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SHARES

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CAN ROBOTS RESCUE RETAIL?

HOW THE APPLICATION OF AI IS TRANSFORMING THE INDUSTRY

PLUS

WHAT HAPPENS NEXT FOR HOLDERS OF **WOODFORD FUNDS?**

HOW MUCH CAN YOU MAKE FROM **DOWNSIZING PROPERTY?**

WHY YOU SHOULD BUY MARSTON'S FOR **A 7% YIELD**

Helping children to develop important money skills

A new financial education scheme could play an important role in producing the next generation of investors

Last week I attended a social gathering where a five-year-old boy was commanding the attention of a large group of people. He was asking them to perform magic tricks which inevitably resulted in a coin appearing behind someone's ear or underneath their foot.

The audience were scrambling around for loose change and the boy was screaming with joy at his ever-increasing pile of money.

The eagerness of the benefactors to part with cash wasn't the biggest surprise, neither was the amount of money bestowed upon the boy – a rather impressive £14.27. Instead, the key point that took me by surprise was how quickly the child was able to sift through the coins and add them up without hesitation. His numeracy skills were very impressive for someone of his young age.

Earlier that day I was standing in line at a convenience store while another child, of slightly older age, tried to buy a magazine costing £3.99. He only had £2 to spend. Other children in his group pointed out that he didn't have enough money yet he just stood still, saying 'but I really want it'.

Both these situations highlight examples of how children begin to interact with money and develop the necessary skills to understand how money can be used. They would be perfect case studies to use in schools to help children contextualise different situations when they need to be able to work out how much money they have, and how far it will go.

That's topical because next week sees an initiative in England aimed at getting four to 19-year olds excited and interested in financial matters. My Money Week provides resources to schools to get children engaged in the subject matter and not make it seem like a maths lessons.

Primary pupils will explore spending and saving, while secondary students will look at borrowing, peer pressure and value for money.

HOW DOES THIS RELATE TO INVESTING?

The path becoming a good investor starts with a sound understanding of how money works and initiatives such as My Money Week have to be applauded.

Pocket money may be one of the first ways a child experiences having their own cash and many families ask their children to do chores to help earn this money. The next step is to get them to open a savings account which older children can often manage themselves.

But if you want to engage children in the world of investing from a young age it is worth exploring Junior ISAs and encouraging them to help pick the stocks that may sit in the portfolio.

Children often respond well to the concept of investing if you tell them they've become part owners of a business. In my own children's case they are particularly excited about having an investment in a fund which owns a stake in the biggest peanut butter maker in the US.

Involving children in financial matters can be done effectively if the conversation or event is linked to things that interest them or affect them on a day-to-day basis. By talking to them on their own level you can make money matters easier to understand and ultimately you are 'investing' in their future.

By **Daniel Coatsworth** Editor

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

In Japan you need to look past the noise.

LET'S TALK HOW.

FIDELITY JAPAN TRUST PLC

With over 3,500 listed companies, there's a lot of financial noise on the streets of Japan. That can be deafening to untrained ears.

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PAST PERFORMANCE

	Apr 14 – Apr 15	Apr 15 – Apr 16	Apr 16 – Apr 17	Apr 17 – Apr 18	Apr 18 – Apr 19
Net asset value	**28.5%**	**13.4%**	**16.0%**	**33.3%**	**-2.3%**
Share price	**25.8%**	**4.1%**	**24.2%**	**40.3%**	**-2.3%**
TSE TOPIX Total Return Index	**29.3%**	**4.2%**	**24.3%**	**15.5%**	**-3.2%**

Past performance is not a reliable indicator of future returns.
Source: Morningstar as 30.04.2019 bid-bid, net income reinvested. ©2019 Morningstar Inc. All rights reserved. The TSE TOPIX Total Return Index is the comparative index of the investment trust.

So if the growth prospects of the world's third-largest stock market sound appealing, listen to your instincts and discover more about Fidelity Japan Trust PLC.

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Fidelity™ INTERNATIONAL

What happens next for holders of Woodford funds?

We explain how investors are affected by a fund suspension and an investment trust sell-off

Investors in several funds managed by Neil Woodford have been dealt a blow over the past week.

Firstly, dealing was suspended in **LF Woodford Equity Income Fund (BLRZQ62)** on 3 June after an increased level of redemptions.

Anyone invested in the fund will temporarily not be able to sell. The suspension has been done to protect investors and give Woodford time to rejig the portfolio to hold more liquid investments.

Secondly, shares in investment trust **Woodford Patient Capital Trust (WPCT)** fell sharply on 4 June. This reflects concerns that the value of holdings in LF Woodford Equity Income, some of which are also held in the investment trust, will be negatively affected should they be sold off by the income fund.

There are also fears that the income fund might sell some or all of its holding in the Patient Capital Trust, of which it owns 9%.

WHY CAN'T I SELL MY INVESTMENT IN THE EQUITY INCOME FUND?

A sizeable number of redemptions from the fund and setbacks with numerous holdings have seen its assets slip from around £10bn to less than £4bn in the past two years. The loss of key client earlier this month, reported to be Kent County Council, appears to have been the final catalyst to make changes, hence the suspension.

As this is an open-ended fund, if investors are selling or redeeming their holdings then assets need to be sold to pay these investors.

Because the fund holds a relatively large proportion of unquoted investments which are not as easy to sell, the asset manager has had to offload the more liquid quoted equities in the portfolio.

This creates something of a vicious circle and is why trading has been suspended to protect current holders in order to rebuild the proportion of more liquid holdings.

WHEN WILL THE SUSPENSION BE LIFTED?

We don't know exactly when dealing in the fund will resume although the asset manager has promised to keep holders informed. We do know that a review must happen every 28 days.

Head of active portfolios at AJ Bell Ryan Hughes says: 'Woodford has indicated that they will be looking to reposition the portfolio away from illiquid holdings during the suspension and therefore investors may have to be patient for the fund to reopen.'

WHAT ABOUT WOODFORD'S OTHER FUNDS?

Both Woodford Patient Capital and **LF Woodford Income Focus (BD9X6D5)**, another fund in the Woodford stable, continue to operate normally. However, Woodford Patient Capital has seen its shares suffer double-digit falls in the wake of the income fund's announcement.

Winterflood Securities says: 'We have concerns that the structural difficulties being experienced by the open-ended fund could have a negative impact on the net asset value, share price and rating of Woodford Patient Capital.'

Card Factory is among the stocks being sold down in Woodford funds

WHY DOES THE STRUCTURE OF THE FUND MATTER?

Investment trusts are closed-end funds and trade on a stock exchange. Any investor seeking to exit an investment trust like Woodford Patient Capital will sell to another investor, rather than asking the asset manager to redeem their shares as per the open-ended income fund.

For this reason, investment trusts are often seen as being more suited to holding illiquid assets than open-ended funds. A rush from investors wanting to sell will only affect the share price and not force the fund manager to conduct a fire-sale of assets in order to pay back investors their money.

It is possible that many investors put money into Woodford Equity Income Fund in the belief that it was full of large cap, liquid stocks. The reality is that the mass of redemptions in recent years has seen Neil Woodford sell many of the more liquid holdings, thereby making the less liquid investments a greater proportion of the overall portfolio.

WHAT SHOULD INVESTORS DO NEXT?

While investors in the income fund have no choice but to wait for the suspension to be lifted, we would suggest in this situation that it is important to review the new portfolio, once Neil Woodford has complete his reconstruction, before making any decisions about whether to hold or exit.

Investors should also take time to revisit all of their investments and make sure they are comfortable with the underlying portfolios of any fund or investment trust holdings.

By **Tom Sieber** &
Daniel Coatsworth

Why Provident Financial's rally could be short lived

Its shares gain ground as a hostile takeover attempt by Non-Standard Finance is batted away

AT 502.6P SHARES in sub-prime lender **Provident Financial (PFG)** may be in recovery mode after it successfully fought off a hostile takeover by smaller rival **Non-Standard Finance (NSF)** but there are several reasons why investors should not get carried away.

Non-Standard is walking away having failed to secure the regulators' approval for the deal. However, there remain question marks over Provident's dividend, particularly given the costs incurred during the battle with its prospective acquirer.

The company could also face increasing impairments relating to bad debts in its Vanquis credit card division.

Broker Canaccord Genuity estimates a 1% increase in the Vanquis impairment rate would translate into an 8% hit for pre-tax profit and notes the company already warned of a higher than expected impairment rate for Vanquis earlier in 2019.

Woodford, which is selling off assets after dealing in its flagship income fund was suspended, owns 24.7% of the business.

The bull and bear case of newly-listed Watches of Switzerland

We take a balanced look at the latest company to join the UK stock market

Despite an inhospitable retail backdrop and a poor post-float showing from another luxury goods group, **Aston Martin Lagonda (AML)**, luxury watch-to-prestige jewellery retailer **Watches of Switzerland (WOSG)** has met with a positive investor reception following its stock market flotation.

Shares in the high-end timepieces specialist ticked up from their 270p issue price to 305p at the start of unconditional dealings (4 Jun).

Watches of Switzerland has raised a net £139.5m of new money which it will use to reduce debt and grow the business, although it is also worth noting that pre-IPO shareholders have sold £63m worth of shares at the stock market listing. The business is now valued at £730m.

THE BULL CASE

Trading as Watches of Switzerland, Goldsmiths, Mappin & Webb and Mayors, the group is a leader in the global luxury watch market and is delivering profitable like-for-like sales growth under chief executive Brian Duffy.

Competitive strengths include its scale and strong relationships with the owners of luxury watch brands including Rolex, Patek Philippe, Tag Heuer, Omega, Breitling, Cartier and Audemars Piguet, which command significant pricing power. Luxury watches are durable assets with outsized demand compared to supply, meaning there is limited margin-eroding discounting.

THE BEAR CASE

There are some significant risks to consider. Watches of Switzerland's products are discretionary in nature and the business is geographically concentrated in the UK; any Brexit-induced downturn in the domestic luxury watch or jewellery markets could impact profitability.

A key tenet of the growth strategy is expansion in the fragmented-yet-competitive US market, historically a graveyard for UK retailers.

And many of the company's US outlets are in Florida and Georgia, regions susceptible to hurricanes which can force store closures. Should the group lose access to the supply of luxury watches or the luxury watch brands fail to supply the group with watches in desired models or quantities, this would crimp earnings growth.

Earnings would also come under pressure if luxury watch brands decide to bypass the group and sell directly to consumers online.

Past acquisitions mean Watches of Switzerland has a substantial amount of goodwill on its balance sheet. Goodwill is essentially the premium for buying a business at a higher price than its identifiable assets. Should its acquisitions fail to perform, future results would may bear the scars of goodwill write-offs.

Watches of Switzerland will reinvest cash flows into growing the business and has no plans to pay out a dividend in the near-term. And one final point to note is that controlling shareholder Apollo Global Management retains significant sway over the voting rights with a 59.2% stake. That creates a share overhang with the market wondering when it may sell down the stake.

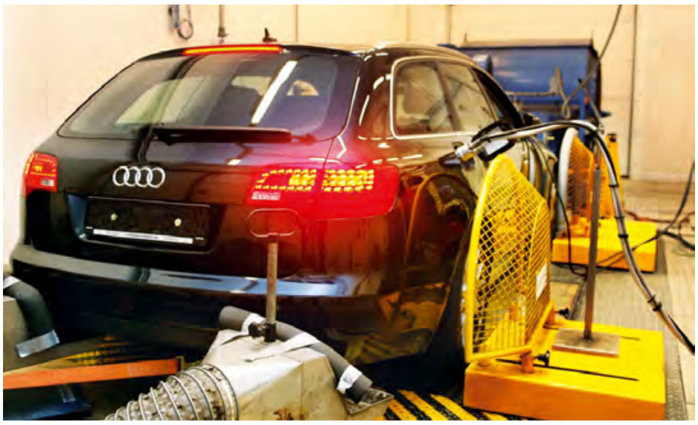
Market unconvinced by Johnson Matthey's progress

The FTSE 100 chemicals group continues to invest as it reshapes its business

Following a strong rise in profit and a big hike in its dividend, it would seem there's reason to be optimistic on FTSE 100 stock **Johnson Matthey (JMAT)**.

But it's not a view shared by the market as the chemical company's shares failed to be lifted by its latest full-year results.

