged at the rising prospect of a military conflict involving a nuclear-armed North Korea. Meanwhile, new or mutating flashpoints in Qatar, Syria and elsewhere in the Middle East are complicated by the unpredictable role a Trump-led United States now plays in international relations. Gold bulls are prone to overstating the inherent unknowability of the future. But it says something the median gold price forecast by Bloomberg analysts – currently $1,235 for this quarter – climbs to $1,265 next year and $1,294 in 2019. That's why gold investors should always focus on stocks that offer a good combination of low costs and realistic shareholder returns, both of which can reduce the fool's errand of calling gold prices month-to-month. For these reasons, we include the growth-focused Polymetal International (POLY) among our tips this week (see page 44).

MINING

Shanta Gold rocked by royalty shift

ALEX NEWMAN

In early March, Tanzania banned the export of gold and copper concentrate. **Shanta Gold (SHG)**, which operates the New Luika gold mine in the country's south-west, was quick to inform the market that, unlike larger peer **Acacia Mining (ACA)**, it would not be affected by the ruling. Four months on, and the spat between Acacia and the government has mutated into legislation that most likely will affect Shanta's production and export of gold as doré (or unrefined bar) form.

In its latest trading update, Shanta said changes to royalty rules meant its next shipment was likely to incur a 6 per cent government take, in addition to a 1 per cent clearing fee imposed in June. That's up from a nominal 4 per cent royalty payment, and enough to force Shanta to launch a review of its operations and cost base.

The news is particularly disappointing for shareholders, as Shanta has made a big effort in recent months to keep a lid on outgoings. In the three months to June, and despite being hampered by the ramp-up in underground production, all-in sustaining costs were 4 per cent down on the first quarter at $735 (£564) an ounce.

While that led to a strong uptick in cash generation, the strain in working capital has also increased. Higher inventories and receivables, lower payables and a 13 per cent increase in unpaid VAT rebates to $14m have led to a cash squeeze and an indefinite suspension of work on the Singida pilot project. The company has now asked authorities for corporate tax payments to be offset against 14 months of VAT rebates Shanta says it is owed.

Five weeks ago, we said the buy case for Shanta Gold relied on its ability to navigate a constrained financial position, and avoid the ire of the Tanzania government. One test passed, another failed. However, a 3 percentage point increase in royalties is likely to increase costs by $40 an ounce, which is not as bleak as the recent share price fall suggests. At 4.75p, we're hanging on. Buy.

Aim looking to keep out the riff-raff

The London Stock Exchange is beefing up the pre-admission process on Aim

MARK ROBINSON

Since the start of the year, the FTSE Alternative Investment Market (Aim) 100 index has outstripped its main board benchmark equivalent by 14 per cent. Five market admissions involving a vendor placing delivered an average share price gain of 45 per cent between January and June, according to Allenby Capital.

The number of new admissions was slightly down on the previous year, although the aggregate size of the market – £93.6bn at the end of June – is challenging the high water mark achieved in 2007. More importantly, the rate of attrition continues to slow. An average of 12 companies delisted per month during the first half of 2016. The rate dropped to nine per month over the second half and has continued to dwindle through 2017. That's progress of sorts.

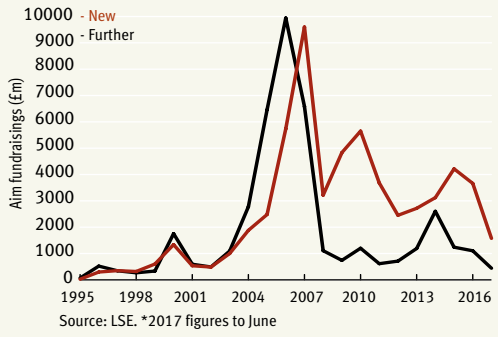
'An average of 12 companies delisted per month in the first half of 2016. The rate dropped to nine per month in the second half and has dwindled through 2017'

Meanwhile, funds generated through admissions rose from £753m to over £919m, according to accountancy firm UHY Hacker Young. The total amount raised on the market since its inception in 1995 has now passed the £100bn mark. Somewhat surprisingly, nearly 60 per cent has been generated through secondary issues, often perceived as the Achilles heel of the market.

And yet the market continues to draw criticism, with the rights of minority shareholders increasingly in the spotlight. Last month, **Standard Life (SL.)** blamed stock market rules that allowed software company Fusionex to cancel its shares on Aim, saying it will leave minority investors lumbered with unlisted and illiquid shares. A similar situation is playing out with Aim-traded **Gemfields (GEM)**. At the end of this month, the emerald and ruby miner will be delisted from Aim after majority shareholder **Pallinghurst Resources (JSE:PGL)** received enough votes (75 per cent) to force a takeover under a nil-premium bid. Shareholders will end up holding a stake in the larger Pallinghurst group, listed in Johannesburg – presumably it's a question of value rather than liquidity that has vexed minority holders.

There have been far more contentious issues in the past – one need only recall the corporate governance issues that have engulfed a number of Chinese companies trading on Aim in recent years. It's even debatable whether a beefed-up regulatory framework would have made any difference to the examples cited above. By its very nature – light-touch regulation, relatively modest fees – the market entails a more acute risk profile. But, occasionally, it's stung into action by criticism.

The history of fundraisings on Aim



Source: LSE. *2017 figures to June



The LSE proposals mean Aim could attract a better class of company

A decade ago, the **London Stock Exchange (LSE)** doubled the maximum fine it could levy on rogue companies and advisers as part of a tightening of regulations. This was in response to mounting criticism of the market's lax oversight, including some very public barbs by the then chairman of the rival New York Stock Exchange. Now, LSE bosses have released a discussion paper on proposals to tighten Aim rules governing the pre-admission process for constituents and nominated advisers (Nomads):

- One of the proposals looks at whether Nomads should commence discussions with the LSE at an earlier stage, setting out key information on companies prior to admission.
- Regulators are also seeking submissions on whether the LSE should publish a list of "non-exhaustive examples of factors" that a Nomad could consider when assessing a company's suitability.
- Another proposal looks at whether the LSE should introduce a minimum fundraising threshold for applicants and if so, whether it should apply to both revenue and non-revenue-generating companies. The paper is also looking at the possible introduction of a minimum "shares in public hands" requirement and if so, what the minimum free float should be.

The LSE will be hoping that changes to the pre-admission process, like the previous change to eligibility for individual savings account (Isa) inclusion, will reinforce the notion that London's junior market will be able to attract a better class of company. Ironic given main board regulators are rolling out the red carpet in a brazen attempt to lure Saudi petro-dollars.

Not reversing QE

Chris Dillow says quantitative easing is not symmetrical. If the Bank of England sells gilts, this will not have the opposite effects to it buying them

MPC member Ian McCafferty has raised the possibility that the Bank of England (BoE) might start to sell some of the £435bn of gilts it bought under its quantitative easing (QE) programme. When asked whether QE should be reversed, he said it was "a question that needs a bit of asking". This raises a tricky issue – that policy is asymmetric, in the sense that the Bank selling gilts would not simply have the opposite effects to its buying of gilts.

Let's start with best estimates. Bank economists have estimated that QE did indeed reduce gilt yields and boost economic activity. Martin Daines, Michael Joyce and Matthew Tong estimate that the first £200bn of QE cut yields in the 15-20 year maturity range by around 1.2 percentage points. And Martin Weale and Tomasz Wieladek estimate that QE equivalent to 1 per cent of GDP (£20bn) added around 0.18 per cent to real GDP.

There are two main mechanisms whereby this happened. One is portfolio rebalancing. BoE demand for gilts raised their prices and reduced their yields. Some investors used the money they got from selling gilts to buy corporate bonds and equities which reduced companies' cost of capital and so encouraged them to invest.

The other is a signalling effect. QE signalled to everybody that the Bank intended for short-term interest rates to stay low for a long time. This reduced gilt yields, because these should be equal to the expected path of interest rates over their maturity. And it stimulated spending (relative to what would otherwise have happened) by giving companies and consumers confidence that borrowing costs would stay low.

Which brings me to the asymmetry. Under QE these two mechanisms worked in the same direction. But under reverse QE, they will work in opposite directions and so offset each other.

The portfolio balance effect means an extra supply of gilts will depress their prices and raise yields. And this will have knock-on effects for corporate borrowing costs which will depress capital spending. That's simply QE in reverse.

The signalling effect is different. If the Bank announces plans to sell gilts, traders will see this as an alternative to rate rises – because monetary policy would be tightened via higher gilt yields rather than higher short rates. They will therefore reduce their expectations for short-term rates. But this will tend to reduce gilt yields – which will offset the portfolio balance channel. The net impact of reverse QE will therefore be small, because the contractionary effect of the portfolio balance channel will be mitigated by an expansionary effect of lower interest rate expectations.

The stronger is the signalling effect, the more true this will be. And we have a good reason to think the signalling effect is strong. It's that later doses of QE had smaller effects upon yields and output than the earlier doses. This is consistent with those earlier doses having a strong signalling effect and the later doses a weaker one.

It's possible, therefore, that reversing QE won't do as much to raise gilt yields as QE did to cut them. For the same reasons, the effect upon output might also be smaller.

There are broader and more important points here. Monetary policy is a strategic game between central banks and the private sector with an uncertain outcome: this is a point made in a different sense by Andrew Caplin and John Leahy in one of my favourite papers. And policy can be asymmetric: a move in one direction is not necessarily the same as the move in the opposite. Economic policy is not a simple hydraulic process whereby pulling levers has stable and predictable effects. It's more complicated than that.

Next week's economics...

The UK economy is growing more slowly than other western ones, next week's numbers could show.

If the ONS's first estimate of second-quarter growth on Wednesday corroborates NIESR's estimate, it will show that real GDP rose 0.3 per cent – implying only very slight growth in GDP per head. The breakdown will probably show that growth in services offset falls in industrial and construction output.

Other data, however, might show that the mix of growth is changing. The CBI should report decent growth in manufacturing output and orders on Tuesday – although it might also say that investment intentions are still weak. But it might say on Thursday that retail sales have been weak this month, in large part due to falling real wages.

By contrast, overseas news should be good. On Monday, flash purchasing managers' surveys should show that growth in the eurozone is around a six-year high, with both manufacturing and services doing well. Germany's Ifo survey the next day might be even better, showing that manufacturing is growing at its fastest rate since the survey began in 1991.

One slight cloud, though, is that such strength might not persist. The Ifo survey is likely to show somewhat weaker expectations for growth, while the National Bank of Belgium's survey could show business confidence at a 10-month low; this has been a good bellwether of eurozone growth in the past.

We should also see good growth in the US. The first estimate of GDP is expected to show annualised growth of 2.5 per cent in the second quarter – twice the UK's rate. And other indicators should suggest such growth will continue. We should see a rise in durable goods orders on Thursday, while the Conference Board should say on Tuesday that consumer confidence, although below March's 15-year high, is still way above average. These high spirits should be confirmed by news from the housing market, where we should see higher sales of existing homes and prices rising by over 5 per cent year on year. That's strong enough to suggest households are in good financial health, but not so strong as to suggest there's a bubble.

We'll see what the Federal Reserve thinks of all this when it releases its policy statement on Wednesday. It is expected to leave rates unchanged (because inflation is not a pressing problem) but will hint at both rate rises and a modest reversal of quantitative easing later this year.

COMMENT

SIMON THOMPSON



On the upgrade

Simon Thompson highlights a quartet of small-cap buying opportunities with strong earnings momentum

While I was on annual leave last week 18 companies on my watchlist released trading statements, almost all of which have been positive, I hasten to add. A raft of updates is clearly in order and I will endeavour to publish these as promptly as possible.

Alternative Investment Market (Aim)-traded UK and eastern European property fund manager and investor **First Property (FPO:56p)** has established a major new fund, Fprop Offices LP, with eight institutional investors to invest in office blocks and business parks across England. The £182m equity raised at first close equates to £260m of buying power based on the new fund's maximum 30 per cent gearing level, a considerable sum in relation to First Property's current third-party assets under management (AUM) of £323m. In effect, after taking into account other mandates won, this means the company's third-party AUM could almost double. Interestingly, instead of earning an annual management fee, First Property has agreed to a profit share, the impact of which analyst Chris Thomas, head of research at brokerage Arden Partners, believes has significant profit potential.

He estimates that, based on an initial yield of 6.2 per cent on purchase, and after taking into account debt funding allowed, the new fund would generate a 7.5 per cent return on equity and produce a profit share of £1.36m for First Property, plus an additional £200,000 on the company's £3m co-investment. After factoring in bonus allocations, this would produce a £1.1m contribution at the pre-tax level. Moreover, if the new fund generates an annual internal rate of return of between 7.5 per cent and 15 per cent, the financial returns ratchet up for First Property; the company is entitled to 25 per cent of the total profits in this scenario, thus highlighting the potential for additional profit upside if investment returns are boosted by capital gains. It's only fair to point out that if capital losses exceed income in any one year, then there would be a clawback on income paid in prior years, a sensible arrangement in my view.

The point being that as Fprop Offices LP's capital is deployed on acquisitions, expect major earnings upgrades. That's because Arden's current year pre-tax profit estimate of £9.1m, up from £8.6m in the 12 months to end-March 2017, doesn't take into account any contribution from the new fund and is solely based on First Property reporting annual revenues of £25.1m, almost all of which are recurring. It's also worth flagging up that the proportion of First Property's profits earned from fund management activities is set to more than double to 18 per cent. In turn, this offers potential for investors to attribute a higher multiple to this fast-growing profit stream, and with good reason, as fund management profit largely drops through to cash and should enable the company to pay a higher proportion of its earnings as dividends. In other words, there is scope for earnings multiple expansion and upgrades from the Fprop Offices LP fund to drive the share price.

In addition, there is potential for upgrades if First Property deploys some of the £13m free cash on its balance sheet on further debt-funded and earnings-accretive purchases of high-yielding commercial property in Eastern Europe, or if sterling remains weak against the euro. That's because Mr Thomas has conservatively factored in an average exchange rate of £1:€1.189 – well above the current rate of £1:€1.14 – on the profits First Property earns from its 10 wholly owned overseas investment properties.

The bottom line is that, rated on 9.5 times prospective earnings, offering a 2.9 per cent forward dividend yield and priced on 1.2 times book value, the risk:reward ratio remains skewed to the upside. So, having first recommended buying First Property's shares at 18.5p in my 2011 Bargain Shares portfolio, booked dividends of 7.265p a share excluding the final payout of 1.1p, which goes ex-dividend on 31 August 2017, and last advised running profits at 53p ('Small-cap gems', 13 June 2017), given the obvious potential for earnings upgrades, I now rate them a buy at 56p and have a new target price of 65p. Buy.

Miton on a roll

First Property is not the only fund manager on my watchlist on the upgrade. The same is true of Aim-traded asset manager **Miton Group (MGR:43p)**.

When I last rated the shares a buy at 40p, and raised my target to 50p ('Going for growth', 20 March 2017), the company had posted a major earnings beat for 2016, and announced that AUM had increased by £192m to almost £3.1bn in the 10 weeks since the December 2016 year-end, thus supporting expectations of another robust year of earnings growth. The momentum shows no sign of slowing as AUM have subsequently surged to £3.45bn, buoyed by net inflows of £195m, and £254m of positive market movements so far this year. That's well ahead of the year-end AUM forecast of £3.3bn, which analyst Stuart Duncan at broking house Peel Hunt had based his forecasts on, prompting him to raise his AUM estimate again to £3.5bn. And this feeds through to profits as Mr Duncan now expects a near-10 per cent hike in Miton's pre-tax profit to

Simon Thompson's book **Stock Picking for Profit** *can be purchased online at www.ypdbooks.com, or by telephoning YPD Books on 01904 431 213 and is being sold through no other source. It is priced at £14.99, plus £2.95 postage and packaging. Simon has published an article outlining the content, 'Secrets to successful stockpicking', which can be read on the Investors Chronicle website.*

£5.6m this year to deliver EPS of 2.5p and a 10 per cent hike in the payout to 1.1p a share.

Importantly, 12 of the 15 funds managed by Miton are ranked in the first or second quartile over the manager's tenure, with the inflows broad based and consistent over the period, thus diversifying the revenue mix and reducing dependency on any one fund. The cash generation of the business stands out, too, as net funds have risen from £17.4m to £18.2m in the 12 months to end-June 2017, even though the board spent £2.6m on an earnings-accretive share buyback programme, and paid out £1.7m in dividends, having raised last year's payout by half to 1p a share.

Investors are starting to cotton on to the bullish momentum, as Miton's share price has just taken out a three-year high around 42p and there is no overhead resistance until the 50p price level, which capped progress a few years ago. That target looks a distinct possibility to me and one that would value Miton's equity on a reasonable 14 times this year's likely post-tax profit net of cash on the balance sheet, and underpinned by a 2.2 per cent prospective dividend yield.

So, having first spotted the earnings recovery potential a couple of years ago when the price was 23p ('Poised for a profitable recovery', 4 April 2015), and banked 1.67p a share of dividends since then, offering 16 per cent of upside potential to my 50p target, I continue to rate Miton's shares a decent buy.

STM upgrades

Aim-traded shares in **STM (STM:52p)**, a company specialising in the administration of assets for international clients in relation to retirement, estate and succession planning, and wealth structuring, have rallied sharply since I last advised buying at 40p ('Five growth opportunities', 30 May 2017), and are about 50 per cent up since I initiated coverage ('Tapping in to a pensions payday', 27 April 2015).

The re-rating is fully justified too as the board's newly upgraded guidance suggests full-year revenues being £300,000 ahead of the £19.5m previous estimate of analyst Jeremy Grime at house broker FinnCap, prompting a 10 per cent pre-tax profit and EPS upgrade to £3.2m and 4.4p, respectively. The drivers behind this outperformance have been the launch of an international self-invested personal pension (Sipp) business in April, which resulted in healthy take-up, with new applications running at three times the rate of STM's UK Sipp offering; a solid outcome from the company's legacy qualifying recognised overseas pension schemes (Qrops) business, an offshore pension scheme approved by HMRC and used by expatriates and mobile employees whose tax domicile can change as a consequence of employment; and a strong performance from STM's life business, which offers an insurance wrapper product.

In my last article, I noted that Mr Grime had not factored into his forecasts any new international Sipp business, nor any cost reductions in the Qrops operations following the UK government's decision to introduce a 25 per cent tax on transfers into Qrops for residents located outside the EU, thus offering scope for outperformance. I also felt that STM was well placed to act as a consolidator in the Qrops market. Indeed, whereas STM has a high margin and annuity style recurring income generated from existing Qrops plans, other smaller players lack the critical mass so are rich pickings for a company with a cash pile of £8.6m, a sum worth 14.5p a share. I can now reveal that the change in tax legislation "is starting to generate opportunities to potentially acquire other books of Qrops business". But even without factoring any earnings enhancing 'run-off' acquisitions of Qrops books, Mr Grime feels that current trading trends point towards STM's revenues rising to £20.1m in 2018 to boost pre-tax profits to £3.4m and lift EPS to 4.8p, representing a 17 per cent upgrade, and warrants lifting their target price from 48p to 60p.

So FinnCap is forecasting a 20 per cent dividend hike to 1.8p a share this year, rising to 2p a share in 2018, implying STM's shares are rated on less than eight times 2018 earnings estimates net of cash on the balance sheet, and offer a prospective dividend yield of 3.8 per cent. That's still a harsh rating and a return to the share price highs around 70p, dating back to the autumn of 2015, will be in order if the current momentum can be maintained. Buy.

Bango outperforms

Aim-traded shares in **Bango (BGO:191p)**, a provider of a state-of-the-art mobile payment platform that enables smartphone users to charge purchases made in app stores straight to their mobile phone account, rallied strongly after I last advised buying at 143p and hit my 200p target price earlier this month ('On the money', 7 June 2017). They have more than doubled since I first advised buying the shares at 93p ('Bang on the money', 26 September 2016).

However, this is not the time to bank profits. A pre-close trading update released ahead of interim results due out on Tuesday, 19 September 2017 revealed that the exit run rate of end user spend (EUS) processed through Bango's payment platform hit £300m at the end of June, up from £195m at the start of the year and massively outperforming the £242m forecast of analyst Ian McInally at house broker Cenkos Securities. This gives Mr McInally "a high level of confidence in our year-end exit run rate of £352m and expectations that Bango can achieve run-rate break-even in the fourth quarter". He adds that "should the acceleration of EUS over the first half be maintained then an upwards revision to our EUS expectations should be necessary."

I would go one stage further. With Bango's payments platform tested to process transaction levels in excess of £5bn, and costs in check, then cash profits could ramp up very sharply from this point onwards, especially as the company has just gone live with a groundbreaking direct carrier billing payment route for online giant Amazon in Japan, and one that enables customers with a KDDI or NTT Docomo mobile phone account to pay for goods purchased from Amazon.co.jp by charging the cost of them to their mobile phone account. These two carriers account for three-quarters of the Japanese market, so is potentially a transformational deal for the company. Bango has potential to generate eye-catching growth in other countries too, having recently launched new store billing routes in Indonesia, Hong Kong, the US and Europe, and also migrated two Google Play routes onto its platform from other suppliers.

Bearing recent developments in mind, my original 200p target price assumed a rating of 13 times Bango's potential net profit in 2020 based on my financial models. However, that was before the Amazon deal which, frankly, could easily raise my fair valuation by half again. Buy.

MORE ONLINE

Simon has published the following articles since the start of last week:

- **1pm:** Buy at 44p ('A trio of small-cap buys', 10 Jul 2017).
- **Solid State:** Buy at 410p, target 480p ('A trio of small-cap buys', 10 Jul 2017).
- **Avation:** Strong buy at 220p, raised target 275p ('A trio of small-cap buys', 10 Jul 2017).
- **Stadium:** Run profits at 133p ('Value opportunities', 19 Jul 2017).
- **PV Crystalox:** Hold at 22.5p ('Value opportunities', 19 Jul 2017).
- **Walker Crips:** Buy at 43p ('Value opportunities', 19 Jul 2017).
- **Inland:** Buy at 59p, target 80p ('Value opportunities', 19 Jul 2017).
- **Gama Avation:** Buy at 250p, target range 275p to 300p ('Value opportunities', 19 Jul 2017).
- **Arbuthnot Banking:** Buy at 1,252p, target 1,533p ('Value opportunities', 19 Jul 2017).

CHRIS DILLOW



60 years of wasted effort

Academic financial economics might have been a massive waste of time

Conventional academic financial economics has been a massive mistake, and investors would have been better off ignoring it and instead learning from Benjamin Graham's work on value investing in the 1930s and 1940s. This is the claim of a new paper by Eben Otuteye and Mohammad Siddiquee at the University of New Brunswick. Orthodox theory – in particular the capital asset pricing model – has, they say, been "60 years of wasted effort".

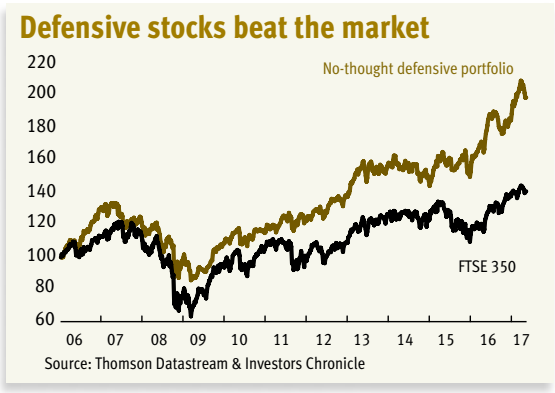
Bold as this claim is, it has mainstream support. Eugene Fama and Ken French, two leading conventional financial economists, have written that the CAPM "has never been an empirical success" and that most applications of it are "invalid".

The model's biggest claim is that equities' returns should be positively related to their sensitivities to market returns – their betas. This, however, is simply false. Economists have known since the early 1970s – pretty much when the model was first tested – that the opposite is the case. It is low-beta stocks, not high-beta ones, that do best. This has prompted some economists to believe, in the words of Eric Falkenstein of Pine River Capital Management, "there is generally no empirical risk-reward relation".

This would have been no surprise to Ben Graham. He thought investors could have both low risk and high returns if they bought shares with a good "margin of safety" – ones whose prices were well below companies' intrinsic value. To him, high returns were not a reward for risk, as the CAPM says, but rather a reward for the skill and diligence required to find undervalued companies.

And it is defensive stocks that often have Graham's margin of safety. Many of these have what Warren Buffett calls "economic moats" – sources of monopoly power such as big brands that allow them to fend off competition and so maintain profits thereby limiting their downside risk.

There's a second failure of the CAPM – the fact that momentum stocks do well. Again, this wouldn't have surprised Graham. He saw what the CAPM denies – that investors can be driven by wages of sentiment. Often, he wrote, "Mr Market lets his enthusiasm or his fears run away with him".



This raises the question: if Graham's approach is so much better than the CAPM, why did academia choose the latter (and still teach it) and ignore the former?

One reason is that Graham's approach is not so much a scientific theory as a guide to action. Its core concept – intrinsic value – is one that different investors estimate differently: that's why rational people trade shares. This means it is difficult to test. The CAPM, by contrast, makes simple falsifiable predictions – albeit ones that have actually been falsified.

'If Graham's approach is so much better than the CAPM, why did academia choose the latter (and still teach it) and ignore the former?'

But there's something else. Otuteye and Siddiquee's criticisms of the CAPM remind me of criticisms of modern macroeconomics. Here, too, critics allege that the discipline has become dominated by theories that are mathematically elegant but practically useless – dynamic stochastic general equilibrium models. Paul Romer alleges that macroeconomics has become dominated by "mathiness" – an erroneous conflation of tricky equations with real science. Perhaps the same is true of financial economics.

The problem here might not be confined to economics. The philosopher Alasdair MacIntyre said in 1988 that universities "can on occasion effectively exclude from academic debate and enquiry points of view insufficiently assimilable by the academic status quo". New work by George Akerlof and Pascal Michaillat shows how this can happen. If new researchers gain preferment by pleasing incumbents – as can happen with decisions on academic tenure or about which papers to publish – then they'll prefer to work within the existing, inadequate theories of those in power rather than challenge those ideas. "When tenured scientists show favoritism toward candidates for tenure with similar beliefs, science may not converge to the true paradigm," they write.

We shouldn't, though, overstate the differences between the CAPM and Graham's approach. Both agree upon one very important fact – that fund managers don't beat the market and so don't justify their fees.

Back in 1972, Mr Graham wrote: "Even the majority of the investment funds, with all their experienced personnel, have not performed so well as the general market."

Gilt's risk

How worried should we be by a possible sell-off of gilts? It's easy to tell stories of how this might happen. Reversing quantitative easing and rising interest rates in the US (and possibly the UK) might upset the market, as might looser fiscal policy here. And it's possible that in both the UK and US tighter labour markets will eventually raise inflation: just because something hasn't happened so far doesn't mean it won't happen.

Let's, though, take a different perspective and look at the numbers on gilt risk.

'Reversing quantitative easing and rising interest rates in the US (and possibly the UK) might upset the market, as might looser fiscal policy here'

Since 1990 the standard deviation of total returns on gilts has been 1.8 percentage points per month, with average returns being 0.6 per cent per month. This implies that we face around a one-in-six chance of losing 1.2 per cent or more in a month or of seeing some kind of loss over 12 months. It also means there's around a 2.2 per cent chance of losing 3 per cent or more in a month.

There are, though, two complications here. One is that gilt returns aren't exactly distributed normally. Instead (as with other assets such as shares and commodities) there is a higher chance of big losses. If gilt returns are distributed as a cubic power law for large moves, there's around a 0.7 per cent chance of losing 5 per cent or more in a single month. (5 per cent is in fact the worst monthly loss since 1990).

Secondly, the standard deviation since 1990 might understate gilt risk. Volatility was very low in the mid-2000s, but has been trending upwards since then. A big reason for this is that as yields fall, prices become more sensitive to given changes in yield.

This suggests we can't exclude the possibility of significant losses on gilts simply as a statistical fact.

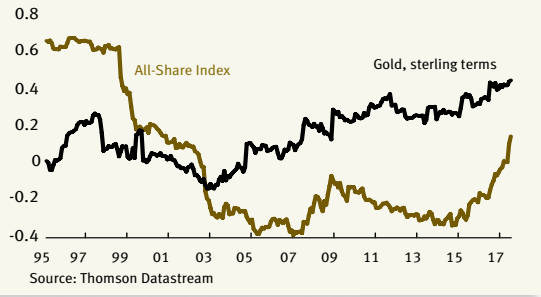
Nobody, however, should own gilts alone. Instead, they are part of a balanced portfolio. Which poses the question: could losses on gilts be offset by profits on other assets, in which case they are not so risky after all?

