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FUNDSMITH AND OTHER **'QUALITY FUNDS'** UNDER PRESSURE

INCOME INVESTORS ON ALERT AS **GLOBAL DIVIDEND GROWTH SLOWS**

OUR TOP PICKS IN THE CLOTHING RETAIL SECTOR

It could get harder to find reliable and growing dividends

Clouds gather over sources of investment income

The search for reliable income remains a tough challenge for investors and unfortunately that quest is becoming even harder as corporate profit warnings rise, potentially leading to dividend cuts.

The UK's FTSE 100 index offers one of the highest yields in the world at 4.6% which is attractive relative to the poor returns you would get from cash in the bank. It is also more generous than many other major markets in the world such as 2.3% from the US' S&P index and 3.7% from Hong Kong's Hang Seng index.

Unfortunately investors must appreciate that these yields are not fixed and so future streams of income can go up and down.

As we discuss in this week's news section, the outlook for dividend growth is less than rosy. A report by asset manager Janus Henderson suggests that dividend growth is slowing. This matters because investors should really seek sources of income that are growing by at least the rate of inflation to sustain their purchasing power.

Last week saw AJ Bell host its annual Investival event for financial advisers that included a session on income investing. In it, Adrian Gosden, a fund manager at GAM, said that investors should consider static dividends as a key risk for 2020.

He made the point that a sluggish economy could make it difficult for companies to win new contracts and thus make it hard for them to grow their dividends. Companies that can achieve dividend growth should therefore be seen as prized assets in a portfolio.

Also presenting at Investival was Edward Bonham Carter, vice chairman of asset manager Jupiter, who made the point that stock selection is very important when it comes to finding income on the markets because of rising levels of corporate profit warnings.

DIVIDEND YIELDS BY COUNTRY

COUNTRY	INDEX	YIELD
UK	FTSE 100	4.6%
Hong Kong	Hang Seng	3.7%
France	CAC 40	3.1%
Germany	Xetra Dax	3.0%
China	SSE	2.6%
US	S&P 500	2.3%
Japan	Topix	2.3%

Source: Shares, Refinitiv

We've already seen FTSE 100 stocks such as **Vodafone (VOD)**, **Centrica (CNA)** and **BT (BT.A)** cut dividends in recent years and a tougher economic backdrop could put a financial strain on other businesses and lead to reduced shareholder rewards.

It is never been more important to seek diversified sources of income. This can be achieved by investing in different sectors and geographies and not being reliant on just a handful of stocks for dividends.

With this theme in mind, next week's issue of *Shares* (28 Nov 2019) will look at a selection of income funds that would suit either someone in retirement or someone looking to invest in cash generative companies who can then reinvest all the dividends to enjoy compounding benefits.

DISCLAIMER: AJ Bell is the owner and publisher of *Shares*. The author owns shares in AJ Bell.

By **Daniel Coatsworth** Editor

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Fundsmith
Emerging Equities Trust

The Fundsmith Emerging Equities Trust (FEET) research team searches the world to find companies that make their money from a large number of everyday, repeat, predictable transactions and will benefit from the rise of the consumer in developing economies.

Fundsmith LLP ("Fundsmith") is authorised and regulated by the Financial Conduct Authority and only acts for the funds to whom it provides regulated investment management and transaction arrangement services. Fundsmith does not act for or advise potential investors in connection with acquiring shares in Fundsmith Emerging Equities Trust plc and will not be responsible to potential investors for providing them with protections afforded to clients of Fundsmith.

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% Total Return

Year to end September	2019	2018	2017	2016	2015
Fundsmith Emerging Equities Trust	-2.4	+5.6	+0.4	+16.4	-11.8
AIC Global Emerging Markets Sector	+6.3	-0.8	+13.3	+30.0	-17.1

Source: Financial Express Analytics

www.feetplc.co.uk **Available for your ISA through your stockbroker.**

Fundsmith LLP is a limited liability partnership registered in England and Wales with number OC354233. Its registered office address is 33 Cavendish Square, London, W1G 0PW

Vodafone could face hefty Kabel Deutschland legal bill

Analysts calculate €5bn worst case cash scenario

Mobile network **Vodafone (VOD)** could be left with a €5bn bill if a German court ruling goes against it next week.

On 27 November, a German court will give its verdict on the valuation fairness of Vodafone's acquisition offer for Kabel Deutschland in 2013. The €87 per share valued the German business at approximately €7.7bn and was part of Vodafone's bid to expand its range of television and fixed-line services in Germany.

That offer was contested by hedge fund firm Elliott Management, a minority shareholder in Kabel at the time with a 14.4% stake. Elliott subsequently filed a legal suit in 2014 demanding higher compensation for minority shareholders. The legal dispute has been dragging on ever since.

Elliott is believed to have been arguing for a fair

value offer nearer €200 per share, and a 'really adverse ruling' for Vodafone could create a €5bn liability, according to Jerry Dellis, an analyst at investment bank Jefferies.

A court loss for Vodafone could see it have to find cash to make the payment in the next one to three years.

Vodafone has already made provision on its balance sheet worth €1.88bn, based on the original offer price plus interest.

Holding auditors' feet to the fire

Watchdog to push for more accountability from audit firms

IN THE WAKE OF numerous accounting scandals over the last two years, the Financial Reporting Council (FRC) – which oversees the accounting profession – is contemplating asking for tougher powers from the Government to set pay standards for auditors and focus management minds on the quality of the work they submit.

Since outsourcing firm Carillion and department chain store BHS were both given a clean bill of health by their auditors before they collapsed, something clearly needs to be done.

The FRC's idea is to implement something along the same lines as the Senior Management Regime (SMR) which applies to the UK banking sector. Under the regime, senior managers can be held accountable if they do 'significant harm' to the business.

Grant Thornton recently invested £7m in a revamp of its accounting team amid a probe into its audit of failed cafe chain Patisserie Valerie

In the same way, if an audit firm's work is considered to be below a certain standard, the FRC could demand that senior partners of the firm pay back some of their bonuses.

Before its collapse, Carillion was given a clean bill of health

Earlier this year the Competition and Markets Authority (CMA) proposed an operational separation of the audit and consultancy businesses in order to address conflicts of interest.

Worries have since surfaced that the big firms could put in aggressively low bids for audit work simply in order to attract the more lucrative consultancy assignments.

Eddie Stobart and Carpetright shareholders poorly served by bids

Rescue offers for haulage operator and carpets seller leave little on the table for investors

Recent takeover approaches for haulage operator **Eddie Stobart Logistics (ESL:AIM)** and flooring retailer **Carpetright (CPR)** are providing a raw deal for retail investors as major shareholders take control.

Investors in Eddie Stobart, famous for the distinctive livery on its heavy goods delivery trucks, face significant losses once currently-suspended shares reopen for trading after the board agreed a 'rescue bid' from a private equity fund.

DBAY Advisors, Eddie Stobart's former controlling shareholder, will acquire a 51% stake, and in return it will provide £55m through a high interest 'pay later' type of loan. Eddie Stobart has been hit by weak trading and an accounting scandal.

DBAY's arrangement doesn't look attractive for the rest of the shareholder base. It implies a £107m valuation for the business, well below its £269m market cap before shares were suspended in August at 71p.

Meanwhile, former boss Andrew Tinkler is reportedly set to table a rival £75m offer.

Tinkler's bid, reports of which emerged over the weekend, relies on £40m from institutional investors (said to be fund firms M&G and Ruffer) and £25m from a rights issue, with £10m coming from his own pocket.

However, a Tinkler bid has been mooted since September and is yet to materialise, while a rights issue with the company's shares suspended will be difficult to pull off.

Fellow transport group **Wincanton (WIN)** has shown interest in buying Eddie Stobart but the firm is still seeking information on underlying profit and cash flow before deciding whether to act.

In the retail sector, long suffering holders of Carpetright shares have lost out on a long-term view. In 2007, shares in Carpetright peaked at north of £12, but the board has now recommended a lowball 5p per share bid from near-30% shareholder Meditor to take the business private.

The cash offer values restructured but still cash-strapped Carpetright at just £15.2m. The business has been clobbered by crippling rents, frail consumer confidence since the Brexit vote and intensifying floor coverings market competition.

Away from the glare of the public markets, Meditor's poker-playing boss Talal Shakerchi will look to take on Carpetright's bitter rival Tapi by investing in the store estate and 'driving new initiatives and improvements'.

Income investors on alert as global dividend growth slows

A further decline in dividend growth is expecting going into 2020

Global dividend payments grew by 2.8% in the third quarter to $355bn, the slowest rate of increase for several years according to research by asset manager Janus Henderson.

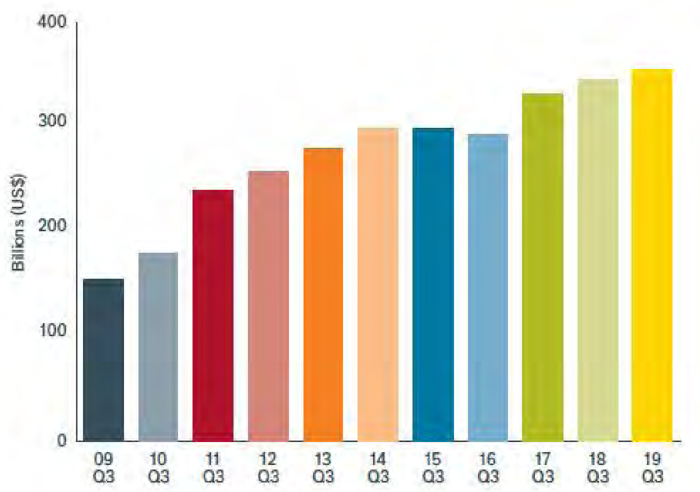
Its Global Dividend index measures how much income firms are paying their investors on their capital and is calculated in US dollars with a base year of 2009 and a base value of 100.

At the end of September the index hit 193.1, meaning that over the past 10 years global dividend payments have increased by just over 93%.

US dividends hit an all-time high of $124.7bn in the third quarter, equal to a record 35% of the total global amount. Underlying dividend growth was 8%, but as profit growth slows fewer US companies are raising their payout.

UK dividends rose by 2.9% to $34.3bn including large special payouts from mining firms, but regular dividend payments rose by just 0.6%.

GLOBAL DIVIDENDS (US$ BILLIONS)



Source: Janus Henderson

Australia, another big source of dividends, was weak with total third quarter payouts down 5.9% to $18.6bn.

The report forecasts a further slowdown in dividend growth this quarter and into next year.

FTSE 350 MOVERS OVER THE PAST WEEK

BEST PERFORMERS		
STOCK	**SHARE PRICE RISE**	**REASON**
PureTech Health	17.3%	Investee company reports encouraging clinical trial results
NMC Health	11.3%	Positive broker comment
AG Barr	11.2%	Bargain hunters emerge after shares hit multi-year lows

WORST PERFORMERS		
STOCK	**SHARE PRICE FALL**	**REASON**
Equiniti	-9.4%	Profit warning linked to weaker contribution from corporate sector
TBC Bank	-8.9%	Regulatory-linked pressure on margins revealed in Q3 update
FirstGroup	-8.0%	Reports first-half loss on writedown of US Greyhound operation

Source: Shares, SharePad. Data to 19 Nov 2019

Why quality growth funds like Fundsmith are feeling the pain

Lindsell Train, Smithson, Blue Whale and similar quality funds are seeing a downturn in price performance

The third quarter of this year represented a major milestone for the UK fund management industry although it's one it would probably prefer to keep quiet.

According to the Investment Association, in the three months from July to September, UK-registered equity funds saw their biggest quarterly outflows since records began as £4.6bn of cash was withdrawn. In September alone £1.7bn was withdrawn, the biggest monthly redemption since the Brexit vote in 2016, with customers pulling £676m from UK equity funds specifically.

Interestingly, these outflows included some of the most popular 'quality' funds held by lots of retail investors. Among the largest individual casualties of these outflows were **Lindsell Train UK Equity Fund (B18B9X7)**, which suffered outflows of £551m, and **Jupiter European Fund (B5STJW8)**, which saw outflows of £725m according to estimates from fund-rating firm Morningstar, perhaps compounded by the exit during the summer of its fund manager Alexander Darwall.

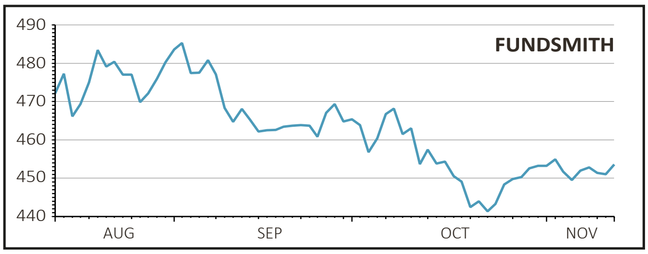
These two funds, as well as many other products with a quality bias and which invest in companies around the world including **Fundsmith Equity (B41YBW7)**, **Smithson Investment Trust (SSON)** and **Scottish Mortgage Investment Trust (SMT)**, have seen a drop in the price of their funds or shares in recent months. Investors should therefore try to understand what's going on in the market.

MARKET MOVEMENTS

As with the overall market, outflows from 'quality' funds were concentrated in September just as UK and European growth stocks underperformed the market and value stocks outperformed.