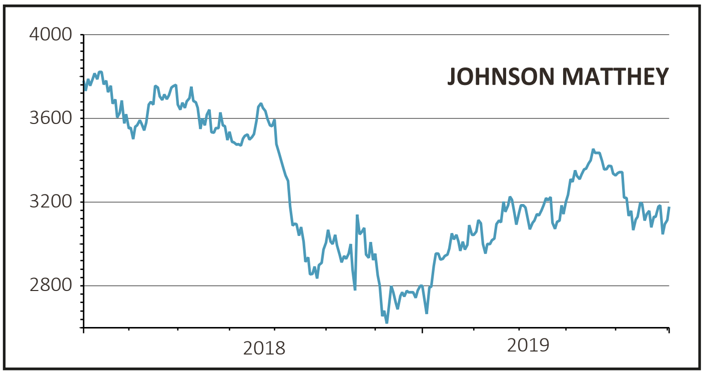
Pre-tax profit in the year to 31 March jumped 53% to £488m, at the top end of expectations, and revenue grew 5% to £10.74bn. The firm also proposed a 7% dividend increase.



The share price was particularly weak immediately after the results were published on 30 May. It would appear investors were more fixated on its New Markets division, which reported an operating loss of £1m in the six months to the end of March, well below the £10m profit that was expected.

Johnson Matthey chief financial officer Anna Manz tells *Shares* the profit drop in the division was for a 'good reason', as the company continued to invest in eLNO, a battery material for electric vehicles (EV) that it hopes will disrupt the market and plans to have in commercial production by 2022.

Some investors still harbour concerns that the structural switch to EV could harm Johnson Matthey, given around 70% of its revenue comes from its Clean Air division, which sells catalysts to reduce emissions from vehicles.



While Manz concedes growth in the division 'may start to tail off' in the future as the EV shift takes hold, she points out the division enjoyed 11% sales growth in a sector which has struggled with a 2% decline in global vehicle production, and adds there are still plenty of growth opportunities.

She says: 'That's down to the great technology we have and as legislation [around vehicle emissions] continues to tighten in Europe, and Asia in particular, it requires more complicated catalysts.

'Legislation in Asia has tightened massively, and we see it as a big growth area from 2020 onwards.'

Analysts at investment bank Citi agree with Manz's assessment, and believe the division's 'sustained performance' is over-looked by the market, with concerns 'overly concentrated' on the risks facing the global auto industry, which in Citi's view are receding.

Fellow investment bank Berenberg points out Johnson Matthey's performance has been particularly strong given its rivals have all issued profit warnings due to issues in the auto industry.

Manz also highlights the efficiencies Johnson Matthey has achieved, savings which have been reinvested to deliver long-term growth.

She says: 'We've made significant efficiencies – it will be £110m by the time we're done – and we're able to reinvest that to build the agile platform we need to deliver growth in four to five years' time.'

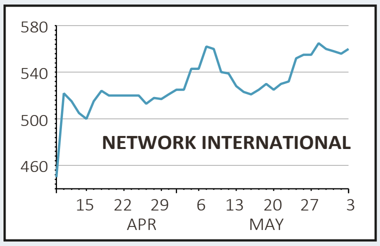
We rate Johnson Matthey as a great stock to own for the long-term.

Network is a growth story you can't ignore

The company can benefit as the Middle East and Africa transition to digital payments

NETWORK INTERNATIONAL ↗ BUY
(NETW) 554p
Stop loss: 443.2p

Market cap: £2.8bn



Buy payment services firm **Network International (NETW)** as a fascinating growth story and a near-term candidate to join the FTSE 100.

Don't be put off by the premium rating of 33 times 2019 forecast earnings as that is justified by the growth potential on offer and the current share price could look a bargain in the longer term.

The company joined the stock market in April 2019 but has been operating in the Middle East since the mid-1990s and in Africa for the past decade.

It facilitates digital payments in these regions in a similar way to a larger peer like Worldpay, taken over in a $43bn deal earlier this year, does in other parts of the world.

Investment bank Berenberg says: 'We believe that Network International's regional exposure is unique because it has leading positions in markets which 1) are protected by the government, 2) attract limited international competition, 3) are very relationship and reputation focused and 4) are underpenetrated in terms of digital transactions.'

This last point is key as the proportion of digital transactions as a percentage of total transactions is as low as 14% in the Middle East and Africa, compared to 21% in Latin America, 22% in Asia Pacific, 51% in Europe and 74% in North America.

The former figure looks likely to grow as these economies mature and with governments introducing policies to support a transition to a more cashless society as they look to bring their countries up to speed with their developed peers.

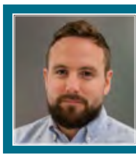
The company has more than a third of the current addressable market in the Middle East with the UAE dominating. Saudi Arabia currently only makes a small contribution for the group but is a sizeable opportunity as it opens up to independent operators like Network.

In Africa, which delivered 25% of 2018 revenue, its main markets are Nigeria, Egypt and South Africa.

There is obviously a risk that the larger operators in this market might look at this opportunity and attempt to gain market share for themselves but the relationships the company enjoys, its scale and the $100m-plus it has invested in its platforms in recent years creates significant barriers to entry.

A more logical scenario is that the company might be targeted for a takeover by one of the industry heavyweights. The company does have $367m net debt although strong cash generation should enable this to be paid down rapidly.

A point to consider is regulatory and political risk in parts of the world which are not necessarily known for their stability, although we take comfort that Nework has been operating in these regions for some time.



By **Tom Sieber**
Deputy Editor

Investing in a healthier society

How companies can target sustainable returns from addressing the world's healthcare challenges

That many of us today can expect to live longer and healthier lives is largely thanks to medical advances. Some of these innovations have been the product of revolutionary science, while other improvements have been incremental.

All of these advances, however, are the product of investment. It often costs companies millions of pounds to develop laboratory research and to manufacture new devices. It also tends to take years to undertake trials and receive approvals – with no guarantees of success, of course.

Where companies can successfully combat the world's major health challenges, I believe long-term investors can be rewarded for their patience, with lasting benefits for society.

Living longer, living better

The importance of addressing these challenges is reflected in the UN Sustainable Development Goals (SDG), which articulate the world's most pressing sustainability issues. Specifically, Goal 3 is to ensure healthy lives and promote well-being for all at all ages.

The importance societies attach to good health is reflected in the amount spent on it. It is typical for better-off countries to spend roughly one-tenth of national income, as measured by gross domestic product (GDP), on healthcare goods and services.

Moreover, the trend is upward. The share of the UK's GDP spent on healthcare rose from 7.4% to 9.6% between 2007 and 2017, according to the OECD. In the United States, the world's largest healthcare market, it rose from 14.9% to 17.2% of GDP during this period.

With societies ageing, putting upward pressure on healthcare costs, companies that can deliver healthcare goods and services at better quality, or better value, should not only enjoy commercial success, but also help extend good health to more people around the world.

Measuring the health benefits

For investors attracted by the sector's ability to deliver societal benefits, I believe it is important to gauge the positive impact that a company is having through its activities. This is not always easy. After all, 'not everything that can be counted counts, and not everything that counts can be counted', to borrow a well-known phrase. Nonetheless, measurability is one of the central tenets of impact investing.

Looking at how a company intends to address a specific healthcare challenge, and reach those who are in the greatest need, as well as the tangible steps it is taking to achieve this goal, is a sound place to start.

It is also important to consider how replicable its products or services are, and whether they would be provided if it did not exist or was not funded. Crucially, as impact investors, we must also consider the materiality of those products or services – for instance, how does a new drug save lives?

Improving lives can have an equally significant impact. ALK-Abelló, for example, is a pharmaceutical company that specialises in developing products for the more than 500 million people worldwide who suffer from allergies.

Among its innovations have been immunotherapy tablets against some of the most common respiratory allergies – including grass pollen and house dust mites – that allow allergy patients to self-administer from the comfort of their own home. Innovations like this can positively transform lives, helping realise Goal 3 of the SDGs.

Pursuing healthy returns

When investing for impact, it is important to analyse companies on their own merits. In every sector there will be leaders and laggards. By providing capital to companies that have a demonstrably positive impact on people's health, long-term shareholders can help them develop their businesses, and therefore contribute to longer and healthier lives.

Through the investments we make, I therefore believe we can aim to have a positive societal impact over the long-term, alongside sustainable financial returns.

Ben Constable-Maxwell is Head of Sustainable and Impact Investing at M&G Investments

To find out more please visit
www.mandg.co.uk/responsible-investing

The views expressed here should not be taken as a recommendation, advice or forecast. The value and income from any fund's assets will go down as well as up. This will cause the value of your investment to fall as well as rise. There is no guarantee that any fund will achieve its objective and you may get back less than you originally invested.

Why you should buy Marston's for a 7% yield

The market does not fully appreciate the transformation of the brewer's business

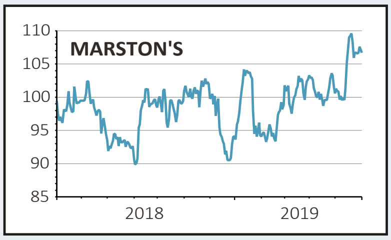
The tough market backdrop may have blinded investors to the impressive re-positioning of pub and brewing firm Marston's.

Free cash flow is expected to rise from £47m in 2019 to more than £80m in 2022, according to broker Shore Capital, and this helps underpin a 7%-plus dividend yield.

We see potential for the stock to perform strongly as the strengths of the business become more widely appreciated.

MARSTON'S
BUY
(MARS) 107.2p
Stop loss: 80p

Market cap: £673m



HIDDEN GEM

Greg Johnson, analyst at Shore Capital, says: 'We continue to view Marston's Beer Company as a jewel in the crown, with less than 10% of volumes now distributed through its own pub estate.'

Marston's owns six national breweries and a significant bottling and canning operation. An £8m investment last year in new canning and state-of-the-art bottling lines mean that the company now packages 40% of the UK bottled ale market.

The company has a significant and logistics operation, delivering to one-in-four of all pubs in the UK. In the last 18 months it has won new contracts from the likes of Punch and **Young's (YNGA:AIM)**.

In addition, Marston's is the UK's largest exporter of beer, and the first half of 2019 (the company's year-end is 29 September) saw volume growth of 17%.

The company is developing a very impressive portfolio of owned and licenced beers, such as Estrella Damm.

There are clear growth opportunities to develop other third-party brands as management recently revealed at the half year results (15 May). They identified the potential for £20m of extra profit in the medium term.

DELIVERING ON STRATEGIC GOALS

The company has two strategic priorities: to increase cash generation and reduce debts by £200m. Recent results show that the company is delivering on these goals. For example, cash from operations grew by 6% to £66.8m at the interim stage, much higher than the reported operating profit growth of 2.4%.

Capital expenditure is expected to be 20% lower in the next two years, while the expected proceeds from disposals are expected to be £129m in the 2020-2023 period, higher than previously guided.

Shareholders benefit very nicely from deleveraging. Lower interest charges mean that equity owners keep a greater proportion of the profits. In theory this should see the shares should settle at a more premium valuation over the medium term.

Marston's currently offers good relative value, with a dividend yield of 7.3% compared to the 5.2% on offer at **Greene King (GNK)**. Management has committed to keeping the dividend at current levels while it reduces the company's debts.

By **Martin Gamble**
Senior Reporter

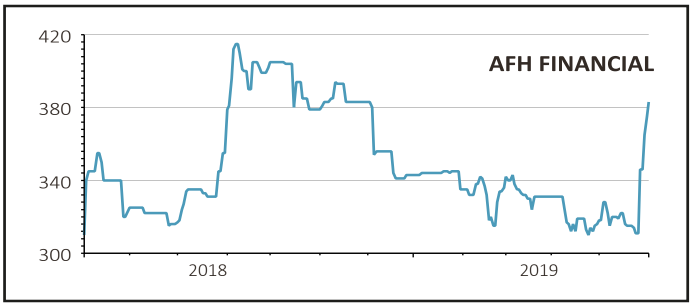
AFH FINANCIAL

(AFHP:AIM) 385p

Gain to date: 11.6%

Original entry point:

Buy at 345p, 24 January 2019



SHARES IN WEALTH manager **AFH Financial (AFHP:AIM)** have rallied sharply after the firm released strong first-half results, confirming our faith in its buy-and-build strategy.

Revenue for the six months to 30 April was up 61% to £36.6m thanks to strong organic growth as well as four deals in the first half, although the full benefits from the latter won't flow through until the second half. Post-tax profit increased by 80% to £4.5m.