A quick glance at the historic numbers suggests so. Since 1990, the correlation between monthly returns on gilts and on the All-Share index has been 0.16, and the correlation between gilts and gold (in sterling terms) has been 0.05. These numbers imply that there's almost a 50:50 chance that a loss on gilts will be accompanied by a rise in shares or in gold.

But this also means there's a slightly greater than a 50:50 chance of us losing on two assets at once.

What matters is why gilts sell off. If they do so because investors become more willing to take risk or more optimistic about economic growth (two things that are hard to distinguish), then losses on gilts would very likely be offset by gains on shares. Similarly, if gilts fall because of fears of worldwide inflation, it's possible (but by no means certain) that their losses would be accompanied by profits on gold.

Correlations with gilt returns
Five-year rolling correlation of monthly returns



Source: Thomson Datastream

But there's another possibility. A gilt sell-off could be triggered by a decline in global liquidity. One way in which this could happen would be if we see a big reversal of QE and significant portfolio rebalancing effects: if investors need to buy gilts from the Bank of England or Treasuries from the Fed, they might – at the margin – sell equities to do so.

Personally, I suspect this is a low risk. Something else, though, does trouble me. It's that correlations between gilts and both equities and gold have been rising recently. This tells us that shocks that cause gilts to move in the same direction as either have become more common since the mid-2000s.

In the case of gold, this could be because changes in inflation expectations have been quite small while moves in real interest rates have been significant: changing views on inflation would cause gilts and gold to move in opposite directions, but changes in real interest rates would cause them to move in the same direction.

In the case of equities, it might be because changing attitudes to liquidity have been more significant than changes in appetite for risk.

Whatever the reason, though, the implication is the same. There is a significant danger that losses on gilts will indeed be accompanied by losses on other assets.

There are two general messages here. One is that we shouldn't take simple historic numbers on volatility and correlations at face value. Both change over time, so such numbers might understate future risk.

Secondly, all this is yet another reason to hold cash, despite negative real interest rates (for now). One of its virtues is that it protects us from correlation risk – the danger that asset prices will fall at the same time. This danger might be small, but it is sufficiently nasty for us to guard against.

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MR BEARBULL

The no-brain solution

Choosing an income fund by formula solves more than one puzzle

This is part 2 – continuing on from last week – of the discussion about how best to generate retirement income from the lump sum that is part of the pension entitlement going to Steve, who recently retired from teaching.

This week we're focusing on what we might label 'the FTSE 100 solution'. First, however, a digression towards equity-income funds – in particular, investment trusts – which can provide a reasonable and rising income stream from a lump of capital while – quite likely – adding to the value of the capital over the medium haul (three to five years).

True, lots of open-ended funds can do the same job; but, because capital can be added and withdrawn on demand, these lack some stability and generally come with higher costs than investment trusts. Hence my preference for so-called closed-end funds, where the equity capital is more or less fixed even if its ownership isn't.

Those big trusts whose shares offer a 4 per cent-plus dividend yield and come at a price below net asset value, with a longer-term performance that's at least up with the pack and low expenses are likely to be as good a bet as each other. There is little point in trying to pick winners. That would entail a combination of portfolio analysis and guess work that would be as demanding as building a portfolio. A quick reconnoitre indicates that any one of **Dunedin Income & Growth (DIG)**, **Murray Income (MUT)**, **Shires Income (SHRS)** and **Merchants Trust (MRCH)** would do a job.

Meanwhile, some components of the FTSE 100 index offer a no-brain solution, even if it involves paying extra in brokers' commission. On average – and weighted by the market value of its components – the Footsie offers a 3.7 per cent yield on dividends likely to grow by a touch more than UK inflation. That's an acceptable starting point, although – as we discussed last week – it's debatable whether it's a superior solution to buying a plain-vanilla annuity with a lump sum.

As we also discussed, it is possible to top the Footsie's starting yield while barely raising the risks that growth in dividend income will stall. That's done simply by bundling into one portfolio equally-weighted holdings of the top 10 FTSE 100 companies by market value. Do that and, on forecast payouts for 2017, the yield starts at almost 4.9 per cent from dividends covered almost 1.5 times by earnings.

A worksheet available online breaks down the Footsie into deciles, showing the components in each group of 10. It also highlights the obvious shortcoming of simply selecting the 10 biggest companies – it concentrates industry-specific risks too much. Three pairs of companies in the 10 are in the same sector. In effect, rather than there being 10 holdings, there are just seven. Express that the other way around – 20 per cent of the capital is invested in each of big oil, big pharma and global mining.

The solution is to eliminate holdings in the duplicated sectors and bring in the next biggest components of the index. Thus **BP (BP.)**, **AstraZeneca (AZN)** and **Rio Tinto (RIO)** are axed. It is pointless holding these when the no-brain solution already has **Royal Dutch Shell (RDSB)**, **GlaxoSmithKline (GSK)** and **BHP Billiton (BLT)**. The next biggest companies to come in are **Diageo (DGE)**, **Prudential (PRU)** and **National Grid (NG.)**.

The decision to include National Grid was not completely formulaic. Shares in **Carnival (CCL)** and **Relx (REL)** – the former Reed Elsevier – had priority by dint of their market value. However, neither offers much dividend yield, whereas National Grid offers 5.2 per cent and its activities are distinct from the other nine, thus – arguably – it brings the diversification that Carnival or Relx would have.

The result is a 10-stock portfolio that starts with a dividend yield of 4.3 per cent (see table). Granted, that's half a percentage point less than simply taking the 10 biggest holdings, but it would be foolish to overlook the duplication of stock market sectors. Sure, life being what it is, even these 10 will run into crisis; although from where those extremities will arise – sector specific or stock specific – it's impossible to say. Nor can I say whether buying 10 big and unloved stocks such as these will be a variation on the 'Dogs of the Dow' investment formula.

Of course, I live in hope, and if an investment exercise as simple as this is successful it would solve not just the matter of Steve's retirement income but a generic need for generating high and rising income from a lump of capital. It would also question the very point of research-driven portfolio selection.

Mr Bearbull's column has appeared since the 1950s. It aims to help readers manage their investment portfolios. email: bearbull@ft.com

Big, unloved, but high yielding

Company	Code	Mkt cap (£m)	Price (£)	Div yield (%)	Div cover	Cash-flow cover
Royal Dutch Shell	RDSB	168,906	20.61	7.3	0.9	0.6
HSBC	HSBA	141,761	7.28	5.6	1.2	3.5
Unilever	ULVR	117,806	41.78	2.6	1.7	0.6
British American Tobacco	BATS	96,977	52.19	3.2	1.7	0.2
GlaxoSmithKline	GSK	78,389	16.15	5.0	1.4	1.7
BHP Billiton	BLT	66,131	12.43	3.5	2.3	0.5
Vodafone	VOD	58,335	2.19	5.8	0.6	16.8
Diageo	DGE	56,767	22.61	2.7	1.8	0.7
Prudential	PRU	45,818	17.80	2.4	3.3	2.7
National Grid	NG.	32,074	9.35	5.2	1.2	1.3
Average of 10				4.3	1.6	2.9

Source: S&P Capital IQ

THE TRADER



Let them eat meat

Food prices could be on the up once again

Over the last half century most countries have managed to provide a better standard of living for their citizens, at least doubling adjusted GDP per capita and some seeing incomes multiply by 23 times their 1960 level (in Singapore's case) or 35 times (Botswana and South Korea). A handful saw negative growth, sadly all in Africa. Data for mainland China is not available, but it's plain to see how much the country has changed since 1980.

'In theory there ought to be a natural limit as to how much we purchase and consume; the reality is that too many of us are greedy and don't know when to stop'

With this new affluence comes the desire to live, eat, and dress better. The internet, improved logistics and global trade mean that goods and services are available more widely, including in remote areas. In theory there ought to be a natural limit as to how much we purchase and consume; the reality is that too many of us are greedy and don't know when to stop. Hence too many are maxing out on their credit card, hitting 'peak stuff', and becoming overweight.

These trends are reflected in wholesale markets, though not necessarily in retail prices as supermarket wars and the death spiral of the department store continue apace. Pork, long considered a delicacy by the Chinese, has seen prices more than double over the past eight months, from 40¢ per pound to a high at 92¢ last week. They seem to be stabilising a little, while establishing a new higher trading band, likely to hold between 60¢ and 100¢ until year-end.

More dramatic price swings have been seen in the futures market for live cattle in Chicago. They set a new record high at 192¢ per pound in 2014, only to then slump to 94¢ in October last year. Like pork it appears to be establishing a new higher trading band, roughly between 110¢ and 150¢ per pound. Demand from the Middle East has more than made up for reduced consumption in Europe.

The biggest increase in consumption has been that of chicken, an animal protein that is cheaper to produce and where most religions allow it to be eaten. The US Department of Agriculture reports that retail prices are up by about 50 per cent since 2007, holding steady at about 150¢ per pound for the past four years. Again chart analysis suggests that we have reached a sustainable level and that the next move is more likely to be another step higher rather than a slump.

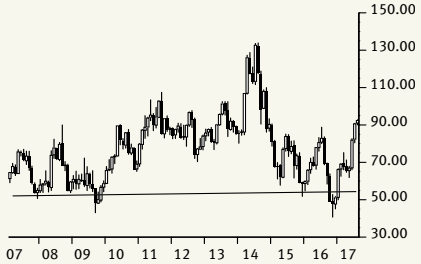
In Britain Seafish UK reported that operating income rose 22 per cent last year as prices for fresh and frozen seafood grew at their fastest pace since the financial crisis. Gross value added rose by 25 per cent year on year to £467m.

Last but not least we look at soybeans because they are the basic unit of animal feed. Like the previous charts it's seen some really wild price swings since 2007, ballooning from 50¢ per bushel on the Chicago Mercantile Exchange to a record high at 179¢ in 2012. Currently forming a base against the 90 cent level, we feel that another price surge could be on the cards; those involved in animal husbandry should consider hedging against this eventuality.

In the meantime, with an eye on our waistlines and wallets, perhaps we should all moderate our animal protein intake and adopt a semi-vegetarian diet.

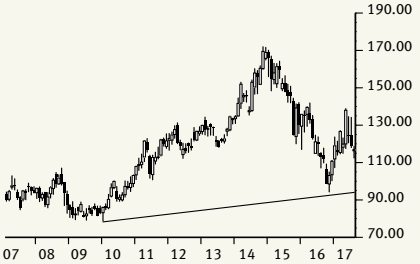
email: nicole.elliott@ft.com

Lean hogs



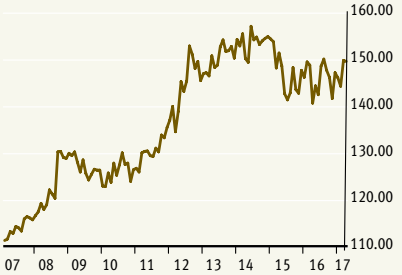
Source: Bloomberg

Live cattle



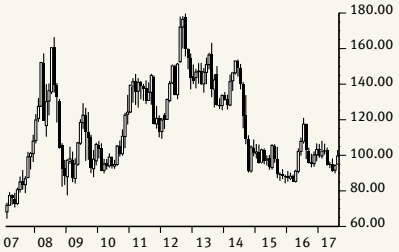
Source: Bloomberg

Fresh chicken



Source: Bloomberg

Soybeans



Source: Bloomberg

NO FREE LUNCH



Blueprint for a housing shortage

In this sideways look, **Paul Jackson** asks: could the housing shortage be institutional?

Earlier this year, the government published a white paper called 'Fixing our broken housing market'. It was all about building more homes, with the implication that builders such as **Persimmon (PSN)**, **Barratt (BDEV)**, **Taylor Wimpey (TW.)**, **Bellway (BWY)** and the like are letting the side down. But are they?

If the market is broken, could it be due to its rules of engagement? Here are 10 examples of misguided beliefs and perverse incentives that could almost have been designed to promote housing shortages:

1. Treat housing like any other investment

Everyone needs somewhere to live – shelter and security are a basic human need. Many people think of their homes as investments too – a source of resentment among those forced to rent. Unlike other types of investment, property also defines local characteristics and carries social consequences.

2. Treat housing as a global asset, open to all

UK housing is seen as a safe investment in a turbulent world. And foreign investment aids the economy – but it also adds to demand. If homes are left empty as a result, supply for domestic purchasers is removed. This helps to push up prices. Telford Homes, which builds in London but markets its flats abroad, claims that most of their properties are rented – where properties are kept empty, they say, they tend to cost £1m or more. Since there are no reliable statistics on how many properties are left vacant at any one time, this might be more widespread than is generally realised.

3. Expect the housing market to self-balance by following the normal laws of demand, supply and price

Intuitively, you would expect increased supply to lower prices as demand is satisfied. But often new-builds increase the prices of existing homes in the surrounding area, suggesting that housing acts more like a Veblen good – higher prices increase demand. When prices rise, buyers are supposed to hold back until prices fall again.

But with Veblen goods, the sellers hold back, expecting prices to rise even more. Potential buyers step in to buy for the same reason. This pushes prices higher. And that increases demand. The opposite happens when prices flatten – if prices fall, demand drops off, sellers and developers resist reducing prices for as long as possible. This downward Veblen effect was seen in the 1991 recession. When sellers eventually capitulated, prices fell by about a fifth, and relative supply began to increase.

So the belief that the housing market is self-balancing and that building enough homes will stabilise prices can itself be counter-productive. When demand exceeds supply, prices rise – but these rising prices in themselves stimulate further demand.

4. Engineer low interest rates

The Bank of England's Term Funding Scheme encourages investment in the economy through rock-bottom interest rates. Commercial banks no longer need deposits from the public – it's cheaper to borrow from the Bank. This makes mortgages cheap, but it also propels savers towards buy-to-let in pursuit of higher returns. But as the economist John Kay and others have observed, this influx of investment helps to push up prices. Squeezed-out first-time buyers then rent instead, and this pushes up rents. A greater demand for rental properties in turn pushes up prices and so on.

'Commercial banks no longer need deposits from the public – it's cheaper to borrow from the Bank'

Buy-to-rent and build-to-rent both provide homes, but low interest rates limit home ownership because they reduce (or fail to increase) the number of homes available for purchase. For owners, buy-to-let backed by relatively cheap lending rates has been a no-brainer. Those squeezed out and forced to rent see it in a different light. For them, low interest rates have promoted a vicious circle that denies them places to buy and makes them pay higher rents.

5. Rely on market forces

The lower end of the residential property market used to be determined by what first-time buyers could afford. That became overtaken by how much those buying-to-let were prepared to pay. They outbid many first-time buyers, so keeping them in the rental market. That helps drive up rents to the point that renters can comfortably bear, or even beyond. Even if first-time buyers do get a foothold, when their homes go up in value they will end up beyond the means of the next generation of first-time buyers.

For too long, there was a reliance on the private sector to build sufficient affordable homes to make a dent in the housing shortage. This reliance only served to prolong it.

6. Distort the market with different tax breaks for landlords versus owner-occupiers

Buy-to-let was originally encouraged to generate more

rental properties. And it worked. That was in response to the 1991 recession. The paradox of a lower tax for letting property and a higher one for living in it has persisted – owner occupiers lost tax relief on mortgage interest long ago; but if they let out their home, until recently they could still offset it against their rental income. This is now being phased out for individuals who buy-to-let, but not for limited companies. The uneven playing field has shifted. It can pay individuals to move their investments into their own limited companies.

Some argue that capital gains tax applies an opposite bias. Home owners are exempt (on their main residence). The tax applies to others – but only when they realise the gain, so the incentive is not to sell. This keeps homes in the rental market that might otherwise have been returned to owner-occupation.

A mixed bag, then. The uneven playing field that initially brought more rental properties on to the market has gone on to hamper their return to owner-occupation.

7. Distort the market by separating annual property taxes from property values

This is a major factor. As long as the annual tax on housing bears little correlation to the current property value, there will be little financial incentive to downsize and little imperative to rent out parts of larger properties. If second homes are not taxed at a premium, holiday homes are encouraged. Houses subdivided into flats (that together might house a dozen people) are taxed higher than similar homes in which just one or two people live. What this all encourages is the under-use of property – the housing stock is there, but it does not reach the market.

The highest rate of council tax is only three times that of the lowest rate and there are many exemptions. Prices of more expensive properties are buttressed by these relatively low annual overheads. If annual property taxes were linked to current property values, more property would come up for sale.

Whisper reform if you dare. Council tax is highly emotive. But dodging reform only helps to depress supply.

8. Apply a blanket pressure to build

The property market is fragmented, with significant local differences. People cluster where the jobs are. They want to live in attractive areas. Popular locations are where housing shortages, particularly of affordable housing, occur. In other places, there can be surplus housing. The market is a dynamic too – people movements, demographic shifts and changing investment patterns can all cause housing pressures to change over time.

Building without focus can too easily result in the wrong sort of housing in the wrong place – hardly a cure for where the housing shortages are.

9. Relax planning controls

The government sells unwanted land to a developer. The developer doubles its value by acquiring planning consent that includes a significant proportion of low-cost homes. A new developer buys the site and disputes that affordable homes are financially viable. Few get built. This is an actual example of the disconnect between intention and practice and it is not uncommon.

Inappropriate development is another. The housing shortage has a produced a presumption to develop land, but if luxury homes are built where affordable ones are needed, it does little to reduce housing shortages.

Builders lobby for fast-track planning consents on the grounds that bureaucracy delays building-starts. But planning controls and enforcement are intended to prevent inappropriate housing – the weaker they become, the less likely it is that the right sort of housing will be built.

10. Focus on supply rather than demand

Many assume that simply building more will eventually outpace the demand for housing. The counter-argument is that increasing supply in itself can stimulate further demand. What if supply can never catch up? The focus would need to shift to other solutions.

Reality bites

So, a broken housing market? If building companies have to work within a framework that bakes in an institutional housing shortage, they can hardly be held wholly responsible for it.

For investors in housing developers, the question is whether the landscape is shifting. In the June election, all political parties recognised the need for social housing and to provide more affordable homes. There is already an increased focus on the rental market. Build-to-rent is one outcome. Rent controls are lurking in the wings. **Grainger (GRI)** and **Mountview Estates (MTVW)** are still managing "regulated" (sitting) tenancies from the last time controls were in vogue. The German rental model has been mentioned. **Phoenix Spree Deutschland (PSDL)** knows all about that.

> 'Pinning the blame on the builders deflects attention from the underlying issues – and notably the need to address the causes of demand as well as supply'

Pinning the blame on the builders deflects attention from the underlying issues – and notably the need to address the causes of demand as well as supply. Demand arises for various reasons, some of them complex. The housing shortage would be threatened by a tax system that changed behaviour and, perversely, by stronger and more selective planning controls.

The apparent myopia among many politicians is because they know that the property market drives much of the economy. Upset it and a recession becomes more likely. Their reluctance to be too candid is also because homeowners tend to vote for those that increase the value of their properties – and there are still twice as many homeowners as renters. As the number of renters increases, this might change, but for the time being the institutional housing shortage is likely to continue. In the absence of a recession, that might be good news for investors; but it is bad news for those left out in the cold.

PROTECT YOURSELF FROM PROFIT WARNINGS

Profit warnings are a fact of life for investors, but when does it make sense to head for the hills and when is it better to buy on weakness? **Algy Hall** supplies the answers



When a profit warning causes a company's shares to tank, there is always the temptation to view the event as a buying opportunity. That's especially true for investors already committed to the investment merits of a company, who will in general be more susceptible to view a disappointment as a short-term, one-off setback rather than a more entrenched long-term issue. Behavioural scientists have even coined a term for this 'look-on-the-bright-side' trait: confirmation bias.

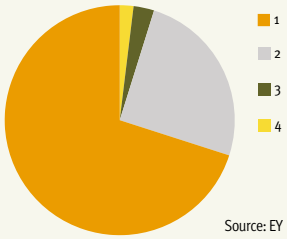
So when trouble strikes, many old hands turn to the adage "profit warnings come in threes" as a necessary sanity check; best to get out quick, or stay on the sidelines and wait for the rest of the skeletons to emerge from the cupboard. Most experienced investors will be familiar with the scenario of one warning following another until ultimately a company's top brass throws in the towel – or has it thrown in for them – and a new broom comes in to deliver one final 'kitchen sink' warning (see box) before things finally get back on track.

However, the reality is that while warnings do indeed sometimes come in threes, or other multiples, they can also sometimes be one-offs, and can indeed even prove buying opportunities (see the Bovis chart on page 26). That means it is important for investors to have some ideas about how to distinguish between profit warnings that may prove to be a standalone event and ones that bear the hallmarks of being part of a series.

Is three the magic number?

Defining exactly what constitutes a profit warning can be nuanced, which means there is a dearth of reliable data on this important subject. Fortunately, consultancy EY has done detailed work monitoring warnings since 1999 and has run an analysis for Investors Chronicle to see just how frequently companies that warned on profits in the 12 months to the end of March 2017 did so more than once. Of 207 companies issuing warnings in the period, 30 per cent had made at least one other warning within a year of the one(s) during the period. The full breakdown can be seen in the accompanying pie chart.

Total number of warnings over 12 months for companies warning in year to end March 2016



Source: EY

While the data does not tally with the strict notion that three is the magic number when it comes to profit warnings, it certainly highlights how risky it can be to view a share price fall caused by a profit warning as a buying opportunity. What's more, while the market does have a habit of over-reacting to bad news, even when a warning is a one-off, there's no certainty the shares will rebound from any fall (see BT chart on page 26). Furthermore, the less at risk the company in question looks of running into further trouble, the less severe any share price reaction is likely to be. Conversely, when it is highly likely more bad news is to follow, share prices can be obliterated in one fell swoop, as has recently been the case with builder and support services group **Carillion (CLLN:68.3p)**, which the market thinks needs a balance sheet fix that will seriously damage the interests of equity holders.

In many ways the need for companies to issue serial warnings is understandable. Companies may be forced to warn before they know the full extent of the trouble they face given management's duty to tell shareholders when it expects financial performance to fall materially (10 per cent) short of expectations. For example, if demand in end markets falls away, the realisation that trading is bad enough to warrant a warning may come at a point when a trend is developing rather than concluding. Often at the time it will not be possible for anyone to forecast how much worse things will get should the situation continue to deteriorate. Likewise, when a company finds it has an issue with a long-term contract, it may take lengthy investigation to understand how bad things really are and whether problems are widespread or a one-off. What's more, while management needs to be mindful of giving an honest assessment of a situation, in the interest of all involved they also have to avoid being alarmist.

The real danger for shareholders is being lured into a 'value trap' on the back of the seeming opportunity created by a share price fall, only to later realise things have continued to worsen (see NCC chart on page 26). EY has identified three types of situation that tend to result in serial profit warnings. We've illustrated each of these with a recent example of a company whose warnings fit the bill. We're also highlighting a number of companies that have recently warned on profits where there are grounds to think there could be more to come.

THREE CLASSIC TYPES OF SERIAL WARNINGS

EY has identified three common characteristics associated with warnings that could be signs of entrenched problems. We outline these, along with an example of a company that has recently experienced such problems.

Contract problems

These often link into a more fundamental issue than one bad contract, such as poor management information due to a lack of IT investment and poor internal controls. It makes it less likely that projects will remain on track and more likely that management won't become aware of a problem before it becomes material.

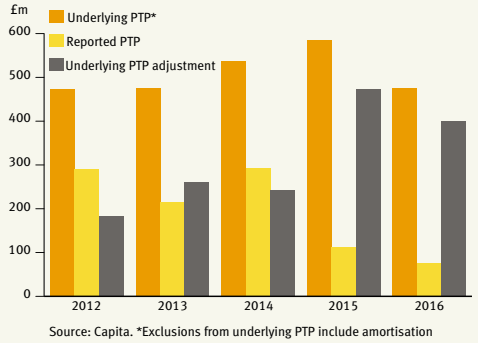
Outsourcer **Capita's (CPI:664.5p)** share price dropped sharply last year after it issued a slew of profit warnings. The trouble started innocuously enough when management revised down organic revenue growth predictions in the half-year report in July 2016, from "at least 4 per cent" to "around 4 per cent", citing uncertainty following the EU referendum decision.

However, this was only the beginning. Delayed client decisions led the group to warn in September that organic growth would be just 1 per cent, and underlying profit forecasts were cut from £614m to £535m-£555m. When this was cut again to "at least £515m" in December, management announced plans to sell a number of businesses it judged to have lower growth potential. In February this year, the group announced it would impair £50m of assets and write down £40m of accrued income (recorded but not collected) following a contract review.

The creeping issues were somewhat glossed over in the years up to the first warning by the group's tendency to book high levels of ostensibly non-underlying charges, which flatter underlying earnings (see chart below). When contract problems are to blame for a profit warning, they can have a tendency to link to a deeper problem than just one contract, given that the same teams and processes are often involved in bidding for multiple jobs. In these cases revisions and smaller warnings can come out in small, worsening updates before the full extent becomes clear in a 'kitchen sink' update. This looks consistent with what has happened in Capita's case.

Since February, there have been some signs that things are turning around. Management announced

Capita underlying vs reported graph



Source: Capita. *Exclusions from underlying PTP include amortisation

What's down the kitchen sink

A classic end to a run of profit warnings comes with a management overhaul and a final, so-called 'kitchen sink' profit warning, where everything possible is thrown into the final warning to create a new base for expectations that is so low the company can finally start making positive progress. These often include 'exceptional' charges of such mind-blowing magnitudes that investors end up blinded by the sheer scale of the write-offs, impairments and provisions.

While this ultimate capitulation is often treated as a good thing, especially if it is not accompanied by a large, dilutive equity issue, such action does not make all of a company's issues magically disappear. This is especially the case when large provisions are created as part of the kitchen sinking operation. Provisions are a type of liability that companies can put on their balance sheets (normally by taking what is deemed an 'exceptional' charge to the profit-and-loss (P&L) account in the year they are created) to be used in future years to offset pre-identified disappointments.

For example, Restaurant Group has come to the conclusion that many of its outlets will not be as profitable as it had assumed when it decided to open them. As well as writing off past investments in these outlets, the company has created provisions for what in the cold light of day now appear to be uncommercially high rents that they will have to continue to pay. While the provision will absorb the effect on profits of the uncommercial element of rent payments, the payments will be a very real drag on future cash generation.

Likewise, support services firms, such as Serco and Capita, that make provisions against obligations to service long-term problem contracts, may have drawn a line under the burden for the P&L account, but the cash losses will continue unless the contract is terminated or restructured. *AH*

▶ the sale of the specialist recruitment business in June, then agreeing a sale of the asset services division a few weeks later for £888m, £65m higher than the consensus estimate. The slimmed down, focused business has now started winning new contracts at an increased rate, securing £318m in the year to date, and has increased its win rate to one in two by value, compared with one in three previously. Management expects a pick-up in contract wins in the second half of the year, further boosting growth (Last IC View: Hold, 698p, 29 Jun 2017). *TD*

When companies get in a perpetual spiral

Less profit means less capital to invest to get back on the front foot. When **NCC (NCC:192.25p)** first informed investors that business wasn't going as well as previously hoped in October last year, the market could have perhaps foreseen the trouble that was to come. That first announcement – though not officially a profit warning – was succeeded by two forecast downgrades. The resulting share price collapse wiped £450m off the group's market capitalisation in just six months.

Up until that first warning, NCC had been highly acquisitive. Its position in the fast-growing cyber security space made investors keen for a slice of the company and by December 2015 its strong share price momentum had seen it promoted to the FTSE 250. Capital raisings allowed the group to buy five new companies in 2014 and 2015, which led to rapid turnover growth and further demand for the shares.

But with the first signs of trouble, many investors jumped ship and NCC saw its share price plummet more than a third in one day. Two more official warnings later and it's no real surprise that investors are less enthused by NCC, particularly given the sporadic way the bad news was released to investors and sudden departure of much of the senior management.

The shares may look cheap compared with this time nine months ago, but they are still not great value given the future prospects for the company and its reputation for mismanagement. NCC's buy-and-build strategy seems to have hit a road-block due to the likelihood that appetite for further equity fundraisings, especially at the current price, would be limited. Without the access to capital it previously enjoyed, the group has found itself struggling to fend off competition in a very attractive market with significant research and development requirements. What has made the situation worse is that profits at NCC's cyber security division, Assurance, are particularly sensitive to slowing revenues. What has made the situation worse is that costs at cyber security division, Assurance, have risen faster than revenues. In recent full-year results the division reported a 35 per cent decline in operating profits to £9.2m even after accounting for positive foreign exchange movements. Plus, the major contracts lost at the end of 2016 have not yet been salvaged.