While the same rotation out of growth stocks

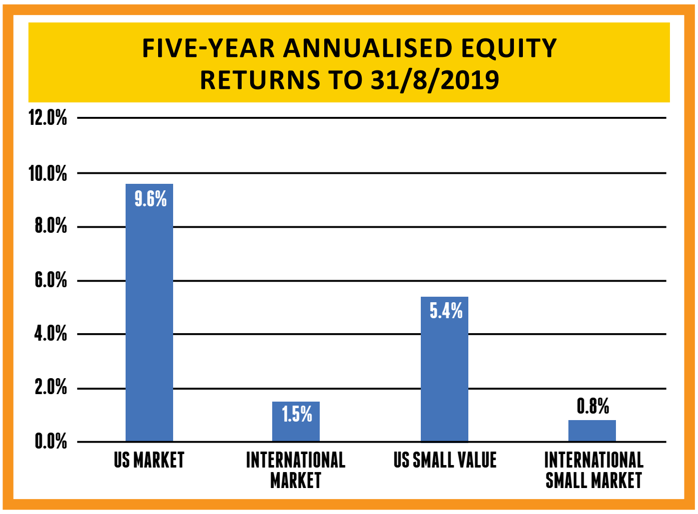
'QUALITY' FUNDS: RECENT PERFORMANCE TRENDS



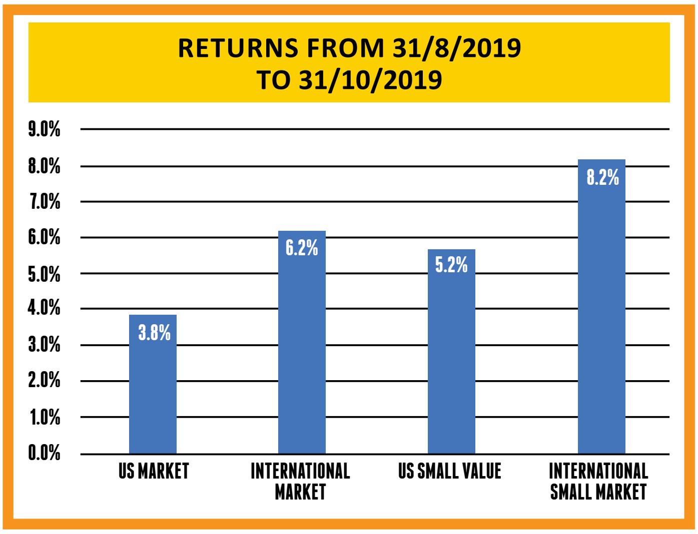
	Change 1 Sep to 30 Sep 2019	Change in 1 Sep to 14 Nov 2019
Baillie Gifford Global Alpha Growth	-1.8%	-0.1%
Blue Whale Growth	-3.1%	-4.4%
Fundsmith Equity	-3.3%	-5.7%
Jupiter European	-1.8%	-3.5%
Lindsell Train Global Equity	-2.9%	-4.0%
Scottish Mortgage	-3.2%	-1.4%
Smithson Investment Trust	-0.6%	-2.2%

Source: Shares, Datastream, FE Fundinfo

Amazon is Baillie Gifford Global Alpha Growth's top holding



Source: Verdad, Capital IQ



Source: Verdad, Capital IQ

into value stocks took place in the US stock market, the effect was less spectacular. Also, the outperformance of smaller value stocks was less pronounced in the US.

Dan Rasmussen, founder of hedge fund Verdad Capital, has compiled two charts to illustrate the impact of this rotation on four different investment strategies: US stocks, US small cap value stocks, international (non-US) stocks and international small-cap value stocks.

The first chart shows the five-year annualised return for each of the strategies up to 31 August this year. The second chart shows the returns from 31 August to 31 October.

The difference is startling and begs the question 'can international stocks and in particular international small cap value stocks continue their outperformance of the past two months?'

Comfort-owner Unilever is categorised as a defensive stock

ARE 'SAFE HAVENS' NO LONGER SO SAFE?

JPMorgan Asset Management forecasts that global growth will be no better than 'modest' over the next 10 to 15 years and warns that investors need to 'rethink safe havens'.

Growth is seen averaging 2.3% over the next decade, down from last year's prediction of 2.5%, but more importantly inflation is expected to fall short of most central banks' targets, which combined with 'much lower starting yields' means fixed-income returns are likely to be much lower, even into negative territory.

The forecast for equity market returns is 6.5% a year in dollar terms but developed markets are only expected to return 5.7% while emerging markets could return 8.7% annually in local currencies.

Safe havens in the UK equity market have been 'quality', 'defensive' growth stocks such as **Unilever (ULVR)** and **Diageo (DGE)**, which are seen as having good earnings visibility, good cash flow generation and in theory are not susceptible to business cycles.

These stocks were relentlessly bid up over the summer to the point where at the start of September they were trading on close to 25 times expected earnings.

Also, businesses like **DCC (DCC)** and **Rentokil (RTO)**, which tend to have steady earnings streams, had their cyclical tendencies air-brushed out allowing investors to propel them to similar valuations to the 'quality' growth stocks.

These kinds of stocks are still cyclical and when they disappoint the subsequent de-rating can be brutal.

VALUATION CONCERNS

Investment bank UBS says that while stocks with the lowest valuations are around 10% 'cheap' against historical averages, the most expensive stocks are as much as 30% more expensive than their historical average.

It says these stocks 'are amongst the worst performing if growth weakens further and lag if the cycle turns up. Thus, we avoid high growth and defensive stocks with big multiple overhangs'.

Bloomberg notes that the top high-flying US stocks started this quarter priced for profit growth of a staggering 25% every year for the next decade, while the actual rate over the past five years was more like 12%.

In contrast, the cheapest stocks are discounting a trend growth rate over the next 10 years below the rate they experienced over the past five years, compounding the mispricing of value relative to growth.

WHAT DOES THIS MEAN FOR INVESTORS IN 'QUALITY FUNDS'?

The message is clear: anyone owning some of the funds we mentioned earlier in the article such as Fundsmith should expect more volatility in the near-term than they might have been used to.

Anyone investing in 'quality' funds should be prepared to ride out any ups and downs along the way. If you're not comfortable with this situation then now might be a time to rethink your investments.

Someone with a 'buy and hold' approach may still be happy owning 'quality' funds but make sure you check the fund manager's style doesn't drift in the search for better returns if market conditions start to favour a different type of investment.

DISCLAIMER: Editor Daniel Coatsworth owns shares in Smithson referenced in this article.

By **Ian Conway** Senior Reporter

Fidelity™ INTERNATIONAL

Investing in **good businesses**, run by **good people**, at a **good price**

Nitin Bajaj, Portfolio Manager of Fidelity Asian Values PLC, explains his investment process and why he focuses on stocks and not news stories..

The investment philosophy which underpins Fidelity Asian Values PLC is quite simple. I try to buy good businesses, run by good people, and buy them at a good price. I don't tend to pay much attention to the latest newspaper headlines, as I think my time is much better spent focusing on things I can control, namely buying businesses that meet my quality and value criteria. It is important for shareholders in the trust to understand and appreciate the philosophy I follow, because the extent of our success over the next five years will be largely driven by the hard work that we put in.

Stock markets will go up and down - this is the normal ebb and flow of the market - but to make money, I believe you need a good philosophy, stay true to that, and be willing to put in the time and effort to implement it effectively.

How I manage money is more or less the way most people manage their personal finances. If you were buying a company today, you would want to buy a good business, then you would want to hire the best people to run it for you, and finally you would want to buy it at the best possible price. I just try to do that in the stock market.

It is easier said than done, because finding good businesses is not that easy. It requires an immense amount of hard work from Fidelity's analyst team and patience from me, because we look at company after company after company, and it is only one out of perhaps 15 or 20 that meets our strict criteria.

Capital preservation is also paramount. I have an obsession with not losing money. When our analysts come to me, I always tell them it is their job to make money; it is my job not to lose money. I am always looking for ways a company's stock price could go down, so I am pessimistic by nature. By challenging the thesis behind an investment, we hope to form a balanced view and make a good decision.

As a bottom-up investor I don't have a differentiated view on calling future macro events and history has shown us many times that the impact of political and economic

policy is complex and multi-layered. What I would say, however, is that after an extended period of global growth over the last decade it would not be surprising to see a downturn in the business cycle at some stage in the next three years. If this were to happen, this is likely to create headwinds for equity market returns globally.

However, the fact that Asia is home to over 17,000 listed companies provides a huge opportunity set to find overlooked or misunderstood investment potential irrespective of the prevailing economic and political conditions. Given this large and diverse investment universe, I believe the only reason we will not make money is if we don't work hard enough, and the team work very hard, so the opportunity is there.

In running the trust, I am supported by a large locally-based analyst team across the region, and that is the key competitive advantage of Fidelity International. Looking ahead, I believe the philosophy will work, and if we work hard and don't get complacent, the trust should do well for shareholders.

Games Workshop has scope to earn a lot more money

Royalty income is accelerating as it generates more value from its assets

Fantasy miniatures and table-top war games retailer **Games Workshop (GAW)** is benefiting from a step-change in royalty income and we believe further exploitation of its intellectual property can take the business to the next level.

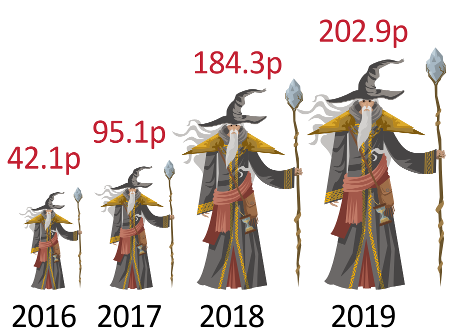
Broker Peel Hunt forecasts royalty income of £10m in the six months to 1 December 2019, nearly double the level from the same period last year.

The company is now demonstrating its potential to commercialise the intellectual property which resides in the Warhammer brand through console and PC games as well as animation and TV content.

Games Workshop says the Warhammer-community.com website achieved over 114m page views from around 6m users in the 12 months to 2 June, up from 70m page views and 5m users in the previous year.

Growing royalty income is an important development for Games Workshop because it demonstrates the 'hidden' value of its brand. Not only that, royalties are almost pure profit and relatively stable and should therefore attract a higher valuation multiple over time.

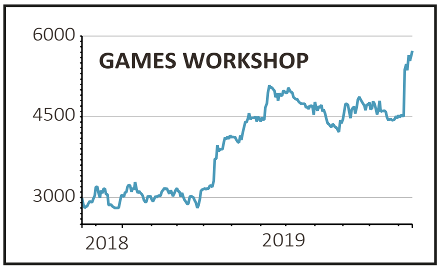
EARNINGS ARE FAR FROM MINIATURE



Source: Company reports. Earnings per share.

GAMES WORKSHOP
BUY
(GAW) £57.30
Stop loss: £45.80

Market cap: £1.8bn



This was illustrated in a recent trading update where the 12% rise in year-over-year revenues to £140m should have converted nearly all into profit.

Games Workshop has a simple but powerful business model centred on the quality manufacturing of miniatures and games. The physical stores are a place where you'll find enthusiasts who aim to interact with everyone coming through the door.

This interaction is designed to create a feeling of being part of a community, and strengthens loyalty while increasing the likelihood of repeat sales.

The company only manufactures fantasy figures, and therefore has potentially unlimited scope for innovation. Popular fantasy series like *Game of Thrones* help to raise interest in the genre, but the company controls its own fortunes as the success of Warhammer demonstrates.

The scope for growth is still significant and comes from well-established channels of Games Workshop stores, which account for 34% of revenue, third-party retailers which represent 47% as well as online stores.

This is an international business too with more stores in North America and Mainland Europe than the UK.

The shares aren't cheap, trading on 24.7 times forecast earnings. Yet Games Workshop is a quality business with a proven track record and is well positioned for further growth.

By **Martin Gamble**
Senior Reporter

HarbourVest is cheap and a great way to play the private equity space

Now's your chance to invest in a diversified portfolio for 16% below its true value

Before they come to the stock market, all companies need to raise capital in order to grow and one of their options is to work with pools of private money set aside specifically for that purpose.

Investing in private equity through an investment trust is not only a good way to diversify your exposure away from publicly-quoted stocks, but it offers the possibility of 'getting in on the ground floor' in some of the most interesting and exciting global opportunities.

HarbourVest Global Private Equity (HVPE) is one of our preferred ways of playing this theme as you are getting exposure to an established investment trust trading below the value of its assets.

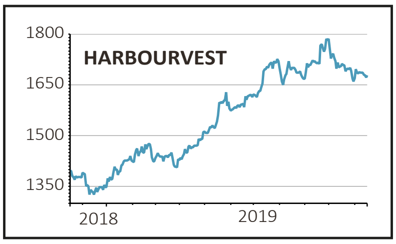
It invests in private companies directly and in portfolios of private companies managed by parent company HarbourVest, which has more than $64bn of assets and more than 35 years of experience in the field.

Its investments are purposely diversified by geography, by sector, by strategy and by stage of investment, and include more than 1,000 companies ranging from early-stage ventures to large cap buyouts.

Over five years the company's net asset value (NAV) in dollars has increased by 70% while the share price in pounds has appreciated by 131%, yet the shares still trade at a 16% discount to NAV.

HARBOURVEST GLOBAL PRIVATE EQUITY ↗ BUY
(HVPE) £16.80
Stop loss: £13.44

Market cap: **£1.35bn**



HarbourVest invests in several shipping-related companies

'HarbourVest is an attractive way to gain diversified exposure to the global private equity market,' says Numis. 'The fund has a good track record. From inception in 2007 to 30 September 2019, NAV per share total return in US dollars was 157.3% against 74.4% total return for the FTSE All-World index.

'The portfolio diversification provides opportunities for long-term growth, limited volatility and capital preservation,' it adds.

On a broader basis, JPMorgan Asset Management expects private equity returns to average 8.8% per year over the next 10 to 15 years compared with 5.7% annual returns on publicly-quoted stocks in developed markets.

As a rule of thumb, if an investment increases in value by 7% a year its value will double in 10 years thanks to the power of compounding.

Private equity investors have become more adept at evaluating risk over the past decade so when the next downturn does come the more experienced players should have greater staying power.

By **Ian Conway**
Senior Reporter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OFFICIAL HOSPITALITY AT THE HOME OF ENGLAND RUGBY
TWICKENHAM STADIUM

JUDGES SCIENTIFIC
(JDG:AIM) £50.50

Gain to date: 77.2%

Original entry point:
Buy at £28.50, 11 April 2019

A NEAR-80% gain in a few short years would be impressive, but to do it in just a handful of months takes luck as well as good judgement.

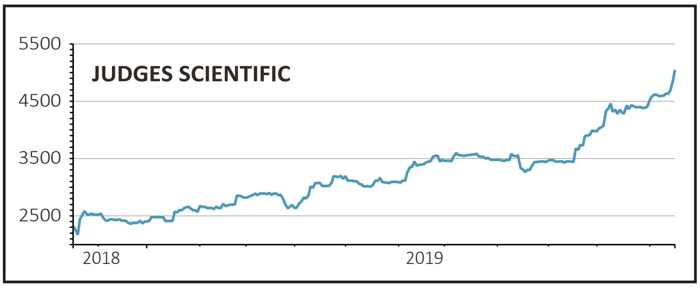
Yet this is what's happened to the performance of **Judges Scientific (JDG:AIM)** since we highlighted its attractions in April.