Funds under management (FuM) grew by 68% to £5.4bn due to inflows, acquisitions and positive market moves, and chief executive and founder Alan Hudson is sticking to his goal of £10bn of FuM within three to five years, together with annual revenue of £140m and a 25% operating margin.

Meanwhile the protection broking business, which offers life insurance and critical cover, almost doubled revenues to £7.3m in the first half and with a dedicated new office for its telephone operations the business could double in size again in the future.

SHARES SAYS: ↗
For as long as AFH can bolt on good businesses at four to five times earnings before interest, tax, depreciation and amortisation (EBITDA) to consolidate its position, we believe it should deliver further strong returns for shareholders. Keep buying.

SHARES AJBell

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What to do when one of your stocks warns on profit

We discuss how share prices react in the aftermath of a profit alert

UK companies this year issued the highest number of first quarter profit warnings since the financial crisis, says consultant E&Y.

The number of warnings was up more than 20% year-on-year as companies were hit by domestic Brexit-related uncertainty as well as global growth fears.

It can be painful for shareholders when a company downgrades profit expectations but not all profit alerts are equal.

In this article we will discuss the different levels of severity of warnings, whether you can anticipate them in advance, how the market reacts and when and if companies can recover.

DIFFERENT WARNING LEVELS

It's a human trait and a handy self-defence mechanism to downplay the ugly truth and companies are no different. A 'broadly in-line' statement is mostly interpreted as a small miss against the market expectations.

Share price reactions can vary quite a bit, but generally a 5% to 10% fall in the share price would be a common reaction.

'Moderately below' market expectations is a clear statement that a company's performance has fallen short of what the management believes is the consensus expectation. It is generally understood by market professionals that this means 10% to 15% below expected earnings.

Share price reactions with these types of warnings can be more brutal, a 'shoot first, ask questions later' approach, and can range from 20% to 30%.

Banknote printer **De La Rue (DLAR)** is a good recent example of a mild profit warning, leading to a punishing 26% fall in the shares on the day.

The consensus of investment analysts before the announcement was for revenues of £510.8m and operating profit of £67m, while the company came up short with profits of £60.1m, a miss of 10%.

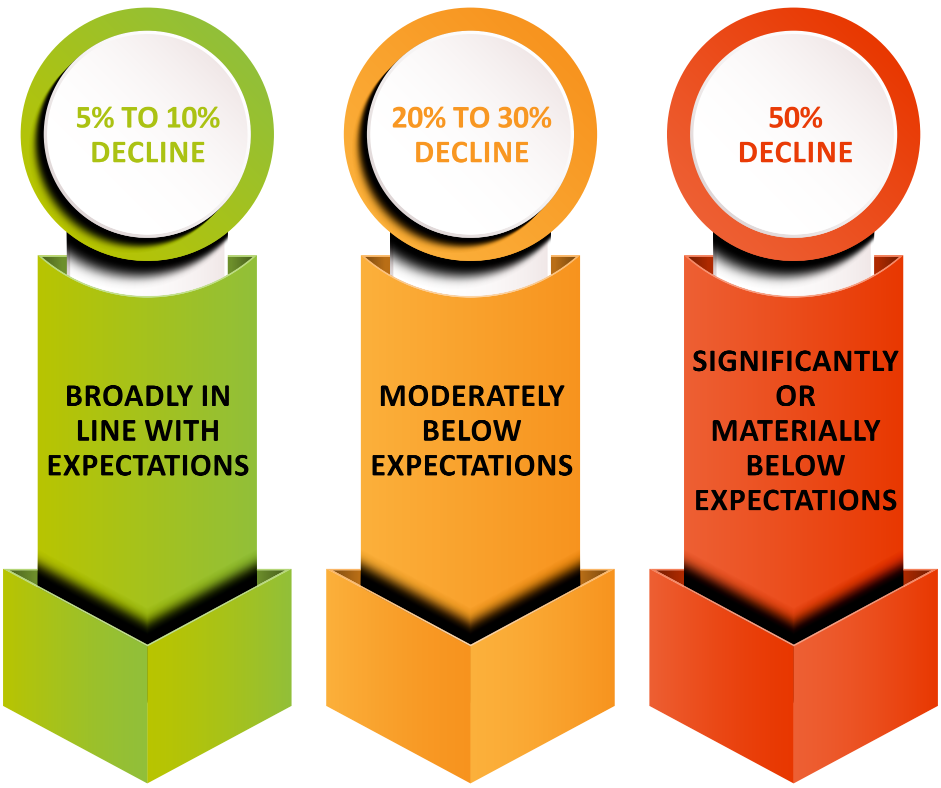
The company pointed to the increasingly competitive banknote print market and warned of significant headwinds in the year ahead. These are all factors which cannot be easily fixed by management actions.

WHAT ABOUT SEVERE WARNINGS?

A company will sometimes

PROFIT WARNING SEVERITY SCALE

Potential share price movements



Source: Shares

> "ONE STUDY SHOWED ON AVERAGE A SHARE WILL UNDERPERFORM THE MARKET BY AROUND 7% OVER THE SIX MONTHS PRECEDING A PROFIT WARNING"

report that earnings are 'significantly' or 'materially below' market forecasts. In these cases, investors should be bracing for a 20%-plus miss or perhaps a loss against a previously expected profit. Share price reactions can be falls of 50% or more.

On 17 May, recruitment company **Staffline (STAF:AIM)** warned that trading had slumped in the first quarter on Brexit worries. The shares fell a staggering 61% to 327p on the day of the warning.

The company said that it expected the current uncertainty to continue to depress temporary recruitment 'throughout the current year'.

The shift from 'temp to perm' is also impacting margins. In particular the company has seen a sharper than expected fall in demand from the higher-margin automotive sector and associated supply chain.

At the same time a high number of transfers have occurred in the higher-margin driving sector, resulting in a further dilution of group margins.

CAN INVESTORS ANTICIPATE PROFIT WARNINGS?

One study showed on average a share will underperform the market by around 7% over the six months preceding a profit warning.

This can be explained by two factors; business fundamentals have already started to deteriorate and the market has begun to price this deterioration into the share price; and insiders may have leaked some information to analysts.

Researchers at the Bank of England examined the financial health of just over 500 firms issuing profit warnings between 1997 and 2001. They found that over 75% of those firms experienced a fall in profit margins between the set of financial accounts immediately prior the warning and the subsequent year-end set of accounts.

Crucially, fewer than 20% of firms in the study that issued a profit warning subsequently went on to reverse the trend in the same financial year. In fact, there was evidence that a decline in profitability is not temporary, with around 80% of firms failing to grow their profit margins to pre-warning levels within at least two years.

These results show that deteriorating financial health is a trend that can take firms a long time to reverse. Having issued one profit warning, their slow rate of recovery makes it likely that at least one other profit warning will follow.

These studies suggest that the chances of a stock returning to levels seen before a warning is very small, especially in the year following the first profit alert.

IT'S NORMAL TO WANT TO HOLD ON

Research has shown that the pain of a loss is twice as powerful as the satisfaction of a gain, first discovered by Amos Tversky and Daniel Kahneman, commonly known as the fathers of behavioural finance. This is sometimes called loss aversion. In practice it means that investors hold on to a losing position hoping that it will recover.

James Montier, a respected analyst and behavioural scientist, has noted that profit warnings have a heightened impact on investors, which causes them to get their timing wrong.

In *Maximum Pessimism, Profit Warnings and the Heat of the Moment*, he explains that evidence shows that stocks which warn continue to do poorly for around a year. 'Hence you should sell at the profit warning,' he says.

'Of course, we don't; we procrastinate and often end up doing nothing for a long time.'

Montier adds that around 12 months after a profit warning, the prices of companies begin to recover, but it's at this point that people are finally getting around to cutting their losses – far too late.

RECOVERY FROM A WARNING DEPENDS ON CIRCUMSTANCES

A study by UK finance professors George Bulkley, Richard Harris and Renata Herrerias looked at 455 profit warnings issued between 1997 and 1999 and tracked the stocks until 2001. Unlike some of the other studies that we discussed, this study looked further ahead. It tracked future earnings announcements that were released to the market.

It found that between 12 and 24 months after a profit warning, the average cumulated excess daily returns of these stocks was a positive 23% relative to the market.

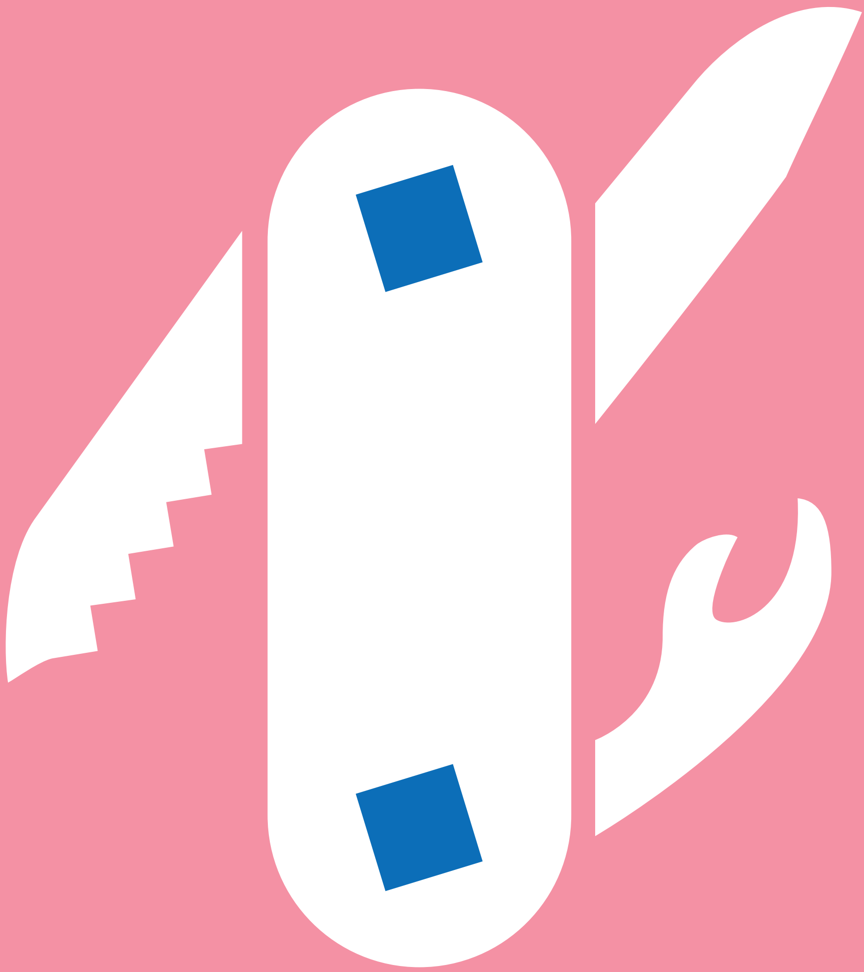
In other words, the stocks showed strong signs of recovery between one and two years after the warning. This can be explained by analysts being slow to change their opinions, even in the face of new information.

So, with some patience all might not be lost in holding out, but this is predicated on seeing some improvement in the business fundamentals.

In general, if a profit warning stems from a clearly identified problem that looks like it can be fixed by short term management actions, the chances of a full recovery in the share price are good to fair.

However, anything related to falling demand for a company's products or a rapid change in the competitive landscape is usually bad news for the longer term development of the business and hence the share price.

By **Martin Gamble**
Senior Reporter



CAN ROBOTS RESCUE RETAIL?

HOW THE APPLICATION OF AI IS TRANSFORMING THE INDUSTRY

The retail sector is at a crossroads. Hit by structural changes as spending shifts online and an uncertain economic environment as well as fast shifting consumer tastes and trends, many in the industry are really struggling. Could robots and artificial intelligence (AI) come to the rescue?

Excitingly, AI is already being deployed in retail, where pure-play online retailers have an advantage in data collection and brick and mortar players can also see healthy returns on investment.

Early and enthusiastic adopters include European online fashion platform Zalando, which has used so-called deep learning to improve warehouse efficiency and in fraud detection and the personalisation of the shopping experience, as well as London-listed **ASOS (ASC:AIM)**, which is successfully deploying AI for product, style and size recommendations.

In this article we will take an in-depth look at how AI is transforming the industry and look at some stocks and funds which are exposed to this emerging theme.

FUTURE-PROOFING PROFITS

With customer expectations constantly evolving, retailers need to adapt business models to futureproof their profits in the face of advanced competition from Amazon, Ebay and many others.