NCC epitomises the troubles that can befall a fast-growing company forced to warn on profits. Its exit from the FTSE 250 stripped it of the access to capital it required to fund its previous acquisitive growth strategy, which has made it harder to rectify its problems. ▶

MORE TROUBLE AHEAD?

Here's a selection of troubled companies that the IC's team of specialist writers think could have more pain to come.

Regulatory shutdown: International Personal Finance

Regulation has been hostile to **International Personal Finance's (IPF:176p)** business model. European regulators are tightening restrictions on how much consumer credit companies can charge customers.

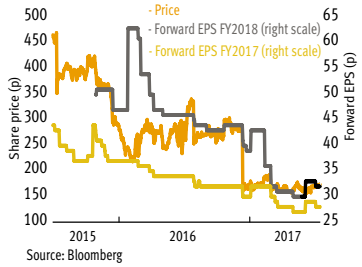
The Polish government's decision to reduce the level of non-interest charges that can be applied to loans had a particularly damaging effect on profits made in the country by the sub-prime lender during 2016. The new rules placed a blanket cap on non-interest charges of 100 per cent of the loan value for the lifetime of the loan. Management predicted the change would take a £30m chunk out of profits over 2016 and 2017, after applying the new pricing regime to loans written during the year to June 2015. However, it expects to mitigate around half of this impact by writing longer-term and larger loans and introducing new products. Nevertheless, pre-tax profits for the Poland Lithuania business – which accounted for 61 per cent of group pre-tax profits – declined by a fifth during 2016.

As management warned in 2015, the lender's pre-tax profits suffered last year because of this, declining by 7 per cent. And there is reason to expect further trouble from Polish consumer finance regulations. That's because the government has proposed reducing its charge cap further to 75 per cent of the loan value, from the 100 per cent implemented in March last year. The proposals are yet to be finalised, making it difficult to quantify any potential impact on earnings. However, the group suffered several downgrades to its forecast earnings (see chart below). In June, the cap – along with an ongoing tax dispute with Polish authorities – also led credit ratings agency Fitch to downgrade its long-term rating on IPF to BB with a negative outlook, from BB+.

What makes IPF's Polish troubles more worrying is the competitive and regulatory pressures in its other markets. Most recently it sold its Bulgarian business – which has been in the red since it was established in 2013 – at a £5m loss. In Romania, more stringent and restrictive creditworthiness assessments for non-banking financial institutions, along with the requirement for the separation of duties between sales and credit vetting, is expected to significantly impact growth this year. In the Czech Republic, growing competition led to a 15 per cent decline in credit issuance last year, which has continued into 2017. Management has introduced new products and is targeting higher-quality customers.

There has been some positive news this year. IPF's Mexican business is recovering from its operational difficulties, growing credit issued by a fifth during the first three months of the year. Meanwhile, the digital business issued 61 per cent more credit during the first quarter, compared with the same time last year, and expects to report a maiden profit in 2018. Nevertheless, with regulatory uncertainty hanging over its crucial Polish market, an appetite to tighten rules around consumer finance and competitive pressures elsewhere in Europe, we think the potential for future profit warnings is high. The shares may be trading at a depressed value of six times forward earnings, but we stick with our sell rating (Last IC View: Sell, 163p, 3 March 2017). *EP*

IPF succumbs to regulatory woes



Source: Bloomberg

Defence that's not defensive: Cobham

Earlier this year, **Cobham (COB:131.7p)** was forced to go cap-in-hand to shareholders in a bid to shore up its balance sheet. The £500m rights issue mirrored a cash call conducted in April 2016, which was undertaken in response to increased (US dollar-denominated) funding commitments linked to the $1.5bn marquee deal to acquire Aeroflex Holding, a Long Island-based manufacturer of microelectronic components and test and measurement equipment.

Initially, City analysts seemed sanguine about the 2014 deal to acquire Aeroflex (including $540m in debt), but the company's growth had slowed at the time of the acquisition and subsequent doubts have emerged over the extent of the cost savings that can be squeezed from integration. It's justified to ask if Cobham paid over the odds.

By the end of 2016, the defence contractor's net debt had ballooned to £1.03bn, against £490m in net assets. That's equivalent to three times cash profits, within the covenant upper threshold multiple of 3.5, but a little too close for comfort. That rate might be passable, or at last explicable, in a more capital–intensive business model. But we think that balance sheet weakness simply reflects persistent trading underperformance while

limiting management's room to manoeuvre.

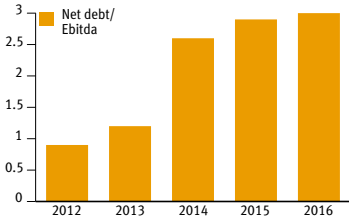
The group revealed £574m in non-cash impairments at the time of February's profit warning, the latest in a succession since November 2015. That write-down was spread across the wireless, integrated electronic and semiconductor solutions business strands, but Cobham has also been forced into a sizeable write-down linked to delayed execution of a development contract for new air-to-air refuelling tankers for the US Air Force, a particular frustration given that the group was a pioneer in the field.

Management has implemented a series of remedial measures designed to improve financial controls and capital allocations. But even if the balance sheet receives the requisite degree of support, there's nothing to say that near-term contractual difficulties will suddenly evaporate. Unfortunately, problems linked to development programmes and underperforming legacy contracts have a habit of lingering.

You might argue that the chances of Cobham delivering another shock on the profit front have been reduced for no other reason than expectations have been lowered, but that might be tempting fate.

Broker JPMorgan Cazenove points out that the average trading margin through 1997-2016 was 15.7 per cent. The rate drops to 9.4 per cent in the current accounting year, while the broker's analysis implies a medium-term margin of 13 per cent, "well below the historic 20-year average". The bottom line, so to speak, is that contracting margins severely reduce headroom in the event of any further contractual problems (Last IC View: Hold, 127p, 6 March 2017). *MR*

Cobham's rising indebtedness



Source: Cobham. Year to end-December

Digital dilemmas: Pearson

In the past four years, embattled education group **Pearson (PSON:637p)** has warned on its profits five times. Its excuses have varied: lower college enrolments, weakness in assessments revenues and print decline. But all in all, the problems lie in the poor US textbook market, which made up 62 per cent of Pearson's 2016 sales and 70 per cent of its profits. With falling student numbers, a rising number of people taking free online courses and a boom in second-hand book sales, it is perhaps unsurprising that Pearson's revenue has struggled. In the final quarter of 2016, net revenue in the North American higher education courseware division fell 30 per cent.

Therefore, to a certain extent, Pearson's tribulations can be associated with poor market conditions. But that is not altogether reassuring as the pressures of the US education market are unlikely to let up. Second-hand textbook sales are growing as a proportion of the overall textbook market, which means inventory visibility at Pearson is poor. Several of the group's contracts now include a high level of estimation (due to the uncertainty surrounding how many booksellers will return stock every year), which means risky deferred revenue is high. Moreover, Pearson's approach to education and receipt of tax-funded education finances haven't made it particularly popular stateside, resulting in fewer contracts to supply US schools with textbooks and assessment material.

Mismanagement is also accountable for the group's problems. Not long ago Pearson was a media empire built through acquisition and investment in many distinct businesses. But in the past six years, management has sold The Financial Times Group (owner of this magazine as well as the eponymous broadsheet), The Economist, and the group's stakes in index provider FTSE International and book publisher Penguin Random House. What's left is a company very exposed to one battered market.

The group has also failed to roll with the rising digital influence in academia. While peers such as RELX (REL) and Informa (INF) now release all their titles both in both print and in digital formats, half of Pearson's publications are still exclusively ink on paper. Management has now set a plan in action to change this, with chief executive John Fallon targeting 75 per cent digital output by 2020. But the transition could cause more difficulties. Last January Mr Fallon warned that the move to a digital model would mean 5 to 6 per cent declines in the US business each year, potentially resulting in further profit warnings (Last IC View: Sell, 731p, 11 May 2017). *MB*

A loss on every ounce: Lonmin

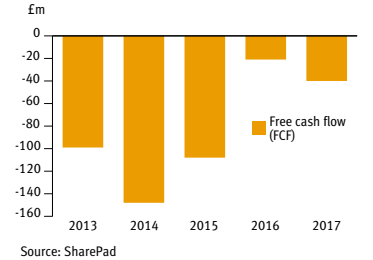
In a recent review of his company's half-year performance, **Lonmin (LMI:95p)** chief executive Ben Magara reflected that while expected costs were rising, the South African platinum miner was "determined to be at least cash neutral". That's one way of saying that it is trying its best not to lose money.

Unfortunately, the deck is stacked against Lonmin. In May, expected unit cost guidance was raised to between R11,300 and R11,800 (£658-687) per platinum group metal (PGM) ounce, as much as 9 per cent ahead of the rand-denominated basket price in the six months to March 2017. Output also fell during the period, in a bid to cut out higher-cost production. Over the coming months, minimising sustaining costs remains the priority, although brokers are increasingly concerned that the planned drop in full-year capital expenditure from R1.8bn to as little as R1.4bn could start to hit medium-term production.

Lonmin's ability to generate free cash flow is further compounded by the high-cost, labour-intensive production on which it is reliant. Worse, any further layoffs are likely to entail fresh political fallout. Furthermore, a 1 per cent mine royalty for local communities tabled in South Africa's new mining charter could have a disproportionate effect on Lonmin's wafer-thin bottom line.

This adds up to a very glum set of forecasts. Peel Hunt expects adjusted pre-tax losses of $74.7m (£58m) in the year to September, narrowing to $52m in 2018, contributing to thinner total equity and further cash outflows. The compounding effect of lossmaking sales and constrained investments means that when we talk of a Lonmin profit warning, we mean additional losses.

Lonmin's free-cash-flow-free zone



Source: SharePad

As a result, Lonmin has become one of the most shorted stocks in the FTSE All-Share, according to Bloomberg and Markit analysis. In fact, the last time 14 per cent of Lonmin's shares were out on loan, the company was weeks away from a highly dilutive rights issue.

At 66p, the shares have fallen 24 per cent since we suggested selling in March. Sadly, we think there is further to go. Management's aim is to pay for sustaining capital expenditure with operational cash flows and third-party funding, but with stubbornly low prices this position cannot continue indefinitely. Exclude an improvement in PGM spot prices, and Lonmin's cash position and liquidity are deteriorating, raising the prospect of further earnings downgrades and the need for new equity.
An improvement in third-quarter operational performance announced this week did lead to a small pick-up in the shares, but we think the group's short-term ambition to remain "at least cash neutral" cannot be achieved without sacrificing much-needed investment in the mines (Last IC View: Sell, 110p, 16 May 2017). *AN*

▶ The new chief executive seems to have a plan, but in the increasingly competitive cyber security space, it seems as though it is going to be tough to revive past glories (Last IC View: Sell, 107p, 2 Mar 2017). *MB*

Macro or sector problem worsening quicker than expected and in stages

A host of negative factors contributed to steadily deteriorating trading last year at former sector darling **Restaurant Group (RTN:321.4p)**, which owns several restaurant chains including Frankie & Benny's and Garfunkel's. Heavy expansion by rival 'eating-out' businesses has meant increasing competition, while tepid wage growth in the UK is putting pressure on demand. Meanwhile, rising costs – from business rates, to minimum wage increases, and food price rises linked to sterling weakness – have added to pressures. As if this was not enough, changing consumer tastes and the growth in popularity of restaurants focused on fast and natural food with counter service seems to have caught Restaurant group on the back foot. The company has a number of characteristics that meant the trouble it has encountered has been particularly painful. A long-term track record of self-financed growth, strong cash generation and high returns meant the company's shares were highly rated when trouble struck, leaving them with further to fall. After a key profit warning in April last year, the shares plummeted by more than a quarter.

Furthermore, the fact that the company operates a predominantly leasehold estate means it is locked into ongoing fixed rent payments at many of its sites, which works to exacerbate the impact of poor trading on profits. The way like-for-like sales are calculated also means restaurants that have yet to reach a mature state are included in the figures, especially when chains are expanding fast. When trading difficulties mean expansion has to slow, this can compound the impact on reported like-for-like sales.

Indeed, after like-for-like sales went negative during the financial year to January 2016, the group reported at the time of its full-year results in March that it had experienced a 1.5 per cent like-for-like drop in the first 10 weeks of its new financial year. Just over a month later, trading had deteriorated so quickly that the company had to issue a warning that like-for-like sales declines had reached -2.7 per cent over 17 weeks. The final quarter of the financial year saw a -5.9 per cent collapse in like-for-like sales. The declines moderated to -1.8 per cent in the 20 weeks to 21 May this year.

The problems at Restaurant group led to the departure of chief financial officer Stephen Critoph after 11 years at the company, and his replacement by Barry Nightengale, who previously held the same role at Monarch and oversaw the airline's turnaround. But after 10 months on the job Mr Nightengale stepped down in April, raising speculation that Restaurant Group was in worse shape than previously thought. A representative for the company said at the time that Mr Nightengale's speciality was turnarounds and that that phase is now behind the company, although this did not stop the shares falling 9 per cent on the day of the announcement.

The management team at Restaurant Group looks quite different since chief executive Andy McCue joined in September last year. Senior hires from Costa, JD Wetherspoon (JDW) and Paddy Power Betfair (PPB) are tasked with restoring the reputation and profitability of the group. They have scrapped the previous management team's strategy of rapid expansion and price increases, which saw pre-tax profits fall to £77.1m last year from £86.8m in 2015. Budget-friendly promotions and family-friendly menu options are now meant to encourage customers back into its restaurants, and customer data will be the base on which future decisions are made. A cost-cutting programme is also meant to save around £10m a year at a one-off cost of £6m, and has already seen 33 restaurants close with another eight scheduled to be shut.

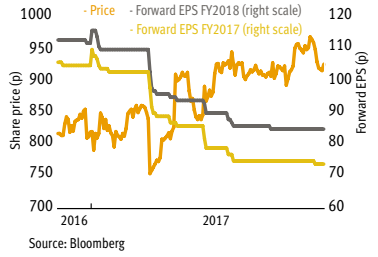
At 309p, the shares at hovering near their five-year low. The Bloomberg consensus 13 times forward earnings estimate looks cheap considering the 5.6 per cent dividend yield. The new management team has us encouraged that a real recovery could be on its way (Last IC View: Buy, 348p, 26 May 2017). *JF*

The good, the bad and the ugly of profit warnings

Bovis – the good

While **Bovis's (BVS:949.5p)** shares stood up reasonably well to a shock profit warning on 28 December 2016, followed by the departure of chief executive David Ritchie early in 2017, the shares tanked in February when the housebuilder said it was reducing the number of homes it planned to build. Low capital turnover (the speed at which investment is turned into sales) has been a persistent cause of disappointment for Bovis shareholders in the past and is the key reason why the company has historically produced a lower return on capital than rivals. However, attempts to speed up building had a costly impact on build quality, triggering the warning. Despite the fact that earnings forecasts are lower, the market now seems to be on board with the idea that management should focus on quality issues before it tries to ramp up output again.

The Bovis bump



Source: Bloomberg

BT – the bad

BT (BT.A:305.4p) shares lost a fifth of their value in January when the company said the cost of an accounting scandal in its Italian operation would be £530m, up from an original estimate in October 2016 of £145m. The difficulties, which include a £500m hit to cash flows, added to concerns about the balance sheet, which carries a £9bn pension deficit as well as £8.9bn net debt. Cash cover for the company's high dividend also looks slim, trading is mixed and the regulatory outlook is uncertain. This backdrop has meant the shares have struggled to make back lost ground. *AH*

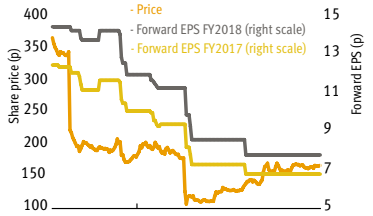
The BT slump



Source: Bloomberg

NCC – the ugly (see page 24)

The NCC dump



Source: Bloomberg

NO WORRIES

Two leading research teams are confident that equity investors will see further upside in 2017, but warn that conditions next year will be less benign. **James Norrington** reports

Readers not au fait with Disney's *The Lion King*, may be unaware of the song 'Hakuna matata'. The title is Swahili, roughly translating as "no worries", and the choice by Barclays' research team to borrow it for their summer 2017 report is a nod to the remarkably low volatility witnessed in financial markets this year.

Leading research teams are now publishing mid-year revisions to their global economic and investment outlooks. Reviewing Barclays' team's analysis alongside that of Morgan Stanley's, the picture that emerges is of a bullish stance for risk assets for the rest of 2017. Of course, these institutions have a vested interest (as we all do) in the continuation of investors' recent positivity but, as the remarkably low level of the VIX (Wall Street's 'fear index') shows, many participants are sanguine about the risks that always underlie financial markets.

A benign macroeconomic backdrop for equities

Low volatility does not mean low risk. Realised volatility has not been high because, thanks to benign macroeconomic conditions, there haven't been triggers for risks to materialise. Implied volatility indices (like the VIX) do not measure risk at all; they isolate the rate of change in options pricing which highlights the fear of risks. Barclays argues that we have been in a sweet spot for risky assets such as equities, hence the mellow market sentiment.

In Barclays' view, there isn't some dangerous market complexity afoot keeping volatility down. It is confident that the synchronised global economic recovery remains on track and, although core inflation in some key economies such as the US and Japan has started to come off a little, falling unemployment should assuage fears of deflation. Barclays actually interprets the slowing inflation positively – as motivation for central banks to refrain from tightening monetary policy too quickly. Morgan Stanley has a similar view and expects a continuation of easy monetary policy and low volatility to drive more risk-taking from investors and induce company chief executives to embark on growth-boosting capex projects.

Global valuations not ready to come off just yet

Morgan Stanley acknowledges that while better growth and monetary policy are supportive factors for equities, in some markets valuation levels do pose cause for concern. They do not, however, anticipate an imminent correction. Although valuations are effective at predicting annualised returns for a wide range of assets on a timescale of five years and upwards, they are a poor predictor of short-term performance. It is common for valuations to overshoot late in cycles and, in any case, not all regions are especially expensive.

The high price/earnings (PE) multiples at which indices such as the FTSE 100 – and especially the S&P 500 – are trading worry investors, but there are still stock markets that look more reasonable. In other asset classes, both teams are more cautious on corporate bonds – especially high-yield US corporate debt – and overall Barclays and Morgan Stanley would both tilt their portfolio allocations more towards stocks than fixed-income investments.

3.8%
BARCLAYS FORECASTS ANNUAL GLOBAL GROWTH OF 3.8% IN 2017, 0.5% HIGHER THAN 2016

Asset allocation not market timing

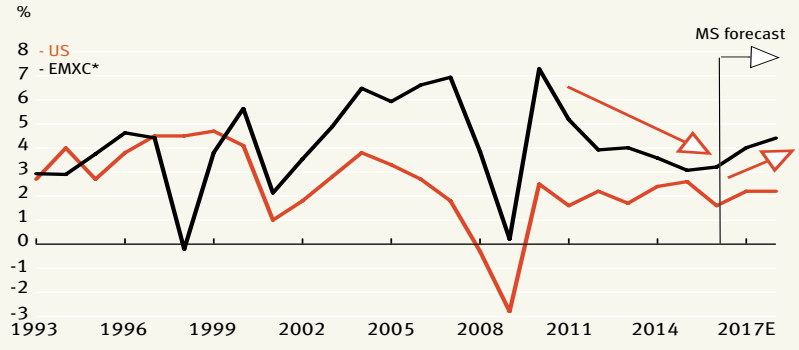
A key point to note is that neither bank uses its research to time when to be in or out of the market entirely. Both houses make decisions on whether to have 'overweight' or 'underweight' allocations towards different assets and regions. Tactical calls are made on the investments they believe will outperform in the short to medium term, while risk is spread within the framework of a diversified long-term investment strategy.

Current tactical tilts

At the asset level, both banks' research teams prefer equities to fixed-income investments. Given the backdrop of an earnings resurgence, tighter spreads in advanced ▶

Optimism has been raised by the first synchronised global recovery since 2010 – the chart below shows how emerging markets and the US are once more growing concurrently

Real GDP growth



Source: IMF, Morgan Stanley Research forecasts
*EMXC excludes Ukraine, Kazakhstan, Venezuela, Nigeria and Saudi Arabia

▶ economy bond markets and the possibility of US tax cuts, Barclays' view is that stocks still have a more attractive risk-reward profile than bonds. Likewise, Morgan Stanley believes equities "are supported by strong earnings growth and rising animal spirits".

Within equities, the two teams differ over preferred regions. For Barclays, there is most upside to be had in the eurozone and it is also very positive towards Japanese stocks. Morgan Stanley shares the enthusiasm for Japan, but in a markedly different call has upgraded its forecast for the US.

Morgan Stanley displays its weightings in a simple grid with five settings from negative to positive, and has just upgraded US equities from its middle setting (neutral) to its fourth setting (slight overweight). European equities remain at neutral and Japanese equities are downgraded slightly from strong overweight to slight overweight. Emerging markets are upgraded from the lowest setting (strong underweight) to slight underweight.

As mentioned, these positions are tactical tilts from the benchmark exposure for institutional investors. The Morgan Stanley benchmark is a 50 per cent weighting towards equities, half of which is in the US market; a fifth each is in European and emerging market shares; and a tenth is in Japanese shares. Overall, the current Morgan Stanley tactical asset allocation sees it move to a 55 per cent equities holding, with 26 per cent in government bonds, 14 per cent in corporate bonds, 2 per cent in commodities and 3 per cent in cash.

Barclays shows its equity allocations as percentage movements from the MSCI World index. The MSCI is a market capitalisation weighted index, so there is proportionately a higher weighting towards bigger equity markets to begin with. This means that, again, over half of equity exposure is towards the US. Therefore, when Barclays says it is "neutral" towards the US, it still has over 50 per cent of its equity allocation towards the world's largest market. Its overweight position towards Europe (excluding the UK) consists of a 2.5 per cent heavier weighting in the region than the MSCI World (17.7 per cent versus 15.2 per cent). Barclays is overweight Japan by 2 per cent (9.7 per cent versus 7.7 per cent) and underweight the UK by 1.5 per cent (4.3 per cent versus 5.8 per cent), and underweight emerging markets by the same amount.

Looking across all asset classes, Morgan Stanley currently has 41 per cent specific regional exposure to the US, 20 per cent to Europe, 10 per cent to Japan and 21 per cent to emerging markets. The rest is made up of securitised credit, cash and commodities. This helps put the research into context and demonstrates that portfolio adjustments are subtle: they involve positioning for macro themes at usual rebalancing intervals. Sensible portfolio management is not about chasing returns,; instead it is about managing risk and not deviating from an acceptable level of potential downside in case your macro calls are wrong or mis-timed.

Momentum has peaked, but the global recovery is intact and equities should benefit

Barclays' case for remaining overweight equities is in part because the global recovery remains broadly intact, even though growth momentum is forecast to decelerate in the second half of 2017. Europe has surprised pleasantly on the upside, but the US growth outlook is considered to be shrouded in uncertainty and the report notes the gradual slowdown in China.

The effects of oil price recovery on inflation in the latter part of 2016 have started to fade and muted wage growth has kept core consumer prices indices (CPIs) low. This, as mentioned, is seen broadly favourably, with the European Central Bank (ECB) and Bank of Japan remaining cautious, although the Barclays report highlights the risk of inflation and growth disappointing.

Political risk, so prominent in 2016, has taken something of a back seat this year. Eurocrats and internationalists have breathed a sigh of relief with the Dutch and French elections apparently stemming the tide of populism. In addition, much of the protectionist rhetoric that was such a feature of Donald Trump's election campaign seems to have been watered down now he is president. For the rest of this year, Barclays flags potential divisions in the US Congress over tax reform and government debt funding, the divisions in the UK over Brexit and China's Party Congress in the autumn as the main political headwinds.

For the rest of 2017, the reports focus more on the rate and sustainability of growth, with Morgan Stanley stating that "the essential debate in today's markets is whether the first or second derivative of GDP matters more". The bearish argument is that the level of growth (the first derivative) might be fine, but its rate of change (second derivative) is set to worsen, something that has signalled good selling opportunities over the past six years.

Morgan Stanley counts itself on the bullish side of the market, arguing that the level of growth will be more important than the rate. On this point it is optimistic, with the breadth of global growth raising hopes of a synchronised recovery. It summarises its view thus: "If the breadth of growth is better, and nominal GDP is higher, we think that sensitivity is reduced, and markets can weather a weakening 'second derivative'."

Growth in capex is good news for an economic recovery previously dependent on consumption

Although the Barclays report says that momentum has peaked, it does not believe a modest deceleration in the second half of 2017 is threatening the overall picture and that, over the full year, there will be a firm uptick in annual growth compared with previous years. Global business confidence measures signal a continued expansion in industrial activity and Barclays feels that accommodative policies and financial conditions remain supportive, raising the possibility of a more sustainable global recovery, powered by business investment and not consumption alone. On this basis, it forecasts annual growth of 3.8 per cent in 2017, 0.5 per cent higher than 2016, and expects this pace to be maintained into 2018.

Finding value in equity markets

The investing style Barclays advocates for the US is value over growth, but the caveat is that this positioning is very much in anticipation of corporate tax cuts

'Barclays is confident the synchronised global economic recovery remains on track'

Private investor asset allocation

The reports discussed here are aimed at institutional clients who have a long time horizon and hold vast quantities of assets. The reports are discussing the broad economic outlook through the prism of the existing opportunity set of investments. It makes sense therefore to have a strategic equity allocation that is regionally weighted by market capitalisation. For a private investor, however, it is probably better to exercise greater caution where the most expensive markets are concerned.

An allocation of 50-55 per cent towards equities is fine, but within that the weighting towards the US stock market, which is so expensive, shouldn't be as high as half (or a quarter of all assets). Being out of such an important and dynamic market is historically a huge mistake, so the middle road is just to take close to an equal-weighted approach with major equities regions. Reducing the US position to 15 per cent, and then putting 10 per cent each in the eurozone, the UK, Japan and emerging markets would be a suitable broad-based approach. This would mean not missing out on any further US upside, as well as having ample stake if value is realised in Europe and Japan. For the US allocation, given prices, a value factor tilt may give the best returns in this latter part of the economic cycle.

For a bond allocation, 10 per cent in US Treasuries is reasonable and although the tightening of US rates is a risk for the capital value of longer duration issues, bonds are likely to behave differently to equities when the S&P 500 finally experiences a correction. A core gilts holding also makes sense for UK investors.

With fixed income such a complex area, it is worth buying a managed fund and employing an expert to make sense of the yield curve, duration risk and liquidity considerations. With the reports we looked at wary of risks in corporate credit and the opportunities highlighted in emerging market debt and asset-backed securities requiring specialist knowledge, a strategic bond fund that covers all of these areas would be a good choice. Finally, taking from the fixed-income allocation to diversify into global real estate, brings a different exposure to growth.

Private Investor Tactical Asset Allocation July 2017

Asset class	Fund	Allocation %
US equities	iShares Edge MSCI USA Value Factor UCITS ETF (IUVF)	7.5
	iShares MSCI USA Quality Dividend UCITS ETF (QDIV)	7.5
UK equities	iShares Core FTSE 100 UCITS ETF (ISF)	10
Japan equities	iShares Core MSCI Japan IMI UCITS ETF (IJPA)	10
Eurozone equities	Vanguard FTSE Developed Europe ex UK (VERX)	10
EM equities	iShares Core MSCI Emerging Markets IMI UCITS ETF (EMIM)	10
	Total equities	**55**
UK Gilts short duration	Lyxor FTSE Actuaries UK Gilts 0-5yr (GIL5)	10
US Treasuries	Lyxor iBoxx $ Treasuries 1-3 yr UCITS ETF (U13G)	10
Strategic Fixed Income	MI TwentyFour Dynamic Bond (GB00B57TXN82)	15
	Total fixed income	**35**
Global Real Estate	HSBC FTSE EPRA/NAREIT Developed UCITS ETF (HPRO)	10
	Total	**100**

Source: Investors Chronicle

and it sees little upside priced from a relative stock perspective.

In Europe, Barclays favours value over low volatility or quality equity investing. European banks are highlighted as near the cheapest they have been relative to US counterparts since 1980. In emerging markets the opportunity highlighted is buying relative value, in particular in emerging Europe, and reduction in exposure to cyclical commodity risks.