The company is a portfolio of niche science-based businesses spanning nanotechnology, fibre optic testing, advanced materials, LED design and x-ray technology.

We originally said it was a proven, high-quality business that was simply too cheap on a 2019 forecast price-to-earnings multiple of 14.8. We saw very good re-rating opportunity and so it has come to pass.

This is in part thanks to September's record half-year results that set new high bars for revenue, adjusted pre-tax profit, earnings per share, cash generation and dividends, but also for management's upbeat comments which put to bed investor concerns about an economic slowdown.

The re-rating leaves the stock trading on 24.3 times next year's expected earnings. Investors taking a multi-year view should stay with the story, but for those with more immediate priorities, this may be a prudent time to top slice profit and take some money off the table.



SHARES SAYS:
Consider taking some profit.

FULLER SMITH & TURNER
(FSTA) £10.20

Loss to date: 4.7%

Original entry point:
Buy at £10.70, 14 February 2019

PUB AND HOTELS group **Fuller Smith & Turner (FSTA)** admits that it has underestimated costs of 'transitioning' the beer business to Japanese brewer Asahi, which struck a deal in January to acquire the assets.

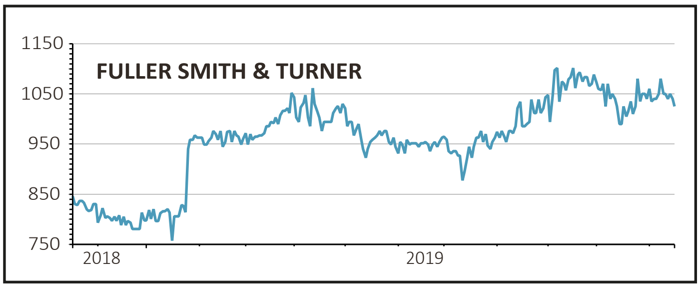
This mistake will result in full-year pre-tax profit to 28 March 2020 being flat on a comparable basis to last year at £31m.

What appears to have happened is that the migration to a new enterprise resource planning system (ERP) has taken longer to deliver benefits than anticipated, resulting in higher running costs.

The ERP issue further complicated the separation of the 174-year-old beer business, resulting in £3.4m of extra costs and the transition period extending to the end of May next year.

The impact appeared larger because analysts' profit forecasts of £42m had gotten out of line with management expectations, which were closer to £37m.

Broker Liberum sees this event as a post-disposal 'reset of the numbers' rather than a profit warning.



SHARES SAYS:
Don't be put off by the setback. We believe the disposal makes strategic sense and once the current transition is complete, the group is well positioned for further growth.

BT investors face dual threat of renationalisation and more dividend cuts

It's an uncomfortable time to be a shareholder in the UK telecoms giant

If **BT (BT.A)** investors thought the dividend was a headache, they are probably nursing a migraine now. A pledge by Labour's Shadow Chancellor John McDonnell last week to take BT's broadband national infrastructure backbone Openreach into public hands really did come out of the blue.

The market has been aware of Labour's plans to renationalise various UK assets, energy and water utilities, but an attack on BT had not previously been on Labour's hit list. Even BT's chief executive Philip Jansen admitted his surprise at the announcement.

There are many barriers for Labour to overcome before it could renationalise such businesses, such as funding the deals. A tax on big technology companies be seen as a vote winner but implementing such a scheme will not be easy, nor will striking a deal to the satisfaction of the taxpayer and shareholders without blowing apart Britain's reputation as a safe place to invest for overseas capital.

Labour is estimating the cost of its BT policy at £20bn which includes £5bn of public subsidy already earmarked for rural network. Yet BT's boss Jansen told the *BBC* that including lost revenues from having free broadband nationwide would probably double that bill.

BT'S CASH FLOW VS DIVIDEND

£ million	2017	2018	2019	H1 2020
Operating profit	3,167	3,381	3,421	1,762
Depreciation & amortisation	3,572	3,514	3,546	2,121
Net working capital	-112	-549	-90	-513
Tax	-551	-473	-431	-83
Net interest expense	-804	-764	-756	-284
Capital expenditure	-3,454	-3,522	-3,963	-2,067
Operating free cash flow	1,818	1,587	1,727	936
Dividends	1,435	1,523	1,504	457
Operating free cash flow minus dividends	383	64	223	479

Source: Company accounts, AJ Bell

Then there's the huge pension scheme issue. BT has previously highlighted pension costs as a material obstacle to a potential Openreach demerger while analysts at investment bank Jefferies believe that the BT pension scheme trustee would 'logically demand very substantial upfront compensation'.

Labour's capacity to get in at Number 10 with enough of a majority to action many of its more controversial policies is perhaps the biggest challenge to renationalising Openreach.

NEW AND OLD WORRIES FOR INVESTORS

BT's share price has held up remarkably well since last week's announcement, drifting just 2% lower to 191.38p. This demonstrates that investors believe Labour has little chance of getting in at Number 10.

However, this isn't a reason to ignore the situation. 'There is a risk that Labour's idea proves popular with voters and other parties feel compelled to move at least some way in this direction', warns AJ Bell's investment director Russ Mould.

Analysts at investment bank Berenberg believe BT could face being politically leaned on by a re-elected Boris Johnson, increasingly the political risk, 'even in the event of a Conservative victory'.

This leaves investors facing another risk to the already difficult juggling act BT must perform to balance its broadband expansion capital investment, meet borrowing costs, fund its pension scheme and retain an income for shareholders from shrinking cash flows.

BT remains a company with little or no growth so income is the key reason to consider the shares. It was therefore disappointing for investors when it cut the half-year dividend in November 2018.

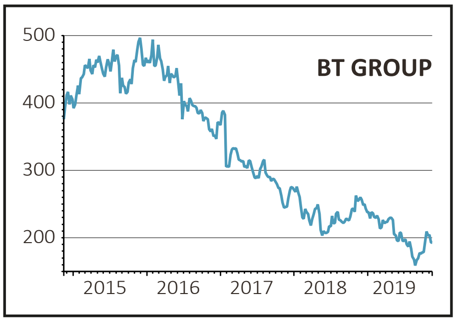
Chief executive Philip Jansen, who took over from previous boss Gavin Patterson in February 2019, retained the full-year dividend at 15.4p per share and pledged to do the same in the current financial year.

A 15.4p per share dividend costs BT around £1.5bn a year and there is reasonable amount of cash flow generated from operations to pay this shareholder reward even after key expenses, such as tax, interest on debt and capital investment are met.

But the margin for error is getting tighter and if profits do come under severe pressure then the dividend could come under threat once again.

STRATEGIC DIVIDEND MOVE?

A tactical cut to dividends, perhaps 20% or 25%, would make a lot of sense. The market already appears to be pricing in a potential cut given how the shares are currently trading on an 8% prospective yield. A stock yielding more than 6% is normally the market's way of saying it doesn't believe dividend expectations are achievable.



Analysts are already expecting cuts from 2021, as illustrated by forecasts in the accompanying table.

A dividend cut would save the company around £400m a year which could be used to speed up its network investment plans while providing a larger buffer against weakening trading.

Such a move would also send regulator Ofcom a message that the company is willing to be flexible in meeting the various demands of all stakeholders, playing its part in developing a faster broadband network for the nation while giving investors a return on capital.

Finally, it would draw a line under an issue that has dogged the company's investment case for several years, namely provide some certainty over the future dividend policy.

'We think it would be the right thing to do to take some dividend off the table, potentially a 30% to 40% cut, and reinvest that money into Openreach,' says Adrian Gosden, head of Strategic UK Equities at fund manager GAM. 'That would bring a whole new raft of people to the story and you'd still get a 5% yield.'

BT: PAST AND FUTURE EARNINGS PROFILE

	2018	2019	2020	2021
Revenue (£bn)	23.7	23.4	23.0	22.9
Pre-tax profit (£bn)	2.6	2.7	2.6	2.8
Dividend (p)	15.40	15.40	15.38	13.26
EPS (p)	20.40	21.60	21.20	22.68

Source: Consensus estimates, Refinitiv. March year-end

By **Steven Frazer**
News Editor

SMALL WONDERS: INCOME FROM THE UK'S MOST EXCITING COMPANIES

BLACKROCK SMALLER COMPANIES TRUST PLC

Smaller companies have typically been employed to add a little spice to a portfolio, to generate some growth alongside their stodgier blue-chip cousins. But they can play plenty of other roles, including as a solution for income.

Roland Arnold
Portfolio Manager
BlackRock Smaller Companies Trust plc

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. The investor may not get back the amount originally invested.

Smaller companies are often thought of as young, immature business models that may be entering new markets, adapting to changing market dynamics or leading technological change, trying to establish themselves among the competition and take market share. Therefore, and rightly so, the priority for many of these companies is investing for growth, and it is assumed that returning cash to shareholders is not high on the list of priorities for a smaller company.

While many of these statements are true and are in part many of the attractions of investing in the smaller companies' universe, we would also argue that UK small- and mid-caps can offer a differentiated source of income. We do not specifically target high yielding shares for the BlackRock Smaller Companies Trust, but our focus on high-quality, cash-generative businesses has the welcome side-effect of delivering a growing dividend to shareholders over the long term.

It is this ability to grow the dividend that we believe is most potent for investors: it is a valuable component to funding people's retirement since it has the potential not just to maintain but grow disposable income. While dividends are not guaranteed and past performance isn't a guide to the future, on this trust, we have increased our dividend every year for the past 16 years and the compound annual increase in dividends over the last ten years to 28 February 2019 has been 20%.

In contrast, equity income funds – a more obvious choice for income – will often hold 'bond proxy' type companies, characterised as companies that have delivered consistent but moderate earnings growth, which are often larger more defensive companies. Importantly, these companies may have a higher starting dividend, but will not be growing dividends, or are doing so at the expense of their balance sheet.

In building a growing dividend stream for investors, the closed-ended structure can be a real advantage. At times of economic stress or recession, some companies may be unable to grow their dividends and in fact may have to suspend the dividend, but we can keep a proportion of the dividend income received in a revenue reserve. Currently the reserve on the Trust is around 1.5 years.

The benefit of having a revenue reserve is that even in times when companies may be holding back on the cash that they

(%)	31/12/13 to 31/12/14	31/12/14 to 31/12/15	31/12/15 to 31/12/16	31/12/16 to 31/12/17	31/12/17 to 31/12/18	31/12/18 to 31/08/19
FTSE All-Share	1.2	1.0	16.8	13.1	-9.5	11.1
Numis Smaller Companies +AIM ex ITs (Constraint index)	-4.8	8.6	12.0	21.9	-15.8	6.9

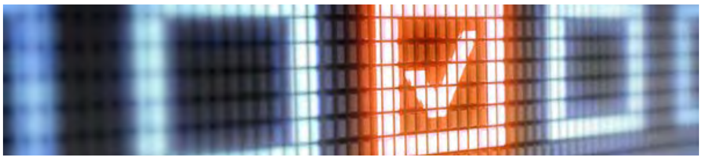
The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Source: BlackRock as at 31 August 2019. Index returns are for illustrative purposes only. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged, and one cannot invest directly in an index. Smaller company investments are often associated with greater investment risk than those of larger company shares.

return to shareholders, the Trust will be able to continue with our progressive dividend policy. To date, the Trust has not needed to use any revenue reserves, and even in the financial crisis of 2008, the Trust was able to grow the dividend through income generated from our holdings.

Income investing shouldn't be an alternative to growth and should happily sit alongside other elements of smaller company investing. Since 1995, the small-cap sector has consistently demonstrated greater earnings growth than its larger peers, which has in turn manifested itself in greater long-term returns for shareholders.

That said, it is certainly the case that small cap investing comes with greater risks. These are earlier-stage companies. There are over 1,500 companies in our universe and there will be weak spots.

An investment trust is a registered company and issues a fixed number of shares to investors. This means the portfolio managers do not have to worry about sudden inflows – or outflows – of money as manager of open-ended funds do. This structure also means that the trust does not need to hold a cash buffer to pay exiting investors.



Investing in smaller companies via an investment trust shouldn't be overlooked as part of an income portfolio. Selected well, smaller companies can provide a growing source of income, while also providing the growth that investors have come to expect from the sector. It is an investment for all seasons.

Unless otherwise stated all data is sourced from BlackRock as at October 2019.

For more information on this Trust, the risks involved and how to access the potential opportunities presented by smaller companies, please visit www.blackrock.com/uk/brsc

TO INVEST IN THIS TRUST CLICK HERE

Risk Warnings

The return of your investment may increase or decrease as a result of currency fluctuations

Trust Specific Risks

Liquidity risk: The Trust's investments may have low liquidity which often causes the value of these investments to be less predictable. In extreme cases, the Trust may not be able to realise the investment at the latest market price or at a price considered fair.

Gearing risk: Investment strategies, such as borrowing, used by the Trust can result in even larger losses suffered when the value of the underlying investments fall.

Smaller companies risk: Smaller company investments are often associated with greater investment risk than those of larger company shares.

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BlackRock has not considered the suitability of this investment against your individual needs and risk tolerance. To ensure you understand whether our product is suitable, please read the fund specific risks in the Key Investor Document (KID) which gives more information about the risk profile of the investment. The KID and other documentation are available on the relevant product pages at www.blackrock.co.uk/its. We recommend you seek independent professional advice prior to investing.

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PRIME PROPERTY PICKS: THE BEST OPPORTUNITIES AMONG REAL ESTATE SHARES

Four ways to make money from offices, warehouses, homes and doctors' surgeries

By **Tom Sieber**
Deputy Editor

The idea of investing in UK property might make you fearful given political instability created by the upcoming general election and ongoing Brexit saga. But there is genuine merit in having exposure to UK property as part of a diversified portfolio given its enduring income appeal.

We believe this exposure should be selective. In this article we identify four of our prime property picks, each of which play into different market hotspots.

INVEST FOR INCOME

There is the option of investing directly in property, either for development or to let, however recent regulatory changes have made this more complicated and you also run into risks such as a lack of diversification and liquidity.

As well as helping you to achieve diversification, a fund or listed property firm opens up access to a wide variety of different types of property including shops, offices, warehouses, homes and alternative assets like healthcare facilities and student accommodation.