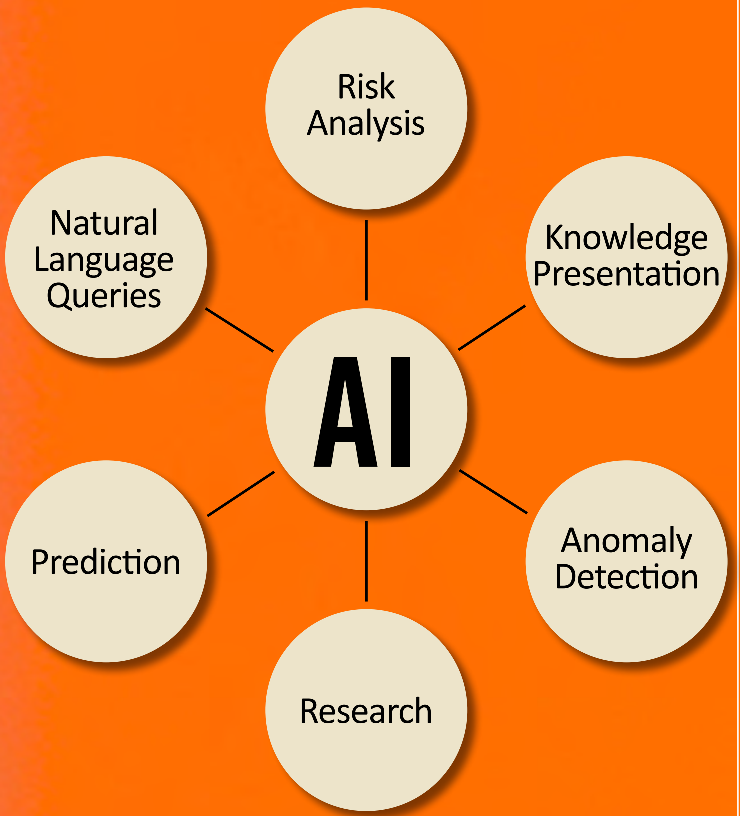
A study from Juniper Research has found that global spending by retailers on AI services will reach a staggering $12bn by 2023, up from an estimated $3.6bn in 2019, so growth in spending of 230%; Juniper expects over 325,000 retailers to adopt AI technology over this period.

Juniper forecasts that retailers will face an AI adoption race, where early mover, AI-equipped retailers will displace slow moving retailers, offering superior service at optimised price points.

According to its research, the use of AI by retailers will unlock efficiencies across back-office operations. Advanced analytics employed in functions such as demand forecasting and automated marketing could make retailers more agile and improve their margins.

Areas of interest to retailers include personalisation, where AI is leveraged to create a more personalised customer experience. The aim is to boost the quality of customer interactions and make a browser more likely to become a buyer. Examples include AI-personalised digital signage, as well as computer vision digital mirrors and an

AI Skills in Retail



Source: Juniper Research

array of visual search technologies.

According to Juniper, in a retail industry that requires more planning than most, 'of all the different elements of the retail market which AI will have an impact on, demand forecasting and supply chain analytics will be the most vital'.

Juniper believes the number of retailers using AI-enabled demand forecasting will more than treble between 2019 and 2023. 'This is the bit (of AI) that is here now,' Juniper analyst Nick Maynard informs *Shares*. 'With the rise of collect-in-store and one-off events such as Black Friday, understanding demand and supply chains is more crucial than ever with AI playing the central role.'

GET SMART(ER)

Smart checkouts powered by AI technologies such as computer vision could play a key role in the retail sector of the future. 'Smart checkouts are a little bit further down the track for large scale deployments,' says Maynard, although he notes 'checkout apps are becoming very popular, certainly in supermarkets in the UK'.

Maynard highlights visual search as 'a really interesting one', pointing out that Swedish fashion powerhouse H&M and Japan's iconic Uniqlo are

What is AI?

Juniper Research defines artificial intelligence or 'AI' as 'a computer program that uses a combination of digital building blocks, such as mathematics, algorithms and data, to solve complex problems normally performed by humans'.

AI has the potential to transform industries ranging from healthcare, finance and transportation to agriculture. It is also proving to be a game-changer in retail, a sector under pressure from higher costs and a surge in customer expectations as digital disruptors raise the bar for personalised service.

Progress is being driven by a subset of machine learning called deep learning, which involves feeding data to neural networks crudely modelled on how we think the human brain might work and using algorithms to have the computer learn from that data.

Deep learning is enabling remarkable improvements in machine translation, natural language recognition and computer vision. At the same time, the proliferation of the internet, particularly on mobile devices, has triggered an explosion in the data necessary to feed deep learning algorithms, and more data is creating smarter machines.

Although the term AI sounds futuristic, we're already benefiting from this technology in our everyday lives. When Facebook auto-tags your friends in photos, the social network does so through deep learning; when you use Google's voice search, the natural language recognition is done by deep learning; and when you put your apartment on Airbnb, the recommended rate is generated by deep learning.

among those retailers offering visual search in their apps.

He also flags the 'virtual mirror' as an interesting in-store solution. 'Using computer vision, the virtual mirror can show you what you would look like with say, a certain cosmetic applied, but without you having to apply it,' explains Maynard.

H&M is an interesting case study, as the clothing colossus is unashamedly investing heavily in artificial intelligence to improve the way it spots trends, plans logistics and attempts to reduce discounts and piles of unsold stock.

Its corporate venture capital arm – H&M CO:LAB – has also invested in London-based e-commerce retailer Thread, which uses AI to power an online personal styling service selling premium-priced fashion.

RISE OF THE CHATBOTS

Juniper's research also found the global number of successful retail chatbot interactions will reach 22bn by 2023, up from an estimated 2.6bn in 2019.

Chatbot use by retailers will enable effective automated customer interactions, allowing them to deliver high quality user experiences in a cost-effective way, while boosting customer retention and satisfaction. 'For me, retail is the space where chatbots make sense,' continues Maynard, 'and it is being deployed by retailers in the returns process'.

AI-based chatbots have already become an accepted part of the retail ecosystem, especially in the e-commerce space, where they could help companies improve profitability.

A potentially lucrative revenue source from chatbots is through 'cart recovery', where chatbots can remind customers of the products still in their shopping cart and ask them if they are willing to proceed with the purchase, do nothing or clean the cart.

According to Juniper, retailers that don't adopt chatbots will face strong challenges from more technologically adept disruptors. The research also found that chatbots leveraged for customer service have a strong potential to reduce costs; with deployments realising annual savings for retailers of $439m globally by 2023, up from $7m in 2019.

As Maynard explains: 'By embracing automated customer service with chatbots, retailers can act in a more flexible and efficient way. The wider retail market means that chatbots are no longer a luxury, they are essential.'

Shepherd's steer

Ian Shepherd, former retail CEO whose book, *Reinventing Retail: The new rules that drive sales and grow profits*, is out in June, believes the regular flow of retailers disappearing is a tragedy and is doing his bit to help them succeed.

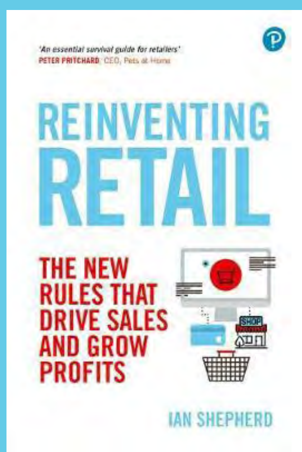
In his book, he writes extensively about 'the importance for retailers of gathering customer data, precisely so that they can do the kinds of analysis that AI unlocks.' Shepherd points out that many of the transactions that traditional brick and mortar retailers generate are essentially anonymous; these retailers use metrics like footfall and average basket size, 'but these tell you nothing about how actual individual customers behave'.

And this is crucial insists Shepherd. 'I worked with one business where we proved that 40% of the revenue came from 10% of the customer base. That will be true for many retailers, but if they don't know who those customers are, they are flying blind.

'If their most valuable customer suddenly stops buying from them and defects to a competitor, they won't even notice let alone do anything about it.' Retailers need to put themselves in a position where they gather information on who their customers are and what they spend.

'That's the real business case for loyalty schemes but you can do the same thing by gathering email addresses at the point of purchase, offering Wi-Fi in your stores and many other techniques,' insists Shepherd.

'Once you've done that, a world of AI and machine learning techniques which have been honed for many years by subscription businesses becomes possible – identify your most valuable customers, work out the "logical next purchase" for each of them, actively manage churn and more.'



Walmart's AI store of the future

While retail industry disruptor Amazon has been rolling out cashier-less Amazon Go stores, which have shelf sensors that track the products on its shelves, Walmart, the world's biggest retailer, is also going all-in on AI.

Its website has been redesigned to be more personalised, and the retail behemoth is also testing ways to digitise its brick and mortar stores, having recently opened its so-called 'Intelligent Retail Lab' at a Long Island grocery store.

Through digital efforts, ceiling cameras and shelf sensors will enable staff to fix problems and restock items efficiently. Furthermore, the technology will detect when shopping carts run low, spills occur and when shelves need restocking – notifying workers by phone alert when items need to be replaced – while detecting when cash registers need to be opened up to prevent long lines forming and its cameras can even detect the ripeness of bananas from their colour.

When a banana begins to bruise, the cameras send an alert to a worker. Normally, that task would have relied on the subjective assessment of a human, who wouldn't have time to inspect each bit of fruit.

Five ways to play

1 Investors can gain exposure to the retail AI theme via investment trust **Scottish Mortgage (SMT)**, which has stakes in Amazon, Google-parent Alphabet and Alibaba.

2 Another option is **Ocado (OCDO)**, whose customer orders are picked and packed in highly automated warehouses using swarms of purpose-built robots.

This process makes up part of its Ocado Smart Platform, which is driven by applications of AI and machine learning and is being successfully licensed out to grocery retailers around the world.

3 Within the small cap ranks, **Attraqt (ATQT:AIM)** provides SaaS solutions that power online shopping experiences. Empowered by machine learning, the company helps retailers to optimise their e-commerce performance, enhancing conversion rates and growing basket values while guiding shoppers to relevant products and content and reducing the retailer's burden of time-consuming manual tasks.

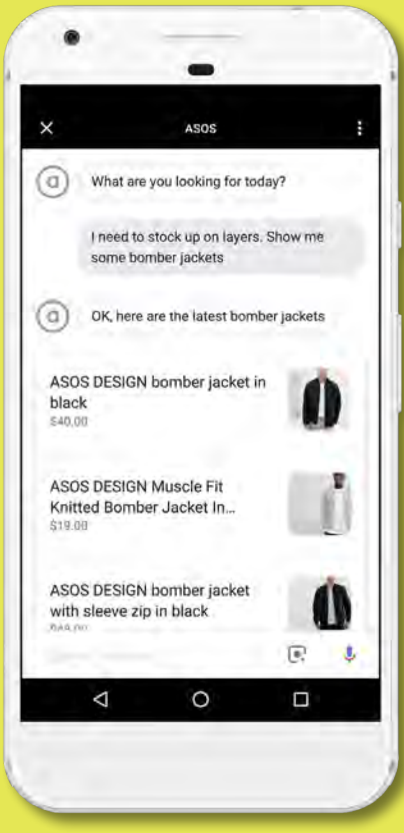
Last month (8 May), Attraqt agreed to buy Early Birds, a provider of an AI-powered SaaS platform that allows internet retailers to personalise their offering to individual customers across both the online and offline channels.

Among the household names retailers Attraqt has previously helped is **Tesco (TSCO)**. The supermarket implemented Attraqt's product and accessory recommendations to track and analyse the behaviour of shoppers from items searched to products added to baskets and purchased.

This data enabled Tesco to suggest relevant additional items to shoppers at every point across the user journey, from initial search to point of purchase and in real-time.

4 In November 2018, ASOS announced the global app roll-out of its sizing tool, ASOS Fit Assistant, which uses machine learning to provide bespoke sizing recommendations on its product pages based on previous purchases and returns.

ASOS has been experimenting with machine learning tools for some time; 'Your Edit', 'Style Match' and the 'You Might Also Like' carousel on product pages are all examples of native ASOS tools that use machine learning to improve the customer experience.



Google Assistant shows the latest ASOS products across popular categories using just the user's voice.

ASOS was also one of the first fashion retailers in the UK to launch on Google Assistant, meaning 20-somethings can discover the latest ASOS products across popular categories using just their voice.