Morgan Stanley has a more bullish stance on the US than the consensus opinion. Barclays and others would point out that Europe is very cheap relative to the US, but Morgan Stanley counters that, saying that while this is true on a normalised PE basis, the divergence in value between the US and Europe is no longer especially large on other metrics. Morgan Stanley flags the fact that sector-neutral relative 12-month forward PE for Europe versus the US has now risen above its long-run average. Also, the renewed strength of the euro is seen as favouring US equities.

Furthermore, Europe's relative performance versus the US recently hit 2.9 standard deviations (SD) above its 12-month average, the highest level since November 2008. Since the 1970s, levels above 2.5 SD have often coincided with tactical peaks in Europe versus US equities. Also, Europe's relative earnings revisions ratio versus the US has rolled over. Again, recent euro/US dollar strength is a factor and Morgan Stanley argues that this points to further weakness in relative earnings revisions momentum.

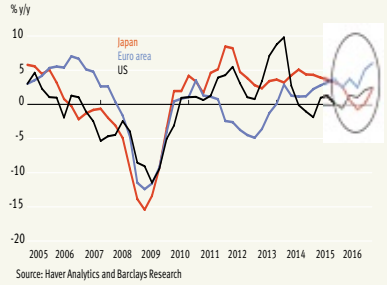
The risk/reward outlook for equities

While unflustered about the implications of low volatility so far in 2017, Barclays points out that many of the drivers of the low volatility regime are reaching their limits. Its expectation is that any US data surprises will be negative, as corporate sentiment surveys have fallen from their peak. Chinese sequential growth is also likely to slow in the second half of the year, albeit remaining relatively stable. Commodities and inflation are falling back, with the oil price again looking weak. Add to this the Fed's tightening of US monetary policy, rising equity valuations and elevated active manager positioning – with short interest at low levels – then scope exists for volatility to return in a meaningful way.

Morgan Stanley also doesn't expect the market tranquillity to last into 2018. It expects central bank policy to become much less accommodative, with increased Fed hiking, the ECB tapering and the Bank of Japan exiting its yield curve control strategy. Also, if its assumptions on growth are right for the rest of 2017, asset prices will be even more expensive by the turn of the year. For now, though, investors should relax and enjoy the calm.

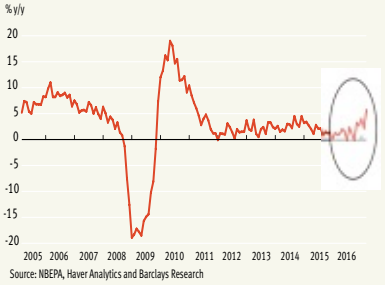
Increased capex should boost trade and support recovery in the rest of 2017

Real gross fixed capital formation



Source: Haver Analytics and Barclays Research

World trade volume



Source: NBEPA, Haver Analytics and Barclays Research

TRADING BIBLES

What's on the summer reading lists at the Society of Technical Analysts? **Nicole Elliot** finds out

IC BOOK CLUB

At this time of year my fellow scribes are invariably drawn to creating lists of recommended reading material for summer holidays. One can be sure that a steady stream of silly novels, boring biographies and turgid finance texts will feature. Bloomberg started in early June and the FT late in the month with a four-and-a-half-page selection. Maybe I'll pack that and ditch the books! As my friend the Supreme Court judge who, like me, has to read an awful lot for work, says: "Reading for pleasure becomes a little more difficult every year. Or are we more demanding?"

With this in mind, and following many requests from those wanting to learn more about technical analysis, I've compiled a list of books on this subject aimed at beginners – and which are also a good read. Choose one and see how you get on. If nothing else it'll give you a handle on the subject, might make you a better trader, and eventually line your pockets more thickly.

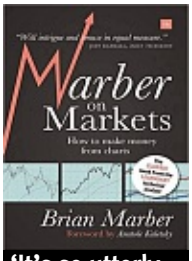
Rather than my thoughts on the subject I've enlisted committee members of the UK's Society of Technical Analysts (STA), a not-for-profit organisation that next year celebrates 50 years since incorporation – with a party at City Hall by Tower Bridge. I've also got some of the biggest names in the business to give me a couple of suggestions apiece.

Here goes, starting off with Axel Rudolf, current chairman of the society and multi-lingual German banker. Being an efficient chap he emailed his reply in first, thereby bagging a book that many others would also have suggested: *Reminiscences of a Stock Operator*, the story of Jesse Livermore by Edwin Lefèvre. First published in 1923, my money broker gave me a copy 30 years ago and I've re-read it several times. As Axel notes: "It has many insights into trading, life, and psychology which are as relevant today as they were when the book was written." Another member pointed out that its other advantage is that it's a small, short book and therefore easy to pack. Axel's second choice is: *Trader Vic – Methods of a Wall Street Master* by Victor Sperandeo because "his set-ups, such as a false breakout, can still be profitably traded today'.

Adam Sorab, past STA chairman and global multi asset manager at CQS, said: "Personally, my first recommendation would be *Behavioural Investing: A Practitioners Guide to Applying Behavioural Finance* by James Montier. The reason is that while many books do a good job of teaching technical analysis techniques, few books do such a good job of teaching one about the very real neurological and psychological barriers to investment success. James's book brings together a lot of solid academic research and pulls the lid on many investment myths. I think it's essential reading for anyone who is ever going to try to make money by investing in markets.

"If I had to give a second recommendation it would be Thomas Cleary's translation of *Art of War* by Sun Tzu. It's a very accessible version of this essential ancient Chinese military strategy text. *Art of War* is a 2,500-year-old piece of writing that still has a huge amount to teach us about coping with conflict and opportunity in today's world."

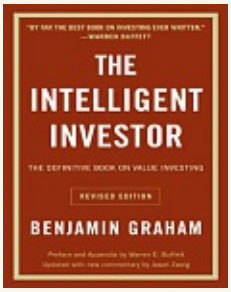
James Cameron, who is responsible for much of the syllabus and exam format of the STA Diploma Course, likes *Getting started in Technical Analysis* by Jack D Schwager where "his purpose is to avoid a textbook approach and show technical analysis as essentially practical, something he achieves brilliantly". You may have heard of his best-selling *Market Wizard* series. His second choice is also *Trader Vic* because "it's a fascinating biographical, forthright, entertaining and enjoyable read" living up to the foreword which claims this book [is] "valuable to everyone, regardless of their level of interest or expertise in the stock or commodity markets".



'It's so utterly irreverent and entertaining that I forgive him for pooh-poohing Fibonacci"

Luise Kliem, who currently sets the STA exams and developed the home study modules, recommends *Marber on Markets* by City legend and my guru Brian Marber, adding: "It's very informative with a practical approach that all investors (particularly private investors) will welcome – and it's so utterly irreverent and entertaining that I forgive him for pooh-poohing Fibonacci." Her second choice, *Candlestick Charts* by Clive Lambert, does what it says on the tin: written in a "clear, informal and engaging style that quickly gives the reader a grasp of what's important".

Treasurer Simon Warren, ex fund manager at health insurer Bupa, proffered these little gems. *Motley Fool: Make your Child a Millionaire* "because it's small and light



Books for beginners

John Douce, librarian of the society's book collection at the Barbican, focused on texts for newcomers because, as Woody Allen said: "stockbrokers invest your money until it's all gone". *The Intelligent Investor* by Benjamin Graham (1894-1976) was first published in 1950 and the fourth edition has a preface by Warren Buffett and footnotes by Jason Zweig. His second choice is by industry veteran Martin Pring, one of his many books being *Technical Analysis Explained.*

Enthusiastic head of marketing and consummate professional chartist Karen Jones' first suggestion is John Murphy's *Technical Analysis of the Financial Markets.* "For a beginner's book I think it's hard to beat. When I first started out this was my reference book of choice." Considered by many a sort of Bible of technical analysis, it runs to many hundreds of pages with as many chart examples – and should be tackled in small doses. "Because I have always been fascinated by Fibonacci I also enjoyed *Fibonacci Trading: How to Master the Time and Price Advantage* by Carolyn Boroden.

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Thank you,

Rosie Carr,
Deputy Editor, *Investors Chronicle*

Claer Barrett
Editor, *FT Money*

YOU CAN ALSO COMPLETE THIS QUESTIONNAIRE AT: investorschronicle.co.uk/vote

1. EXECUTION ONLY STOCKBROKING

Name of your execution-only stockbroker:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Support (Your email or call is always answered and dealt with quickly)					
Security (Broker is financially secure, good controls on dealing systems)					
Cost (Low commissions and low minimum charge)					
Sharedealing app (Easy to use, speedy and reliable, regular updates and improvements)					
Research (Up-to-date company/sector reports available)					
Administration (Systems easy to use and few errors)					
Range of services (Deals in all the stocks you want; other products/services available)					

Additional comments about what you especially like/dislike about this broker:

2. FULL SERVICE STOCKBROKERS

Name of your full service stockbroker:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Contact (Your call is always answered quickly)					
Security (Broker is financially secure, good controls on dealing systems)					
Cost (Low commissions and low minimum charge)					
Research (Up-to-date company/sector reports available)					
Administration (Systems easy to use, prompt paperwork and few errors)					

Additional comments about what you especially like/dislike about this broker:

Do you trade paper certificates (Circle as appropriate)	YES	NO
Do you deal through CREST? (Circle as appropriate)	YES	NO

3. SIPP PROVIDERS

Name of your Sipp provider:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Cost (low dealing and annual fees)					
Range (Can you trade all the underlying assets you want?)					
Customer service (Do they offer advice and support and offer excellent administration?)					

Additional comments about what you especially like/dislike about this provider

4. SELF SELECT ISAS

Name of your Self Select Isa provider:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Cost (low dealing and annual fees)					
Range (Can you trade all the underlying assets you want?)					
Customer service (Do they offer advice and support and offer excellent administration?)					

Additional comments about what you especially like/dislike about this provider

5. UNIT TRUSTS/OEICS

Name your favourite unit trust/Oeic:

Additional comments about what you especially like/dislike about this fund

6. INVESTMENT TRUSTS

Name your favourite investment trust:

Additional comments about what you especially like/dislike about this investment trust

7. PEER TO PEER LENDING

Name of the peer to peer lender that you use:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Returns (The rate you receive is what you expected or close to it)					
Ease of use (The platform is easy to navigate and the vetting procedures are clearly explained)					
Level of risk (Risk appears to be managed well)					
Transparency (Charges and default rates are clearly highlighted)					

Additional comments about what you especially like/dislike about this peer-to-peer lender

8. DISCRETIONARY / ADVISORY WEALTH MANAGERS

Name of your wealth manager:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Financial Performance					
Range of investments advised on					
Communication					
Cost/fees					
Trustworthiness, reliability and competence					

Additional comments about what you especially like/dislike about this manager

9. TAX PLANNING ADVICE

Name of your tax adviser:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Financial Performance					
Range of investments advised on					
Communication					
Cost/fees					
Trustworthiness, reliability and competence					

Additional comments about what you especially like/dislike about this provider

10. INVESTING PLATFORM

Name of the investment platform you use:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Charging structure (dealing fees, annual admin charges)					
Ease of use and portfolio visibility					
Range of investments (shares, funds, investment trusts, ETFs)					
Tools and information					

Additional comments about what you especially like/dislike about this provider

11. PRIVATE BANKING

Name of your private bank:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Charges					
Service and communication					
Range of services					
Security and competence					

Additional comments about what you especially like/dislike about this bank

12. CONTRACTS FOR DIFFERENCE

Name of your main CFD provider:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Tightness of spreads					
Quality of trading platform/telephone service					
Quality of mobile trading app					
Range of products					

Additional comments about what you especially like/dislike about this broker

13. SPREAD BETTING

Name of your main spread-betting provider:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Tightness of spreads					
Quality of trading platform/telephone service					
Quality of mobile trading app					
Range of products					

Additional comments about what you especially like/dislike about this broker

14. FOREX

Name of your forex broker:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Tightness of spreads					
Quality of trading platform					
Quality of mobile trading app					
Customer support and service					

Additional comments about what you especially like/dislike about this broker

15. INVESTMENT SOFTWARE AND DATA TOOLS

Name of the investment tool, software or data provider which you use:

HOW DO YOU RATE THEM ON:	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Value for money					
Customer support					
Usefulness of product or service					

Additional comments about what you especially like/dislike about this provider

16. REGISTRARS

Please rate any of the following registrars that you have used (eg for managing share certificates or through an employee share scheme):

Take into account the quality, speed, cost and ease of use of the service you received.	VERY GOOD	GOOD	AVERAGE	NOT GOOD	POOR
Capita					
Computershare					
Equiniti					
Neville					
Other:					

Additional comments about what you especially like/dislike about this provider

17. AWARD FOR SERVICES TO PRIVATE INVESTORS

Nominate an individual in the financial services industry that you believe deserves an award for their contribution to services for private investors:

THANK YOU for taking the time to fill in the questionnaire

To enter the prize draw, please fill in your details below or attach a business card and post to: IC/FT Awards, AC Market Research, PO Box 1540, High Wycombe HP12 9EH

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Address

Postcode

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E-mail

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to travel with, it's very cheap, it explains to the novice investor that you have to get saving early as compounding is key. Because it also shows people they should be doing important things like having a will". He adds another two, *The Trading Athlete* by sports psychologist Shane Murphy and trader Doug Hirschhorn and *Market Wizards* (again), which is available as an audiobook (handy if you want to zone out from the family!)

STA fellow Mark Tennyson-d'Eyncourt said: "I have a nasty feeling that my recommendations don't fit your criteria, but here goes: *Charters on Charting* by David Charters, but it might be out of print." Then *The Great Crash of 1929* by JK Galbraith, which became almost mandatory reading in dealing rooms in 2007 and 2008. He also suggests Adam Smith's *Money Game* and *Beginners Please,* a 1975 edition of extracts from Investors Chronicle "where the technical analysis chapter also acts as a primer and where the charts show the major tops in 1972 and the declines through to 1974. A real bear market! This should be required reading for younger analysts".

Charles Newsome, divisional director at Investec Wealth & Investment (who moonlights as vice-chairman of the STA) was succinct. *Steve Jobs* by Walter Isaacson. "OK, it's a biography but I think it's a must read and gives an insight into this brilliant man". *The Outsiders* by William Thorndyke, which is "the story of eight unconventional outsiders who thought differently about capital allocation".

Clive Lambert, whose candlestick book was chosen earlier, now pops up in his guise as part of the STA marketing team. Two of his three choices were picked earlier, but his third more than makes up for this, *Extraordinary Popular Delusions and the Madness of Crowds* by Charles Mackay. "It amazes me how often 'investors' forget about bubbles, and this is a cracking read that serves as a great reminder to anyone who is thinking about piling into Bitcoin right now... for example!"

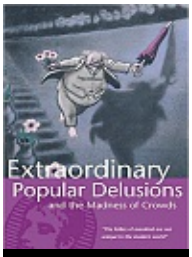
Trading systems consultant David Watts likes *Secrets for Profiting in Bull and Bear Markets* by Stan Weinstein, "the most lucid book on the use of moving averages". Then *Technical Analysis of Stock Market Profits: A Course in Forecasting* by Richard Schabacker, "the first real bible of technical analysis". I would agree here, adding that my first primer was Edwards & McGee's *Technical Analysis of Stock Trends*, which interestingly focuses on commodity futures markets as these were then at the forefront of investment thinking.

Youthful hedge fund manager Tom Hicks says he'd have to go for *Reminiscences* (yes, yet another plug for this delightful little book) and – toe-curlingly – *Ichimoku Charts: An Introduction to Ichimoku Kinko Clouds* by Nicole Elliott. Yes, yours truly's "was the book that got me into trading using Ichimoku techniques" and which Luise liked for its writing style.

Company secretary and veteran fellow of the society Anne Whitby says: "I'm afraid I have no books to recommend. I've only ever read one (because I had to proofread it) by Ellie Gifford and it's now out of print." This reminds me of one of my fellow bank trading colleagues who insisted on working from home saying he wanted to keep away from the chatter and noise of the markets.

For those interested in commodity markets I've roped in ex-head of risk management at United Biscuits, Brenda Sullivan. She says: *Economics of Futures Trading* by Thomas Hieronymus is a classic. "This book makes accessible the relationship between futures and the cash or physical markets. These concepts underpin all asset classes and price movements." Then another gem, Peter Steidlmayer's *New Market Discoveries* just one of which was the Market Profile technique. "This method put order into markets before we had digitalisation and this method of arranging data links to geometry and the statistical concept of standard deviations."

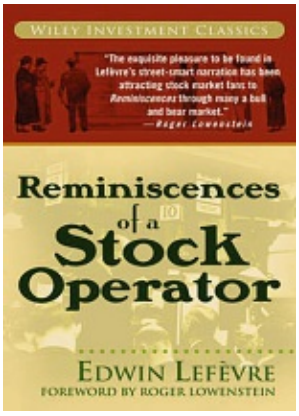
Book reviewer, technical analyst and private trader Simon Gray likes Alexander Elder's *The New Trading for a Living* where "its strengths are market psychology, risk control and account management". As an alternative to Schabacker is John Burford's *Tramline Trading – A Practical Guide to Swing Trading with Tramlines, Elliott Wave and Fibonacci Levels*. Quite a mouthful, a new one on me, published by Harriman House in 2014.



"It amazes me how often 'investors' forget about bubbles, and this is a cracking read that serves as a great reminder to anyone who is thinking about piling into Bitcoin"

Which segues neatly on to Stephen Eckett's choices, he who set up Harriman House in the early 1990s, which is now the UK's leading publisher of books on finance, investment and trading. Stephen picks *A Beginner's Guide to Charting Financial Markets by* Michael Kahn. He says: "This book gives the basics; it covers only the nuts and bolts of chart analysis leaving the whiz-bang stuff well alone.". His second choice is Clive Lambert's book, so I'll give you his third, Eoin Treacy's *Crowd Money* where "at its heart is the application of insights into crowd psychology. The author's approach to measuring the rhythm of the market has been the secret weapon of alpha generators for decades".

I've kept the best until last. A hero of mine, the man who single-handedly revived Elliott Wave theory, and the maverick who likes combining all sorts of areas of thinking – call him Renaissance man – Robert Prechter. As he bills his firm 'World-Class Market Analysis since 1979' he too likes the *Popular Delusions* book. His other choice is too cheeky to be true: penned by his very own hand and published this year *The Socionomic Theory of Finance*. Trying to piece together psychology and herding tendencies, mood, linear extrapolation versus bubbles, scepticism and economics, this I think is an 813-page brain teaser. "I wouldn't call it beach fare, but I think it's fun!" It's packed in my case for an imminent trip to the Italian Lakes. Thanks Bob.



Reminiscences of a Stock Operator was popular with our contributors

Read more about all the contributors here: www.sta-uk.org/about-sta/executive-committee/

If, after the holiday reading suggested here, you found the learning process worthwhile you could always sign up for the Diploma Course run by the Society of Technical Analysts at the London School of Economics; or buy their Home Study software if you live further afield. Details on their website www.sta-uk.org

MONEY

PORTFOLIO CLINIC: STOP WORRYING ABOUT MARKET TIMING 40
INVESTORSCHRONICLE.CO.UK/YOUR-MONEY

TRADING PLATFORMS

Barclays' new platform may be more expensive for larger portfolios

Several readers have contacted us about changes Barclays has made to its investment platform. We've investigated to help investors decide what they should do

KATE BEIOLEY

Barclays (BARC) is overhauling its DIY investment platform to make its service, which was geared towards share investing, more cost-effective and user-friendly for investors buying funds. The shift will benefit buy-and-hold investors who want to hold both funds and shares, as they are likely to pay less with the new Barclays Smart Investor service than with the Barclays Stockbrokers model. But customers with large portfolios could pay more, and those who have access to a spouse's account or hold multiple accounts under one name will no longer be able to.

What is happening to Barclays and why?

The switch from Barclays Stockbrokers to Smart Investor will take place on 28 August 2017. The aim is to modernise Barclays' service from a stockbroking business that favours frequent traders and sharedealers over buy-and-hold fund investors. Clare Francis, head of customer engagement and content, says: "We decided that rather than just upgrade the stockbrokers site, it made sense to start again and build something completely new. Overall, we feel that it's a fairer model that means the cost and charges you pay are reflective of your activity and portfolio size, and there are no hidden charges that are common with investing because they're all wrapped up into one fee."

'The aim is to modernise Barclays' service from a stockbroking business that favours frequent traders and sharedealers over buy-and-hold fund investors'

Who will benefit?

DIY investors with fund portfolios will benefit from reduced annual charges, which will undercut many low-cost platforms. Barclays has cut its fee on fund holdings from 0.35 per cent of assets to just 0.2 per cent of assets per year. Fees will be charged monthly and be subject to a monthly minimum charge of £4 – or £48 a year.

An investor with between £0 and £250,000 held in funds will pay less with Smart Investor than with AJ Bell Youinvest, which charges 0.25 per cent on fund holdings up to £250,000, Bestinvest.co.uk, which charges 0.4 per cent for that amount, and Charles Stanley Direct, which charges 0.25 per cent. At present an investor would pay more to hold funds with a value of up to £250,000 with Barclays Stockbrokers than with those platforms.

There will be a £500 a year annual charge to hold £250,000 in a Smart Investor individual savings account (Isa) in funds compared with £874 per year to hold the same amount under Barclays' current charging structure due to Smart Investors' 0.15 per cent cut in annual charge.

Barclays new single per-customer charge will include exit fees and transfer fees, which are currently charged separately to the annual fee. Exit fees can be substantial for those wanting to sell out of investments: for example, Hargreaves Lansdown charges £25 per line of stock to transfer out shares and Charles Stanley Direct charges £10 per holding to withdraw shares from an Isa.

Buy-and-hold investors will also benefit from lower dealing fees and will no longer pay more for trading less. Smart Investor will charge £3 per fund trade and £6 per stock, exchange traded fund (ETF) or investment trust trade, down from a maximum of £11.95 per trade.

Barclays Stockbrokers currently tiers its dealing fee based on the volume of trades

Barclays' old and new charges

	Current fees	Smart Investor fees
Dealing fees	1-9 deals in month £11.95, 10-19 deals £8.95, 20+ deals £5.95	£3 for funds, £6 for other investments
Annual fees	Admin fees: Isa: half-yearly charge of £15 + VAT. General investment account: £12 + VAT per quarter if no trade is placed in the quarter. Sipp: £155 + VAT per year (£38.75 + VAT per quarter). Fund Administration Fee: 0.35% per year, min £35 per year per account. No further change on fund holdings over £500,000	Customer fee: 0.2% fund holdings, 0.1% assets in other Investments (£200,000 cap exclusive to Barclays Stockbrokers customers). Sipp admin fee £125 + VAT per year

Source: Barclays

made, charging either £5.95, £8.95 or £11.95 to trade funds and shares, with the most frequent traders paying the lowest fee and customers trading between one and nine times in the previous month paying £11.95. Those who trade more than 20 times in a particular month are charged £5.95.

Smart Investor will be cheaper for dealing shares and funds than platforms such as Alliance Trust Savings, which charges £9.99 per trade regardless of investment type, and Halifax Share Dealing, which charges £12.50 per trade. AJ Bell Youinvest charges £9.95 per deal, although that reduces to £4.95 if customers trade 10 or more times in one month, and Bestinvest charges £7.50 per share trade.

Barclays hopes to appeal to investors who want an easy-to-use and transparent online investment portal, and customers who already bank with Barclays will be able to access all of their accounts in one place.

People it will not benefit

However, customers with large share portfolios may pay more under the new model. Barclays customers holding stocks, investment trusts and ETFs will pay a percentage-based fee of 0.1 per cent of assets they hold instead of a single fixed annual fee of £30 plus value added tax (VAT). Currently customers with a Barclays Stockbrokers Isa or general investment account can pay just £36 a year, but the new minimum charge for any account will be £48. Fixed fee models benefit investors with larger portfolios, as they pay the same cost even as the size of their assets increases.

Ms Frances says: "Without a doubt there will be some Barclays customers who will pay more than they do currently, but the vast majority will pay less."

To mitigate the fee increase for customers with larger stock portfolios, for the next three years Barclays will not charge for assets over a value of £200,000 held in investments other than funds, such as ETFs, investment trusts and shares. So, for example, an investor with a £500,000 share portfolio would pay a maximum annual charge of £200 a year. But that is still far higher than the £36 per year they would currently pay.

"Providing you hold a small to medium amount of money in funds and equities you will be slightly better off [with Smart Investor]," says Steve Nelson, head of research at consultancy The Lang Cat. "If you have a chunky portfolio of stocks and shares, however, the 0.1 per cent charge might bite a little. There is no magic amount but we typically say that when your portfolio reaches six figures, you are likely to save a lot of money by opting for a platform with fixed fees."

Investors wanting to mainly deal shares in an Isa or general investment account who have large portfolios may prefer an investment platform that charges a flat fee instead of a percentage-based fee. Such platforms include Hargreaves Lansdown, The Share Centre and Interactive Investor.

Hargreaves Lansdown caps its annual fee for portfolios of shares, investment trusts, ETFs and bonds at £45 per year for Isas and £200 for self-invested personal pensions (Sipps), and does not charge an annual fee for a general investment account. For share portfolios of £250,000 or less Smart Investor's annual charge will be lower, but Hargreaves Lansdown is likely to be more cost effective for larger portfolios of shares, ETFs and investment trusts. For example, a new Barclays Smart Investor customer could pay up to £500 in annual fees compared with £45 with Hargreaves Lansdown.



'Barclays new single per-customer charge will include exit fees and transfer fees, which are currently charged separately to the annual fee'

Other platforms with a fixed fee structure include AJ Bell Youinvest, which caps its annual fee at £30 per year for shares-only portfolios held in Isas. But Hargreaves Lansdown and AJ Bell Youinvest charge infrequent traders more than Smart Investor to deal stocks and shares so, depending on the size of your portfolio and the amount you want to deal, the saving might not be great.

Frequent dealers may also be better off looking for a platform that charges lower dealing fees, or reduces dealing fees for frequent trades. And fund investors may want to opt for a platform that does not charge to buy and sell funds. Examples include Hargreaves Lansdown, TD Direct Investing and Fidelity Personal Investing. However, Smart Investor will be cost competitive for investors dealing both funds and shares infrequently.

Fidelity Personal Investing offers free fund dealing, but charges 0.1 per cent of the value of an investment trust or ETF trade.

iWeb doesn't have annual charges but levies a one-off set-up fee of £25 to open an Isa or general dealing account. It charges £5 per deal for every kind of security.

Services Barclays will no longer offer

Customers will not be able to hold multiple investment accounts of the same type under one name with Smart Investor. The idea of this is to bring together all customers' accounts and assets in a single place online and enable them to manage all their assets via one online dashboard.

Barclays is also scrapping its old Market Master general investment account, which carried no annual charge if customers traded more than once per quarter, and replacing it with a new investment account. This means that customers with multiple trading accounts, for example, will no longer be able to hold those. And they could end up paying more in annual fees than in the past, because they will ▶

How the platforms compare

Platform	Range of investments	Company reports and accounts by email and letter?	Notifications of company events?	Multiple accounts under one name?*	Charge per account or customer?	Third-party access	Accounts held in trust
Hargreaves Lansdown	Full range	Yes, hard copies via letter on request	Yes corporate actions but no AGM. Can facilitate votes for clients	Yes	Account	Yes	Yes
Charles Stanley Direct	Full range	Clients can hold CREST accounts and receive all communications from companies	Yes, via CREST account	Yes	Account	Yes	No
Trustnet Direct	Full range	No – online only	Yes, online only via news feed on portfolio	No	Customer	Yes	No
IG	Over 9,000 global shares, over 6,000 ETFs & ITs	No – online only	Yes, online only	Yes	Account	Yes	Yes
AJ Bell Youinvest	Full range	No	Only corporate actions, not AGMs	Yes	Account	Yes	Yes
ATS	Full range	Yes, via shareholder enfranchisement service, whereby company communicates directly with customer as well as nominee (your platform)	Yes	Yes	Account	Yes	Nov
Interactive Investor	Full range	Yes, post only	Corporate actions yes, AGMs no, though customers can request attendance	Yes	Customer	Yes	Yes
Fidelity Personal Investing	Full range of funds, investment trusts etc. no share dealing	na	na	Yes	Customer	Yes	Yes
Barclays	Full range	No	Available online but no longer possible to save preferences and be notified of upcoming events	No	Customer	No	No

Source: IC survey *Excluding Isa restrictions

▶ be charged by the volume of assets they hold across accounts rather than per account, with a minimum of £48 per year.