As valuations recovered following the financial crisis, investors had the luxury of enjoying both capital growth and income from property. These two sources of return are measured by declines or growth in net asset value (NAV), i.e. changes in what a property investor's holdings are worth minus any liabilities, plus the yield achieved by renting out properties.

Capital growth through increases in NAV might be more difficult in the current environment, given a more volatile backdrop and depressed level of transactions but savvy property pickers should still be able to generate sustainable and inflation-busting income.

Stephen Inglis, chief executive of London & Scottish Property Investment Management, the asset manager of **Regional REIT (RGL)** which invests in offices and warehouses outside London, says: 'We have extensive experience in dealing with similar assets through the 2008-2012 downturn where the valuations fell but income was maintained. In fact, the income was increased by 3% over that period.'

'PLENTY TO LIKE ABOUT UK REAL ESTATE'

Peter Lowe, manager of **BMO Real Estate Investments (BREI)**, comments: 'There is plenty to like about UK real estate, not least the yield premium, income growth in most sectors outside of retail, good levels of occupancy for quality stock and a relative absence of typical "late cycle" behaviour in the lending and development space.'

Yield premium refers to the higher levels of income on offer from real estate relative to other assets like bonds.

RETAIL PROBLEMS

As Lowe's comments suggest, while all parts of the real estate market are exposed to fluctuations in the economy, retail as a category faces a particular challenge.

This is caused by structural changes not related to the usual ebb and flow of the market, namely the fact that many of us are choosing to shop online rather than on the high street or in shopping centres.

It is putting pressure on rental income from shops and occupancy rates and feeding into valuations.

The struggles in the retail sector are neatly illustrated by recent results from two of the largest investors in UK property – real estate investment trusts **British Land (BLND)** and **Land Securities (LAND)**.

On 12 November Land Securities announced overall like-for-like net rental income up 1.4%. For offices income was up 2.5%, specialist properties enjoyed growth of 7.7%, but income from retail tenants fell by 1.5%. Asset values were down 2.8% largely linked to the company's shopping centre and retail park holdings.

On 13 November British Land revealed the value of its shopping centres, retail parks and shops had fallen by £599m in six months, or 10.7%, to £4.8bn.

SELECTED UK PROPERTY FIRMS - PREMIUM / DISCOUNT TO NAV

Big Yellow (Self-storage)	60.3%
Assura (Health centres)	33.8%
LondonMetric Property (Industrial)	36.5%
SEGRO (Industrial)	25.2%
Tritax Big Box (Industrial)	0.7%
Derwent London (Offices)	-7.1%
Shaftesbury (West End of London)	-7.9%
Great Portland Estates (Mixed in London)	-10.4%
Land Securities (Mixed)	-30.7%
British Land (Mixed)	-34.5%
Hammerson (Retail)	-59.1%
Intu (Retail)	-81.9%

Source: Shares, Google Finance, company reports, as at 14 November 2019

IMPORTANT POINTS ABOUT INVESTING IN PROPERTY

- The various investment vehicles for gaining exposure to the property market include construction firms, property developers and landlords of commercial property as well as investment trusts, traditional funds and exchange-traded funds.
- Real estate investment trusts (also known as REITs) face extra regulation but also a tax regime that almost replicates the situation you would face if holding property directly. In practice they have to pay out most of what they receive in rent as dividends.
- The advantage closed-ended funds (i.e. investment trusts) have over traditional open-ended funds such as unit trusts and Oeics is that because they have a fixed number of shares, they do not have to sell assets to meet redemptions when investors want to withdraw their money.
- The regulators plan to introduce new rules for open-ended property funds, many of which had to be suspended in the wake of the EU referendum in 2016 as they couldn't sell assets quickly enough to return cash to panicked investors.
- At times of market volatility closed-ended property funds and listed property firms could trade at a discount to their net asset value.

OFFICES

OFFICE PROPERTIES OPERATE on a two-speed market in the UK. In London there has been plenty of building activity, even in the wake of the Brexit vote, with cranes dominating the skyline. Outside London this is generally not the case and there has been very little new building in the last decade or more.

This creates stronger dynamics for the regional office market, where the limited new supply of office space helps support returns from existing properties. As the chart shows, returns from this part of the market have been higher than in London in recent years.

Nick Montgomery, head of UK real estate investment at Schroders and who steers **Schroder Real Estate Investment Trust (SREI)**, highlights the example of Cheltenham which benefits from playing host to UK spy agency GCHQ.

'This was one of the best performing parts of the portfolio in our recent half year period.'

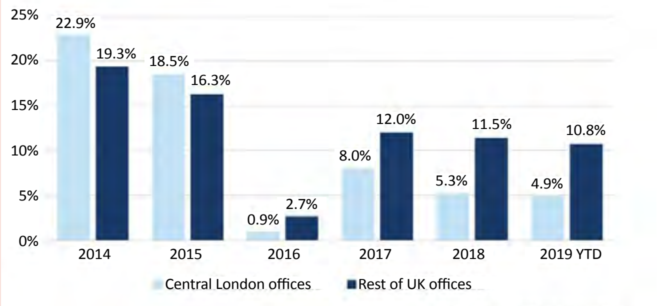
US defence firm Northrop Grumman is the trust's main tenant in the Gloucestershire region and, as Montgomery observes, there is no new supply in that area which is driving rental growth.

That does not mean the London office market should be written off. A recent third quarter update from **Derwent London (DLN)**, which as its name suggests is focused on the capital, showed a 46% jump in lettings and a fall in its vacancy rate to 0.6%. Of its three major developments, representing 790,000 square feet of property, 70% is pre-let. Derwent doesn't just invest in offices, but they account for the bulk of the portfolio.

Its latest figures are testament not just to the quality of this portfolio but also to the enduring appeal of London despite Brexit-related uncertainty. Many businesses are still going to look to base themselves within the M25 to be close to the centres of finance and politics in the UK.

The greater focus of international capital in London offices means valuations are arguably more sensitive to Brexit outcomes than those of regional offices. Montgomery at Schroders says there is a 'wall of capital' sitting on the sidelines which could be released in the event of greater clarity on the political situation in the UK.

CENTRAL LONDON AND REGIONAL OFFICE RETURNS



Source: CBRE, Peel Hunt (July 2019)

OFFICES TOP PICK:

BUY REAL ESTATE INVESTORS AT 53.4P

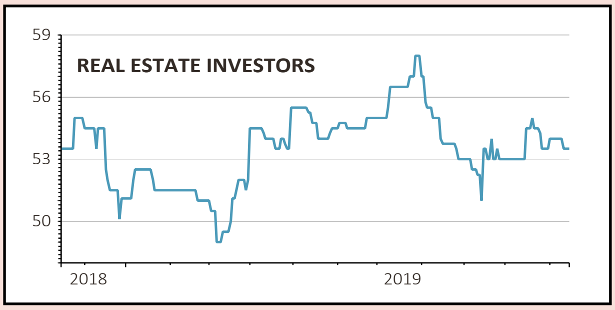
DISCOUNT TO FORECAST NAV: 25%
FORECAST YIELD: 7.1%

BUY

Improvements to transport connections and population migration from London are helping to support office property valuations in the Midlands and **Real Estate Investors (RLE)** offers a way to play this positive trend.

Liberum says: 'Improving regional conditions provide the backdrop for further growth in rents, which should enhance Real Estate Investor's already high income return.'

Offices represent 38% of the portfolio. Based on Liberum's forecasts the company trades at around 75% of net asset value and offers a well-covered yield in excess of 7%.



THE STRUCTURAL SHIFT in the retail sector, where the internet has gone from accounting for less than 3% of total retail sales in 2006 to nearly 20% today, has proved toxic to retail property valuations.

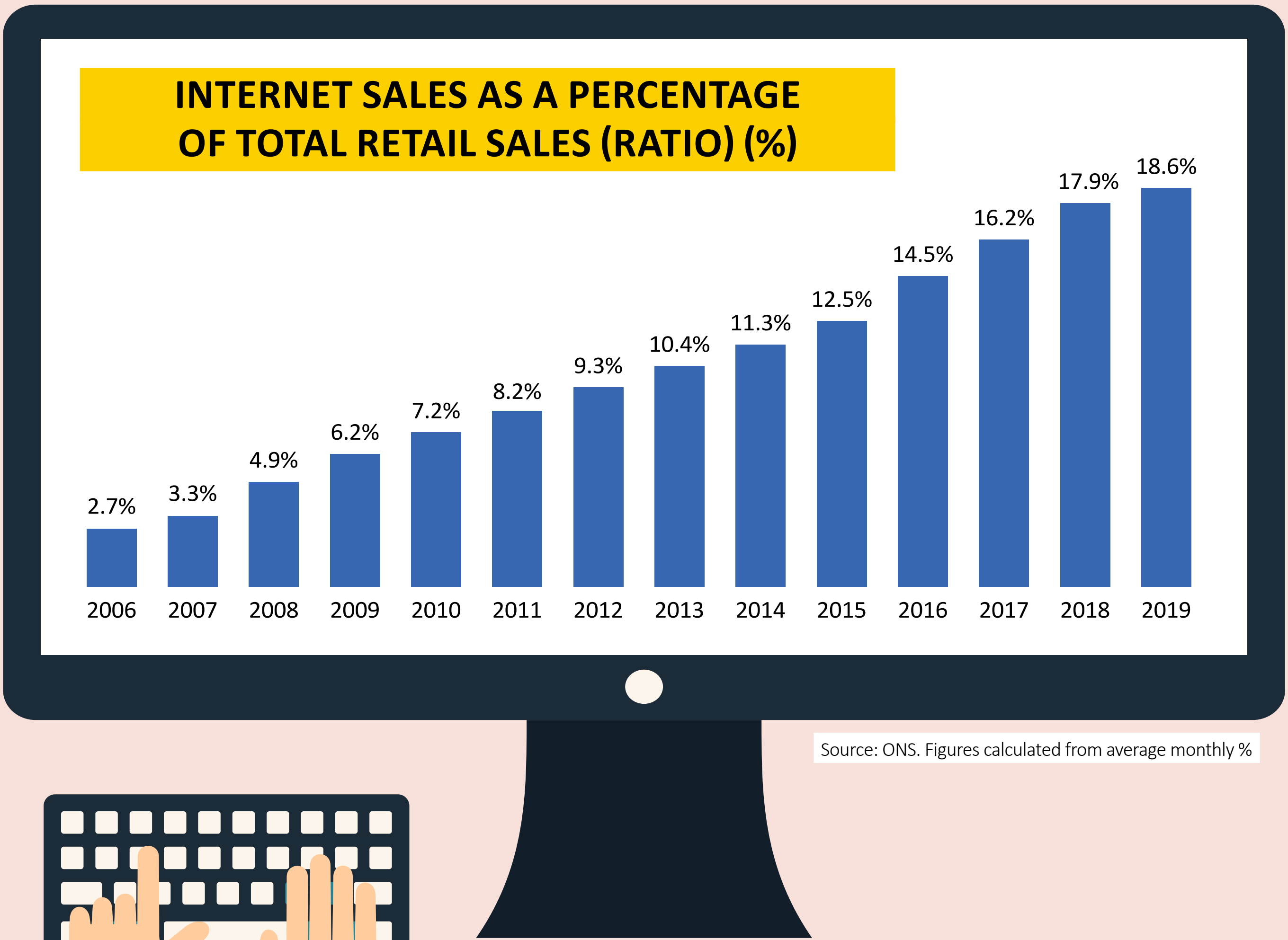
Tenants who historically rented large numbers of physical outlets have struggled and in some cases gone out of business while more savvy operators have been reducing their physical footprint and driving a hard bargain on rental discussions.

The two main specialist investors in this space, **Hammerson (HMSO)** and **Intu Properties (INTU)**, trade at substantial discounts to net asset value principally because people still do not see a floor for valuations in the sector.

Fund manager Alex Wright believes this has created an opportunity in Hammerson. Wright, who steers the **Fidelity Special Values (FSV)** investment trust, says: 'The UK-focused retail landlord faces challenging fundamentals but its current discount to NAV more than compensates for this situation. This low starting point offers limited downside and we expect management to pursue further asset sales and bring down leverage.'

In our view it is too early to call a recovery in retail, particularly if one of your principal aims when investing in property is to secure a stable stream of income.

Notably Intu, which has a more strained balance sheet than Hammerson, was forced to cancel its dividend in February 2019 thanks to its big borrowings, falling rental income and the dwindling valuation of its assets.



Source: ONS. Figures calculated from average monthly %

WAREHOUSES

RETAIL WOES HAVEN'T extended to the warehouse sector where demand is rising for storage and distribution centres to facilitate online orders.

The requirement to serve customer demands for click and collect and delivery to the doorstep, as well as the expectation for online retailers to offer an efficient returns system, creates a need for different types of warehousing space and plenty of it.

These assets are typically leased on long-term rental agreements which are linked to inflation and the markets have switched on to the appeal of such industrial assets. Landlords of warehouses command premium valuations and one player, **Segro (SGRO)**, has even ascended to the ranks of the FTSE 100.

There are broadly three types of warehouse asset. Big box or mega distribution facilities which are upwards of 500,000 square feet; regional distribution units which are between 100,000 to 500,000 square feet; and last mile or urban logistics which tend to be 100,000 square feet and below.

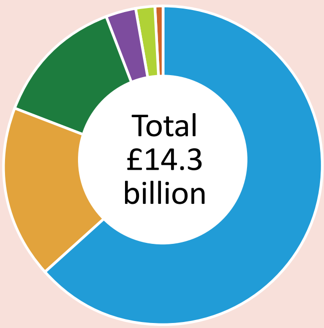
Heightened competition for assets has put pressure on the yields available when acquiring operational assets, particularly larger super-sized or big box warehouses. The larger size of these assets makes them attractive to a range of institutional investors.

It now looks like the market is settling down. **Warehouse REIT (WRH)** raised cash in April for a £133m spending spree on multi-let warehouses in the 100,000 square feet and below category which is its sweet spot.

Andrew Bird, managing director of Tilstone Partners, which manages Warehouse REIT, says: 'When we raised capital it was all about the fact open-ended funds had started selling and some of the heat that we had in the market 12 months ago was just coming off. Reality had come into the market as investment volumes came down.'

Bird points out that Warehouse REIT is still able to acquire assets at less than the cost of construction. This suggests that while the economies of scale might make it worth developing a big box asset from scratch, smaller warehouses just aren't commercial to build. This should see supply remain constrained and support rental income from this part of the market.