5 Mid Wynd International Investment Trust's (MWY) managers first began looking at the automation theme five or six years ago. As fund manager Simon Edelsten recounts: 'The heavy industrial growth had already taken place; cars and shipbuilding have been highly automated for years. We were waiting for two things to happen – for the average price of robots to go down, which would increase the range of processes they could be engaged in, and for breakthroughs in their agility.'

Both of these breakthroughs have now happened, explains Edelsten. 'We have reached the point where machines can pack raspberries and eggs without making an Eton mess in your shopping bag. That will affect retailers.

'You only have to go into a Tesco on a Saturday now to see how many staff are wandering around the shop loading trolleys for customers who have ordered online. That is an area ripe for automation. But AI and automation can benefit other retailers too.'

Edelsten adds: 'Many people think that Amazon is killing the high street but there is still life in it. Online clothes retailers still haven't cracked a way of making sure customers keep all the clothes they order.

'Returns really eat into profits. That's where retailers with a physical presence have an advantage. AI and automation are helping them to introduce just-in-time principles to stock control. These "big box" warehouses that you see by the sides of the motorway are increasingly being filled with sophisticated technology that enables retailers to work out what sizes to send where and as soon as the need arises.

'That should boost sales and also reduce the amount of stock they have to hold, which reduces the floor space you need, cutting costs and boosting margins.'

Edelsten argues the retail winners will almost certainly be those that invest in automation and AI. 'We don't take a gamble on picking the right retailer. We have invested instead in the provider of the automation and stock control software.'

A very successful investment for Mid Wynd has been Japanese outfit Daifuku, widely acknowledged as the world leader in warehouse automation and a company now working with Japanese fashion retailer Uniqlo.

Mid Wynd's other investment addressing the theme is Unibail, which owns the Westfield shopping centre business and trades on a hefty discount to book value because the market thinks retail is dead. Unibail has grasped the fact that retail is a social experience and is stuffing its centres with cinemas and other entertainments to draw shoppers in. Many of the stores renting space are there to provide a human face to the core online offering. Retailers need a physical presence and Unibail provides it.

Edelsten concludes: 'AI and automation and Amazon – the three As – are seen by many as a threat to traditional retail, but AI and automation can really benefit those retailers that embrace it and the businesses like Daifuku and Unibai on which they depend.'

By James Crux
Funds and Investment Trusts Editor

A little less upside **is a risk worth taking**

AN INVESTOR WHO put £1,000 into Amazon in 1997 would now be looking at an investment worth £1.6m, but with nearly 2,000 companies listed on the London Stock Exchange, the odds of finding the next Amazon are slim. In fact the average company listed on the exchange has, at some point in the last five years, seen more than half of the value wiped off its shares.

Diversification; investing in a wide range of uncorrelated assets, solves this dilemma, and investment trusts provide an excellent mechanism to achieve it.

Majedie Investment Trust offers a very broadly diversified portfolio, including several funds with very high minimum investments, which would normally be beyond the reach of ordinary investors.

The trust's largest fund holding, mirroring the flagship MAM UK Equity fund, invests in UK equities aiming for total returns in excess of the FTSE All Share. It has produced NAV total returns in excess of 450% since launch, underperforming the FTSE All Share in only four calendar years.

MAM Tortoise Fund, the trust's second largest holding, is an absolute return focused global equity fund aiming to generate positive returns in all market conditions, with very low correlation to the equity markets.

Like its more famous peer Lindsell Train, Majedie owns a significant stake (17%) in the management company behind these funds – Majedie Asset Management (MAM).

Launched in 2002, MAM has grown rapidly and now has more than £12bn under management. Dividends from this investment add to the trust's ability to generate income for its shareholders and dividends – wholly covered – have increased by 30% since 2014.

Relative to AIC its peer group, the trust offers a significantly higher yield than any of them – 4.1% compared to an average of 1.7%, yet it remains on a wide discount.

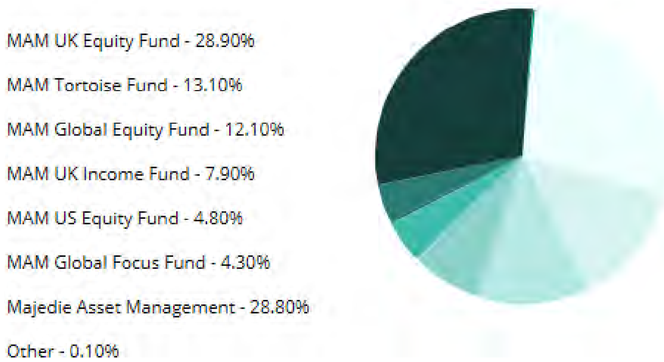
This could be because performance has lagged behind racier, growth focused competitors. Over ten years to the end of April the trust has delivered respectable annualised NAV total returns of 8.5%, less than the return generated by the FTSE All Share over the same period.

But this is a diversified vehicle, with defensive strategies like the Tortoise fund designed to reduce risk and the trust aims to protect wealth as well as grow it. It will – by design – lag when investor appetite for risk is high.

Closer examination shows when investors are risk averse, the approach pays off. On the two occasions in the last decade when the FTSE has ended the year in negative territory, the trust protected capital on the downside, limiting losses and outperforming the index by a comfortable margin.

Given sky high equity valuations and the febrile political climate, investors may soon think a little less upside is a risk worth taking.

MAJEDIE INVESTMENTS PLC – A BROAD MIX



Learn more about Majedie and other investment trusts at **www.trustintelligence.co.uk**

‘When will pensions dashboards launch?’

AJ Bell senior analyst Tom Selby explains the latest developments

For a while I read a lot about pensions dashboards and how they were going to make my life easier. I have had 10 employers during my career and saved in a pension with most of them (a mixture of defined benefit and defined contribution).

I’m now 63 and starting to think about winding down to retirement. How much longer will I have to wait to track down all my lost pension pots?
Ruth

Tom Selby
AJ Bell
Senior Analyst says:

The pensions dashboards project first kicked-off in 2016 with the aim of creating a free online service – or multiple online services – which can show you all your retirement pots in one place. Under the original plans it was hoped dashboards would be operational in 2019.

Although the Government still intends to launch something this year via the Money and Pensions Service (MAPS), the tight timescales involved mean the initial version is likely to be very limited indeed.

Policymakers have already said it could take three to four years to get dashboards fully operational, in part because it will cost schemes time and money to get their data ready. And with Brexit dominating Parliamentary time it’s not clear when they will be able to write the rules needed to force all schemes to take part.

So lots of uncertainty already, and that’s before we even mention the prospect of a general election.

Not only will the dashboard scheduled to be available this year have extremely restricted coverage, it will also be tested on a limited number of people. In short, I wouldn’t wait around for this initiative to get your affairs in order because you might be waiting a while.

There are other steps you can take to deal with this common retirement headache, although a bit of research and legwork will be required.

Write out a list of all your former employers where you may have built up pensions, either through guaranteed defined benefit schemes or defined contribution schemes such as personal pensions and SIPPs. You should then contact each of them to find details of any pension arrangements you may have had during your time there.

If you aren’t sure who to contact at your former employers then don’t fear as the Pensions Tracing Service is a handy tool to help you with this process. The easiest way to access it is online via this **link**.

Alternatively you can call free on 0800 731 0176, or write to: The Pension Service 9, Mail Handling Site A, Wolverhampton, WV98 1LU.

Once you’ve located your pensions you will be in a better position to decide whether you want to combine some or all of them with one provider to make them easier to manage (although this won’t be possible with any defined benefit plans).

You should also get a firm handle on your state pension entitlements – the Money Advice Service **calculator** is a good place to start.

Armed with this information you’ll be in a good position to build a sustainable retirement income plan.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

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

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

How much can you make from downsizing?

Selling your home and moving somewhere smaller might not solve a pension problem

Lots of people who haven't saved enough in their pension pots say they will rely on downsizing their home to release more money – but how realistic is this?

People rely on rising house prices to help fund part of their retirement, and many people have included downsizing in retirement in their pension financial plans. By moving to a smaller, cheaper property many people think they can release a lump sum of cash to help bolster their savings.

A quarter of people who downsized their home ended up with less money than they thought they would, according to research from finance firm OneFamily – as legal, moving and renovation fees swallowed up more money than many downsizers had predicted.

This is particularly problematic when you consider that one in five said they had no choice but to downsize to release money for their retirement income.

EXAMINING THE COSTS

So what are the costs? The average person questioned by OneFamily said they ended up with £105,900 from the sale of their property, but this was almost £29,000 less than they anticipated. If you're moving you need to factor in estate agent costs (which are typically between 1% and 1.5% of the value of the property), legal fees and stamp duty.

But other costs get missed off the list, including removal costs, the cost of redecorating your new pad or giving your current home a lick of paint to sell it, and the fees involved in buying any new furniture for your new house.

Another reason for the shortfall in money received is that people have unrealistic expectations of what their home will sell for, and of what they can buy their next property for.

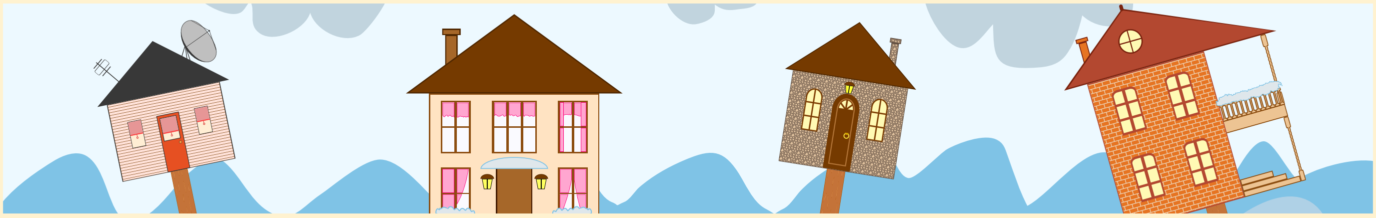
This is another factor that can hamper downsizers – there is a lack of stock in some areas of the kind of property they want to move into. Research by Central Bedfordshire Council, for example, found that 61% of people want to move into a bungalow when they downsize. This makes sense as it avoids having to navigate stairs and the properties are often purpose built for older people.

However, there isn't enough supply to meet the demand in many areas. Developers point out that in London and the South East, where land prices are at a premium, they need to make more use of the footprint of the property – meaning they are more likely to build a large family home or a block of flats.

People often point to the mass rise in house prices over the long period they have owned their property – highlighting this as the reason they can take a sizeable chunk of money out of their home.

But if you're staying in the same area, the places you're buying will also have risen in price, which will suck up some of your gains. Do you research on what you can actually afford to buy, and work out if it leaves you with enough of a lump sum at the end.

Considering downsizing? Go through this checklist first:



Work out accurate costs:
Get quotes from solicitors, removal companies and estate agents.

But also consider if you need to do any work to your place before selling, and the cost of that, or do you need to de-clutter and pay for storage to make the house more attractive to buyers.

Push down these costs as much as practicable, every pound you pay out in fees is less money in your back pocket after the move.

Be realistic on what you can sell for:
There are loads of tools online that you can use to work out how much your house is worth. But look at the recently sold prices, via Zoopla or Land Registry data, rather than a property's listing price.

Be as objective as possible on the flaws with your home and whether it's comparable to others that have recently sold. Estate agents will also value the property for free, but remember they are also trying to get your business.

Is there anywhere you want to buy?
Before you put your property up for sale make sure that there's actually properties out there that you'd be willing to buy.

It can be tricky to find a home that's smaller than your current one without feeling pokey.

Also, think about future-proofing so you don't have to incur the costs of moving again – do you want to be nearer a town for when you can no longer drive, is the garden manageable, is it close to a station for visiting relatives?

Work out the stamp duty you'll pay:
Stamp duty has become one of the big barriers for people with sizeable property wealth moving. It can add considerably to your housing costs. Buying a £500,000 home will set you back £15,000, for example, while an £800,000 home will cost you £30,000 in stamp duty. There's no getting away from these fees, so you need to factor them in.

Be realistic on timeframes:
The property market is sluggish at the moment, so it's taking many sellers longer to offload their home than they expected. The OneFamily research found that on average it took seven months from people listing their property to moving, but that's the average and it might well take longer. Don't leave it until the last minute, when you absolutely have to move or you may end up compromising more on price.

Have you discussed your move with your family and children?
Aside from the financial side of leaving the home you may have lived in for decades, there's an emotional side too. Speak to your children about your plans, get their help with moving, work out whether it's more sensible to move closer to family – have all these discussions as early as possible.