Other platforms still let you hold multiple accounts, including Isas from previous years, and multiple general investment accounts. Those include AJ Bell Youinvest, Fidelity Personal Investing and Hargreaves Lansdown.

Many platforms also charge per account rather than per customer, including Hargreaves Lansdown, Charles Stanley Direct, IG, AJ Bell Youinvest and Alliance Trust Savings.

Barclays says many of its customers will benefit from paying one fee instead of several different ones for different accounts. For example, many of its customers may be paying annual fees for Isas, Sipps and general investment accounts with the broker, but from 28 August will pay just one fee for all of those, which could be lower.

Smart Investor customers will also no longer have access to their spouse's accounts or be able to give access to third parties with an authorisation letter. "We will still offer joint accounts but, because our system is now integrated with online banking, through the online banking portal, we are not able to allow people to access each other's account for security reasons," explains Ms Frances.

But other platforms still allow you to appoint a third-party to access your account through a letter of authorisation. These include Charles Stanley Direct, Hargreaves Lansdown and Trustnet Direct.

Barclays will carry over power of attorney (POA), executor or court appointed third-party agreements, but this will become a telephone-only service. It will not be possible to hold portfolios in trust with Smart Investor. At present Barclays Stockbrokers customers can manage shares and funds in bare trusts if they are the trustees. Barclays says fewer than 1 per cent of customers will be affected. Trustees who want this capability could instead use platforms such as Interactive Investor.

Smart Investor customers will receive less information and fewer notifications about companies they invest in. Barclays says that company reports and accounts will still be available to view online, but customers will no longer receive these by email or letter. Barclays will also not save customer preferences on notification of particular company events, although investors will still have access to this information online.

Investors who want to receive information about companies, attend annual general meetings (AGMs) and be notified of events could consider platforms such as Alliance Trust Savings. This runs a shareholder enfranchisement service whereby the company communicates directly with the investor as well as Alliance Trust Savings. Investors receive copies of annual and interim reports, notices of general meetings and information about proposed corporate actions such as bonus issues of shares, takeovers and mergers, and changes in the investment objectives of a fund.

Barclays' new charges:

Annual charges for a £500,000 shares-only portfolio

New Isa	£200
Current Isa	£36
Current general dealing account including inactivity fee	£57.60

Total annual cost for a £500,000 shares-only portfolio with 12 trades a year

New cost	£272.00
Current Isa cost	£179.4
Current general dealing account cost	£200.60

Total costs for a £250,000 funds portfolio with 12 trades a year

New charge	£536
Current Isa charge	£875
Current general dealing account including inactivity fee	£875

Annual charges for a £100,000 shares and funds portfolio

New charge	£150
Current Isa charge	£211
Current general dealing account including inactivity fee	£232.60

Source: Barclays and Investors Chronicle

'Barclays says many of its customers will benefit from paying one fee instead of several different ones for different accounts'

DIY investment platform cost comparison

Provider	Annual charges – Isas and dealing accounts*	Flat/ fixed fee for shares?	Extra Sipp charges?	Cost per fund trade	Cost per share trade
Alliance Trust Savings	£120 pa (incl 4 free trades)	No	£17.50 + VAT per month (incl 4 free trades)	£9.99	£9.99
AJ Bell YouInvest	Funds: 0.25% ‹ £250k, 0.10% £250k – £1m 0.05% £1m – £2m, › £2m, no charge Shares: 0.25% max £7.50 per quarter (£30 per year)	Yes	No	£1.50	£9.95, £4.95 if 10 or more trades in previous month
Barclays Smart Investor	Funds: 0.20% on all assets Shares: 0.10% of all assets Min £48 and max £1,500 per year for all	Yes	£150 per year	£3.00	£6.00
Bestinvest	0.4% £0-£250k 0.2% £250k-£1m ›£1m, no charge	No	0.35% not 0.4% on first £0-£250k	Free	£7.50
Charles Stanley Direct	Funds: 0.25% ‹£250k, 0.20% £250k – £500k 0.15% £500k – £1m, 0.05% £1m – £2m › £2m, no charge Shares: 0.25% min £24 max £240 per year, (charged per month, waived if one trade made within month)		£120 annual fee, waived if you hold more than £30,000 across accounts	Free	£11.50
Close Brothers	0.25%	No	No	Free	£8.95
ClubFinance	No fee providing 3 trades per quarter Otherwise £60 per year	Yes	na	£4.95	£4.95
EQ Shareview	Shares: 0.50% pa with £24k min and £90k max for Isa No annual charge for dealing account	No	na	na	£12.50
Fidelity Personal Investing	Funds: £45 ‹ £7.5k, 0.35% £7.7k - £250k 0.20% £250k-£1m (charge applies to whole portfolio when threshold reached).‹£1m, no charge. ETFs and investment trusts: Max £45 per quarter (£180 per year)	Yes	No	Free	0.10% dealing fee
Halifax Share Dealing	£12.50 per year for Isa. No charge for dealing account . £180 pa › £50k	Yes	£90 pa ‹ £50k	£12.50	£12.50
Hargreaves Lansdown	Funds: 0.45% £0-£250k 0.25% £250k – £1m 0.1% £1m – £2m › £2m, no charge Shares: 0.45% max £45 per year	Yes	No, but shares annual fee capped at £200 per year not £45	Free	£11.95. £8.95 if 10-19 trades in previous month £5.95 if 20 trades or more in previous month
HSBC	Funds: 0.39% Shares: £10.50 quarterly	Yes	No	Free	£10.50
iDealing	£20.00 pa	Yes	£20 pa platform fee	na	£9.90
Interactive Investor	£20 quarterly fee (£80 per year, comes with 2 free trades per quarter)	Yes	No	£10. £5 for rest of month if paid for 10 full price trades that month	£10. £5 for rest of trades that month if paid for 10 full price
iWeb	£25 one-off account opening fee for Isa and dealing account £180 pa › £50k	Yes	£90 pa ‹ £50,000 £180 pa ›£50,000	£5	£5
Selftrade	0.30% ‹ £50k 0.25% £50k – £250k 0.15% on assets over £250k Max £250 charge per quarter (£1,000 pa)	No	£118.80 pa	Free for buys, £11.75 per sell	£11.75, £9.99 for ETFs. £6.00 if 20 trades placed in a month across all accounts
TD Direct Investing	0.30% ‹ £250k 0.20% › £250k (min £20 per year, max £200) Isa has £36 per year charge if balance is below £5,100	No	Additional product charge of 0.25% taken twice a year. Min £96, max £240 per year	Free	£12.50 per trade. £8.95 if 10-19 trades in the previous three consecutive months. £5.95 if 20 or more trades
The Share Centre	Share account – £1.50 per month + VAT (£21.60 per year) Isa – £4.00 per month + VAT (£57.60 per year)	No	£172.80 per year incl VAT	1% of deal (min £7.50).	1% of deal (min £7.50)

Source: The Lang Cat and provider websites *Unless stated otherwise, 'shares' includes investment trusts, ETFs and bonds

Stop worrying about market timing

Our reader should stop worrying about timing the market and ensure he is holding his investments in a tax-efficient wrapper

CHRIS DILLOW, LAITH KHALAF & JAMES NORRINGTON

Mark is 26, single and lives in London. He works as an IT consultant on a salary of £45,000 a year.

"My main goal is growth with capital preservation," says Mark. "Most of my wealth – £20,000 – has come from inheritance, which I invested in the stock market. I have been investing since I was about 18 and my university fees were paid on my behalf.

"I am fully aware that with my income and assets I could put down a deposit to buy a home, but because of the income-to-price ratios in London I would prefer to invest in assets other than London residential property at present.

"I have done very nicely from the stock market and used to have a good global spread of investment trusts with some defensive shares. However, over the past year I sold these and rotated towards more defensive assets given equity market valuations. However, I am now wondering if I made the correct move as I have no immediate requirement for this money.

"I am not necessarily concerned about my investments going down in value so long as the reason for buying originally hasn't changed. What I am worried about is buying back into equities at their current valuations, and then watching them readjust down to more sensible levels knowing that I shouldn't have bought in at such expensive prices.

"I am comfortable having around 10 per cent of my portfolio in peer-to-peer loans via LendInvest, because they are secured against commercial property, which means there is the potential to recover their value if they default.

"I enjoy undertaking research on the Alternative Investment Market (Aim) companies recommended by Investors Chronicle columnist Simon Thompson and, if I agree with his view, investing in them.

'The most reliable lead indicators we have, such as foreign buying of US equities and global price-money ratios point to only mediocre returns, which implies significant downside risk'

"I lost around £5,000 when I was at university by investing in **Rolls-Royce (RR.)**. But in hindsight, that was a good move as it taught me a lesson, and the money I did recoup from that investment was reinvested in **Burford Capital (BUR)**. I think I am overexposed to this fund but my average buy-in price was 235p, and I believe in running your winners and cutting your losers.

I have recently invested in **Primary Health Properties (PHP)** and **Forterra (FORT)**, and trimmed my holding in **Telford Homes (TEF)** by £1,000.

"I am thinking of investing in defensive shares such as **Unilever (ULVR), National Grid (NG.)** and **BAE Systems (BA.)**. I would also consider investing in anything Simon Thompson recommends as he pointed me towards Burford Capital – I wouldn't mind investing in another company of that type."

THE BIG PICTURE

Chris Dillow, Investors Chronicle's economist, says:

You ask whether you've made the correct decision to shift into safer assets in light of high equity valuations. I can't say whether it's the correct decision, because nobody knows the future. But I can say it's a reasonable one. We're at that time of year when there's unusual downside risk to equities. And the most reliable lead indicators we have, such as foreign buying of US equities and global price-money ratios, point to only mediocre returns, which implies significant downside risk.

Mark's portfolio

Holding	Value (£)	% of the portfolio
Accrol (ACRL)	4,850	4.57
BP Marsh & Partners (BPM)	4,998	4.71
Burford Capital (BUR)	11,637	10.97
Forterra (FORT)	1,000	0.94
Inland Homes (INL)	3,782	3.57
PCF (PCF)	3,756	3.54
Telford Homes (TEF)	4,058	3.83
Capital Gearing Trust (CGT)	14,662	13.83
Personal Assets Trust (PNL)	14,662	13.83
Fidelity Strategic Bond (GB00BCRWZS59)	8,500	8.02
Royal London Sterling Extra Yield Bond (IE00BJBQC361)	8,500	8.02
Primary Health Props. (PHP)	6,500	6.13
LendInvest loans	10,837	10.22
Other peer-to-peer loans	500	0.47
Cash	7,796	7.35
Total	**106,038**	

However, you should not be thinking in binary terms such as 'correct or incorrect', or 'in or out' of equities. The best thing someone of your age can do is invest regularly, for example via a direct debit into a pension or individual savings account (Isa). Such a process means you'll buy fewer shares or units when their prices are high, and more when they are low.

You should not worry about being right or wrong – everybody is wrong occasionally. Instead, you should have good sustainable habits such as saving regularly, and an asset allocation you are comfortable with.

Laith Khalaf, senior analyst at Hargreaves Lansdown, says:

There's a lot to like about how you go about investing: you've started young and invested an inheritance when it would have been easy to spend it. But I think you seem to be worrying too much about market timing: no one knows when it's a good or bad time to enter the market.

Regarding all the money you're going to invest in the stock market over the next 40 years, sometimes you'll be lucky and sometimes you won't. It's not under your control, but it will even out in the long run – so a better use of your time would be to concentrate on picking good companies and funds, and making sure they are held tax-efficiently. So if you don't hold these investments in a tax shelter, consider putting them into an Isa or Lifetime Isa.

It's good that you've taken a bad investment experience and learnt from it. Even the most seasoned fund managers make bad decisions, so it's important to understand

How to improve the portfolio

Chris Dillow says:
Your portfolio is curious. It looks like a 'risk barbell' construction – high-risk speculative assets alongside lots of index-linked gilts via your holdings in **Capital Gearing Trust (CGT)** and **Personal Assets Trust (PNL).**

And other than Primary Health Properties and the defensive stocks in Personal Assets you've few ordinary low-risk equities.

For me, this is a problem. You are to a large extent depriving yourself of two traditionally good sources of return. One is the tendency for the general market to rise over time. The other is the tendency for defensive stocks to do better than they should. The virtue of defensives is not so much that they protect you from market falls – if the market drops they'll fall too, although probably by less – rather it is that they beat the market on average.

But by focusing on Aim you are exposing yourself to an asset class that traditionally underperforms. Aim stocks have fallen on average over the past 20 years, not least because investors pay too much for the small chance of huge outperformance. Burford Capital is very much an exception.

One common mistake people make is what psychologists call 'base-rate neglect' – in looking at individual cases they neglect general probabilities. And Aim investors often do this: they see what looks like an attractive stock and neglect the fact that the chances of small speculative stocks doing well are not great.

I also fear that, insofar as you are taking on systematic risk, you're exposed to cyclical risk. In the event of an economic downturn, you'd suffer losses on your housebuilders and probably on your other Aim holdings as sentiment to the market tends to be cyclical. You might also see losses on your peer-to-peer loans as defaults rise: don't be wholly confident that the lending is secured, as a downturn would see the collateral devalued.

My general advice would be to diversify away from Aim. Someone of your age should be investing regularly into a tracker fund. Aim is like a racecourse – it might be a place for an enjoyable flutter, but it shouldn't be the centrepiece of a financial strategy.

Laith Khalaf says:
I don't think there's anything wrong with keeping some defensive assets in your portfolio, but given the long time frame you potentially have before you call on the money, I'm not sure such a big exposure to fixed interest is warranted unless you have very high conviction.

Besides, if you think equity markets are overvalued, you could make similar comments about bonds. So rather than trying to second guess the direction of markets I would suggest thinking about how much of your portfolio you are happy to have in bonds for the long term, and use that as your guide to positioning the asset allocation.

You also have quite a lot of stock-specific risk – particularly as you are investing in small companies. While there's nothing wrong with that, and I am loath to discourage you from unearthing hidden gems, consider adding a couple more funds to create a diversified core around which you can add stocks that catch your attention.

At the moment it would only take a couple of wrong turns by the companies you are invested in to see a big chunk of your portfolio lost.



Property-linked holdings will suffer if the UK goes into recession

James Norrington says:
I like the sound of your original portfolio – internationally diversified collective funds plus some defensive shares is a sensible approach, along with the strategic bond funds you still hold. The concern I have with your current portfolio is that the investments are all very dependent on the UK economy. With Brexit negotiations casting a shadow over the prospects for the country, you are very exposed.

The peer-to-peer investments are often loans to small UK companies and you also have several property-linked holdings, which is another area that will suffer if the UK goes into recession. Commercial property would certainly take a significant hit, which has ramifications in terms of the security of your peer-to-peer loans.

Like some equity markets, UK property is expensive, so your reluctance to take on a large mortgage and risk negative equity in a crash is understandable. This does need to be set against the cost of renting – money you'll never see again – and the opportunity at the moment to borrow at ultra-low rates. But this is a big decision you need to be comfortable with and, in a way, your UK property shares are a hedge if the housing market doesn't crash.

You enjoy investing in some of the smaller companies that Simon Thompson recommends. Many of Simon's picks have done fantastically well, but you need to remember that these are risky investments, so make sure they don't account for too much of your total portfolio.

Set a budget for small-caps, say 10 to 20 per cent of your portfolio, depending on what you'd be able to stomach losing in the worst-case scenario, and be prepared for an investment to occasionally go wrong. Of course, uncovering hidden gems that make double- and triple-digit returns can also make a very positive difference to your portfolio.

that this is part and parcel of investing, and when it happens you need to dust yourself off, learn your lesson and move on.

James Norrington, specialist writer at Investors Chronicle, says:

Firstly, you are to be applauded for starting investing so young. Thanks to the magic of compound returns, you are giving yourself a better chance of having enough money in around 40 years when you are approaching retirement age. You also have a good income at a young age, so have the security of not having to live off your investments. Coupled with the time you have to recover from losses, this means you have capacity to invest in riskier assets such as equities which, despite high valuations in some regions, look like the best bet for generating above-inflation returns.

You seem to be slightly obsessed with market timing, but at this stage in life, and in your circumstances, time is your friend. There are stock markets that are not so expensive, for example the reflation trade in the eurozone has further to run and there is still value in Japan. If you are worried about expensive markets like the US S&P 500 and some FTSE 100 sectors, then just have an underweight holding in these regions. You won't lose as much in a correction and until this comes you won't be missing out on further upside.

Want to see your portfolio analysed by our experts?

email portfolio.clinic@ft.com
None of the commentary here should be regarded as advice. It is general information based on a snapshot of the circumstances.

TIPS

SHARES 36 FUND TIP 41
TIP UPDATES 42
INVESTORSCHRONICLE.CO.UK/TIPS

TIPS OF THE WEEK



Shaftesbury owns a big chunk of the West End's leisure hotspots, where footfall is on the rise

REAL-ESTATE INVESTMENT TRSUSTS

BUY

SHAFTESBURY (SHB)

Shaftesbury looks Brexit-proof

Bull points

- Strong rental income
- Unaffected by Brexit
- Significant reversionary value
- Modest loan-to-value ratio

Bear points

- Modest dividend
- Vulnerable to terrorist acts

At a time when political uncertainty and Brexit appear to be creeping into every crevice, it is reassuring to find a company that has remained relatively aloof from all of this. With 14.5 acres of property in the heart of London's West End, **Shaftesbury (SHB)** does just that. The property portfolio, accumulated over three decades, comprises nearly 600 buildings focusing mostly on restaurants, cafes, pubs and shops but with a sprinkling of offices and apartments. And given that a large proportion of footfall in the estate is made up of the 19m or so tourists that visit London each year, there is a distinct international angle to this domestically-placed real-estate investment trust (Reit). Footfall is also expected to swell further once the new Crossrail link is completed.

One of the main strengths of the portfolio is the lack of new space that is available in the West End, coupled with a thriving local economy. This means tenants tend to stay put, and when vacancies arise there is always someone ready to fill the space, usually at a higher rent. The vacancy rate is just 3 per cent of the estimated rental value (ERV), and much of this is from properties that are undergoing refurbishment. Meanwhile, exposure to obsolescence is almost nothing because premises are supplied to tenants in shell form, leaving the occupier to finance the fit-out.

The strength of demand means that Shaftesbury is able to push through rental increases, and in the six months to March 2017 new lettings renewals and reviews were concluded at 9.7 per cent ahead of ERV as at March 2016. And there is significant 'reversionary' income (properties generating rent below current market values) yet to be released. If all rents were marked to market, annualised income would be £30.2m, or 27 per cent higher. This is particularly encouraging given industry-wide concerns about the possible impact of recent rises in business rates on rental growth.

IC TIP RATING
Tip style: GROWTH
Risk rating: LOW
Timescale: LONG TERM

Almost half of the 'reversionary' income is linked to new refurbishment projects and should be realised as they are completed and let. A total of 216,000 sq ft was redeveloped or refurbished in the first half, including completion of Thomas Neal's warehouse and Central Cross on Charing Cross Road.

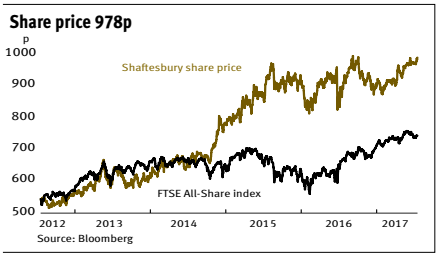
With so little property changing hands, Shaftesbury has still managed to recycle capital, raising £5.4m, including the sale of four apartments at a 9.2 per cent premium to book value. Acquisitions totalled £28.1m. And unlike many other property companies, Shaftesbury managed to increase the upward valuation of its portfolio from a year earlier. Finances are in pretty good shape, too, and following a refinancing last year the weighted average cost of debt fell from 3.9 per cent to 3.7 per cent.

Shaftesbury's restaurants, cafes, pubs and shops cover 1.1m sq ft and generate 70 per cent of group income. But use is also made of the space to be found above these

outlets, which is where the remaining 30 per cent of income is generated. These spaces are usually small offices and apartments, where the long-term trend has seen demand consistently exceeding supply. Terror incidents, such as the atrocity recently experienced in tourist hotspot Borough Market, and the knock-on effect for visitor numbers (typically lower footfall lasts about three months) are a potential issue given the high-profile location of Shaftesbury's estate.

However, the value of a large estate in such a prime location is significant. Property entrepreneur Samuel Tak Lee seems very aware of this, based on recent share purchases taking his holding to over 20 per cent. Among other properties, Mr Lee owns Langham Estate, a holding of West End prime retail and office space bought in 1994. Since then, he has built up a portfolio covering 14 acres between Soho and Mayfair and there is speculation that he could launch a bid for Shaftesbury.

With tourist numbers boosted by sterling's weakness, Shaftesbury should have little trouble maintaining high levels of occupancy in what is a vibrant and popular area for visitors and for the people who work and live there. The shares trade at a premium to forecast net asset value and the dividend yield is low. However, there is a steady income stream, rental growth and historical evidence that shows Shaftesbury weathering any potential economic downturn much better than most. And who knows, perhaps Mr Lee will make an offer. Buy. *JC*



Shaftesbury

Ord Price: 978p **Market Value:** £2.7bn
Touch: 977-978.5p **12-Month High:** 1,008p **Low:** 855p
Forward Dividend Yield: 1.6% **Trading Property:** nil
Premium To Forward NAV: 6% **Net Debt:** 34%
Investment Properties: £3.36bn

Year to 30 Sep	Net asset value (p)*	Net operating income (£m)	Earnings per share (p)*	Dividend per share (p)
2014	713	79.7	12.2	13.1
2015	869	78.8	13.0	13.8
2016	888	84.1	14.0	14.7
2017*	897	96.7	17.0	15
2018*	920	101.4	18.1	15.8
% change	+3	+5	+6	+5

*Peel Hunt forecasts adjusted EPS and NAV
Normal market size: 2,000 Matched bargain trading Beta: 0.26
Last IC view: Buy, 971p, 10 May 2017



Bicycle retailer Halfords is falling foul of squeezed margins and currency pressures amid a leadership vacuum

GENERAL RETAILERS

SELL

HALFORDS (HFD)

Avoid Halfords' margin squeeze

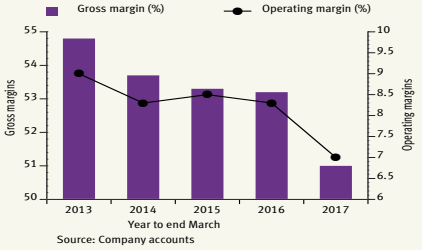
Bull points

- Manageable debt
- Attractive dividend

Bear points

- Contracting margins
- Sterling pressure
- Autocentres' like-for-like stagnation
- Management vacuum

Margins decline



Although the full-year numbers from bicycle retailer **Halfords (HFD)** were largely in line with the City's post-profit-warning expectations, we are growing increasingly concerned about an ongoing margin squeeze and its potential to create future disappointments. A fall in gross margin from 51.2 per cent to 48.6 per cent at the retail division (86 per cent of group revenue) especially highlights how susceptible the group has been to the prolonged devaluation of sterling against global currencies.

And, while bulls argue sterling weakness could benefit Halfords by increasing the number of 'staycations', the logic of how this translates into better sales of bikes looks stretched. Cracks are starting to show in the group's autocentres division – once hailed a growth engine for the company. And the group is still without strategic leadership following the surprise departure of recently installed chief executive Jill McDonald. Should consumer data continue to worsen, we see Halfords' shares – even at their current lowly valuation – as vulnerable.

IC TIP RATING
Tip style: SELL
Risk rating: HIGH
Timescale: SHORT TERM

The trajectory of margins is the major concern, with the high and fixed cost of rents, rising staff costs and higher business rates all exacerbating the impact of the decline in gross profits at the operating profit and post-tax level (see graph).

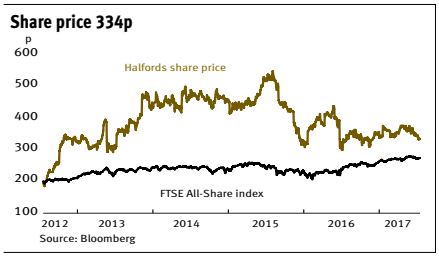
The retailer's robust first half may not prove as encouraging as it first appears. Halfords' sales tend to benefit from good weather, and a sunny spell early in the year coupled with the timing of Easter may have simply brought sales forward. Broker Peel Hunt thinks sales momentum could fade as the summer continues. The period also benefited from price increases in reaction to the weak pound, which has the potential to weigh on demand from squeezed consumers. Volume growth remains more modest and has largely stagnated ▶

▶ across the industry for the past 10 years. Why Halfords should be the one to turn this trend around – particularly when household incomes are feeling the squeeze – isn't clear.

As far as currency headwinds go, a longer-term challenge for Halfords involves forcing suppliers to offer it better terms, which could be a struggle. There are also mounting concerns about the autocentres division – once considered higher margin and a good buffer to the retail division. Bosses have poured a significant amount of investment into this part of the business, but real profit growth seems difficult to generate. Like-for-like growth is also flattening out, having managed just a 0.6 per cent rise at the time of full-year results, implying that new space is the only serious driver of the top line.

One shouldn't underestimate the change in management here either. Jill McDonald, who was only installed as chief executive in 2015, has left for high-street stalwart Marks and Spencer (MKS). That leaves any tangible strategic overhaul on hold for now, although the arrival of an inspiring leader could help the shares to re-rate eventually.

The dividend, which is forecast to yield close to 5 per cent this year, should provide some support for the shares and the multiple to forecast earnings is not high. But a lack of strategic leadership, an uncertain summer season, multiple headwinds and an established trend of margin contraction means we think there's downside to the shares. Sell. *HR*



Halfords

Ord Price: 334p **Market Value:** £665m
Touch: 333.8-334.2p **12-Month High:** 381p **Low:** 304p
Forward Dividend Yield: 5.5% **Forward PE Ratio:** 10
Net Asset Value: 205p* **Net Debt:** 21%
*Includes intangible assets of £394m, or 198p a share

Year to 31 Mar	Turnover (£bn)	Pre-tax profit (£m)**	Earnings per share (p)**	Dividend per share (p)**
2015	1.01	81.1	32.3	16.5
2016	1.02	81.5	33.2	17.0
2017	1.10	75.4	30.2	17.5
2018*	1.16	74.1	30.1	18.0
2019*	1.21	78.0	32.0	18.5
% change	+5	+5	+6	+3

Normal market size: 3,000 Matched bargain trading Beta: 0.56
**Numis forecasts, adjusted PTP and EPS, excludes special dividend of 10p in 2017
Last IC view: Hold, 374p, 31 May 2017

MINING

POLYMETAL INTERNATIONAL (POLY) BUY

Buy the gold dip with Polymetal

Bull points
- Growing production
- Decent dividend yield
- Lowly-rated shares
- Possible FTSE 100 re-entry

Bear points
- Safety record
- Gold price volatility

Do gold and silver mining shares sometimes over-react to weaker precious metal prices? Take **Polymetal International (POLY)**, for example. In the past three months, the Russia-focused group has lost a fifth of its market value, compared with a mere 5 per cent decline in the price of gold and silver. Despite the shares' sensitivity to precious metal prices, Polymetal has benefited from a depreciating rouble, weak oil prices and renewed financing terms in the period. What's more, all-in sustaining costs, which include production costs but exclude new capital projects, are not expected to breach $825 (£635) an ounce of gold equivalent in 2017. At this level, Polymetal will be throwing off enough cash to maintain its title as one of the best dividend payers among the London-listed gold miners, and fund capital projects that should help boost production by more than 40 per cent by 2020.

IC TIP RATING
Tip style: GROWTH
Risk rating: HIGH
Timescale: MEDIUM TERM

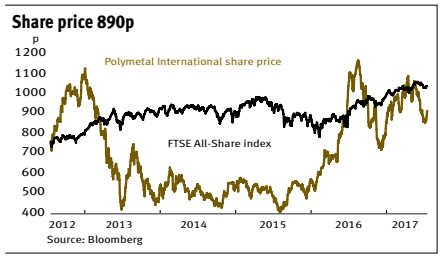
Polymetal has said it can do all of the above, so long as gold remains above $1,200 an ounce. Since the beginning of February, gold's weekly average price has not dipped below this level. And there are macroeconomic and market factors that lead us to think this will persist (see page 11).