MARKET CAPITALISATION – £m



WAREHOUSES TOP PICK:

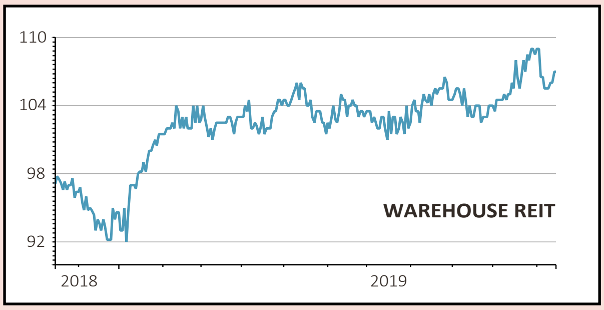
BUY WAREHOUSE REIT AT 106.7P

DISCOUNT TO FORECAST NAV: 3%
FORECAST YIELD: 6.3%
Source: Peel Hunt

BUY

Its portfolio is focused on smaller to medium-sized warehouses in urban locations with good transport links. For the most part this is catering for tenants involved in 'last mile' delivery – serving the last line in the supply chain from the online retailer to the customer's doorstep.

Constraints on the supply of this type of facility mean the company should be able to boost rental income, particularly as it refurbishes recently acquired assets and this in turn should underpin dividend growth. Unlike some of its larger peers, which trade at big premiums to the value of their assets, it trades at a 3% discount to forecast NAV.



HOMES

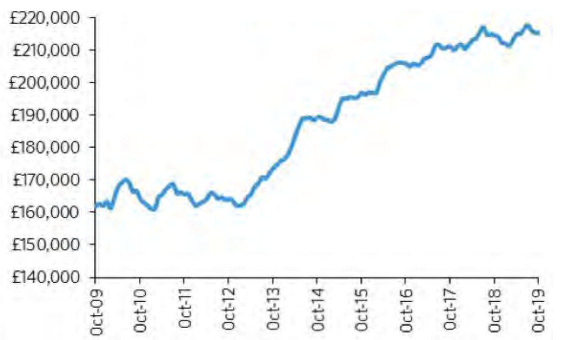
THE ARGUMENT AGAINST having exposure to residential property in your portfolio is a straightforward one. Anyone who owns their own home already has a lot of money tied up in this area of the market, even if it is not being held as an investment.

In addition, growth in house prices has begun to stall. However, the pressures on housing supply and the affordability issue means there is still a lot of demand for rental properties in the UK.

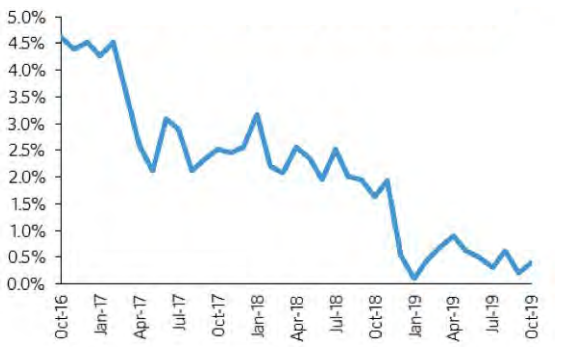
Among them is **Residential Secure Income (RESI)**. Fund manager Ben Fry says: 'Our target returns are just rental returns – we're not looking for any house price growth, we're purely a rental product.'

He argues the niches in which the company is active provide a 'great opportunity' to achieve a secure return which grows with inflation over time.

AVERAGE UK HOUSE PRICE



ANNUAL PERCENTAGE CHANGE



Source: Nationwide

HOMES TOP PICK:

BUY RESIDENTIAL SECURE INCOME AT 90P

DISCOUNT TO FORECAST NAV: 16.7%
FORECAST YIELD: 5.6%
Source: Jefferies

Residential Secure Income invests in three main areas which all encompass what Fry describes as 'economically insensitive tenants'. This includes retirees paying rent out of their pension, people in shared ownership schemes and local authorities trying to meet statutory requirements for housing in their areas.

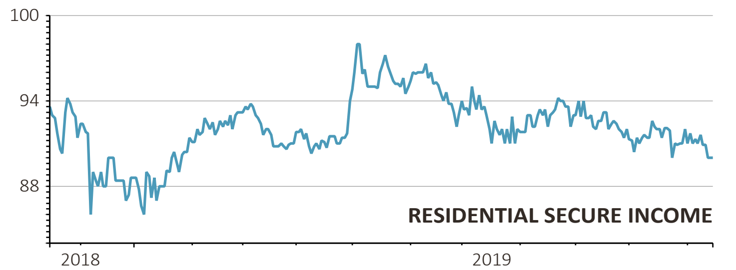
'All political parties are in favour of shared ownership, the independent retirement living sector has huge demographics behind it, and the homeless situation is huge and not going anywhere,' adds Fry.

Residential Secure Income operates in a broadly similar space to several other trusts but has unfairly been dragged down by a storm around supported living where it has no involvement.

Supported living describes the arrangement whereby someone who has or wants their own home also has support from a care provider to help them live as independently as possible.

The supported living space has been hit by interventions from the regulator of social housing. It has issued negative notices against several of the big housing associations used by **Civitas Social Housing (CSH)** and raised questions over the model which sees associations, despite being low on capital, entering lengthy property leases with the likes of Civitas and **Triple Point Social Housing (SOHO)**.

The association with the problems facing some of its peer group sees the shares trade at a significant discount to NAV. Numis says: 'Given that Residential Secure Income does not have exposure to supported living, we feel the current discount is unjustified.'



ALTERNATIVES

SOME TYPES OF property don't fit neatly into any of the traditional categories and these have typically been labelled as 'alternative property'.

> "Alternatives are increasingly moving into the mainstream"

They include health facilities, hotels, leisure centres and student accommodation.

A report from global real estate services firm Cushman Wakefield shows alternatives are increasingly moving into the mainstream, growing from 5% of UK commercial real estate investment volumes in 2009 to 28% in 2018.

Some niche areas benefit from particular drivers which make them less exposed to what is happening in the wider property market and the economy.

ALTERNATIVES TOP PICK:

BUY ASSURA AT 71.6P

PREMIUM TO FORECAST NAV: 27.6%
FORECAST YIELD: 4%
Source: Stifel

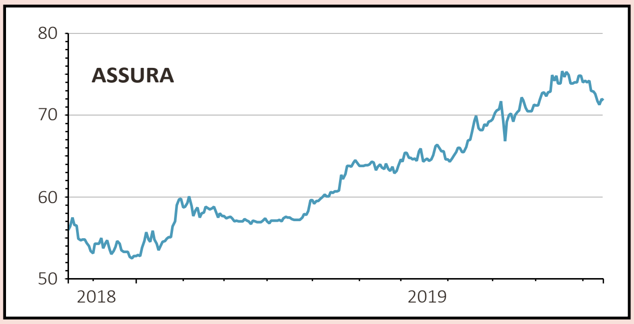
BUY

FTSE 250 constituent **Assura (AGR)** designs, builds, invests in and manages GP surgeries and primary care centres in the UK.

The NHS appears to be a priority across all political parties in the UK and there is a need to update and upgrade its existing buildings. The organisation says up to 3,000 centres are not fit for purpose which, as Assura CEO Jonathan Murphy tells *Shares*, 'creates a positive backdrop for us'.

As broker Stifel notes: 'Assura operates 560 medical centres out of a total addressable UK market of 9,000, offering plenty of opportunity for substantial expansion in the medium term.'

The shares are not cheap after a strong run in 2019 and trade at a sizeable premium to net asset value but still offer an attractive yield given the security of the income stream and the scope for growth.



A CONTRARIAN APPROACH CAN PAY DIVIDENDS

As contrarian investors, we prefer to plot our own course rather than follow the herd. Our quest is to find 'ugly ducklings' – companies that are shunned by others but offer a real prospect of improvement. And while the obvious upside to this approach is the potential for share price appreciation, it can also offer another valuable source of returns as unfashionable companies often have higher than average dividend yields.

Seeing the value in ugly ducklings

It goes without saying that the 'ugly ducklings' we choose are unloved, but we believe that they have the potential to improve their businesses. We look for companies that have the strength and flexibility to adapt and thrive over the longer term. A sustainable dividend from such companies is attractive to us as it offers a return while we wait for our thesis to unfold.

Of course, not every investment in our portfolio pays dividends and we wouldn't necessarily overlook a prospective investment for that reason. A company navigating the low point in its cycle might opt to forgo a dividend to reinvigorate its business. This prudent approach can hasten the company's recovery and potentially allow more sustainable dividend payments to recommence. Indeed, a dividend reinstatement can be an important signal that the company's rehabilitation is underway.

This scenario is currently playing out at Tesco, one of our biggest holdings. Tesco cut its dividend after a difficult period, during which profits fell and discounting rivals gained market share. Since then, the company has regained its footing, allowing management to reintroduce the dividend. While Tesco, in line with all the other UK based retailers, will need to cope with the potential fall out from the Brexit process, it remains, in our view, well placed to be able to execute its turnaround plan.

As long-term investors, we have time on our side as we wait for a nascent recovery to become established. Patience is key to contrarian investing. A certain fortitude is also required to withstand the anxiety of the market, while holding steadfastly to our convictions. But the potential pay-off can be more than worth the wait.

From sour grapes to an exceptional vintage

One of the most notable successes of this patient approach is Treasury Wine Estates, formerly the biggest holding in our portfolio. We invested

“ a return while we wait for our thesis to unfold ”

in this company in August 2015, when it was very much out of favour. The catalyst for change was a new management team, whose strategy transformed the business from an 'ugly duckling' to an elegant swan, before we decided to sell our stake (or, to continue with the metaphor, it flew our nest) leaving a £39 million profit – almost three times our original investment. While not all of our investments will prove fruitful, this example demonstrates why patience can be such a virtue.

Enduring growth

Paying dividends to our own shareholders has been part of our heritage of 132 years. We've recently increased the frequency of our dividend payment to quarterly. One of our aims is to grow the dividend ahead of UK inflation and this is supported by a record of raising our dividend in each of the last 35 years. However, it should be remembered that dividends are not guaranteed and can fall as well as rise. ■

28 October 2019

RISK WARNING

Please remember that past performance may not be repeated and is not a guide for future performance. The value of shares and the income from them can go down as well as up as a result of market and currency fluctuations. You may not get back the amount you invest. The Scottish Investment Trust PLC has a long-term policy of borrowing money to invest in equities in the expectation that this will improve returns for shareholders. However, should markets fall these borrowings would magnify any losses on these investments. Investment trusts are listed on the London Stock Exchange and are not authorised or regulated by the Financial Conduct Authority. Please note that SIT Savings Ltd is not authorised to provide advice to individual investors and nothing in this article should be considered to be or relied upon as constituting investment advice. If you are unsure about the suitability of an investment, you should contact your financial advisor.

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Know your fund: Invesco Income and High Income

Don't jump to conclusions that fund manager Mark Barnett is suffering from the same problems that triggered the demise of Neil Woodford

INVESCO INCOME FUND: TOP HOLDINGS	
STOCK	**% OF FUND**
BP	5.74%
British American Tobacco	4.59%
Next	3.47%
Derwent London	2.98%
Legal & General	2.90%
Tesco	2.77%
Royal Dutch Shell	2.58%
Oxford Nanopore	2.54%
Capita	2.49%
PureTech Health	2.41%

INVESCO HIGH INCOME FUND: TOP HOLDINGS	
STOCK	**% OF FUND**
BP	5.92%
British American Tobacco	4.77%
Next	3.78%
Legal & General	3.17%
Derwent London	3.04%
Tesco	2.83%
Royal Dutch Shell	2.76%
Capita	2.50%
Cranswick	2.46%
British Land	2.44%

Source: Invesco

Invesco fund manager Mark Barnett has come under increasing pressure following the downgrade of his income funds, **Invesco Income (BJ04HW5)** and **Invesco High Income (BJ04HP8)**, by fund researcher Morningstar.

The latter has highlighted concerns about the funds' increased exposure to small and mid-cap companies at the expense of larger, more liquid names. In response Barnett said that his funds are 'appropriately positioned, well diversified and able to generate liquidity should investors wish to buy or sell'.

Liquidity has become a sensitive issue for investors following the demise of Neil Woodford's income fund which was full of illiquid holdings, namely investments that couldn't be sold quickly.

WOOFORD COMPARISON

Barnett has found himself fighting off criticism that he has made similar mistakes to Woodford, a former colleague at Invesco. The Morningstar report has somewhat exacerbated the situation.

We think it is worth looking at the evidence before jumping to conclusions as Barnett's current situation is not the same as Woodford's.

Ryan Hughes, head of active portfolios at AJ Bell, comments: 'People need to be careful in drawing parallels between what happened at Woodford and Mark Barnett's funds. Yes, Mark was Neil's protégé to a degree and their investment approaches have some similarities but it is important to note that Woodford had gone down a very different road with his equity income fund by the time it suspended.

'Investors should therefore be evaluating Mark's investment approach and the portfolios within his funds in their own right.'

Barnett has backed Card Factory despite a series of profit warnings

BARNETT'S INVESTMENT POLICY

Both the Invesco Income and High Income funds aim to deliver a mixture of income and growth via investing in UK equities. Barnett looks for undervalued businesses where the share price can appreciate and the income stream can grow.

The inclusion of growth in the investment style explains why his portfolios include non-dividend paying companies such as outsourcer **Capita (CPI)** and healthcare provider **PureTech Health (PRTC)**.

Both funds invest at least 80% of their assets in shares domiciled or carrying out their main activities in the UK. The funds can invest in unquoted and private companies and can use derivatives to manage risk.

The benchmark used to compare performance is the Investment Association UK All Companies sector. The manager is not constrained by any benchmark and is free to construct portfolios that differ widely from the FTSE All-Share index.

THE INVESTMENT PROCESS

Barnett employs a long-term fundamental approach that combines a high-level macroeconomic view which informs active stock picking across the entire market cap spectrum.

The funds' starting point is to highlight areas of the market which are unloved or where a macro headwind has been mispriced. Barnett will look to get exposure to these areas of the market by populating the portfolios with individual stocks.

Barnett and his team use a variety of traditional metrics such as price-to-earnings ratios and price-to-book value to screen for mispriced stocks. He conducts fundamental research using his own stock knowledge as well as input from Invesco's broad UK equities team.