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

Favourite funds to play a European renaissance

With Europe beginning to show signs of recovery we look at some choice collectives

European economies have had a tough time recently, having been singled out as the global laggards when it comes to growth.

Proclamations of doom were made at the start of the year, when fears grew that the euro area could be heading for a recession.

But there are signs, particularly in the advanced markets that have slowed the most, that things could be turning round.

Data shows that the Eurozone economy grew by 0.4% in the last quarter, which was faster than expected, and some economists think the region will pick up and avoid being pulled into the downturn facing developed economies elsewhere in the world.

An easy way to access this European renaissance is through investment funds. But where to begin?

Ryan Hughes, head of active portfolios at AJ Bell, prefers to pick fund managers who have been there and done it, something which can be particularly important when holding a fund for the long-term.

Growth in European countries typically goes in cycles, so having a steady hand in charge of a fund who's been there before, during and after the global recession for example, can certainly be a wise move.

Hughes says: 'If you have a manager with only three years' experience, we've been in a bull market for the last 10 years. If we have another downturn, how will they perform? Will they stick to their approach or will they start panicking? We don't know how they would perform under pressure.'

HERE ARE FOUR FUNDS THAT AJ BELL HAS PICKED ON ITS FAVOURITE FUNDS LIST IN THE EUROPE (EX UK) SECTOR.

FP Crux European Special Situations (BTJRQ06)

Three-year annualised return: 9.99%. Benchmark: 8.1%

Hughes says this fund is his number one pick in the sector, mainly because the fund's manager is hugely experienced when it comes to European companies, and has a deep knowledge of the ones he invests in.

The fund looks to invest in European companies (excluding the UK) which are in what is called 'special situations', i.e. something atypical that has happened which means they are now unpopular with investors.

The idea is that the underlying investment case for these unloved companies, across the market cap spectrum, remains strong and there is therefore potential for the share price to grow significantly if and when they turns things around.

Hughes believes the fund's manager, Richard Pease, is better than most at finding these companies on the European mainland.

He says, 'We like the manager, Richard Pease, who has been doing this for 30 years. He invests nothing like the index, he likes companies with managers that have been at the helm for a long time.'

Schroder European (0764812)

Three-year annualised return: 9.46%

Benchmark: 8.1%

Different to the other European funds on AJ Bell's favourite funds list, the Schroder European looks only at large cap companies, stays relatively close to its benchmark index, and has a big team of analysts supporting manager Martin Skanberg.

The fund aims to find undervalued stocks that have the ability to grow regardless of the prevailing market environment, and Skanberg looks to identify 20 new ideas to invest in each year to keep the competition for capital strong, hence the need for a big analyst team.

Its one-year performance has been 'dire' according to Hughes, with a one-year annualised trailing return of -8.25%, much worse than the others on the list, but says that's fine for now because 'it will do well when value is in favour'.

Baring Europe Select Trust (B7NB1W7)

Three-year annualised return: 13.51%

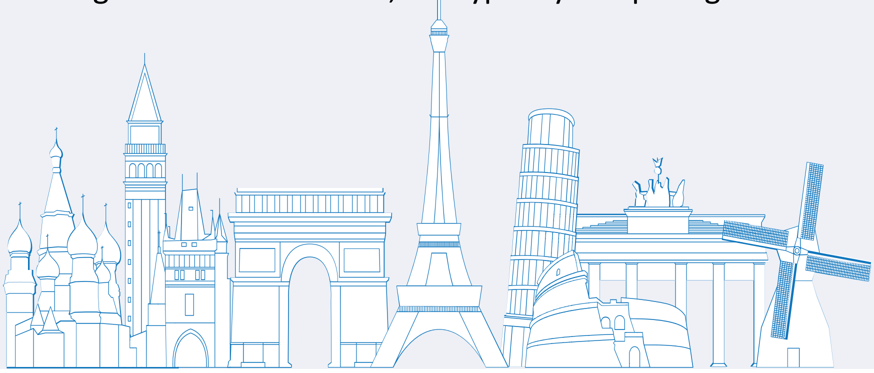
Benchmark: 12.29%

Unlike the BlackRock and Schroder funds, this fund has a much smaller team, led by manager Nick Williams – who has around three decades' experience in the field – and two co-managers as well as a dedicated analyst.

But that seemingly hasn't had any negative impact on returns, and the fund has performed better on an annualised three-year basis than the other Europe-focused funds on the list.

What it lacks in team size it more than makes up for in holdings, with the portfolio typically comprising 80 to 110 stock positions, which at the higher point can be more than double the other funds.

With a focus on small caps, it may look a little more risky, but its geographic split is across a number of wealthy, developed European countries, and Hughes says the fund doesn't go after the 'racy, high risk' end of the market. 'These are high quality, if a little boring, companies that have already made a profit,' he adds.



BlackRock European Dynamic (BCZRNN3)

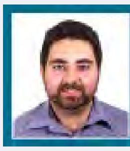
Three-year annualised return: 12.93%

Benchmark: 9.05%

Described as a 'go anywhere' fund, a strategy which theoretically allows managers to pick the best investments instead of being pigeon-holed into certain regions, sectors or company sizes, this fund certainly ignores its benchmark.

Run by manager Alister Hibbert and supported by an extensive team of analysts and portfolio managers, the fund's holdings display characteristics of both growth and value investing, and are based on growth potential, conviction and the chances of the anticipated returns actually materialising.

Because its portfolio can be very different to the benchmark, it's worth noting the fund's performance can be volatile.



By Yoosof Farah
Reporter

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Is it worth paying a premium for infrastructure funds?

These assets offer steady income at a price and you need to watch the political risk

On the face of it, investing in infrastructure seems like a wise move.

After all, you tend to get a steady stream of income for a long period of time. Assets such as ports, airports and toll roads aren't going anywhere anytime soon, and due to their essential nature their earnings are both predictable and less likely to be hit by volatility. They also have an explicit link to inflation through regulation.

So when it comes to putting money into infrastructure investment trusts, which through one way or another put your cash into these assets, the relatively clear visibility on how much money they're going to get from them means you're likely to get a solid, reliable income that rises with inflation.

WHAT IS THE CATCH?

Most of these trusts at the moment trade at a premium, which means the shares trade at a higher price than the net asset value (NAV) of the fund.

These premiums may exist because the managers are being conservative on their assumptions over things like inflation and interest rates, says William Heathcoat Amory, an analyst at Kepler Partners.

INFRASTRUCTURE INVESTMENT TRUSTS

	Premium (or discount) to NAV (%)	Net yield (%)
3i Infrastructure	22.6	3.0
BBGI	16.5	4.4
Bluefield Solar Income Fund	16.3	5.9
GCP Infrastructure	15.2	5.9
Greencoat Renewables	13.8	5.4
Renewables Infrastructure Group	12.1	5.2
John Laing Environmental Assets	12.1	5.6
Sequoia Economic Infrastructure	10.2	5.4
Foresight Solar Fund	9.8	5.6
Greencoat UK Wind	9.1	5.1
Next Energy Solar Fund	8.3	5.7
SDCL Energy Efficiency Income	7.1	0.0
Gresham House Energy Storage	5.1	0.0
International Public Partnerships	4.2	4.7
US Solar Fund	4.1	0.0
HICL Infrastructure	3.7	4.9
Premier Global Infrastructure	-8.7	9.1
Utilico Emerging Markets	-10.4	3.2
Gore Street Energy Storage	-10.8	4.9
Ecofin Global Utilities & Infrastructure	-13.2	4.8

Source: Winterflood 4 June 2019

So if it costs more to invest per share than the value of the assets, then why bother?

ALL DOWN TO YIELD

Amory says it's difficult to find this sort of security of income elsewhere, and in comparison to gilts or other types of bonds the yields can be attractive, given the low interest rate environment we're currently in.

'The yields are pretty generous, and secure, so investors are happy to pay a premium for that,' he says. 'Institutional investors for example are happy to pay above net asset value. They are sophisticated investors, and they realise it's not bonkers to pay above the NAV.'

So does that mean investors should simply look past the premium and just focus on the yield? Hold your horses.

POLITICAL RISK

He adds that paying a big premium at the moment could be quite dangerous, as sentiment can quickly change when it comes to investing in infrastructure due to the political nature of the asset class.

That means it is possible you could pay a big price now to get in and access that steady stream of income, but then all of a sudden there's an election, Labour win and the trust's shares start trading at a 10% discount.

When looking at infrastructure trusts, it's important to consider how they would fare if there is a change of government, something which could well be around the corner given how volatile the current political climate is in the UK.

In the event of a general election, Stifel analyst Iain Scouller says the PFI sector would see the most nervousness due to that possibility of Labour going ahead with their stated aim of nationalising infrastructure.

If this were to happen, education and health projects would be the most affected, Scouller says, with those with higher exposure to these areas – **HICL Infrastructure (HICL)** and **International Public Partnerships (INPP)** – more affected than the others.

Also worth considering is the sensitivity of these trusts to interest rates and gilt yields, given their impact on the valuations of their assets.

Though given the exceptionally low base of both at the moment, Scouller believes a big rise wouldn't be likely to cause big discount rates or consequent reductions in NAV.

He says, 'In terms of sensitivity, we think the sector could certainly withstand a rise in the 10-year benchmark gilt yield from its current 1.2% up to 3% or possibly even up to 3.5% with little or no damaging impact on NAV valuations.'

Sequoia Economic Infrastructure Income (SEQI)

This trust yields 5.4% and while the shares trade at a 10.2% premium, this is not the highest among infrastructure investment trusts.

It also has the lowest fees in the sector, with an ongoing charge of 1.03% a year.

The trust offers exposure to a globally diversified portfolio of economic infrastructure debt, which includes sectors like transport, technology, utilities, media and telecoms, power, accommodation and renewables.

In a research note last November, Winterflood analyst Kieran Drake said the infrastructure debt sector has historically had lower default rates and higher recovery rates than the broader debt sector.

Sequoia is also considering a new share issue this year as it continues to diversify its portfolio.

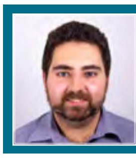
HICL Infrastructure (HICL)

One option for investors seeking a progressive, quarterly dividend-paying investment with scope for capital growth is HICL, trading at a premium of just 3.7% to NAV, far lower than the 16.5% for **BBGI (BBGI)** for example or the 22.6% for **3i Infrastructure (3IN)**.

This could be because it is more at risk if Labour win a general election and utilities get renationalised, as it holds more of them than the other funds.

But even if this did occur, Scouller says investors should expect only modest 'haircuts' to portfolio valuations, and HICL stated in November last year that the amount contractually payable in the event of nationalisation would be around 98% of the portfolio value.

At 4.9%, its yield is also higher than the two aforementioned trusts, and HICL is projecting dividend growth in the next year or two.



By **Yoosof Farah**
Reporter

Is Bitcoin really back?

Cryptocurrency recovers to become the best performing asset of 2019

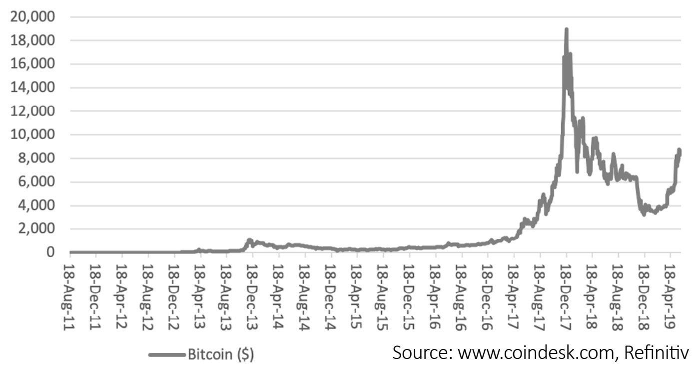
Well, here's a funny thing. As global stock markets suffered their first down month of the year in May and bond markets rallied strongly, amid an apparent dash for safety in the face of continued uncertainty of global trade, Brexit and fresh unrest in the Middle East, one asset class gathered fresh positive momentum – cryptocurrencies.

This adds another chapter to a remarkable story. To pick out the biggest cryptocurrency, Bitcoin, which is worth $150bn or 55% of the total crypto market capitalisation according to the website *Coinmarketcap.com*, it now trades at its highest level in over a year at just shy of $8,500.

This is a huge contrast to December 2018 when the cryptocurrency could apparently do nothing right as it crashed to $3,195, its lowest level in 17 months. That was also a big turnaround from December 2017 when Bitcoin could seemingly do not wrong as it reached $18,941, the latest in series of all-time highs.