But even if gold and silver prices drift, Polymetal shares offer investors value that neither of its two closest peers Randgold Resources (RRS) and Fresnillo (FRES) can match. On an enterprise value-to-cash profits ratio – a measure that takes into account debt levels – both companies are more than 50 per cent more expensive than Polymetal. Perhaps equity investors see that as a fair adjustment for Polymetal's $1.5bn of net debt (although this is forecast to fall) and the risks of doing business in Russia.

In fact, Polymetal's rating is broadly in line with Centamin (CEY), which relies on production from one mine. Conversely, the Russian miner boasts eight discrete operations, and will next year bring a significant resource in the shape of the 7.3m ounce Kyzyl deposit. At an initial cost of just $375m, the mine will provide a decade of high-grade open-pit production, with all-in sustaining costs of just $518 an ounce and an internal rate of return of 33 per cent, assuming gold at $1,200 and a 10 per cent discount rate.

Getting Kyzyl over the line along with other projects requires capital expenditure to peak at $370m this year, before declining to around $250m in 2019. The fall-away in spending should start to boost free cash flows, debt repayments and a continuation of the prospect of special dividend payments.

Aside from the vagaries of gold spot prices, Polymetal carries risks. High costs at the Mayskoye and Kapan mines weigh on the group's overall profitability. A horrible safety record since the beginning of the decade, raises doubts over claims of "best practice". But the group is at an inflection point, with a track record of capital discipline that suggests expansion will be profitable. And if that leads to the shares' re-rating, a potential re-entry to the FTSE 100. Buy. *AN*



Polymetal International

Ord Price: 890p **Market Value:** £3.83bn
Touch: 889-890p **12-Month High:** 1,191p **Low:** 712p
Forward Dividend Yield: 3.5% **Forward PE Ratio:** 9
Net Asset Value: 228¢ **Net Debt:** 136% £1=$1.29

Year to 31 Dec	Turnover ($bn)	Pre-tax profit ($m)*	Earnings per share (¢)*	Dividend per share (¢)*
2014	1.69	-138	-53.0	41.0
2015	1.44	276	52.0	51.0
2016	1.58	564	93.3	42.0
2017*	1.84	603	109	35.2
2018*	2.15	720	132	39.7
% change	+17	+19	+22	+13

Normal market size: 2,000 Matched bargain trading Beta: 0.74
*Panmure Gordon forecasts, adjusted PTP and EPS figures, includes special dividends in 2014-16 Last IC view: Buy, 982p, 20 Mar 2017

AIM: HOUSEHOLD GOODS & HOME CONSTRUCTION

BUY

WALKER GREENBANK (WGB)

Buy Walker Greenbank for post-flood growth

Bull points

- Recovery from flood
- Increase in branded sales
- Clarke & Clarke acquisition
- Licensing deals

Bear points

- Pension deficit
- UK consumer uncertainties

In December 2015 disaster struck luxury interior furnishings group **Walker Greenbank (WGB)** when one of its factories flooded, destroying much of its inventory and manufacturing capability. We think the market is overlooking the potential upside as the group recovers from this misfortune, for which it has now been fully compensated by insurance payouts totalling £19.3m. The bounce-back from the flood disruption coincides with the bedding in of a major acquisition, a pick-up in international orders and the benefits of recent licence sales in the US and China.

Walker Greenbank designs, licenses and markets high-end wallpaper, fabrics and paints. It also manufactures from two sites. The business is separated into brand (70 per cent of sales and 90 per cent of profit) and manufacturing divisions, and among the iconic British names it owns are the likes of Sanderson and Morris & Co.

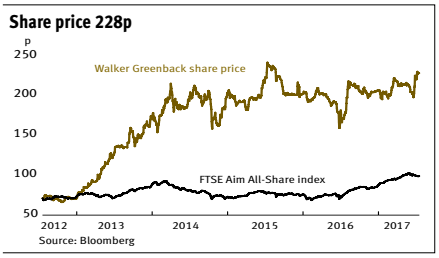
Trading improvements since the first half of last year suggest the company is well on its way to putting the flood behind it. While the disruption caused organic branded sales to fall 4.7 per cent in the first half of last year, as the year went on conditions improved, with growth of 2.4 per cent in the final 17 weeks. In the first 20 weeks of the current financial year, branded sales were up 4.5 per cent. While the international nature of the business means currency has flattered the result, on a constant currency basis growth was still 1.1 per cent in the recent 20 weeks. Insurance payments largely mitigated the hit from the flood to manufacturing sales, and stock levels have now been rebuilt.

In addition to organic growth, earnings are expected to be substantially boosted by last October's acquisition of Clarke & Clarke for £42.5m, which includes a contingent payment of £17.5m based on four-year performance. Clarke & Clarke specialises in more affordable modern designs that should complement the existing business well. Broker Investec reacted to the acquisition at the time by hiking earnings expectations for the current year by over a fifth, and management says the business is meeting expectations. In fact, it could do better still if there is a continuation of the "noticeable" increase in manufacturing export orders that Greenbank saw at both its factories in the first 20 weeks of the year.

IC TIP RATING
Tip style: GROWTH
Risk rating: MEDIUM
Timescale: LONG TERM

Licencing sales provide another reason for optimism. These are being focused on to improve branded sales growth and two recent deals for blinds and bedlinen in the US and China should boost second-half earnings. The company should also benefit in the second half from the launch of a new spring range and performance should be pepped up by last year's investment in state-of-the-art printing equipment as part of the refit of the flood-hit factory.

While a £7.4m pension deficit and the large contingent acquisition payment are considerations, we think the shares' rating of 14 times forecast earnings looks very attractive for the growth on offer. And even though consumer weakness in the UK is an issue, Greenbank has enough positive factors working in its favour to mean brokers may find reasons to upgrade forecasts as the year progresses. Buy. *JF*



Walker Greenbank

Ord Price: 228p **Market Value:** £161m
Touch: 225-230p **12-Month High:** 232p **Low:** 170p
Forward Dividend Yield: 2.2% **Forward PE Ratio:** 14
Net Asset Value: 74p* **Net Debt:** 10%
*Includes intangible assets of £32m, or 45p a share

Year to 31 Jan	Revenue (£m)	Pre-tax profit (£m)**	Earnings per share (p)**	Dividend per share (p)
2015	75	7.3	10.7	1.9
2016	88	8.9	11.6	2.8
2017	92	10.4	12.9	3.6
2018**	119	14.3	16.0	4.6
2019**	128	15.3	16.8	5.0
% change	+8	+7	+5	+9

**Investec forecasts, adjusted PTP and EPS figures
Normal market size: 1,500 Matched bargain trading Beta: 0.08
Last IC view: Buy, 214p, 26 Apr 2017

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TIPS OF THE YEAR
The eight tips we selected at the start of 2016 delivered a 16.1 per cent total return compared with the FTSE All-Share, which returned 20.8 per cent. Over five years, the Tips of the Year returned 132.8 per cent versus 63.1 per cent from the index.

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OPEN-ENDED INVESTMENT COMPANY

BUY

SMITH & WILLIAMSON GLOBAL GOLD AND RESOURCES (GB00B3RJHY30)

Get golden protection with Smith & Williamson Global Gold & Resources

Bull points

- Inflation hedging
- Decent relative performance
- Experienced manager
- Reasonable ongoing charge

Bear point

- High volatility

Inflation may have fallen by 0.3 per cent to 2.6 per cent in June, but it is still over five times higher than the 0.5 per cent it was at this time last year. This rapid rise is bad news for savings and investments, as it erodes the spending power of future interest and dividend payments and eats away at the worth of your original capital. But one way to protect your portfolio from this is to add a fund with exposure to gold, which has long been used to hedge against inflation.

"Gold is very cyclical: there are periods of time where it outperforms when everything else is underperforming," says Darius McDermott, managing director of Chelsea Financial Services. "At this stage in the cycle where many things look fully valued, I don't think gold is fully valued and, with lots of geopolitical uncertainty, I think it's sensible to keep a little bit of your portfolio in gold. **Smith & Williamson Global Gold & Resources (GB00B3RJHY30)** is an excellent fund if you're bullish about gold."

This is one of the better performing funds focused on this area – over one, three and five years it has outperformed its benchmark, S&P/TSK Global Gold Index.

The fund aims for capital growth over the long term and mainly invests in the shares of gold mining companies, as well as in those of other resources companies. Metals and mining companies make up 88.2 per cent of the portfolio, with chemicals accounting for 1.3 per cent and energy equipment and services 0.6 per cent.

The fund is run by AGF Investments, which is based in Canada, and manager Ani Markova has been at the helm since its launch in 2011. Because the gold price is volatile Ms Markova focuses on finding companies with strong balance sheets and the ability to execute existing projects.

She looks for slightly different characteristics depending on the size of the company. With larger companies, she prefers management teams that are willing to improve the business by stripping out unnecessary costs. And as smaller companies are often more reliant on just one or two mines, she focuses more on the quality of their assets.

"The team looks to invest across the market capitalisation spectrum and is able to move relatively quickly due to the fund's small size," say analysts at Bestinvest.co.uk. "The management team is an experienced one and sees its Canadian base as an advantage, since more than half of global resources stocks are listed in that country, facilitating management meetings. The fund has a Canadian bias, investing at least 51 per cent in local companies." Seventy-three per cent of its assets are listed in Canada, and nearly 11 per cent in the US.

IC TIP RATING

Tip style: GROWTH
Risk rating: HIGH
Timescale: LONG TERM

Smith & Williamson Global Gold & Resources also has a reasonable ongoing charge of 0.72 per cent.

Gold is a notoriously volatile asset, so if its price falls this fund is likely to be negatively affected, even though it invests in the shares of gold mining companies rather than the metal itself. However, the fund has outperformed over the long term, the period over which you should hold volatile assets such as gold mining shares. And given the background of rising inflation and continued geopolitical uncertainty, gold could appreciate and have a positive impact on the fund.

So if you're looking to hedge against inflation, willing to accept the higher risk of investing in gold and have a long enough investment horizon to ride out the volatility of mining shares, Smith & Williamson Global Gold & Resources could be a good way to diversify and achieve growth. Buy. *EA*.

Smith & Williamson Global Gold and Resources

Price: 57.3p
IA Sector: Specialist
Fund type: Oeic
Market cap: £43.8m
No of holdings: 90*
Set-up date: 8/06/11
Manager start date: 8/06/2011*

Source: Morningstar as at 18/07/17

3-year mean return: 11.92%
3-year Sharpe ratio: 0.30
3-year standard deviation: 36.45%
Yield: 0%
Ongoing charge: 0.72%
More details: smithandwilliamson.com

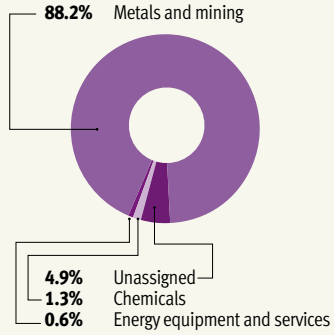
*Smith & Williamson Investment Management as at 31/05/17

Top 10 holdings

Agnico-Eagle Mines	4.6%	Silver Wheaton	3.0%
Central Fund of Canada 'A'	4.0%	Franco-Nevada	2.9%
Detour Gold	3.5%	Roxgold	2.4%
OceanaGold	3.4%	Randgold	2.3%
Tahoe Resources	3.3%	Endeavour Mining	2.2%

Source: Smith & Williamson Investment Management, as at 31/05/17

Sector breakdown



'Gold has long been used to hedge against inflation'

Performance

	1-year total return (%)	3-year cumulative total return (%)	5-year cumulative total return (%)
Smith & Williamson Global Gold & Resources	-23.1	12.5	-15.0
S&P/TSX Global Gold TR USD index	-24.8	9.2	-30.4

Source: Morningstar as at 18/07/17

AIM: HEALTHCARE EQUIPMENT & SERVICES

TRISTEL (TSTL)

Tristel beats expectations...again

Having conquered the UK hospitals market with its market-leading antibacterial wipes and foams, **Tristel (TSTL)** has set its sights on the rest of the world. Overseas sales now make up half of the group's total revenue and this strong growth helped the group deliver a better-than-expected second half. As a result, full-year revenues and profits are due to leap 17 per cent and 21 per cent, respectively, ahead of previous expectations.

Demand for products has been particularly strong in Germany, Asia and Australia, and overseas revenue rose 47 per cent as a result. UK sales growth has been considerably slower at 4 per cent, but that isn't altogether surprising considering Tristel has provided all of the surface disinfectants to the NHS for many years.

The company's exploits in the US are adding to the excitement. In early July, Tristel submitted an application for the approval of its chlorine dioxide disinfectant foam with US regulators. Approval – which is expected in the first half of 2018 – would give the group access to the world's biggest healthcare market. Management recently incorporated a subsidiary in Delaware, and is now in discussions with prospective distribution partners.

A 9 per cent share price rise following this trading update added to the strong momentum that has seen Tristel's market capitalisation double in the past year. But the overseas potential for the group's products makes us think that this impressive growth story has further to go. Buy at 233p. *MB*

Buy

TRISTEL

What we said: BUY
When: 23 APRIL 2015
Price: 73.5P

+217%

FOOD PRODUCERS

DAIRY CREST (DCG)

What we said: Buy
When: 7 July 2016
Price: 523p
Share price change to date: +10%

Dairy Crest (DCG) stated ahead of its annual general meeting that it is on its way to meeting its full-year expectations, despite cost pressures from "substantially" higher cream prices. Combined sales volumes of the company's four key brands – Cathedral City, Clover, Frylight, and Country Life – are 7 per cent ahead of the same time last year. This was driven by a good period for Cathedral City – its sales volumes were up 15 per cent on last year.

The company has cut back on promotional activity for Country Life to alleviate some of the pressure of rising cream costs.

Shares were up nearly 5 per cent after the update, suggesting shareholders are confident, despite pressure on butter margins. We're also optimistic about growth prospects from investment in whey protein and researching uses of galacto-oligosaccharide. Buy at 575p. *JF*

Buy

AEROSPACE & DEFENCE

QINETIQ (QQ.)

What we said: Buy
When: 1 September 2016
Price: 230p
Share price change to date: +10%

Shares in **Qinetiq (QQ.)** clicked into reverse after the defence contractor announced that new orders were slower than expected in the first quarter. Management revealed that revenue was broadly flat in its Europe, Middle East and Asia (EMEA) services division, but that some customer contract award decisions were deferred or delayed. Nevertheless, it expects the division to deliver modest revenue growth in the year to March 2018, but warned that the issue of lower baseline profit rates for single-source contracts persists, representing "a headwind for operating margins".

Revenue in the global products arm was also flat, but is expected to grow through the accounting year – helped along by a full-year contribution from the drone targets business acquired from rival Meggitt (MGGT) in late 2016.

At 252p, the shares trade at 13 times forecast earnings excluding year-end cash. We're still buying into the high-tech contractor's long-term growth story. *MR*

Buy

AIM: PHARMACEUTICALS & BIOTECH

ALLERGY THERAPEUTICS (AGY)

What we said: Buy
When: 21 July 2016
Price: 19.8p
Share price change to date: +51%

Strong demand for allergy soothers Pollinex and Pollinex Quattro has sent revenue up 15 per cent at constant currencies to £64m at **Allergy Therapeutics (AGY)**. A full-year trading update sparked a 17 per cent share price climb after management at the specialist biotech group revealed that sales will come in ahead of previous expectations.

Despite a flat market in Europe, Allergy has gained strong momentum in the past year by winning business from its competitors. Broker Panmure Gordon is yet to forecast profits at the group, although net losses are expected to be lower than previously anticipated after the development costs of some crucial clinical trials rolled over into the 2018 financial year.

Allergy has augmented its recent good scientific news with a positive financial update. This balance between strong trading and investment in future products is why we think its shares still look undervalued at 30p. *MB*

Buy

GENERAL RETAILERS

N BROWN (BWNG)

What we said: Sell
When: 8 September 2016
Price: 211p
Share price change to date: +34%

Shares in **N Brown (BWNG)** dropped 8 per cent after the group said it would be forced to take another £35m-£40m exceptional charge in relation to historic customer redress over the selling of general insurance products. The new charges relate to the period between 2006 and 2014, with the majority of the redress falling between 2006 and 2011.

Bosses say this will affect cash flows from 2019 onwards, although the board has said it will try to take mitigating actions to reduce the cost of this redress programme.

Analysts seem keen to emphasise the point that underlying trading remains strong here, but we see the shares – particularly after their recent rally – as vulnerable to bad news. At 283p, the shares only trade on a fairly undemanding 13 times broker N+1 Singer's forecast earnings, but we think there are more compelling prospects to be found in the sector. *HR*

Sell

FUNDS

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NEWS

BMO launches equity income maximising ETFs

KATE BEIOLEY

BMO has launched three exchange traded funds (ETFs) on the London Stock Exchange that track the FTSE 100, Euro Stoxx 50 and S&P 500 indices, and target a yield of 3 per cent over that of these indices.

They are the first ETFs listed on a European exchange to use the process employed by funds including **Fidelity Enhanced Income (GB00B87HPZ94)** and **Schroder Income Maximiser (GB00BDD2F083)**, which currently yield around 7 per cent.

BMO Enhanced Income UK Equity UCITS ETF (ZWUK), **BMO Enhanced Income Euro Equity UCITS ETF (ZWEU)** and **BMO Enhanced Income USA Equity UCITS ETF (ZWUS)** replicate the popular income-boosting strategies employed by active funds such as Schroder Income Maximiser and Fidelity Enhanced Income, but at a lower cost – they have an ongoing charge of 0.3 per cent.

However, the ETFs aim to deliver similar returns to the indices they track with a higher income and lower volatility, rather than outperform them like active funds.

BMO Enhanced Income UK Equity and BMO Enhanced Income Euro Equity will have an expected total gross yield of about 7 per cent, and BMO Enhanced Income USA Equity will have one of about 5 per cent.

The ETFs generate their extra income by selling call options on the indices they track.

Buyers of BMO's index options pay the ETFs a premium for the right to acquire the stocks they hold at a slightly higher price than the current price. This is known as a covered call strategy and means that when these stocks reach the agreed price the ETFs must be prepared to sell them to the acquirer, and take profits.

In return the ETFs receive a steady income stream on top of any income derived from their underlying holdings.

Investors in these types of funds can receive market-beating yields from the stocks that make up the mainstream indices. The steady income stream the ETFs will receive means they are likely to be less volatile than mainstream indices, and when markets are falling they should hold up better than mainstream index trackers.

Another advantage is that the income generated by these ETFs will not come at the expense of capital growth. A major drawback of higher-yielding equity income ETFs is that the shares they track pay out too much of their income as dividends and cannot divert as much capital to future growth. But covered call ETFs hold the same stocks as mainstream indices and their income is not wholly dependent on dividends.

These ETFs should be particularly useful in flat or falling markets, as the income boost protects their investors from losing the same amount as the broader index.

But these ETFs will not outperform a broad market ETF in total return terms when markets are rising. Just as covered call ETFs do not feel the full brunt of a market downturn, they also do not partake in full market rallies because they have to sell out of stocks when they reach their agreed option price, known as the strike price.

Oliver Smith, portfolio manager at IG, says: "This [covered call] strategy means that you receive an immediate income boost but the upside is capped and determined by the option strike price. It works well compared with a regular stock index if you think markets will trend sideways or be weak, and from that perspective could be interesting for investors."

In recent years, benchmarks such as the FTSE 100 and S&P 500 have trended sharply upwards, so an investor seeking total returns would have been better off with a low-cost mainstream equity index ETF, rather than one using a covered call strategy.

Over the 10 years to 18 July 2017 the S&P 500 covered call index delivered a total return of 68.2 per cent in contrast to the S&P 500 index's 106.4 per cent return. In this case a higher income would not have been enough to replicate the dramatic capital growth of the S&P 500.

However, Mr Smith says: "Markets are not hard-wired to go up in a straight line so the next 10 years could show us something different if markets go through periods of volatility."

ETFs using covered call strategies could generate higher implicit costs because they have to trade more than mainstream ETFs. But Christine Cantrell, UK ETF sales director at BMO, says because these ETFs sell index options rather than stock options it reduces the trading volume. It also means the spreads these ETFs pay on the options are lower.

And BMO's large size in the US, where it already runs a series of covered call ETFs, means dealing costs should be lower.

Castlefield CFP SDL UK Buffettology is amassing cash due to high share prices

Keith Ashworth-Lord is not prepared to invest "willy nilly"

EMMA AGYEMANG

Castlefield CFP SDL UK Buffettology Fund (GB00BKJ9C676) invests using similar principles to renowned US investor Warren Buffett, who is well-known for his buy-and-hold approach.

The fund's manager, Keith Ashworth-Lord, aims to emulate Mr Buffett's style by finding companies he can hold indefinitely, and buying them at a point when circumstances have caused their share prices to be undervalued. Often this means he will invest on market dips.

The companies Mr Ashworth-Lord favours must have attributes including: a business model that is easily understandable, transparent financial statements, consistent operational performance with relatively predictable earnings, and the ability to generate high returns on capital employed and convert a high proportion of accounting earnings into free cash.

The fund typically holds between 25 and 35 stocks and Mr Ashworth-Lord deliberately keeps it concentrated as he believes this allows him to understand each company in more depth.

Since launching in 2011 the fund has consistently delivered strong returns – in terms of performance it is in the top quartile of the Investment Association (IA) UK All Companies sector over one, three and five years.

The strong performance has drawn investors to the fund, so that its assets under management have increased from £30m at the start of 2016 to around £150m.

But buying good companies at discounted prices is now proving more difficult as markets overall are looking expensive, and as a result the fund's allocation to cash has climbed to 18.2 per cent. "The inflows have been extremely strong, but I've not been prepared to invest it willy nilly," says Mr Ashworth-Lord. "There has got to be a very good business case for putting the money to use."

In March the fund also received £4m in cash from the takeover of one of its holdings, Lavendon Group. Mr Ashworth-Lord has topped up existing positions in soft drinks manufacturer **AG Barr (BAG)**, which produces branded products such as Irn-Bru and Rubicon. He believes the company has scope to grow Irn-Bru's market share in England and Rubicon's market share in Scotland. And AG Barr has made progress on reformulating its drinks with lower sugar, ahead of the sugar tax that will come into force next year.

He has also been adding to an existing holding in pizza delivery company **Domino's Pizza (DOM)**, which suffered a share price fall in June on the back of a sell note produced by broker Investec.

"With the best will in the world, there was nothing new in that report that made me think I might revisit what I think about Domino's," says Mr Ashworth-Lord. "The net result was the shares got bashed up, which was a wonderful opportunity to buy into a business that over the past 15 years has been a 15-bagger [made 15 times his money]. It's been a cracker and it's got a lot more to go."

He has also bought retailer **Next (NXT)**, another company whose shares have been substantially beaten up, and **Craneware (CRW)**, which engages in the development, licensing and ongoing support of computer software for the US healthcare industry.

However cocktail bar company **Revolution Bars (RBG)**, which Mr Ashworth-Lord added in January, suffered a 40 per cent fall in its share price in May. "The reason was a wholly unexpected profit warning seemingly based on management failing to anticipate and control operating costs," he says. "Revolution is now a sitting duck if management fails to get a grip."

Typically, the fund's philosophy means Mr Ashworth-Lord will only sell a stock if:

- There has been a permanent deterioration of the business, its growth prospects or management.
- An alternative, better investment proposition has come up, but cash is needed to invest in it.
- A mistake has been made and the reality of the business is a lot less favourable than originally thought.

Despite his view as a "committed Brexiteer" that there is value in leaving the European Union, he does not pay too much attention to the macroeconomic picture.

He explains: "I just carry on trying to find great businesses and seeing if I can invest in them for a price where I think I'm going to get more in cash flow from here to judgement day. And then I discount it back and compare it to what I'm being asked to pay, and if that works out then I will invest."

However he acknowledges that over the next five to 10 months UK businesses focused on domestic consumption might get weaker. But for investors it is the long term that counts.

"We are all going to be a lot richer in five or 10 years' time than we are now in the western world and gross domestic product (GDP) per capita will grow," he says. "I believe that once we've freed ourselves from the EU it will grow even faster. Concentrate on the businesses that are going to be bigger and better in 10 years' time – the rest is noise."

Top 10 holdings

Scapa Group	5.37%	Trifast	3.72%	AB Dynamics	3.06%
Bioventix	4.78%	Liontrust Asset Management	3.37%	Mattioli Woods	2.99%
Games Workshop	4.40%			AG Barr	2.87%
RWS Holdings	3.82%	Dart Group	3.29%		

As at 30 June 2017

Performance

	1-year total return (%)	3-year cumulative total return (%)	5-year cumulative total return (%)
Castlefield CFP SDL UK Buffetology	23.0	57.9	143.1
IA UK All Companies sector average	16.8	26.8	73.1
FTSE All-Share index	16.2	25.0	64.0

Source: Morningstar as at 15/07/17
See online version for full data set

Alliance Trust's new selection process

Craig Baker tells Leonora Walters how he selects Alliance Trust's equity managers

Craig Baker CV

Craig is co-manager of Alliance Trust and global chief investment officer at Willis Towers Watson, a role he has been in since 2014.

He has worked at the company, previously called Towers Watson, in a number of roles, including global head of investment research between 2011 and 2014, and head of manager research between 1998 and 2011.

He is a fellow of the Institute of Actuaries, and has a degree in mathematics from the University of Nottingham.

Earlier this year **Alliance Trust (ATST)** shareholders approved changing its structure to a multi-manager approach. This is where a fund's manager outsources the management of its investments to external managers, who each run a portion. Other funds using this approach include Witan Investment Trust (WTAN).

It follows a number of other changes at Alliance Trust due to pressure from activist shareholder Elliott Advisors, which included an overhaul of its board, a greater focus on equities and a drive to reduce costs.

The team in charge of picking these external managers is investment consultancy Willis Towers Watson, which was appointed as Alliance Trust's manager in April. This is a departure from the internal management structure the trust previously had.

Willis Towers Watson has chosen eight managers to run the trust's equity portfolios. These are: Black Creek Investment Management, First Pacific Advisors, GQG Partners, Jupiter Asset Management, Lyrical Asset Management, River and Mercantile Asset Management, Sustainable Growth Advisers and Veritas Asset Management.

Narrowing it down to these eight has involved a detailed research process. "There are 3,740 managers that we've done formal research on," explains Craig Baker, co-manager of Alliance Trust. "Typically that involves numerous meetings, including two to three hours with the portfolio manager and the analysts, maybe going through some valuation analysis on particular stocks."

"Out of those 3,740 there's 560 that we give a specific rating to and then, within that, 184 have a top rating. 40 of these run global equity mandates, some of which are closed to new money and some of which would not be appropriate for running a 20-stock portfolio, so you narrow your universe down a bit more – maybe to about 20 managers. To get our final eight it was a case of picking managers that think and construct portfolios differently, so you've got genuine diversity in the portfolio."



Once Mr Baker and his co-managers – Stuart Gray, David Shapiro and Mark Davis – have chosen the managers, they monitor them and if necessary reweight them. "Although there is pretty much daily interaction between us, once a month we formally agree the target weightings to each of the managers in the portfolio and review those weightings on the basis of giving us a portfolio that is dominated by stock selection," explains Mr Baker. "We also set rebalancing ranges around that, as some managers perform better or worse than others over short periods of time, and if the rebalancing range goes outside a certain bound we will use cash flows to change that.

For example, they take money away from the best-performing managers and add to the underperforming ones on a rolling basis to move closer to their model weighting and because they "are naturally contrarian by nature".

They aim to have low manager turnover "but things do change that cause us to want to change a manger", adds Mr Baker.

Examples would be departure of key individuals, senior people becoming less involved in research, or performance inconsistent with a given manager's approach and style.

They also monitor underlying managers on a quantitative basis, using software tools they have built in-house. This includes risk analysis and looking at what trades the managers have made.

Many funds have a multi-manager structure, but Mr Baker maintains that Alliance Trust has a number of differentiating factors. For example, its active share – the number that shows how different the portfolio is to the benchmark and how much ability it has to outperform – is over 80 per cent, while many multi-manager portfolios have one of between 40 per cent and 60 per cent, according to Mr Baker.

And Alliance Trust's managers, with the exception of GQG Partners, run concentrated 20-stock portfolios. "[When] a portfolio manager puts together an equity portfolio they have 10 to 20 great ideas and make those their largest overweight positions relative to the benchmark," says Mr Baker. "But they also put a number of other positions into the portfolio that are primarily for risk management rather than alpha generation. And while the vast majority of long-only equity managers outperform with their 10 to 20 largest positions, the rest of their portfolio, which they added for risk management purposes, detracts value."