He builds the portfolios without regard to the benchmark, basing his decisions on fundamental conviction levels while considering the downside risk and liquidity. He adopts a 6% limit on individual stocks, but has no constraints on sector weights.

For example at the end of September 2019 the High Income fund had a 42% weighting in financials compared with 21% for the benchmark.

Historically he has had a clear focus on strong and sustainable cash flows because they were considered a good indication of a company's ability to grow dividends.

FUND POSITIONING

Barnett believes that the most compelling opportunities in the current climate lie outside the 'the dominant top tier' of the FTSE All-Share Index, in cash generative companies – 'many of which are UK-orientated which been overlooked by the market, in a climate of political uncertainty'.

It should be remembered that the investment policy states that in a changing global environment investors' interests are 'best served by employing a well-tested investment process, which is based on fundamental company analysis and a prudent approach to valuation'.

The issue isn't that Barnett has strayed from his tried and tested investment process, but that the process has logically resulted in shifting the funds' focus towards smaller, domestically-focused stocks, at the expense of large liquid internationally-exposed companies.

One criticism levelled at

Barnett by Morningstar is that 'an increasing number of stock-specific issues, notably among smaller, less proven businesses, have raised concern over the depth of fundamental analysis and focus on risk.'

Morningstar points out that while Barnett has support from seven other fund managers and analysts they have their own strategies to manage which leaves Barnett with a 'considerable workload'.

Barnett himself commented recently that 'over the last few years, the performance of the funds has been disappointing in capital appreciation terms and I regret some of the stock-specific challenges'.

One example is specialist card retailer **Card Factory (CARD)** which has issued a number of profit warnings over the past two years. However in a recent trading statement the company reported positive like-for-like sales growth. That said the stock is trading at half the peak levels achieved in 2015.

THE LIQUIDITY FACTOR

In response to Morningstar's concerns on liquidity, Barnett points out that more than two-thirds of the funds are invested in companies worth more than £1bn. In addition he has reduced exposure to unquoted investments from £944m to £493m since taking over management of the funds in 2014 and less than 1% is invested in companies worth less than £100m.

Although Barnett believes that the funds can generate enough liquidity to meet redemptions, it is clear that running a large portfolio with exposure to small and mid-cap companies is more challenging from a portfolio construction perspective than investing in large caps. The risk is that the funds, being so large in size themselves, will end up owning bigger chunks of smaller firms.

PERFORMANCE HAS LAGGED

The Invesco Income fund has delivered 1.96% annualised returns over the past five years compared 6.6% for its benchmark, according to the asset manager's latest factsheet.

While this is disappointing for holders, past performance isn't always a good guide to future performance. The contrarian nature of Barnett's approach means that 'suffering' poor short-term performance is the price paid for delivering superior longer-term performance.

Barnett has endured an unusually long period of underperformance, but one thing in the funds' favour is that market trends are prone to reversing without warning.

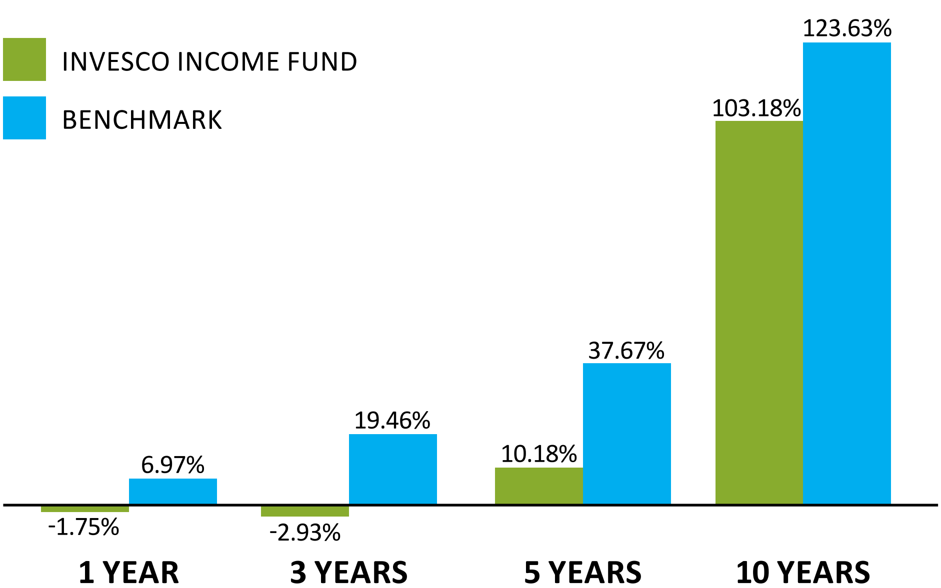
As the manager has highlighted, global equity markets have reached such an extreme level that £1 of revenue sourced in the UK is now worth less than a third of $1 of revenue sourced in the US.

In other words pessimism towards the UK has driven a fundamental mispricing which will benefit the fund if and when that condition normalises.

We've recently written about how there are signs value investing is coming back into favour. If that trend continues then Barnett could be in a strong position to benefit.

DISCLAIMER: Invesco is a shareholder in AJ Bell, owner of *Shares*. The author and editor Daniel Coatsworth own shares in AJ Bell.

INVESCO INCOME FUND



Source: Invesco

By **Martin Gamble**
Senior Reporter

FIND OUT ABOUT THE FUNDS WHICH BENEFIT FROM A 30% TAX BREAK

If you have appetite for risk and can lock your money away for at least five years, VCTs can be a useful option

Sponsored by

octopus investments

Experienced investors may be aware of an investment which benefits from a 30% boost straight off the bat. But for the uninitiated, welcome to the world of venture capital trusts (VCTs).

Venture capital trusts are funds that allow investors to claim up to 30% income tax relief on an investment of up to £200,000 a year.

You need to hold the investment for at least five years, but any dividends will be tax free and you will have a capital gains exemption on disposal.

Such funds are currently enjoying a boom in demand, with investors putting £731m into VCTs in 2018-19, the second highest amount on record.

And no wonder. As well as the 30% tax break, VCTs can be an ideal accompaniment to your portfolio. You get a wealth of tax benefits without the product needing to be held in an ISA, so you can use that wrapper to make other tax-efficient investments.

While it sounds great, it is important to note that VCTs are not for everyone and there is a higher price to be paid than for other investments.

Initial charges for VCTs are typically in the region of 4%, on top of an approximate 2% annual management charge and possibly other fees for administration costs, running costs and performance fees.

Arguably these costs reflect the complexity of the space and the need to make sure investments qualify for the relevant tax relief.

But for those who don't mind risk and have time to lock their money away as it potentially grows, VCTs can be a useful option.

HOW DO THEY WORK?

You put money into a closed-ended fund which invests in more risky, early-stage companies and get tax benefits as a reward.

You can't get your money back for five years, unless you pay back the tax relief. The idea is that you are helping Britain's exciting, entrepreneurial businesses to grow.

'VCTs have been around for decades with governments of all different flavours,' says Paul Latham, managing director of Octopus Investments. 'They are basically investment trusts but with extra bells and whistles.'

There are typically three types of VCTs – those that invest in companies not listed on the stock market, ones that invest in AIM-quoted stocks, and limited life VCTs, which have a goal of capital preservation.

The majority usually have a dividend yield of around 5%, which is considered by most VCTs managers as a sustainable payout, according to Amati Global Investors' CEO Paul Jourdan.

'We still pay 5% in the down years, and we still pay 5% in the good years,' he says. 'We recognise that many of our investors want that reliable income from our product, and we think 5% is a good dividend that's sustainable across market cycles.'

One of the largest vehicles by assets is the £1bn **Octopus Titan VCT (OTV2)**, which invests in unquoted early stage companies that may generate revenue but are probably not making a profit yet.

For those concerned about investing in risky companies, Latham says these risks are managed best in a VCT than any other investment vehicle.

'We have an established and well-diversified portfolio,' he says. 'A few of those companies will fail, but they're balanced out by the ones that do succeed.'

Among the success stories he picks out from the Titan VCT are well-known names like property site Zoopla and specialist travel play Secret Escapes.

NOT ALL VCTs ARE THE SAME

Not all VCTs invest in the same way. For example **Amati AIM VCT (AMAT)** invests in AIM-quoted stocks.

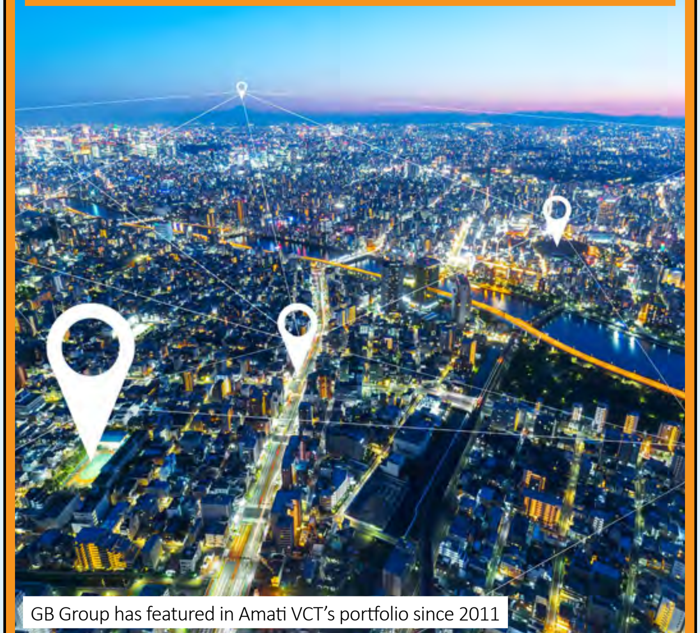
'AIM is an easy way to value companies,' says Jourdan. 'If you're investing in private companies, the pressure builds to find a trade buyer and make your exit, but for us, we can genuinely be long-term investors.'

Given most VCTs have been around for a long time – they were first introduced by the Conservatives through the Finance Act 1995 – they tend to invest for the long-term.

One of the Amati VCT's most prominent investments, which it still holds, has been identity management firm **GB Group (GBG:AIM)**, which the VCT backed in 2011 when it listed on AIM and now has a £1bn market value.

Other success stories include video game specialist **Keywords Studios (KWS:AIM)** and e-learning firm **Learning Technologies (LTG:AIM)**, which are both valued at

CURRENT VCT OFFERS STILL OPEN


GB Group has featured in Amati VCT's portfolio since 2011

Name	Type
Albion VCT	Generalist
Amati AIM VCT	AIM
Blackfinch Spring VCT	Generalist
Calculus VCT	Generalist
Downing ONE VCT	Generalist
Draper Espirit VCT	Generalist
Mobeus VCTs	Generalist
Octopus Apollo VCT	Generalist
Octopus Titan VCT	Generalist
Pembroke VCT	Generalist
Puma Alpha VCT	Generalist
Seneca Growth Capital VCT	Generalist
Triple Point VCT 2011	Generalist

Source: Wealth Club

around £750m.

Jourdan says he looks for companies with a 'very strong business proposition', as well as management teams that have 'the right skillset to succeed on AIM', something that not all of them possess.

One other consideration VCT managers highlight when selecting businesses is not to be bamboozled by jazzy startups in niche areas. Promises of a complex, proprietary offering which could be the next big revolutionary thing that changes our world and makes you a fortune should be treated with care.

More often than not, those are the companies that will end up failing.

'Medtech, fintech – if we don't understand it, we don't invest in it,' says Andrew Wolfson, managing director of the **Pembroke VCT (PEMV)**, which invests in the hospitality and consumer-facing brands often ignored by other VCTs.

'That's the easiest way to lose money,' he adds. 'It looks good, but you don't really understand what it does.'

Pembroke's portfolio includes companies such as the UK arm of American fast food chain Five Guys and a fashion label launched by model Alexa Chung.

WHAT ABOUT LIQUIDITY?

While there are a lot of success stories from VCTs, most of the companies in which they invest are still very small and so – particularly post-Woodford – there is a concern over liquidity, and whether investors may not be able to get their money back even if they did want to pay the penalty charge and redeem their investment early.

'If everyone asked for all £1bn back, we wouldn't be able to do that', says Latham, 'but that wouldn't happen anyway, and there is activity within the VCT which means we can fund (redemptions).'

For those with the risk appetite to invest in VCTs, we now take a look at three products which are currently open to new investors.

GOLDEN RULES FOR BUYING AND SELLING

- You should buy VCTs direct from the fund manager or a specialist VCT broker during the offer periods to get all the tax benefits.
- You can buy VCTs on the open market (also known as the secondary market) but you would lose the 30% income tax relief.
- You will lose significant tax benefits by selling before five years is up, regardless of the type of VCT product originally purchased. Selling a VCT in this first five years should only be done as an action of 'last resort'.
- If you do sell before the first five years is up, you would need to tell the taxman HMRC and reimburse the relevant income tax relief amount.

THE EXPERT'S VIEW
Richard Barnes, VCT product manager at Octopus Investments

'VCT season is in full swing. While there is a lot of choice in the market, the most popular VCTs tend to close ahead of tax year end. As a result, we've seen inflows come earlier in the tax year, as investors don't want to settle for their second choice.

'The VCT sector continues to grow and we've seen an uptick in demand over the last few years, driven by further restrictions to pensions and buy-to-let. Investors have always looked for ways to supplement their retirement, especially tax-efficient ones that can complement their pension and ISAs.

'VCTs offer a great way to do this, and since they invest in UK smaller companies it also adds an asset class investors wouldn't normally have access to. However, the value of a VCT investment, and any income from it, can fall or rise and investors may not get back the amount invested. VCT shares can fall or rise in value more than other shares listed on the Main Market of the London Stock Exchange and may be harder to sell. Tax reliefs are dependent on a VCT maintaining its qualifying status and tax treatment depends on personal circumstances and is subject to change.'

OCTOPUS TITAN

The UK's largest VCT, Octopus Titan focuses on tech-enabled businesses with high growth potential and has a portfolio of around 67 early stage companies in a wide range of sectors.

As well as Zoopla and Secret Escapes, other success stories include SwiftKey and graze.com, and it has sold stakes in some of the start-ups it has backed to the likes of Amazon, Google, Microsoft and Twitter.

The VCT targets a dividend of 5p a year, and special dividends may also be paid if portfolio companies are sold at a significant profit.

It has delivered a 32.7% total return over the past five years.