Bitcoin's renaissance means it has more than doubled in 2019 in dollar and sterling terms, to make it the best performing asset class of the year so far.

BITCOIN HAS REBOUNDED IN 2019



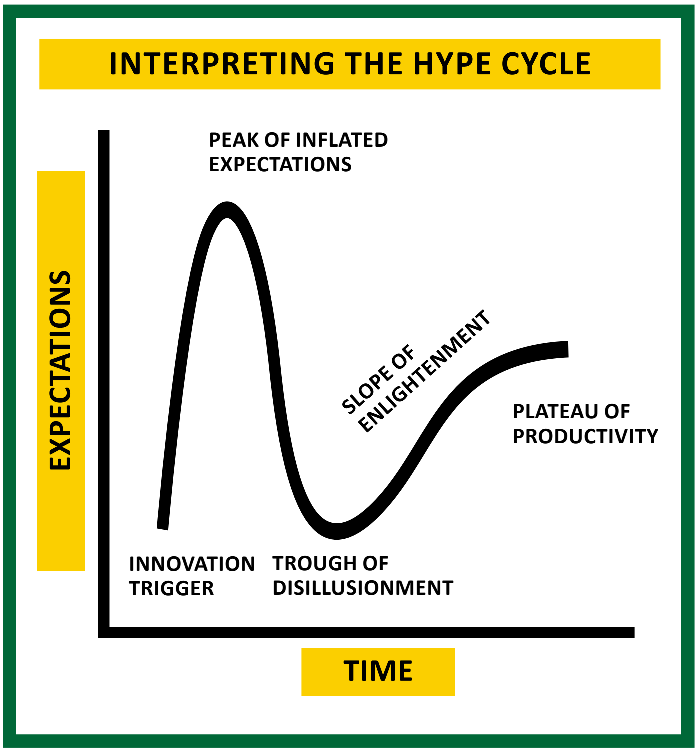
Source: www.coindesk.com, Refinitiv

BITCOIN HAS LEFT OTHER ASSET CLASSES TRAILING IN ITS WAKE IN 2019

	Capital return 2019 (sterling)	Capital return 2019 (local currency)
Bitcoin	117.7%	116.5%
S&P 500	12.5%	11.2%
Global Equities	10.9%	9.7%
NYSE FANG+	8.8%	7.5%
FTSE All-Share	7.6%	7.6%
Global Sovereign Bonds (Inv. Grade)	6.8%	5.6%
Global Corporate Bonds (Inv. Grade)	5.4%	4.3%
Emerging Market Equities	4.2%	3.0%
Gold	1.7%	0.5%

Global equities based on MSCI World index. Global Sovereign Bonds and Global Corporate Bonds based on Barclays Aggregate indices. Emerging Market equities based on MSCI Emerging Markets index. Source: Refinitiv

This now begs the question of whether Bitcoin, or cryptocurrencies more generally, can be an asset allocation option for investors within a diversified portfolio.



Source: Gartner

MONEY, MONEY, MONEY

It can be argued that cryptocurrencies are money, as they facilitate transactions over time and distance and represent a trusted medium (at least by some), just as cowrie shells, cows, metal, slips of paper and plastic cards have since time immemorial.

So long as someone believes in cryptocurrencies, they and their network have a value – and the more people in the network then the more value they may have.

Bitcoin has some unique issues relating to its design that could yet prevent mass adoption:

- The bitcoin mining process that is required as part of the computational process to create new Bitcoins and provide proof of work is inefficient and energy intensive.
- Bitcoin's supply is limited to just 21m. There are already 16m in issue and it is estimated that all Bitcoin will have been mined by 2040.
- Bitcoin has a clumsy cost structure. Miners receive a bonus for solving the algorithm when they mine a coin and this is paid in Bitcoin as a tiny percentage of the face value.
- This was no big deal when Bitcoin first reached the $1 mark in 2011, two years into its existence, but became a big issue when Bitcoin crossed $10,000 in 2017. It made transactions costly, prohibitively so for micro-payments in coffee shops or supermarkets.
- Bitcoin is not a particularly efficient payment system. It is slower than Visa, which can handle around 1,700 transactions per second, against Bitcoin's maximum of around seven.

Rival cryptocurrencies Ethereum and Ripple can manage around 15 and 1,500 respectively across their blockchains. This suggests that even if Bitcoin is not around for ever, blockchain will be as it facilitates financial transactions across many industries and both the public and private sector.

There are three other possible drawbacks to Bitcoin and cryptocurrencies more generally. They are still not universally accepted. Individuals cannot buy their weekly groceries or pay their tax with them.

They are subject to fraud (not that this necessarily distinguishes them from other forms of remote payment or investment). They have no intrinsic value (though the same can be said for gold or paper money) and they do not generate a yield or cash (which some gold miners do, for example).

Under such circumstances many investors may shy away or seek alternative portfolio diversifiers. But Bitcoin's current resurgence is eye-catching and it may be that we are still in the early days of cryptocurrencies and blockchain-enabled payment systems – Bitcoin's price in dollars does, for the moment, look an awful lot like the 'Hype Cycle,' as designed by consultant Gartner.

It may also be no coincidence that Bitcoin and cryptocurrencies found fresh support just as equities wobbled, bond markets rallied and central banks did a policy U-turn, leaving interest rates untouched or even cutting them, rather than raising them.

Bitcoin's resurgence may reflect fears over the global economy and the prospect of lower rates for longer or even more monetary stimulus if things get really difficult, as central banks lose control, although gold's failure to perform this year does not fit with such a narrative.

By **Russ Mould**
AJ Bell Investment Director

How fast are earnings growing among FTSE 100 stocks?

The names delivering earnings expansion and how they are valued

Which blue-chip stocks have the fastest earnings growth?

By using market screening tools and comparing growth with valuation we have come up with some useful insights which could provide the basis for further research.

RELIABLE GROWTH OR DANGER AHEAD?

Employing data from Stockopedia we measured earnings growth for FTSE 100 constituents over two periods, five years and 10 years.

Using two sets of data tells us whether growth has been a) consistent over the past 10 years, b) faster over the first five years and slower over the last five years, or c) slower over the first five years and faster more recently.

This is crucial because the danger with 'growth' stocks is that eventually they tend to go ex-growth. When they do, in theory they should de-rate but well-loved stocks can sometimes defy gravity for quite a while, propped up by bullish broker reviews and a positive consensus among the fund management community.

When stocks which are trading on elevated multiples can no longer meet earnings estimates the market's judgement is typically harsh. For example,

Table A

Name	10y EPS CAGR %	5y EPS CAGR %	12M Fwd PE	Share price % vs 10 Yr High
Hargreaves Lansdown	16.2	9.6	38.5	-7.0
Halma	12.4	13.1	33.2	-0.2
Spirax-Sarco Engineering	10.3	10.6	31.2	-5.6
Rightmove	21.0	19.5	28.3	0.0
Experian	3.2	0.9	27.7	-0.2
London Stock Exchange	15.6	20.4	25.9	-1.5
Rentokil Initial	5.3	0.8	25.4	-3.9
Intertek	10.5	9.9	24.7	-12.1
Diageo	5.2	0.6	24.5	-0.4
Croda International	10.5	6.7	24.0	-4.8
Sage	6.7	15.8	23.3	-9.7
St. James's Place	14.7	-2.5	22.8	-16.4
Unilever	4.8	7.1	21.1	-0.4
Compass	8.6	7.8	20.7	-1.3
Smith & Nephew	4.1	5.3	20.4	-0.6
InterContinental Hotels	6.5	4.9	20.0	-1.0

Source: Shares, Stockopedia

in mid-April catering supplies company **Bunzl (BNZL)**, for years the epitome of a reliable growth stock, disappointed investors. Its shares, which were trading on over 20 times forecast earnings, slumped by 12% and have yet to recover.

According to our screen there are 16 large-cap stocks trading on a rolling 12-month forward earnings multiple of 20 times or more, as per table A in this article. We have used a rolling 12-month basis as it smooths the transition from this financial year to the next by incorporating elements of both.

SOME STOCKS ARE CHEAP FOR A REASON

At the other end of the spectrum there are 13 stocks trading on nine times 12-month forward earnings or less with most more than 50% below their 10-year share price highs – see table B. To put this into perspective, a stock trading at a 50% discount to its highest price of the last decade would have to more than double to make a new high.

In some cases these are serial low-growth stocks, such as cigarette-maker **British American Tobacco (BATS)**, ex-monopoly telecom operator **BT (BT.A)** and medical and industrial equipment-supplier **Smiths Group (SMIN)**. Stocks which barely grow their earnings typically trade at low multiples and they make up for the lack of re-rating potential with chunky dividends.

Arguably some of the other names are former growth stocks which have gone ex-growth, such as budget airline operator **EasyJet (EZJ)** and tobacco-producer **Imperial Brands (IMB)**.

Not unreasonably, investors don't pay high multiples for stocks once they are ex-growth. However, included in this group are a handful of stocks which are delivering growth but are trading at big discounts to their peers in terms of valuation. These include packaging outfit **DS Smith (SMDS)**, life insurer **Legal & General (LGEN)** and housebuilder **Taylor Wimpey (TW.)** – with one in particular trading at an

Table B

Name	10y EPS CAGR %	5y EPS CAGR %	12M Fwd PE	Share price % vs 10 Yr High
EasyJet	22.2	5.5	9.0	-53.9
British American Tobacco	6.1	5.4	8.8	-49.9
Anglo American	-0.4	28.5	8.7	-44.2
DS Smith	11.6	13.4	8.5	-41.3
Taylor Wimpey	31.0	26.9	8.2	-16.0
ITV	18.0	8.5	8.2	-60.0
Legal & General	7.0	14.2	8.1	-12.2
Barratt Developments	5.0	29.5	8.1	-14.7
3i	21.3	18.0	8.0	-3.0
BT	2.7	1.1	7.9	-61.3
Imperial Brands	7.8	-2.3	6.9	-53.1
Aviva	-4.8	3.9	6.6	-29.5
Barclays	4.1	13.6	6.6	-58.6

Source: Shares, Stockopedia

unusually large discount to its previous price peak.

Barclays (BARC) has seen a material improvement in its earnings over the last five years yet the market has totally ignored it.

Considering that rival **HSBC (HSBA)**, which has a similar mix of retail, commercial and markets divisions, trades on over 11 times forward earnings yet has actually *shrunk* its profits by 3% a year for the last five years, on the face of it a re-rating of Barclays to say nine times earnings – or 36% higher than today's price – doesn't seem outlandish.

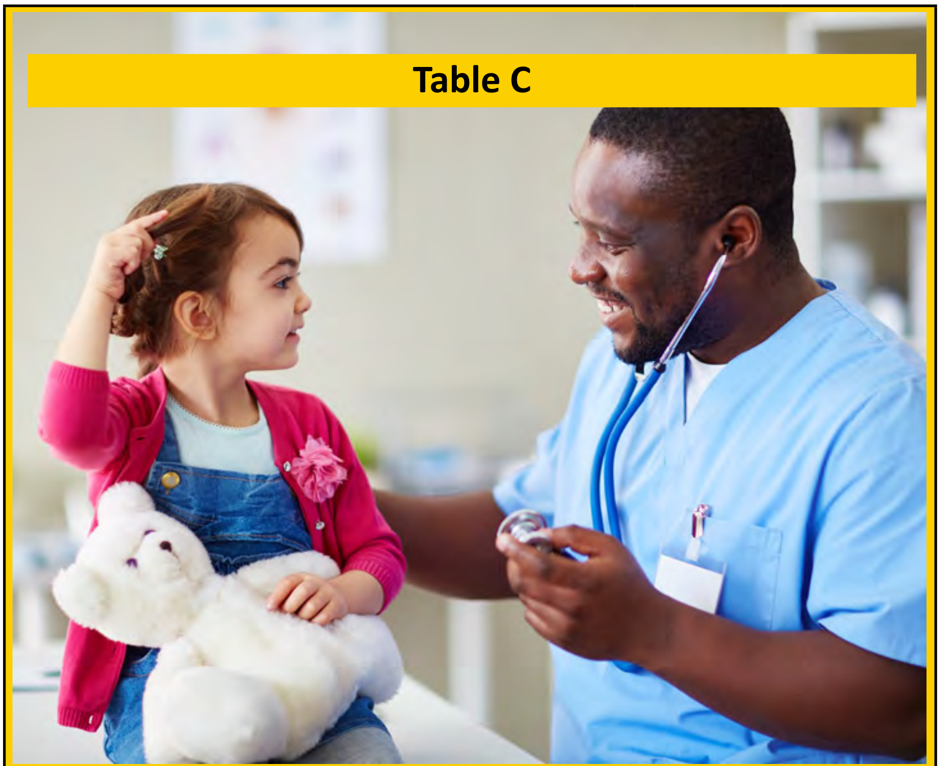
(HIGH) GROWTH AT AN UNREASONABLE (LOW) PRICE

The average rate of earnings growth across both five and 10-year periods in our screening is around 10%. Meanwhile the average 12-month forward rating is 15.5-times and the average discount to the 10-year share price peak is 23%. We should stress that these are mean or average values, not market capitalisation-weighted, but they are still useful for context.