Mr Baker says what they are doing is putting together some "great stockpickers" and just taking their very best ideas, so "you end up with an overall portfolio that is nice and diversified, and still has very high active share".

He adds that it is not just academic research that shows this approach works. "Let's take the example of the most famous and most successful investor in history – Warren Buffett has been doing exactly that for 60 years."

But while they are introducing a radically new structure to the fund, they are also firmly committed to maintaining what has become a tradition of 50 years at Alliance Trust – annual dividend increases.

"We don't say to the underlying managers that they have to produce a yield of x per cent," says Mr Baker. "Rather we've chosen managers that when blended will give us the kind of yield we need to allow a progressive dividend policy over time."

SHARES

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TAKING STOCK

Mark Robinson is deputy companies editor



The politics of energy

Reports of the death of fossil fuels, if not greatly exaggerated, take insufficient account of climate change's political dimensions

In last week's issue, both our editor and chief energy specialist were musing on the "inevitable period of managed decline" faced by the global oil industry. As we're dealing with a finite resource (anyone recall 'peak oil'?) the term 'inevitable' is obviously germane, but for investors the central consideration is how long it will take for the industry to buckle, contract, evolve or consolidate in the face of the seemingly inexorable rise of non-fossil fuel power sources.

Last week's editorial concluded that it may be some time before the shift in the world's energy mix has a profound effect on the likes of **Royal Dutch Shell (RDSB)**, but the evidence suggests that the transition to a greener future is gathering momentum. Earlier this month, BlackRock closed its Global Renewable Power Fund II with $1.65bn (£1.26bn) in commitments from institutional investors. The final figure was well in advance of BlackRock's initial $1bn target, perhaps vindicating the launch of the fund at a time of regulatory uncertainty ushered in by the perceived laissez faire attitude of the current US administration towards environmental regulation and its explicit support for the US coal industry.

BlackRock's new fund taps into a wider narrative bound up with the Paris climate accord and the United Nations Framework Convention on Climate Change, which target a reduction in greenhouse gases that will limit the increase in the global average temperature to well below 2°C above pre-industrial levels. The 2017 edition of Bloomberg's New Energy Outlook estimates that of the $10.3 trillion invested in electric power through to 2040, $7.4 trillion will be given over to renewable generation. However, the report goes on top say that an additional $5.3 trillion will be required to meet the UN target.

To put that into perspective, the Paris-based International Energy Agency estimates that total energy investment in 2016 was just over $1.7 trillion, or 2 per cent of global GDP. Last year was noteworthy in that the electricity sector edged ahead of the oil and gas sector to become the largest recipient of energy investment. That represented a global first, but oil and gas still accounted for two-fifths of overall energy supply investment.

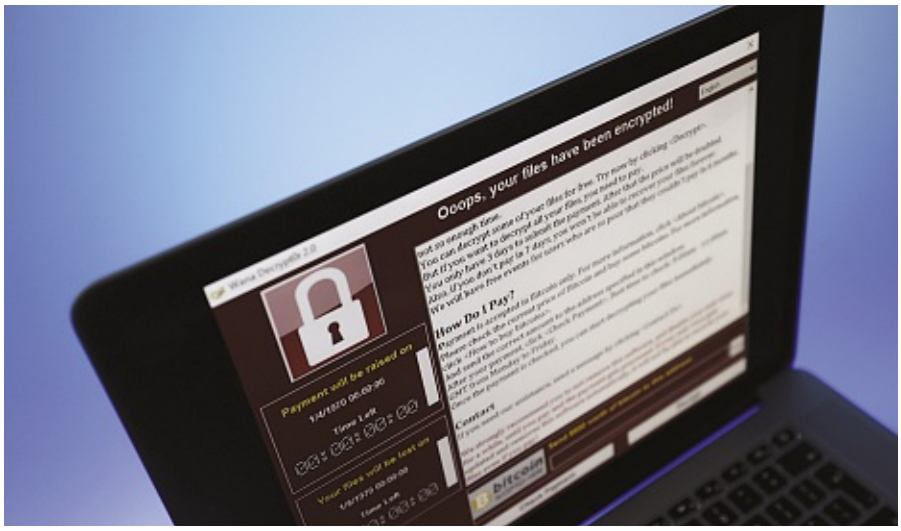
With renewable commitments on this scale, it's understandable why Bank of England governor Mark Carney and others have warned that investors in fossil fuel companies could be left holding a pup, because to achieve the UN climate target only roughly a fifth of the world's proven reserves of oil, gas and coal can be burnt.

There is a flip-side to this conjecture. Investors who rush into the renewables market could also be left high and dry because it's still far from certain which forms of 'green' technologies are likely to prevail in the long run, a point borne out, for example, by the wide disparity in the capital costs of onshore wind energy projects across Europe. Among other factors, industry valuations are far from reliable. We would do well to remember the dot-com and housing bubbles.

A cynic – or perhaps a realist – might take the view that President Obama's signing of the Paris accord and President Trump's subsequent repudiation are both politically symbolic, but essentially meaningless from a practical perspective. That's because countries have essentially signed up to loosely binding commitments to reduce greenhouse gas emissions many years from now. The language is deliberately ambiguous and the accord has no teeth from a legislative perspective: there's no compulsion. And that's to say nothing of the lengthy list of corporate and national opt-outs on greenhouse gas emissions. At best the Paris agreement might be described as a tentative first step.

But the excoriation that followed Trump's decision to pull out of the Paris accord demonstrates that the political battle is essentially zero-sum, mirroring the wider climate change debate. On both sides of the argument, the position held seems more like an article of faith.

I hold no particular scientific expertise on man-made climate warming. But I would suggest that the Paris accord is quantitatively insignificant – mere political window dressing. We're more likely to see real change on the environmental front because of the problem of growing air pollution in major cities, not only in China but in the western economies. Let's not forget that it was this issue that drove major infrastructure and regulatory change in London, ergo the Great Stink of 1858 and the Great Fog of 1952.

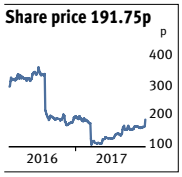


Is this the start of the long road to recovery, or will investors have to stomach yet more disappointment?

SOFTWARE & COMPUTER SERVICES

NCC results reassure

'Business as usual' seems to be the key message **NCC's (NCC)** new management wants investors to take away from these results. Like-for-like revenue ticked up 3 per cent, bolstered by £21.1m of sales from acquisitions. Geographical expansion is under way, with 39 per cent of revenue now coming from outside of the UK. Good numbers, if the mayhem of the past six months can be brushed aside. Many investors appear to have done just that, sending the share price up 8 per cent on results day.



In November 2015, the group raised £126m from shareholders to fund two acquisitions in the fast-growing cyber security space. Now management has been forced to admit that it overpaid for those businesses and has taken a £62m write-down on intangible assets. That and other "significant charges" – which include long overdue holiday pay provisions and dividends being paid illegally from non-distributable reserves – swung the group into an operating loss of £53.4m, from a profit of £11.4m this time last year.

Even after stripping out those charges, adjusted cash profit fell by a fifth to £36.2m. The problems lie in the assurance division (now 83 per cent of group revenue) where rapidly spiralling costs have outstripped the 21 per cent acquisition fuelled revenue growth. A big fall in adjusted operating margins sent operating profit down £9.2m, equivalent to a 35 per cent fall even after accounting for positive foreign exchange movements.

Salvation can be found in the Escrow division, which remains stable and cash generative. Meanwhile, management seems to have devised a credible plan to get the business back on track. Broker Jefferies is confident that the detail provided in these results has unearthed all of the group's skeletons and although pre-tax profit forecasts for the year to May 2018 have been slashed to £28.4m, this is marginally up on the £26.1m reported in these numbers. Adjusted EPS is forecast at 7.2p against 6.7p in 2016-17.

But we still have concerns. Despite management reassurances, there is currently no tangible evidence of margin recovery or a return of the large contracts lost in the second half. This is a highly competitive marketplace where slip-ups are bound to be punished. For that reason we still advise investors to steer clear. *MB*

Sell

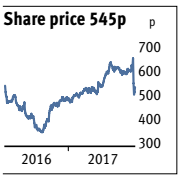
Ord Price: 191.75p **Market Value:** £530m
Touch: 191-192p **12-Month High:** 377p **Low:** 88p
Dividend Yield: 2.4% **PE Ratio:** na
Net Asset Value: 76.7p* **Net Debt:** 21%
*Includes intangible assets of £268m, or 97p a share

Year to 31 May	Turnover (£m)	Pre-tax profit (£m)	Earnings per share (p)	Dividend per share (p)
2013	99	18.8	7.0	3.10
2014	111	23.2	8.7	3.50
2015	134	21.4	8.0	3.98
2016	209	9.4	2.5	4.65
2017	245	-55.3	-20.4	4.65
% change	+17	–	–	–

Last IC view: Sell, 107p, 2 Mar 2017 | Ex-div: 31 Aug | Payment: 29 Sep

AIM: TRAVEL & LEISURE

Dart warns on Brexit uncertainty



Dart (DTG) was feeling the Brexit blues when its shares fell 14 per cent after executive chairman Philip Meeson warned the travel company might not have the freedom to fly to all its destinations after the UK leaves the EU. Sentiment wasn't helped by a fall in pre-tax profit last year, the result of heavy investment in new operating bases at Birmingham and London Stansted airports, as well as a £10.9m foreign exchange revaluation charge.

Resilient ticket prices and strong demand for leisure-based travel in the first half faded towards the end of the year, leading to heavier discounts. The average ticket price for the year fell by £4.46 to £86.65. Although this drove higher customer volumes, up to 7.1m passengers from 6.1m in the previous year, the operating profit margin fell 1.5 percentage points to 6 per cent. Its distribution and logistics business, Fowler Welch, saw revenue growth of 14 per cent to £163.5m on the back of new contract wins, but a tough market and a bad debt write-off pushed operating profit down by £0.9m to £4.5m.

Analysts at Canaccord Genuity expect pre-tax profit of £74.8m in the year to March 2018, giving EPS of 42.2p, compared with £101m and 58.8p in FY2017.

Despite the fall in profits, the group still managed to increase the dividend. But the tough market conditions and warnings on Brexit are making us nervous. We're taking a more prudent view until we can see that these concerns have been addressed. *JF*

Hold

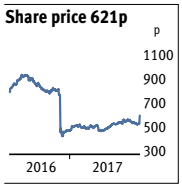
Ord Price: 545 **Market Value:** £808m
Touch: 544-545.5p **12-Month High:** 665p **Low:** 355p
Dividend Yield: 1% **PE Ratio:** 11
Net Asset Value: 291p **Net Cash:** £169m

Year to 31 Mar	Turnover (£bn)	Pre-tax profit (£m)	Earnings per share (p)	Dividend per share (p)
2013	0.87	40.5	21.7	1.87
2014	1.12	42.1	24.7	2.74
2015	1.25	40.2	22.4	3.00
2016	1.41	104.2	60.2	4.00
2017	1.73	90.1	51.8	5.27
% change	+23	-14	-14	+32

Last IC view: Buy, 429p, 18 Nov 2016 | Ex-div: 21 Sep | Payment: 27 Oct

FINANCIAL SERVICES

IG diversifies as regulatory storm builds



There is little spread-betting specialist **IG Group (IGG)** can do about the low level of volatility in the UK and some European markets. This subdued UK sales of leveraged over-the-counter products in the 12 months to May, making them flat on the previous year. Revenue per client was down 7 per cent in its largest market, but the number of active clients rose.

However, management is trying to diversify the business by growing its sharedealing and investment services. The idea is that such services will encourage inactive account holders to resume trading, says Peter Hetherington. That service was rolled out to Australia and France during the period. Sales increased from £0.8m to £2.4m.

While EU operations grew slowly, recently opened offices in Dubai and Switzerland got off to a strong start. In fact, in non-EU offices – where the regulatory environment is more stable – sales almost doubled to £31m. That made the EMEA region the stand-out performer, generating a 17 per cent increase in sales to £138m. The Asia-Pacific region also grew revenue by a solid 9 per cent to £114m.

Numis expects pre-tax profits of £211m during the 12 months to May 2018, giving EPS of 45.4p (from £214m and 45.9p in 2017).

The shares are trading at 14 times forward earnings, a discount to rival CMC Markets (CMCX) at 17 times. With the European Securities and Markets Authority consulting on tighter rules, as well as the UK regulator, there is too much uncertainty to buy in. *EP*

Hold

Ord Price: 621p **Market Value:** £2.28bn
Touch: 621-621.5p **12-Month High:** 968p **Low:** 442p
Dividend Yield: 5.2% **PE Ratio:** 13
Net Asset Value: 200p* **Net Cash:** £231m
*Includes intangible assets of £157m, or 43p a share

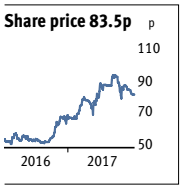
Year to 31 May	Turnover (£m)	Pre-tax profit (£m)	Earnings per share (p)	Dividend per share (p)
2013	398	192	39	23.25
2014	408	195	40.4	28.15
2015	427	170	36.1	28.15
2016	456	208	44.9	31.4
2017	491	214	46.2	32.3
% change	+8	+3	+3	+3

Last IC view: Hold, 531p, 2 Feb 2017 | Ex-div: 28 Sep | Payment: 27 Oct

AIM: SOFTWARE & COMPUTER SERVICES

Ideagen keeps growing top line

Management at **Ideagen (IDEA)** was keen to emphasise the value added by acquisitions made over the full year to 30 April 2017 – not just buying companies for the sake of it, but finding ways to integrate new businesses in a way that enhances their current offering. Revenues for the IT software specialist grew by almost a quarter during the period, which included underlying organic growth of 10 per cent, suggesting that it is not simply inflating its top line via acquisition. But the costs of the strategy meant operating profit fell 30 per cent to £0.7m.



Ideagen is increasingly moving from a licencing model towards a subscription-based model. Progress has already been made, with recurring revenues comprising 57 per cent of Ideagen's total, up from 54 per cent last year. Management expects that this could reach 70 per cent in the medium term.

The four acquisitions made in the period were intended to add intellectual property and recurring revenue, as well as vertical integration, with one such example being Covalent – purchased to add a risk management element to Ideagen's audit management offering Pentana.

Analysts at FinnCap expect £9.7m of pre-tax profit in the year to April 2018, giving EPS of 4.2p, compared with £6.9m and 3.2p in FY2017.

Ideagen has proved that it can grow organically and by acquisition. Its shares aren't cheap at 20 times forward earnings, falling to 18 times in FY2018. But there's net cash on the balance sheet and good forecast top-line growth. *HC*

Buy

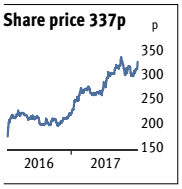
Ord Price: 83.5p **Market Value:** £165m
Touch: 83.0-84.0p **12-Month High:** 98p **Low:** 52p
Dividend Yield: 0.3% **PE Ratio:** 209
Net Asset Value: 23.4p* **Net Cash:** £4.2m
*Includes intangible assets of £56.4m, or 28.5p a share

Year to 30 Apr	Turnover (£m)	Pre-tax profit (£m)	Earnings per share (p)	Dividend per share (p)
2013	6.5	-1.32	-0.87	nil
2014	9.0	1.07	0.72	0.150
2015	14.4	0.61	0.35	0.165
2016	21.9	1.00	0.74	0.183
2017	27.1	0.66	0.40	0.210
% change	+24	-34	-46	+15

Last IC view: Buy, 68p, 26 Jan 2017 | Ex-div: 2 Nov | Payment: 22 Nov

AIM: FOOD & DRUG RETAILERS

Conviviality profits from acquisitions



Integrating acquisitions can be a tough task, but managers at beverage distributor and wholesaler **Conviviality (CVR)** are doing well, judging by these numbers. Last May, the group bought rival wine group Bibendum, after wholesaler Matthew Clark was acquired in October 2015. The successful integration of both companies led to a doubling in profit for the year to April 2017, as well as £6m-worth of cost synergies.

Now, the focus is shifting to organic growth. Last year, like-for-like revenue grew 5.8 per cent, well ahead of the wider market, with a similar growth rate expected by City analysts this year. On that note, trading during the first nine weeks of the new financial year went well. Sales at the major wholesale business were tracking 9 per cent ahead of last year, while festivals and events turnover was up 7.6 per cent. Finally, the retail business has pushed like-for-like revenue up 0.5 per cent, with Wine Rack performing well.

Broker Investec Securities expects pre-tax profit of £53.4m for the year ending April 2018, giving EPS of 24.1p, compared with £45.8m and 21p in FY2017.

Chief executive Diana Hunter says the company's secret of success lies with its "one-stop-shop" model, which both customers and franchisees appreciate. Although the shares have had a good run of late, they still trade on just 14 times earnings. With the earnings upgrade cycle expected to continue, we think this one could have further to run. *HR*

Buy

Ord Price: 337p **Market Value:** £581m
Touch: 335-337p **12-Month High:** 343p **Low:** 180p
Dividend Yield: 3.7% **PE Ratio:** 31
Net Asset Value: 125p* **Net Debt:** 44%
*Includes intangible assets of £285m, or 165p a share

Year to 30 Apr	Turnover (£bn)	Pre-tax profit (£m)	Earnings per share (p)	Dividend per share (p)
2013**	0.37	6.6	na	na
2014	0.36	4.8	6.1	8.0
2015	0.36	9.0	10.7	8.3
2016 (restated)	0.84	9.1	4.6	9.5
2017	1.56	22.5	10.8	12.6
% change	+86	+147	+135	+33

**Pre-IPO figures
Last IC view: Buy, 261p, 30 Jan 2017 | Ex-div: 7 Sep | Payment: 5 Oct

WEEK AHEAD

Monday 24 July

Interims: Ascential, Dialight, McColl's Retail, Microgen, Reckitt Benckiser, SThree
Final: Tungsten Corp
Trading statements: Cranswick, Ryanair
AGMs: Active Energy, Connemara Mining, Cranswick, Mx Oil, Paternoster Resources, Petrel Resources, Prime People, Proxama, Solo Oil, Uvenco
EGM: Proxama
Companies paying dividends: Gabelli Value+ Trust (1.2p), MS International (6.5p), The Mission Marketing (1p)

Tuesday 25 July

Interims: Croda International, Domino's Pizza, Fevertree Drinks, Gresham Technologies, Informa, Pentair, Provident Financial, Rathbone Brothers, Segro, Spectris, Tyman, Virgin Money
Finals: Games Workshop, PZ Cussons
Trading statements: Intermediate Capital, Victrex
AGMs: Acal, Big Sofa Technologies, Fuller Smith & Turner, GB Group, Intermediate Capital, Mediclinic, Mytrah Energy, Volex
EGMs: Centaur Media, DS Smith, Safestore Holdings, Surface Transforms
Economics: CBI business optimism, total orders, selling prices
Companies paying dividends: Coca-Cola (37.93p), Hargreave Hale VCT2 (4p)

Wednesday 26 July

Interims: CNH Industrial, GlaxoSmithKline, Global Graphics SE, Hammerson, Huntsworth, International Personal Finance, GKN, ITV, Jupiter Fund Management, Metrobank, Quartix Holdings, Shawbrook, Staffline, Tarsus, Tullow Oil, Unite
Finals: Joules Group, Van Elle Holdings
Trading statements: 3i, Antofagasta, Brewin Dolphin, Compass Group, Marston's, Paragon Group of Companies, Sage Group
AGMs: Evgen Pharma, Flybe, FreeAgent Holdings, Graphene Nanochem, Halfords, James Cropper, Mitie, Motorpoint, PayPoint, Polar Capital, Vertu Motors
EGM: Monitise
Economics: BBA house purchase loans, GDP (Q2), Index of services
Companies paying dividends: Cardiff Property (4p), Electrocomponents (7.3p)

Thursday 27 July

Interims: Anglo American, AstraZeneca, Bodycote, British American Tobacco, Burford Capital, Countrywide, Dialog Semiconductor, Foxtons, Impellam, Inchcape, Indivior, Intu Properties, Jardine Lloyd Thompson, Just Eat, Lancashire Holdings, Lloyds Banking, National Express, Primary Health Properties, RELX, Rentokil Initial, Royal Dutch Shell, Schroders, Smith & Nephew, St James's Place, Vesuvius, Weir Group
Finals: Angle, Diageo, Renishaw
Trading statements: Britvic, CMC Markets, Daily Mail & General Trust, Hogg Robinson, Kaz Minerals, Ladbrokes Coral Group, Tate & Lyle, Thomas Cook
AGMs: 1Spatial, Aquila Services, Bonmarche Holdings, Caffyns, Charles Stanley, CMC Markets, D4t4 Solutions, Escape Hunt, Hogg Robinson, Immunodiagnostic Systems, Metal Tiger, Norcros, Orogen, Record, Tate & Lyle, Trifast
EGMs: Thor Mining, TP Group
Economics: CBI retailing and total distribution reported sales
Companies paying dividends: Big Yellow (14.1p), Fuller Smith & Turner 'A' Ord (11.55p), JPMorgan Global Emerging Markets Income Trust (1p), Land Securities (11.7p), McKay Securities (6.3p), Netcall (1.05p)

Shareholders in drinks giant **Diageo (DGE)** will be looking to see if the alcoholic beverages company will be able to deliver on its promise of organic revenue growth in the mid single digits when it reports its full-year results next week, along with improvements to margins and cash generation. In May chief executive Ivan Menezes reiterated the company's commitment to improving efficiency, which will allow Diageo to invest more in its key growth brands.

The spirits maker appears to be addressing previous concerns about weak American sales with the June acquisition of George Clooney's tequila company, Casamigos, for $1bn (£0.77bn). The tequila brand sold 120,000 cases in 2016, primarily in the US, delivering a compound annualised growth rate of 54 per cent over the past two years. At the half-year US sales were already showing improvement, with growth in organic operating profit in North America coming in at 6 per cent – double consensus expectations.

Diageo expects the Casamigos deal to be neutral in terms of earnings per share impact for the first three years, but positive thereafter. Consensus forecasts expect the company to deliver £12bn in revenue for the year to June 2017, and pre-tax profit of £3.5bn (FY2016: £2.9bn), equating to adjusted EPS of 105p, according to Bloomberg. At 2,241p, the shares are trading at 22 times expected earnings. We're sticking with a buy. *JF*

Friday 28 July

Interims: Barclays, Berendsen, Equiniti, Essentra, Holders Technology, IMI, International Consolidated Airlines, Laird, Morgan Advanced Materials, Rightmove, UBM
Trading statements: BT Group, Lonmin
AGMs: Amur Minerals, Bellzone Mining, Boxhill Technologies, Diversified Gas & Oil, Gear4Music, Johnson Matthey, MetalINRG, Red Leopard Holdings, RM2 International, ULS Technology, United Utilities, Vodafone
Economics: GfK consumer confidence (July)
Companies paying dividends: Aberdeen Latin American Income Fund (0.875p), Aberdeen Smaller Companies Income Trust (1.75p), Acal (6.05p), BP Marsh & Partners (3.76p), Biffa (2.4p), Bisichi Mining (3p), Braemar Shipping Services (5p), Character Group (9p), Dunedin Smaller Companies Investment Trust (2.15p), Henderson High Income Trust (2.325p), Lowland Investment (12p), Majestic Wines (3.6p), Marwyn Value Investors (2.064p), Octopus Apollo VCT (1.7p), Pacific Industrial & Logistics (3p), Palace Capital (9.5p), Paragon Group of Companies (4.7p), Prime People (3.25p), Ranger Direct Lending (26.93p), Real Estate Investors (0.75p), Renewi (2.1p), Royal Mail (15.6p), Scottish Investment Trust (5.5p), Shires Income (3.75p), St Mark Homes (5.5p), Telecom Plus (25p), Troy Income & Growth Trust (0.65p), UP Global Sourcing Holdings (1.62p), Vianet (4p)

Companies going ex-div 27 Jul

Company	Dividend (p)	Payment
Bankers Investment Trust Ord 25p	4.7	31 Aug
Bilby Ord 10p	1.5	30 Aug
Custodian Reit	1.6125	31 Aug
Fenner	1.4	7 Sep
Investec Ord	0.2p 13	14 Aug
Porvair Ord 2p (new Co)	1.5	1 Sep
Somero Enterprises	10.3	14 Aug
SSE Ord 50p	63.9	22 Sep
System1 Group (special)	26.1	23 Aug
System1 Group	6.4	23 Aug

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STOCK SCREENS



Three safe-yield buys

My safe-yield screen boasts a 151 per cent total return over the past six years compared with 63 per cent from the FTSE All-Share Index

ALGY HALL

After coming a cropper in the wake of the Brexit vote, my safe-yield screen has been back on form over the past 12 months (a 19.4 per cent total return versus 15.7 per cent from the FTSE All-Share). And it's not only the batch of stocks the screen selected this time last year that have shown good poise. My update of the 2015 screen last July happened near the point of maximum Brexit-related pain for its share picks, which made for the first period of 12-month underperformance in the screen's then five-year life (a negative 10.5 per cent total return compared with negative 2.5 per cent from the index). However, since that point, those 2015 shares have almost entirely made up the ground with the FTSE All-Share index (see the buy-and-hold table). That's of some significance to the way I analyse this screen's effectiveness as I believe its selection criteria should be well suited to seeking out long-term holdings. Generally, this has proved to be the case.

Looking at the annualised buy-and-hold performance of the screens run in each of the past six years relative to the FTSE All-Share (see chart), buy-and-hold has been superior to the strategy of jumping from one safe-yield portfolio to the next on the date of publication about half the time. The chart shows annualised numbers for both the raw cumulative performance and the performance once an annual charge of 1.5 per cent is factored in to represent the notional sharedealing cost associated with backing a new set of screen results each year.

The cumulative performance of the screen looks good, although not as good as the result from simply holding the original six share picks from the 2011 screen and reinvesting all the income. The 2011 shares were **John Menzies (MNZS), Clarkson (CKN), Cranswick (CWK), Hiscox (HSX), AstraZeneca (AZN)** and **Beazley (BEZ)**, which between them have managed a 244 per cent total return. The total return from the safe-yield strategy from switching between portfolios each year stands at 151 per cent over the six years, compared with 63.2 per cent from the index or 129 per cent after factoring in the 1.5 per cent charge.

My main concern – aside from the role of luck – with the screen's ability to sustain its strong run is the same as it was last year; namely, the potential end of the low interest-rate environment that has increased the attraction of reliable high-yielding shares. On this front, some comfort can be taken from recent signs that the Federal Reserve could soften its stance on monetary tightening due to persistently weak inflation data, especially wage inflation. However, valuations for the market as a whole are very high by historic standards, so there remain reasons to be worried. That said, an average forward earnings multiple for the six stocks passing all the screen's tests is relatively modest at 14.