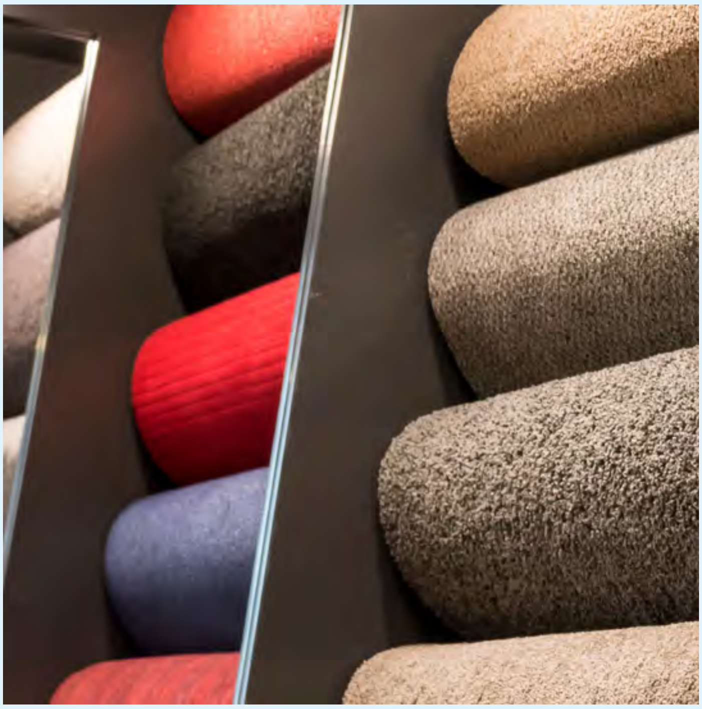
AMATI AIM VCT

The Amati AIM VCT has a portfolio of more mature, revenue-generating companies along with earlier-stage life science and software investments.

The VCT typically invests in stocks with a market cap above £50m, which Jourdan says is all about liquidity – 'it's an expression of confidence. If markets become anxious, investors might feel there's not as much liquidity if they have a market cap below £50m.'

The fund has delivered 66.7% total return over five years.

PEMBROKE VCT



Pembroke owner Oakley Capital is a well-established name in venture capital investing, meaning the investment team at Pembroke has a strong background in this area.

This VCT has a distinctive investment strategy, with investments focused on scalable consumer brands, ones which investors can walk down the high street and see.

Its lack of successful exits so far means the VCT, which launched more recently than most of its peers, has delivered a negative five year share price total return of 2.6%.

Its shares are trading a 26% discount to net asset value.

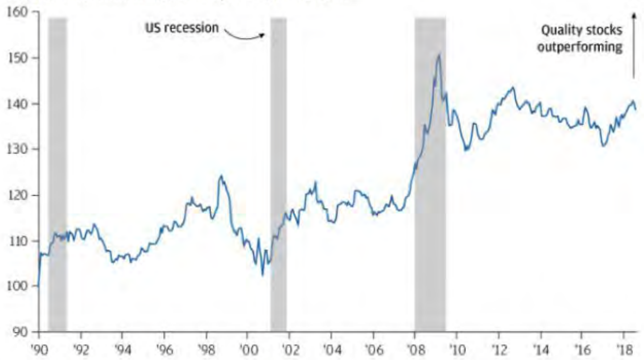
By **Yoosof Farah** Reporter

NOW'S THE TIME FOR US QUALITY

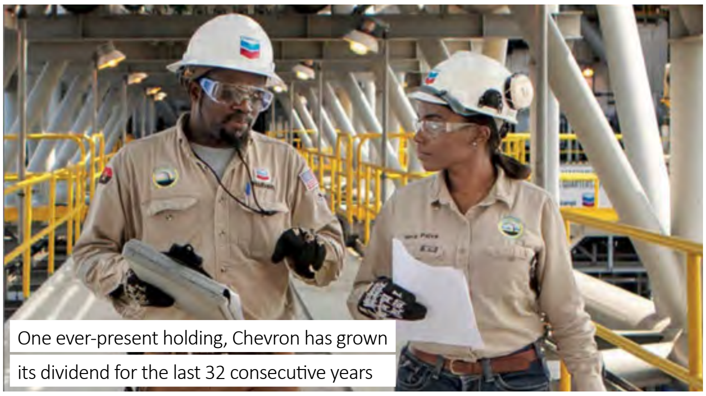
When it comes to investing in the world's largest economy, the £3 billion JPM US Equity Income Fund really stands out from the competition. Portfolio manager Clare Hart explains how the fund's exclusive focus on quality, value and dividends allows it to share in the long-term growth of the US stock market while keeping a lid on volatility whenever the going gets tough.

Clare Hart
Portfolio manager

S&P 500 QUALITY/S&P 500 RELATIVE PERFORMANCE
Relative total return index level, rebased to 100 in



Source: J.P. Morgan Asset Management Quantitative Beta Strategies, Standard and Poor's, J.P. Morgan Asset Management. S&P 500 Quality index is the top quartile quality stocks in the S&P 500 determined by JPMAM Quantitative Beta Strategies based on measures of profitability, financial risk and earnings quality. Periods of "recession" are defined using US National Bureau of Economic Research (NBER) business cycle dates. Past performance is not a reliable indicator of current and future results. Data as of 31 August 2018.



One ever-present holding, Chevron has grown its dividend for the last 32 consecutive years

Conservative exposure

Home to some of the world's largest companies and strongest brands, the US stock market commands a significant allocation in most diversified investment portfolios. However, while US equities provide the potential for strong long-term returns, periods of volatility can be unsettling—even for the most experienced of investors.

That's why we focus only on high quality, attractively valued US stocks that pay a consistent dividend. We believe companies with these characteristics can better withstand the market's ups and downs and ultimately provide investors with attractive returns over the long term.

The results of this more conservative approach are clear—since its launch back in December 2008, the JPM US Equity Income Fund has participated in the growth of the US stock market while delivering significantly lower volatility returns, with less exposure to falling markets compared to the median fund in its sector[1].

Deep company knowledge

The fund's success is built on our commitment to fundamental company research and long-term investing. We don't look for short-term gains by focusing on the fast-moving headline grabbers, but instead we seek to capitalise on the significant long-term value that can be found among America's many stable, high quality companies. These quality stocks have tended to perform well during periods of economic weakness, so have the potential to add resilience to portfolios.

We focus particularly on established companies with strong franchises, stable profits and low dividend payout ratios (which means the company's dividend is only a relatively small part of its profits). This combination suggests that a company will likely maintain the ability to pay compelling dividends, with the potential for future growth and appreciation.

To identify these high quality opportunities, we

[1] Since inception standard deviation for the JPM US Equity Income Fund has been 12.4% compared to 13.7% for the median fund in the IA North America sector. Since inception downside capture relative to the IA North America sector has been 90% for the JPM US Equity Income Fund and 105% for the median fund in the IA North America sector. Source: Factset, J.P. Morgan Asset Management, Morningstar. All performance details relate to A (net acc) GBP unless otherwise stated. Fund inception date is 15 December 2008. Past performance is not a reliable indicator of current and future results.

spend the time to really get under the skin of the stocks we cover. Supported by a team of more than 25 experienced sector analysts, we regularly meet with management teams and take the time to fully analyse the numbers, building up a complete picture of the opportunities and risks posed—often over many years.

High quality focus

Whenever we uncover a stock with the characteristics we seek, our intention is to invest for the long term. Fifteen of the fund's current holdings—representing around 25% of the fund's assets as of 28 February 2019—have been constant portfolio fixtures since the fund was launched more than a decade ago.

One ever-present holding is oil producer Chevron*. Incredibly, the company has grown its dividend for the last 32 consecutive years, making it one of Wall Street's true dividend aristocrats. Thanks to a diversified business model, disciplined capital spending and strong balance sheet, we believe Chevron should be able to continue to return significant cash to shareholders through a variety of energy price environments.

Another core holding that we've held since launch is drug maker Pfizer*. The company has paid a dividend consistently since 1980 and has increased its payout for the last nine years. Supported by a low payout ratio, well-diversified high quality drug pipeline and attractive profit margin, we believe Pfizer can sustain its dividend for many more years to come.

Disciplined investing

Our disciplined long-term approach helps ensure risk is managed within the fund at all times, while also leaving room to take advantage of market weakness to buy quality companies at lower valuations. There are a number of components to our risk management process that allow to manage it but not necessarily reduce it.

First, while the fund is benchmark agnostic , that doesn't mean we take huge bets. In fact, a high degree of diversification across sectors, and within sectors and subsectors, is a hallmark of our strategy. Even when you have done as much due diligence as you possibly can across sectors, bad things can happen to good companies. Being diversified helps mitigate against that risk although it does not negate it fully.

Most importantly as a value manager, we focus at all times on avoiding "value traps"—those stocks that look cheap but continue to get cheaper. We do this by identifying effective management teams. By investing in a dividend paying stock with a 30% payout ratio, for example, shareholders are leaving the company's management 70 cents on the dollar to play with. The question we ask is: can the management team make more money by using the money not returned to shareholders effectively? That's what will drive share price appreciation.

Your US market access

For investors looking to share in the growth of the world's largest stock market, an equity income investment strategy can provide particularly effective exposure—capturing a significant proportion of the market's potential upside, while managing downside risk.

The JPM US Equity Income Fund has generated attractive, lower volatility returns from US equities for over 10 years. Find out how your US equity allocation could benefit from our high quality dividend approach and the expertise of our experienced portfolio management team.

[Click here to find out more]

*The companies above are shown for illustrative purposes only. Their inclusion should not be interpreted as a recommendation to buy or sell.

[2] The Benchmark is S & P 500 Index (Net of 15% withholding tax). The Benchmark is a performance comparator and the Fund may bear little resemblance to its Benchmark. The Benchmark has been chosen as it reflects the main investment universe and strategy for the Fund. Please refer to the definition of Benchmark in the Glossary of Terms for further information.

Why transport stocks need to get back on the rails

What trends in freight, shipping and trade can tell us about the markets

By **Russ Mould**
AJ Bell Investment Director

Regular readers of this column will be well aware that it is a bit of a trainspotter – and for that matter a ship, truck and planespotter, too.

This is because it is a great adherent of Richard Russell's Dow Theory, which argues that if the Dow Jones Transportation index is thriving then the better-known Dow Jones Industrials index should flourish too.

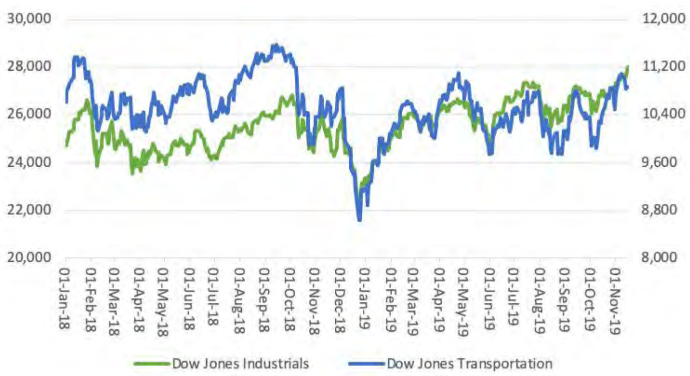
The logic implies it can only be good news if the share prices of the firms moving goods around the world by road, rail, sea or air are doing well. If something is sold, it has to be transported.

By default, the opposite holds true, or so the theory goes. Weak transport stocks could mean inventories are piling up on shelves and forecourts, to herald production cuts and a potential downturn in industrial activity, economic output, corporate earnings and potentially stock market valuations.

It is therefore interesting to see that the Dow Jones Transportation index still lurks 6% below its September 2018 peak, even as the Dow Jones Industrials index hits the 28,000 barrier for the first time ever.

It would not do to over-dramatise this point, as the Transportation index is still up by 19% in the year to date. But Dow theory says the index needs to lead the Industrials and when it lags attention should be paid. So pay attention we must.

THE DOW JONES TRANSPORTATION INDEX IS RISING A LOT MORE SLOWLY THAN THE DOW JONES INDUSTRIALS INDEX



Source: Refinitiv data

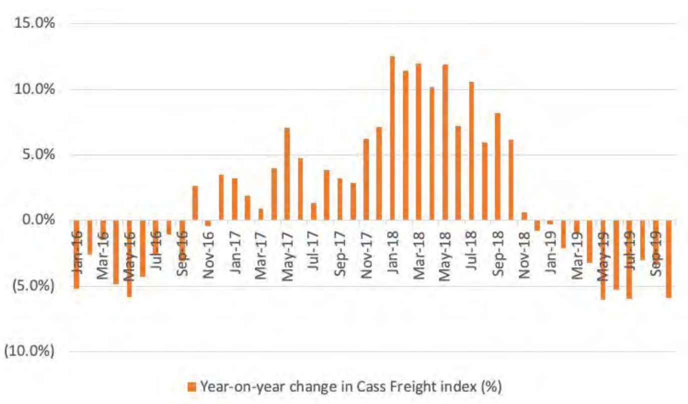
COLLAPSE IN CASS INDEX

The Dow Jones Transportation index's inability – thus far – to set new highs does unfortunately tally with quite a few economic datapoints from the US.

One is the Cass Freight index, which measures monthly freight activity in North America. October's reading showed a 5.9% year-on-year drop in activity. That was the eleventh decline in a row and prompted Cass to make three key observations:

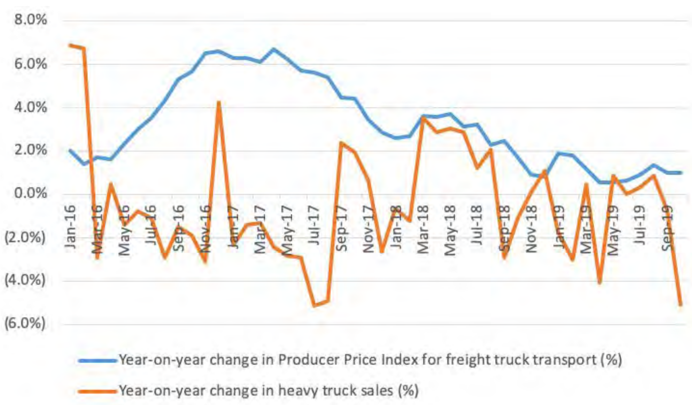
- The shipments index has gone from 'warning of a potential slowdown' to 'signalling an economic contraction'.
- Demand is weaker across almost all modes of transportation, both domestically and internationally.
- Several key modes, and key segments of modes, are suffering material increases in the rates of decline, signalling the contraction is getting worse.