Rather than just identify growth at a reasonable price, is it possible to find high growth stocks trading on below-average multiples?

Using our screen to look for stocks with consistent growth above the market average, a similar rating or better on forward earnings plus a similar discount to the price high does throw up some interesting names for further research – see table C.

Table C



Name	10y EPS CAGR %	5y EPS CAGR %	12M Fwd PE	Share price % vs 10 Yr High
NMC Health	40.2	26.8	16.4	-45.1
Berkeley	24.2	32.6	10.5	-18.4
Mondi	24.3	16.5	10.1	-26.3
Ashtead	28.4	35.3	9.5	-22.3

Source: Shares, Stockopedia

UAE-based healthcare provider **NMC Health (NMC)** tops the list with a staggeringly high earnings growth rate and a surprisingly large discount to its previous price-high. The fact that it is slightly more expensive than the average stock on a forward earnings basis is neither here nor there in our book.

Over the last five years, Barclays has seen a material improvement in its earnings


By **Ian Conway**
Senior Reporter

Understanding the different investment fund charges

How effective is the OCF in helping investors research different products?

Funds are obliged by the regulator to display their ongoing charges figure (OCF) to give investors a clear picture of the total costs they will pay for buying, selling and holding units in a fund.

The lion's share of the OCF is related to fees paid to the fund manager. This is to compensate the manager for providing stock selection, portfolio construction and risk management.

Actively managed equity fund fees typically range from 75 basis points (0.75%) to 250 basis points (2.5%) per year, although you can get cheaper ones. Bond funds can be cheaper still.

The second largest part of the OCF is the administration fee. The administrator plays an important role in managing a fund, as they do the work which links the trading in the fund to the valuation of the assets and keeping unit holder records.

Fund managers are not permitted to handle client money directly; all the buying and selling decisions in the fund are transacted through an authorised broker who then liaises with the administrator in order to settle the trades.

Administrators provide a daily or monthly valuation of the assets in the fund, keep the register of fund holders, calculate performance fees and provide safe custody of the assets.

HOW MUCH DOES THE ADMINISTRATOR GET?

The administrator usually charges the fund based on a percentage of the assets under management or AUM.

A typical rate might start at 0.25% on the first £100m, with a sliding scale applied for higher amounts. For the very large funds with billions of pounds worth of assets, the manager will negotiate a maximum administration fee.

Many people assume that the larger funds have the lowest administration fees. Analysis by AJ Bell finds little evidence that this is true.

The administrator receives higher fees when the fund's assets grow, while it may not do any extra work to earn the higher fees.

OTHER FEES TO CONSIDER

The third element of the OCF is swallowed up by fees related to regulation, such as auditing fees, independent directors' fees and stock exchange listing fees. These could be around five basis points (0.05%) for a fund that has £100m in assets.

It doesn't stop there. If you buy your fund units through a

HOW FUND CHARGES TEND TO BE CALCULATED

ONE-OFF CHARGES

Eg: entry or exit charge (if applicable)

+

ONGOING CHARGES FIGURE

Annual management charge + other expenses

+

INCIDENTAL COSTS

Portfolio transaction costs + performance fees (if applicable)

HOW COSTS DIFFER ACROSS A RANGE OF FUNDS				
Funds	**Transaction cost**	**OCF**	**Total cost**	**Transaction costs/Total costs**
Vanguard FTSE All Share Index A Acc GBP in GB	0.05%	0.08%	0.13%	38%
Aviva Inv UK Equity Income 1 TR in GB	0.29%	1.00%	1.29%	22%
JOHCM UK Equity Income Y Inc TR in GB	0.19%	0.66%	0.85%	22%
Aberdeen UK Equity Income A Acc in GB	0.12%	1.30%	1.42%	8%
Janus Henderson UK Equity Income & Growth A Hedged Acc EUR in GB	0.12%	1.69%	1.81%	7%
Jupiter UK Growth Inc TR in GB	0.12%	1.77%	1.89%	6%
iShares 350 UK Equity Index (UK) A Acc in GB	0.03%	0.51%	0.54%	6%
Allianz UK Opportunities A in GB	0.07%	1.38%	1.45%	5%
7IM AAP Balanced A Acc in GB	0.05%	1.12%	1.17%	4%
Fundsmith Equity I Acc in GB	0.04%	0.95%	0.99%	4%
Fidelity Special Situations A Acc in GB	0.02%	1.66%	1.68%	1%

Source FE Analytics 22 May 2019

platform, and let's face it, most retail investors do, you will also pay a platform fee. The FCA, a regulator, wants funds to include the distribution costs into the OCF but that doesn't always happen.

TRANSACTION COSTS

Transaction costs of buying and selling portfolio holdings are not included in the OCF.

For a large FTSE name, dealing costs average around eight basis points (0.08%). There is also a spread between buying and selling prices of around six basis points (0.06%).

Total dealing costs can vary enormously from fund to fund, depending on how often the fund manager chops and changes the portfolio.

HELPING INVESTORS

Research by an FCA-sponsored team suggests that simply providing consumers with information does not guarantee that they will use it in their decision-making. However, clearly presenting understandable and engaging information in a prominent way can increase the effectiveness of disclosures.

Investors should carefully look at the charges and ask the manager if it is not clear, so that they can make informed decisions.

The most effective way to get investors to incorporate charges into their decisions is to take a leaf out of the tobacco industry and clearly label warnings.

There could also be more work done around transaction costs and how these relate to different styles of management. For example, some managers have a buy and hold strategy with low transaction costs while others have more of a trading approach.

Both of these strategies are fine – and higher costs can be justifiable if the manager and their approach generates superior results.

There is some evidence to suggest that funds with the lowest fees tend to outperform funds with high fees. But you should not assume that all low-fee funds are the best.

Greater compliance with the rules should lead to more transparency and hopefully better outcomes for investors. Ultimately it's about investors being able to identify value for money rather than pure lowest cost.

By **Martin Gamble**
Senior Reporter

The ETF aiming to profit from less liquid stocks

We examine a unique looking actively-managed product

Liquidity is typically seen as the investor's friend. It represents the ease at which you can buy and sell shares quickly and easily, and without causing a drastic change in the price.

However, there is research which suggests less liquid investments can generate premium returns – in part as compensation for the lack of liquidity and the perception that these equities are riskier than more liquid shares.

Investors can tap into this theme via an exchange-traded fund from Vanguard. For an ongoing charge of 0.22%, **Vanguard Global Liquidity Factor (VLIQ)** tracks stocks which, when compared to others in the investment universe, have low trading volumes and other measures of trading liquidity, including lower trading share and dollar volumes, based on percentage turnover, and price impact.

LIQUIDITY – THE DEGREE TO WHICH A SECURITY CAN BE QUICKLY BOUGHT OR SOLD IN THE MARKET

Vanguard Global Liquidity Factor – sector breakdown

- Financials – **30.9%**
- Industrials – **15.5%**
- Consumer services – **13.3%**
- Consumer goods – **10.6%**
- Oil & Gas – **8.8%**
- Basic Materials – **7.8%**
- Technology – **4.3%**
- Utilities – **4.1%**

Source: Vanguard

VOLATILE STRATEGY

In 2016 and 2017 the ETF achieved returns of 16.7% and 20.1% respectively but in 2018, a tough year for equities in general, it turned in a negative performance of -15.9% which shows that the strategy isn't a guaranteed winner.

Mark Fitzgerald, Vanguard's head of ETF product development in Europe, says the product stands out in the way it is constructed as it seeks to capture the so-called 'illiquidity premium' without the unintended bias towards small cap stocks.

'In this space it is a struggle to find an appropriate competitor product. Most of the development around this area tends to be around small caps.

'People traditionally have focused on small cap positioning with an understanding of what that means and the premium to be had – that is that shares are

What is the difference between active ETFs and smart beta?

THE DEVELOPMENT OF ETFs in the last decade has seen the emergence of products which rather than tracking a simple index like the FTSE 100 will seek to filter stocks based on different criteria including levels of volatility or dividend yield.

These are known as smart-beta ETFs. Vanguard's factor products don't track an index at all, instead the firm's quantitative analyst team actively manage the portfolio of the product.

As Vanguard's Fitzgerald explains: 'Our quants team effectively check and test portfolio holdings on a daily basis. If you have a benchmark it will rebalance every six months and this means your exposure to the factor will decay. We take an active approach to tweak and keep it on course.'

If a stock doesn't fit the relevant criteria it can be removed immediately rather than sitting in the ETF for months until the underlying index is updated.

less liquid and are not traded as efficiently.'

Fitzgerald explains that at the same time as delivering the factor-based exposure, there is a focus on maintaining diversification. 'The philosophy here is very much in line with John C Bogle's maxim of not looking for the needle in the haystack and just buying the haystack.'

The factor-based ETF can choose from a large list of global stocks and will often have thousands of holdings, aiming for around a third of the available universe.

Fitzgerald adds that while capturing lower liquidity stocks, Vanguard looks to avoid a situation where that might compromise the liquidity of the overall portfolio.

PART OF A BROADER PRODUCT SUITE

Vanguard Global Liquidity Factor is part of a quartet of ETFs, launched in 2015, which track global stocks based on different 'factors' which are defined as underlying investment drivers that explain the performance of markets – see table.

The roster comprises actively managed ETFs focused on value, liquidity, momentum and minimum volatility. All four have an ongoing charge of 0.22%.

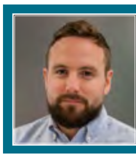
The minimum volatility ETF uses a model which is designed to measure stocks' exposure to a variety of factors that drive volatility such as sector, liquidity, size, value and growth. The model also assesses the interaction between these factors and their impact on the overall volatility of the portfolio.

The momentum-based instrument looks for stocks which have performed relatively strongly on a six-month and 12-month basis.

The value-focused product uses metrics including price-to-book or price-to-earnings ratio, estimated future earnings, and operating cash flow to filter stocks.

Fitzgerald explains Vanguard can keep the costs on these products low thanks to its scale, which means cheaper commissions on trading, and because the cost of employing quant analysts is cheaper than paying the licence fee on an index.

There is also an aim to strike a balance between tweaking the portfolio to ensure it remains in line with the relevant factor and trading too frequently.



By **Tom Sieber**
Deputy Editor

Vanguard Factor ETFs

- Vanguard Global Liquidity Factor (VLIQ)
- Vanguard Global Minimum Volatility Factor (VMVL)
- Vanguard Global Momentum Factor (VMOM)
- Vanguard Global Value Factor (VVAL)

KEY

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

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

7 June: Fuller Smith & Turner. **11 June:** CML Microsystems, Halma, IG Design, Motorpoint, Quiz, Trifast. **12 June:** Enteq Upstream, Norcros. **13 June:** John Laing Environmental Assets, OnTheMarket, Record, DS Smith, Volex, Majestic Wine.

Half year results

10 June: Ferguson.
11 June: Oxford Metrics, RWS.

Trading updates

11 June: Bellway. **12 June:** Boohoo.com.
13 June: PZ Cussons.

WHO WE ARE

EDITOR: Daniel Coatsworth @Dan_Coatsworth

DEPUTY EDITOR: Tom Sieber @SharesMagTom

NEWS EDITOR: Steven Frazer @SharesMagSteve

FUNDS AND INVESTMENT TRUSTS EDITOR: James Crux @SharesMagJames

SENIOR REPORTERS: Martin Gamble; Ian Conway @SharesMagIan

REPORTER: Yoosof Farah @YoosofShares

CONTRIBUTORS Russ Mould, Tom Selby, Laura Suter

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

CONTACT US:
support@sharesmagazine.co.uk

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PRODUCTION
Head of Design: Darren Rapley
Designer: Matt Ely

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