The screen itself is not that imaginative. It looks for a decent dividend that looks well supported by fundamentals and appears to offer growth prospects. It also looks for stocks with low betas, which is a measure of how sensitive a share price has historically been to

2016 performance

Name	TIDM	Total Return (11 Jul 2016 - 10 Jul 2017)
Polypipe	PLP	61%
Marshall	MSLH	58%
Savills	SVS	46%
Smurfit Kappa	SKG	45%
Moneysupermarket.com	MONY	42%
EasyJet	EZJ	37%
Taylor Wimpey	TW.	36%
Headlam	HEAD	29%
Cineworld	CINE	29%
Bovis Homes	BVS	28%
Computacenter	CCC	22%
Photo-Me Int	PHTM	21%
Restaurant Group	RTN	17%
Big Yellow	BYG	11%
Lookers	LOOK	6.7%
PayPoint	PAY	6.1%
ITV	ITV	1.4%
Dairy Crest	DCG	1.4%
Novae	NVA	-4.2%
KCOM	KCOM	-14%
BT	BT.A	-25%
Dunelm	DNLM	-28%
FTSE All-Share	-	16%
Safe Yields	-	19%

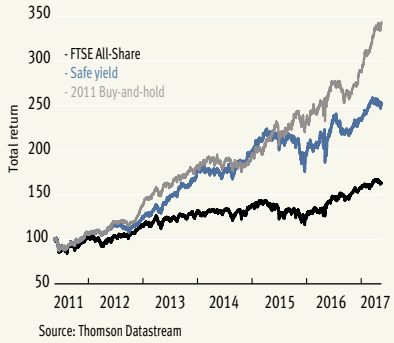
Source: Thomson Datastream

Buy-and-hold performance of safe-yield screens

Buy and hold from	FTSE All-Share	Safe yield
July 16	15.7%	19.4%
July 15	17.3%	16.6%
July 14	24.0%	70.0%
July 13	32.9%	151%
July 12	63.7%	95.4%
July 11	63.2%	244%
Cumulative	63.2%	151%
Cumulative (1.5% pa chg)	63.2%	129%

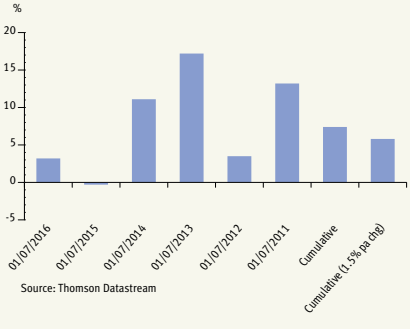
Source: Thomson Datastream

Safe-yield vs FTSE All-Share



Source: Thomson Datastream

Safe yields, buy-and-hold annualised out/underperformance



Source: Thomson Datastream

Safe-yield shares for 2017 – Full marks

Name	TIDM	Market cap	Price	Fwd NTM PE	Dividend yield*	Fwd EPS grth FY+1	Fwd EPS grth FY+2	3-mth momentum	Net cash/ debt (-)
Telecom Plus	TEP	£853m	1,092p	20	4.4%	4.2%	18%	-12%	£19m
Jupiter Fund Mgmt	JUP	£2.3bn	515p	15	5.3%	12%	4.1%	15%	£337m
Playtech	PTEC	£3.0bn	942p	13	3.1%	39%	7.4%	1.2%	€79m
WPP	WPP	£20bn	1,559p	12	3.6%	11%	6.6%	-10%	-£4.1bn
Babcock International	BAB	£4.3bn	850p	10	3.3%	4.8%	6.7%	-2.6%	-£1.4bn
Inchcape	INCH	£3.1bn	757p	12	3.1%	9.7%	5.1%	-11%	-£352m

Source: S&P CapitalIQ *Includes special dividends

wider market movements. A low beta is often regarded as an indicator that a company's business may have defensive qualities – ie, be less sensitive to the economic cycle.

- Dividend yield of at least 3 per cent.
- Dividend cover of at least two times.
- Interest cover of at least five times.
- Dividend growth in each of the past three years.
- Forecast earnings growth in each of the next two financial years.
- An average return on equity over the past three years of at least 12.5 per cent.
- Cash conversion (measured as cash from operations as a percentage of operating profit) of over 100 per cent.
- A market capitalisation of at least £250m.
- Beta of 0.75 or less.

Six shares have passed all the screen's tests and I've taken a closer look at three.

TELECOM PLUS

Over recent years **Telecom Plus (TEP)** has struggled to grow its business, but it has not struggled to pay its dividend. Despite expectations of muted profit growth in the financial year to the end of March 2018, the company has stated that it intends to lift its dividend payout to 50p, equivalent to a 4.6 per cent yield.

Telecom Plus operates a buyers club for its customers that tries to get them a better deal on a range of bills. The biggest part of the business is energy and this is where the company has run into problems. Having locked in a long-term deal to keep prices below those set by the big six, it has seen new entrants to the market undercut its offers as they've attempted to exploit falling wholesale prices. However, a number of these companies have started to struggle and prices are heading back up, which should make it easier for Telecom Plus to compete and win more business.

While waiting for the energy market to get back to a more 'normal' state, Telecom Plus has been busy trying to find ways to pep up growth. It has changed the way it incentivises distributors, which is expected to weigh on profits this year – but has led to more customers taking on more of its five established services (gas, electricity, mobile, broadband and landline). The more services customers take, the more profitable they are and the longer they tend to stay with the company. Telecom Plus has also been looking at new markets to move into and has recently entered home insurance. It has also reduced its plans to return cash following the sale of a subsidiary from £70m to £25m to give itself more firepower to pursue opportunities.

The balance sheet is strong and the dividend is supported by solid cash generation. While the earnings multiple does not scream value, the yield should provide good support for the share price, and if customers start flocking to the company once more, there could be good upside.

Last IC View: Buy, 1,227p, 14 June 2017.

PLAYTECH

If a lack of customer growth is a key reason behind the attractive dividend yield on offer from Telecom Plus, the same cannot be said of safe-yield share pick **Playtech (PTEC)**. However, while the net cash position and current strong trading mean the yield looks well underpinned, some readers are likely – for good reason – to take issue with the tag 'safe' being applied to this company.

Israeli gaming technology provider Playtech is benefiting from growth in its end markets and is also expanding through acquisition. The strategy has served it well, but the shares' rating hardly reflects the growth on offer. The key reason for this is that there are aspects to the business that make investors uneasy. The gambling business, which represents over 90 per cent of revenue, serves many unregulated markets. The possibility that new, tough gambling laws will be introduced in these jurisdictions creates uncertainty about revenues. Meanwhile, the group's move into the contracts for difference (CFD) market has been overshadowed by the Financial Conduct Authority's (FCA) desire to clamp down on the practices of this industry, where investors run the risk of making potentially ruinous losses in ultra-quick time.

However, Playtech continues to increase the proportion of its gambling sales that are regulated and it has the scale and experience to make the best of any new rules that are introduced. Management believes the changes in the CFD market could play to its advantage by creating new barriers to entry to smaller operators. Again, its scale and experience in handling compliance should play to its advantage. In fact, smaller rivals that struggle to adapt to new regulations could prove good pickings for acquisition.

The shares are priced on an earnings multiple that is below that of peers. While the risk factors go some way towards helping explain this, such concerns should be countered to some extent by the fact that contracts with nine out of 10 of its current technology licensees are long term, and the group has a wide geographic spread. What's more, a problem contract with Sun Bingo has recently been performing better than brokers had expected, which provides some additional reassurance.

Last IC View: Buy, 886p, 23 February 2017.

INCHCAPE

Not all that long ago car dealers were basking in the glory of soaring new car sales and the prospect of a boost to higher-margin aftersales work further down the line. But the mood has changed to one of trepidation in recent years. The financing deals that helped boost high car sales, so-called personal contract purchase (PCP) arrangements, are now seen as a potential risk to both the lending and car industries.

PCP loans work by providing financing for a car purchase with the guarantee that the vehicle can be sold back at an agreed minimum price later. Historically, cars have usually been sold back above the minimum, which provides a nice downpayment for a spanking new set of wheels funded with a new PCP. The fear is that the popularity of these deals is leading to a glut of nearly new cars, falling prices, losses for those holding PCP loans backed by questionable collateral, and ultimately an unseemly end to the party.

While this gloomy scenario has the potential to hit both **Inchcape's (INCH)** new and used car businesses, the group should be somewhat protected from any fallout by its international diversification. That said, there are grounds to worry that its most recent international foray could cause headaches. Last December it paid £234m for a large dealership chain in South America. At the time, general expectations for an ongoing recovery in commodity prices were higher than they are today and the link between the region's economies and commodities means the acquired business may face tougher than expected trading.

All these worries aside, though, the group's most recent trading update in March was encouraging and led to modest analyst upgrades

Last IC View: Buy, 796p, 9 March 2017.



The National Living Wage and increasing business rates are two of the difficulties the pubs sector faces

Pub companies' great cost challenge

Pub operators are looking to insulate their margins from rising costs

JULIA FAURSCHOU

A stroll through central London on any given night would give the impression that pubs are thriving as punters pile out onto the streets with a pint. A survey by the Office for National Statistics (ONS) last year found that a visit to the pub was the most popular leisure activity in the UK, with more than a third of respondents having visited one within the week. In 2016, of the £201 the average British household spent on leisure outside the house each month, £46.22 of this was spent on drinking while £86.57 was spent on eating. Over the past five years, spending on eating and drinking out has increased by 21 per cent. Now, as price inflation coupled with lack of wage growth begins to squeeze on incomes, pub companies are hoping that UK consumers will still prioritise little luxuries such as a trip to a pub in place of more extravagant treats.

Despite pub trips being the most popular leisure activity of late, it hasn't entirely been smooth sailing. The pub groups are beginning to suffer a headache of their own as a wave of cost pressures start to weigh on margins. Business rates are undergoing the first revaluation since 2010, and those pubs in London are set to see the highest spike in rates paid. The National Living Wage also came into effect over a year ago and, as of April 2017, has brought the minimum amount that staff can be paid to £7.50 per hour for those aged 25 and over. Meanwhile, companies with a wage bill of more than £3m will have to pay a levy of 0.5 per cent of gross wages each month.

Adding to the cost burden is the introduction under the new Pubs Code of the ability to break the 'beer tie', which previously saw big pub companies supply beer and supplies exclusively to the landlords that lease their properties. The beer tie makes it easier for more pubs to open and stay open; instead of having to buy a property outright, landlords can lease a location from an existing pub group. Under the agreement, the parent company then supplies drinks, furniture, glassware, and other necessary supplies, and economies of scale allow this to happen at a lower price. In exchange for this easier arrangement, pub landlords cannot order beer from any other suppliers, even if it is cheaper. If a landlord does decide to break the beer tie, their contract would then shift to a 'market rent only' (MRO) option where they pay the pub company rent to use the location but are not obligated to order their supplies. The pub company may choose to increase the rent on tenants who break the beer tie as a way to make up for lost income from supplies.

Cost pressures

JD Wetherspoon's chairman Tim Martin is never one to mince his words. At the preliminary results Mr Martin called the tax disparity between supermarkets and pubs the "biggest danger" to the pub industry. Under new regulation, the company is set to see higher costs in the second half of the year as business rates increase costs by £7m, electricity taxes by £4m, excise duty by £7m, and the apprenticeship levy by £2m. The company was largely unaffected by the living wage since it had increased employee pay before the changes came into effect. So far the margin has been insulated by some price increases and the disposal of less profitable pubs, but the price-sensitive nature of the typical Wetherspoons punter could make shareholders nervous.

"Unprecedented cost pressures" face **Fuller, Smith & Turner (FSTA)**, according to chief executive Simon Emeny. Business rates are expected to add £2m to costs next year. The company has launched a number of events to keep customers coming in the doors of their pubs, including a *Shakespeare in the Garden* programme, a competition to win a pub for a day, and sharing photos on social media to whet appetites. A shift to higher-margin beers has also partially helped Fullers offset higher costs. To avoid any staff shortages post-Brexit the company is covering the cost of applying for a permanent residence card for any EU nationals who have worked for the company for at least a year.

Greene King (GNK) is leaning on its scale and cost efficiencies to mitigate higher costs. The company bought Spirit Pub Company in 2015 and completed its integration of the business a year early, which resulted in cost synergies of £35m mainly through overheads, purchasing and distribution. With locations all over the UK, the geographic spread of its pubs should also help to insulate it from a downturn. Although the company is expecting cost inflation of around £60m over the next year, it's already managed to find ways to account for between £40m and £45m of that sum.

Marston's (MARS) is combating added costs and increased competition by making acquisitions to boost its market share. In May

it bought the Charles Wells Brewing and Beer Business for £55m in an effort to increase its presence in London and the south east and to potentially expand into Scotland. The company has also deliberately targeted new openings in areas of relatively limited competition and curbed costs through long-term relationships with suppliers and fixed price contracts to actively manage the risk to margins.

Added costs hurt margins at **Mitchells & Butlers (MAB)** during the six months to April 2017, as the adjusted operating margin fell from 14.2 per cent to 13.3 per cent. In order to avoid a further squeeze, the company said it is encouraging customers to trade up to pricier options for a more "premium experience", as well as putting pressure on general managers at individual locations to better manage costs. The company has also taken action on pricing, but has still managed to cut prices in some areas while increasing in others.

In the last set of results management at **Young & Co's (YNGA)** hinted that it may have to put through some price increases to offset higher costs and mitigate the impact on margins. While they recognised that this could be off-putting to some customers, they figured that if people are getting paid more under the new wage requirements they could be more willing to spend. The company has also emphasised that it has negotiated some fixed-price arrangements with food and drink suppliers, and have even been looking at ways to decrease the amount of electricity and other utilities they use in an effort to cut costs.

Break the beer tie

The impact of tenants opting to break the beer tie in favour of the MRO option will be felt by pub companies for a number of years to come as pub landlords choose to go on their own as scheduled rent reviews roll around. For now it appears that this issue is being downplayed by a number of the pub companies as they emphasise the cost benefits of landlords sticking with them, but not all have been immune.

EI Group (EIG) stated at its half-year results that it now operates 2,184 long-term lease agreements, down by 851 since the ability to break the beer tie was announced in 2014. Management said that it expects rent reviews taking place every five years to be the trigger for landlords to opt for MRO. Of the 499 rent reviews that have so far taken place, 171 MRO offers have been made, and four of those have concluded with a free-of-tie arrangement. The group has also done well to sell off pubs that it feels are underperforming, with net proceeds from disposals of £65m in the six months to March.

Some pub groups have been largely immune to the new code so far. Greene King reported at the full-year stage that none of its licensees have chosen to break the beer tie. At the half-year stage in May, Marston's chief executive Ralph Findlay said the code shouldn't have a material impact on the company as only around 11 of its pubs are tenanted and leased, of which only a "handful" have opted for MRO.

As inflation and sluggish wage growth begin to weigh on spending power, consumers may be tempted to put off larger purchases or extravagant holidays in favour of smaller, more affordable luxuries. Pub companies are hoping that a pint or a meal out will still factor into budgets. The most recent Coffer Peach tracker, which looks at casual dining market data, saw like-for-like sales up 0.6 per cent nationally during June, with a particularly strong performance from pubs in London. The most significant increase to business rates will be in London, and so particularly strong performance in the capital could help companies offset the higher cost. Pub and bar groups saw collective comparable sales up 1.1 per cent in June, while casual dining restaurant chains fell by 0.2 per cent. If costs are managed sensibly, we still think there is reason to be bullish on areas of the pub sector.

Favourites

Fuller, Smith & Turner is a stalwart in the pubs sector. It continues to deliver revenue growth year after year and increase its dividend, and at 17 times earnings the shares look reasonably priced compared with their own history. We also like that Marston's appears well insulated from the effects of the beer tie and has intentions to make further acquisitions. At nine times forward earnings, the stock looks cheap compared with the sector average.

Outsiders

The price sensitive nature of the typical JD Wetherspoon customer has us nervous that price increases may not go down so well, sending customers to the supermarket for a cheaper alternative. With shares trading around 18 times forward earnings it looks expensive compared with peers. Mitchells & Butlers has a plan to get customers to buy more premium products, but it's a risky one, especially as consumer confidence falls, which could add more pressure onto the already squeezed margin.

THE BROKER'S VIEW

National living wage, one year on

A recent acceleration in cost of living expenses means that discretionary disposable income is declining for the first time since 2013. As essential item inflation heads towards 3 per cent, we expect discretionary income to start to decline in the second half of the year, putting pressure on sector trading. Notably, households in the bottom two quintiles are already experiencing declines (-15 per cent and -6 per cent respectively) perhaps evidenced by slower retail sales and the weak Coffer Peach tracker over Easter (-3.8 per cent).

Following the introduction of the National Living Wage in April 2016, pub/restaurant companies have been adjusting to the reality of 5 per cent wage inflation. April 2017's increase leaves the National Living Wage at 60 per cent of average sector wages, increasing the 'bite' of each successive increase. Furthermore, labour market data for 2016 shows that average wages in the sector grew by over 6 per cent even for those workers already earning above the minimum. This confirms that differentials play an important part in setting sector wages. Updating our cost model, we expect the National Living Wage to reach 865p by 2020.

Most operators have responded by increasing labour efficiency, automating scheduling and looking for offsetting cost savings elsewhere. Most acknowledge that such savings will become incrementally more difficult, meaning that price rises could be the only way to protect profits and margins in the medium term. There is some evidence of success on this front: consumer prices in the restaurants/cafes category are running at +2.8 per cent compared with 1.7 per cent one year ago. However, the Peach sector index is moving oppositely, 1 per cent in the first quarter from 3 per cent last year, suggesting that footfall is relatively volatile for the sector in aggregate.

Tim Barrett, head of travel and leisure research at Numis Securities

AIM: PHARMACEUTICALS & BIOTECH

Horizon Discovery buys from General Electric

MEGAN BOXALL

Horizon Discovery (HZD) – one of Britain's brightest companies in the rapidly expanding world of gene editing – is bulking up. The group has announced the proposed acquisition of gene modulating company Dharmacon (which is currently owned by General Electric) for $50m in cash (£39m) and $35m in new shares.

In order to fund the $50m cash element of the acquisition, Horizon has also announced that it is returning to the market to raise £80m gross – almost half its current market capitalisation – via the placing of 39m shares at 205p. The remaining proceeds from the fundraising will be used to boost the group's cash reserves, which were worryingly depleted at just £6m at end 2016. Following the acquisition, a subsidiary of GE will own 9 per cent of the enlarged group.

Despite the forthcoming dilution from the placing and issuance of new equity to GE, investors reacted well to this announcement. Dharmacon is profitable and expected to be earnings accretive, which is certainly good news for the group's plans to turn a profit by the end of the current financial year. But this is a mountain of an acquisition and the risks involved in the integration leave us at hold at 237p.

OPEN OFFERS

TP Group (TPG)

Announced	10/07/17
Last payment	21/07/17
Total amount raised	£3.9m
Terms	1:7
Issue price	6.5p
Market price	7p
Adjustment factor	na

The specialist engineer, which is engaged, among other things, in the provision of clean air systems for Royal Navy submarines, is to raise up to approximately £23.9m, in aggregate, by a placing of 308m ordinary shares at 6.5p each (generating £20m), together with up to 60.35m shares under a 1:7 open offer. The funds will be used primarily to fund acquisitions with the potential to grow the business to achieve targeted annual revenues in the range of £90m to £100m in 2020. **Take up.**

TAKEOVERS

Target	Bidder	Terms	Value	Closing date
Berendsen Support services	**Elis SA** Support services	*	£2.17bn	tba

*540p cash per share and 0.403 new Elis shares, excluding an 11p dividend. European textile rental group Elis first made its intentions for its smaller UK peer known in April. Since then management at Berendsen has rebuffed two takeover offers before recommending this approach, which values the shares at a 44 per cent premium to the share price before the first takeover attempt. **Await documents**.

Booker Wholesaler	**Tesco** Supermarket	*	£3.7bn	tba

*42.6p cash per share and 0.861 new Tesco shares. This recommended offer – a 12 per cent premium to Booker's share price on the day prior to the announcement – has been referred to the Competition and Markets Authority (CMA). The CMA recently announced an in-depth competition probe that could delay approval until December. **Await documents**.

Cape Oil equipment & services	**Altrad Investment Authority SAS** Construction equipment	265p cash per share	£332m	tba

The offer, which has the backing of Cape's directors, represents a 46 per cent premium to its closing price on the day prior to the announcement, or a 31.4 per cent premium based on its average closing price (202p) over the previous 12 months. Altrad has already received acceptances amounting to 22.1m shares, equivalent to 18.2 per cent of Cape's issued capital. **Await documents**.

Electric Word Sports media	**Sport Business Acquisitions** Bidco	3.93p cash per share	£16.58m	28/07

Electric Word has chipped away at its portfolio, which now just comprises Sports Business Group – a service provider to the sports media market. The Bidco – founded and financed by Riccardo Silva and Marco Auletta, who both have experience in sports media – has targeted the company for its potential growth. The offer is a 16 per cent premium to the target's share price on the day before the offer was made and has already received approval from more than the 75 per cent of shareholders. **Accept**.

Kennedy Wilson Europe Real estate	**Kennedy Wilson** Real estate	*	£1.5bn	tba

*0.667 new Kennedy Wilson (KW) shares for each Kennedy Wilson Europe (KWE) share, or 0.3854 new shares and 300p in cash. A cash and shares option has been added to this offer. The new option implies a share price of 1,145p, up on the original offer of 1,030p. KWE's share price responded well to this update, but we await the scheme documents before making a judgement on the most attractive option. **Await documents**.

Monitise Financial services	**Fiserv** Financial services	2.9p cash per share	£70m	24/07

Shares in Monitise – an Aim-traded financial services technology company – have suffered in the economic and political turbulence of late. US headquartered Fiserv has therefore jumped on the chance to increase its own portfolio of services with this all-cash offer, which values the shares at a 26 per cent premium to the closing price on the day prior to the announcement. **Accept**.

Novae Non-life Insurance	**Axis Capital** Insurance services	700p cash per share	£467.6m	tba

The recommended cash offer, implemented via a Scheme of Arrangement, represents a 20 per cent premium to the mid-market price of 581p on the day prior to the offer, implying a multiple of 1.5 times Novae's net book value as at the end of 2016. **Await documents**.

Sky Media	**21st Century Fox** Media	1,075p cash per share	£11.7bn	tba

This recommended offer has now been reviewed by Ofcom and been referred to the European Commission. **Await documents**.

Touchstone Innovations Investment services	**IP Group** Investment services	*	£490m	15/09

*2.2178 new IP Group shares in exchange for each Touchstone share. IP Group recently upped its offer which values Touchstone at 304p a share – a 10 per cent premium to the closing price on the day before the announcement. The offer remains below the target's net asset value of 312p a share but as the majority of the target's shareholders also own IP Group, this looks like a done deal. **Accept**.

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DIRECTORS DEALINGS

BUYS

Company	Director	Date	No. of shares	Price (p)	Value (£)	Holding (shares)	Holding (%)
Apax Global Alpha	Chris Ambler	11 Jul 17	6,553	152.588	9,999	6,553	0.001
CAP-XX*	Bruce Grey	7 Jul 17	150,611	8.724	13,139	4,069,665	1.366
CAP-XX*	Patrick Elliott (ch)	7 Jul 17	150,611	8.724	13,139	5,897,847	1.979
Chaarat Gold	Martin Wiwen-Nilsson	12 Jul 17	30,000	18.5	5,550	9,842,857	2.798
Christie	David Rugg (ce)	10 Jul 17	9,835	91.5	8,999	2,827,844	10.660
Concha	Chris Akers (ch)	6 Jul 17	1,000,000	0.174	1,740	1,000,000	0.062
Concha	Chris Akers (ch)	6 Jul 17	1,000,000	0.1799	1,799	2,000,000	0.123
Concha	Chris Akers (ch)	6 Jul 17	1,000,000	0.19	1,900	3,000,000	0.185
Concha	Chris Akers (ch)	6 Jul 17	2,000,000	0.2	4,000	5,000,000	0.308
Diageo	J Ferrán (ch)	10 Jul 17	362	2285	8,272	33,685	0.001
Dunelm	John Browett (ceo)	12 Jul 17	9,098	546.5	49,721	64,128	0.032
Fenner	Michael Ducey	12 Jul 17	58,150	335	194,803	86,450	0.045
Fenner	Christopher Surch	12 Jul 17	5,945	334	19,856	12,773	0.007
GLI Finance	John Whittle	10 Jul 17	76,800	12.95	9,946	104,550	0.034
Hogg Robinson	Paul Williams	10 Jul 17	25,000	69.75	17,438	185,000	0.057
Kodal Minerals	Robert Wooldridge (ch)	6 Jul 17	26,520,195	0.2825	74,920	76,938,144	1.230
Norman Broadbent	Mike Brennan (ceo)	6 Jul 17	25,000	13.5	3,375	666,315	1.600
Northgate	Claire Miles	11 Jul 17	5,000	427.59	21,380	5,000	0.004
Phoenix Global Mining	Dennis Thomas (ceo)	12 Jul 17	250,000	3.66	9,150	10,651,870	4.636
Produce Investments	Robert Johnston	7 Jul 17	10,000	182.5	18,250	30,000	0.111
Rolls-Royce	Ian Davis (ch)	7 Jul 17	215	919	1,976	44,102	0.002
Rolls-Royce	Ruth Cairnie	7 Jul 17	211	919	1,939	12,899	0.001
Rolls-Royce	Frank Chapman	7 Jul 17	431	919	3,961	25,361	0.001
Rolls-Royce	Kevin Smith	7 Jul 17	287	919	2,638	22,888	0.001
SDX Energy	David Richards	10 Jul 17	5,469	45.97109	2,514	953,000	0.510
SDX Energy	David Richards	11 Jul 17	7,000	42.90635	3,003	960,000	0.514
SDX Energy	Paul Welch (ceo)	12 Jul 17	35,000	45	15,750	659,247	0.353
SDX Energy	Paul Welch (ceo)	12 Jul 17	50,000	44.7	22,350	624,247	0.334
Safestay	Michael Hirst	10 Jul 17	50,000	52	26,000	50,000	0.146
Schroder Oriental Income Fund	Fergus Dunlop	12 Jul 17	12,142	251.2	30,501	12,143	0.005
Sound Energy	James Parsons (ceo)	6 Jul 17	53,158	47.02	24,995	1,721,187	0.236
Sound Energy♥	Marco Fumagalli	6 Jul 17	200,000	49.581	99,162	67,217,162	9.215
Sound Energy♥	Marco Fumagalli	7 Jul 17	200,000	51.308	102,616	67,417,162	9.243
Tatton Asset Management	Lothar Mentel	6 Jul 17	65,614	156	102,358	463,419	0.829
Tharisa	Antonis Djakouris	7 Jul 17	43,250	83.644	36,176	43,250	0.017
UIL	David Shillson	10 Jul 17	4,593	172	7,900	50,838	0.056
UIL	Warren McLeland	10 Jul 17	4,593	172	7,900	38,227	0.042
UIL	Alison Hill	10 Jul 17	4,593	172	7,900	14,348	0.016
VPC Specialty Lending Investm'ts♥	Richard Levy	6 Jul 17	71,916	82.75	59,510	1,652,558	0.439
Victoria Oil & Gas	Ahmet Dik (ceo)	10 Jul 17	9,220	55.47	5,114	938,749	0.849
Victoria Oil & Gas	Ahmet Dik (ceo)	11 Jul 17	10,000	56.25	5,625	948,749	0.858
Victoria Oil & Gas	Andrew Diamond (fd)	6 Jul 17	8,800	56.5	4,972	12,800	0.012
Victoria Oil & Gas♥	Kevin Foo (ch)	7 Jul 17	25,000	54.3	13,575	2,257,638	2.042
Zenith Energy	Andrea Cattaneo (ceo)	6 Jul 17	100,000	8.25	8,250	2,047,485	1.756
Zenith Energy	Andrea Cattaneo (ceo)	6 Jul 17	100,000	8.719	8,719	2,147,485	1.842
Zenith Energy	Andrea Cattaneo (ceo)	7 Jul 17	100,000	8.85	8,850	2,247,485	1.911

SELLS

Dixons Carphone	Andrew Harrison	10 Jul 17	1,000,000	278	2,780,000	4,281,745	0.371

*Placing/tender/open offer ♥Spouse/connected party

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Dixons deputy sells down

HARRIET RUSSELL & MARK ROBINSON

We noted in February that **Dixons Carphone (DC.)** chief executive Seb James and chief financial officer Humphrey Singer had offloaded shares in the electricals retailer to the tune of £951,300 and £630,000 respectively. Now deputy chief executive Andrew Harrison has also chosen to garner close to £2.8m via the sale of 1m shares in July.

In light of price inflation and slow wage growth in the UK, the fortunes for companies such as Dixons Carphone look precarious. At the moment, however, the company appears to be benefiting from a natural hedge against the weak pound via its European operations, allowing for a 47 per cent improvement in pre-tax profits last time around.

At 266p, the shares are trading on just eight times forward earnings. But rather than being a value-based opportunity, we reckon that could be the market's way of demonstrating nerves over a future deterioration in discretionary spending. We remain neutral. Hold. *HR*

Fenner insider's profession of faith

Dealing activity by insiders remains subdued, reflecting the close periods ahead of the main half-year reporting season. **Fenner (FENR)** reports its full-year figures in November, so two non-executive directors, Michael Ducey and Chris Surch, have been building their positions in the Yorkshire-based engineer.

Michael Ducey was only appointed to the board in January, but has already amassed 86,450 shares in the group. His latest outlay amounted to £194,503, perhaps unsurprising given this month's trading update that revealed operating profit "comfortably ahead of previous expectations".

Fenner manufactures industrial belts, seals and other specialist components, including conveyor systems for mines and grain silos, but the group has singled out the strengthening revenue from the medical businesses within its advanced engineered products division as encouraging. The group is also seeing a step-up in orders linked to the oil and gas industry, as capital budgets start to recover.

At 357p, shares in the group trade at 19 times forecast earnings and are 25 per cent up on our January buy call. Management has achieved much over the past year, boosting margins and cash flows, and we remain positive for the group's prospects – but we think the market is now up to speed on our value call. Back to hold. *MR*

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*Alternative Investment Market †Overseas shares

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