US FREIGHT VOLUMES ARE SOFTENING…



Source: Cass, FRED - St. Louis Federal Reserve database

… AND THIS IS STARTING TO TAKE A TOLL ON TRUCK ORDERS



Source: Cass, FRED - St. Louis Federal Reserve database

There are lots of cross-currents here, including firms building up inventory and then liquidating them again as deadlines for new US tariffs on Chinese goods come and go, and the 40-day strike by 49,000 workers at General Motors production facilities.

But the persistence of the freight trend is a worry and it is starting to filter through to other parts of the US economy – just look at how the cost of hauling by freight is sagging and how, in turn, that is weighing on orders for new trucks.

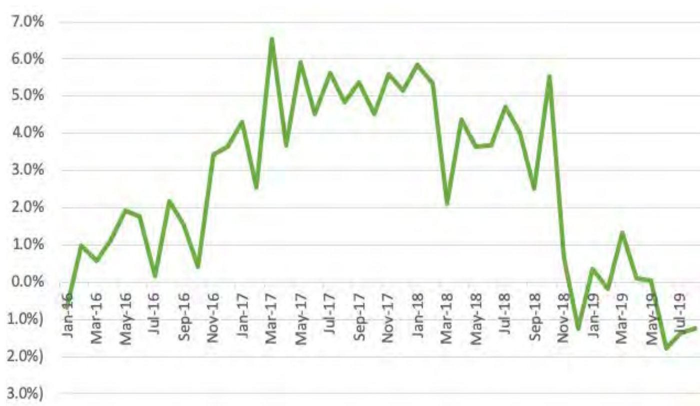
If that latter trend is not already showing up in durable goods orders, industrial production (and jobs) data, then surely it will soon, unless there is a rapid improvement. No wonder the Atlanta Fed's GDP Now and the New York Fed's Nowcast surveys are busily cutting their forecasts for American economic growth, to just 0.3% and 0.7% respectively, down from the third quarter's 1.9% annualised rate.

SHIPPING FORECAST

But these freight and transport-related issues are not unique to the US, even if the White House's ongoing trade dispute, and negotiations, with Beijing could be one major influence.

Global trade volumes are fragile, too, according to monthly World Trade Monitor published by the CPB Netherlands Bureau for Economic Policy Analysis.

WORLD TRADE VOLUMES SEEM FRAGILE TOO



Source: www.cpb.nl – World Trade Monitor

Stock markets may not seem unduly fussed, buoyed as they are right now by interest rate cuts from central banks and hopes for a US-China trade deal. But corporations are taking note. Just ask Copenhagen-quoted AP Møller Maersk, the world's largest container shipping company (a status which may make it a decent proxy for global growth).

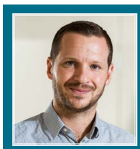
Chief executive officer Soren Skou has just cut his outlook for growth in global container demand to 1% to 2%, from 1% to 3%, for 2019. The better news is the forecast of 1% to 3% growth for 2020 looks more optimistic, but the company's depressed share price suggests investors remains unconvinced.

Its longstanding relationship with the FTSE All-World index broke down in 2017 and has yet to recover. It could therefore be argued there is a growing disconnect between cheap-money fuelled markets and the underlying macroeconomic and corporate profit picture.

‘How much can I put in my SIPP when my only income is from pensions?’

AJ Bell’s Tom Selby explains the rules around pension contributions

I am retired and my income is all from pensions. How much can I contribute to my SIPP in this tax year? I have no other earned income and have not yet taken any income from my SIPP.
Anonymous



By **Tom Selby**
AJ Bell
Senior Analyst

You are only able to make tax-relieved pension contributions up to 100% of your ‘relevant’ UK earnings during any given tax year.

If, for example, you had a salary of £20,000 in 2018/19 and no other taxable income, then the most you could pay into a pension in that tax year, inclusive of tax relief, would be £20,000 (i.e. a personal contribution of £16,000 plus £4,000 tax relief).

Relevant earnings include things like salary and bonuses. They do not, however, include dividends or pension income.

If you don’t have any relevant UK earnings (which will be the case if your income is derived entirely from pensions) you can pay a maximum of £2,880 a year into a pension and receive tax relief of £720, so will end up with £3,600 added to your pension (with the tax relief added by your pension provider).

The other thing you need to consider is your age. Tax relief is only granted on pension contributions up until the age of 75, so if you’re older than this and pay money into a pension you will receive no tax relief.

The amount of tax relief you can receive when saving in a pension each year is also controlled by the annual allowance which, for most people, stands at £40,000. If you save more than this amount there is a corresponding tax charge which effectively cancels out the extra tax relief you receive.

Anyone who has accessed taxable income from their pension, usually via flexi-access drawdown or an ad-hoc lump sum, will be subject to a £4,000 annual allowance (the ‘money purchase annual allowance’).

This also kicks in for those who buy a flexible annuity (one whose payments can vary) and where someone in ‘capped’ drawdown exceeds the income limit (150% of the equivalent Government Actuaries Department, or GAD, annuity rate).

There is also a lower allowance for people on very high incomes. This annual allowance ‘taper’ affects anyone with ‘adjusted income’ above £150,000 and ‘threshold income’ above £110,000.

Broadly speaking, adjusted income is total taxable income plus any pension contributions made by your employer and threshold income is total taxable income less any personal pension contributions.

Where both these limits are exceeded, your annual allowance drops by £1 for every £2 of adjusted income above £150,000, to a minimum of £10,000 for those with adjusted income of £210,000 or more.

Please note an earlier version of this article incorrectly stated that buy-to-let rental income counts as relevant earnings.

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.

POLAR CAPITAL

BANKS:
IGNORE THEM AT YOUR PERIL

Trading at multi-year lows, banks are the key reason why the financial sector has underperformed underlying equity markets over the past few years. September 2019, however, highlighted how exposed investors are to any change in sentiment as banks, seen as value stocks, were the biggest beneficiary of the rotation out of growth stocks and into value stocks sparked by a rise in bond yields. Many investors lost out as banks' share prices jumped sharply.

Lower interest rates are a negative for the banking sector as their net interest margins (the difference between what they receive in income on mortgages and other loans they have made, and what they pay out to savers) have come under pressure. There is the fear these margins will continue to fall to unsustainably low levels, making banks less and less profitable. However, there is much banks can do to offset this and maintain profitability.

If interest rates remain at their historically low levels over the coming years, banks will need to change their business models to adapt to this environment. We would expect a shift to banks keeping less loans on their balance sheets while increasing their fee income from arranging/structuring loans which would be positive for their ability to continue to return a significant amount of capital to shareholders, either via share buybacks and/or dividend payments.

Fears over a recession have also negatively impacted sentiment on the sector. This is understandable against a background of weaker economic data, however we feel that assumptions based on the last financial crisis are excessive. Instead, we expect a mild deterioration at worst and therefore question the low level of valuations that the banking sector is trading at relative to the broader equity market. For US banks, we believe one would need to see an increase in provisions for loans that borrowers have defaulted on, of 2-4 times their current levels to justify current share prices.

Banks have significantly strengthened their balance sheets over the past 10 years at the behest of regulators and have been more cautious in their appetite to grow their loan books, therefore reducing risk to investors from the next economic downturn. What is surprising, therefore, is these exceptionally low valuations price in some, if not all, of a risk of a recession over the coming months. In this low growth environment, they also offer

investors very high dividend yields as well as a geared exposure to interest rates.

Markets currently assume interest rates will remain low for some time but as the economist JK Galbraith said about economic forecasting: "There are two kinds of forecasters: those who don't know [how to forecast] and those who don't know they don't know [how to forecast]". If and when interest rates start to rise again the banking sector will be one of the biggest beneficiaries while other sectors are likely to suffer. Anyone wanting to own a diversified portfolio of equities/funds ignores banks at their peril.

Nick Brind
Fund Manager, Polar Capital Global Financials Trust
14 November 2019

What is regular investing, and will it help me?

How putting a set amount each month into the markets can smooth returns and take the hassle out of investing








Regular investing can help to smooth out your returns. It is a great way to get into the savings habit and can give you good discipline, but will it generate the highest returns?

Rather than saving up your money and then putting a chunk of it into the market when you've reached a certain amount, regular investing involves putting a set amount into your investments each month.

Many investment platforms will allow you to start as little as £25 or £50 a month, which means you don't have to start with a king's ransom. You could seek to increase contributions as your disposable income grows.

A big advantage is that you don't have to remember to invest your cash each month as it is done automatically. Everyone has a 'life admin' list as long as their arm, and often it can be easy to plan to invest money but forget to do so.

This means that rather than your money sitting in cash for three months before you remember to invest it, with regular investing automatically buying specific funds or shares you're getting constant access to investment markets.

IMPOSING DISCIPLINE

On top of regular investing making you more organised, it also means you have a rigid investment process that you stick to. This is important as often emotions can get in the way of investing, and if markets fall investors can panic and decide to sell.

Many investors think they can time the market, and will be able to decide when is exactly the right point to buy into a fund or share. Getting it right is harder that you think.

Even professional investors fail to time markets accurately every time, so your chances of being able to predict when the market will hit its peak or trough are pretty slim. And it could mean you end up buying at the wrong point, or just leaving your money in cash for months while you wait for the right time.

Having the discipline imposed on you to invest regularly is particularly useful for first-time investors, as if you've not experienced markets falling before it can be very easy to get spooked and sell, or avoid buying.

SMOOTHER RETURNS

Regular investors benefit from smoother returns, thanks to something called 'pound cost averaging'. Because you're putting a regular amount in the market, regardless of market movements, you'll help to smooth out any volatility.

YOU CAN INVEST AS LITTLE AS £25 PER MONTH

So-called pound-cost averaging means that when markets rise you are buying fewer shares or units in a fund and when they fall you're buying more when

HOW POUND COST AVERAGING WORKS

Month	Share Price		Regular investment	Shares purchased	Lump sum investment	Shares purchased
1	£5.00		£200.00	40	£1,000.00	200
2	£4.50		£200.00	44		
3	£3.50		£200.00	57		
4	£4.00		£200.00	50		
5	£5.00		£200.00	40		
Average share price	**£4.40**	**Total**	**£1,000.00**	**231**	**£1,000.00**	**200**
			Value after five months @ £5.00 per share	**£1,155**	**Value after five months @ £5.00 per share**	**£1,000**

Source: Shares

they are cheaper. The table shows how this could work in a hypothetical example.

So how much could you save from a small amount each month? If you put away £50 a month over 10 years, assuming investment returns of 5% after fees, you'd build up a pot of £6,910, while over 20 years you'd end up with £19,175, showing how a small amount each month can really add up over time.

Let's look at some real-life examples. If you invested £100 a month over the past 10 years you would have invested a total of £12,000 excluding charges. If you had invested it in the FTSE 100 you'd be sitting on £16,899 today, while if you'd put it in the MSCI World index you'd have £21,675 today.

However, assuming you have all the money available at the start of the year, you'd have been slightly better off investing it in a lump sum at the start of January.

If you'd taken that same £1,200 annual investment and invested at the start of the year, after 10 years you'd have £17,185 if you'd put it in the FTSE 100 and £22,364 if you'd invested in the MSCI World.

This is partly because your money has more time in the market – if you invest at the start of the year that £1,200 is invested in the markets for the entire 12 months, whereas with monthly investing only £100 is invested for the full 12 months, with your final £100 monthly instalment only in the markets for one month before the year end.

However, this depends greatly on how markets perform when you put that lump sum in. If you invested £1,200 and then the market immediately fell, you'd likely have been better off with monthly investing.

WATCH OUT FOR CHARGES

Charges is one area you need to consider. If you're only investing £25 a month you need to make sure you're not investing in lots of different funds, as it will cost you a dealing fee each time. However, you will save money in fees with lots of investment platforms if you opt for regular investing.

On AJ Bell YouInvest, for example, you would usually pay £9.95 when you buy or sell shares, but this is reduced to £1.50 if you're doing so through regular investing. Assuming you buy two shares a month, regular investing could save you £200 a year, compared to making the same two share purchases a month on an ad-hoc basis.

Each platform will have a different day that they carry out the deal. For AJ Bell Youinvest it's the 10th of the month, or the next working day if that falls on a weekend or bank holiday. However, you can make any changes to the regular investment until midnight the day before the deal.

The other thing you need to watch out for is that you have enough cash in your account to make the regular investment. If you don't then the deal won't be done. However, you can set up a direct debit from your bank account to your investment account each month to avoid falling short.

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

THE IMPERATIVES OF GROWTH INVESTING

James Anderson, joint manager of Scottish Mortgage Investment Trust, talks about why we need to embrace risk and volatility to achieve long-term rewards.

The value of your investment and any income from it can go down as well as up and as a result your capital may be at risk.

This is not an easy article to write. It comes with an apology to any readers who think it is too dogmatic. But the investment industry has turned in on itself in a fateful way for our economies and societies. We need to rediscover a sense of purpose beyond competing with each other for assets, immediate returns and via Byzantine metrics that rarely make any sense other than to consummate insiders. If this sounds arrogant then so be it. It's too important an issue to be ignored.

What's the point of capital markets? There are surely two fundamental components behind any satisfactory answer. The core objective, even the genius, of equity capital is to utilise the savings of society to provide the necessary risk capital in order to both drive economic progress and deliver returns to savers. This is in one sense the canonical description of stock exchanges as the enablers of industrial achievement best remembered in railway and railroad epics of the 19th century in Britain and the Americas. It's also not too far away in substance, if not form, from the Chinese economic transformation of the last decades. The remarkable savings of the population were transmuted into world-leading industries, if without adequate reward.

But the ideal of productive investment is long gone in most equity markets of today. This is especially true of developed markets and above all in Britain. Companies pay out far more money in dividends and share buybacks than they receive for new issues or to provide new risk capital. Indeed it's worse than that. In aggregate, companies invest less of their cash flow than they spend on dividends. When new capital is urgently required it rarely appears from British institutional investors. When banks desperately needed more money it was taxpayers who found the necessary billions. When ARM required heavy investment it was taken over by Japan's SoftBank.

Whilst we may be able to assist in communicating with capital markets, we don't believe we could run Tesla

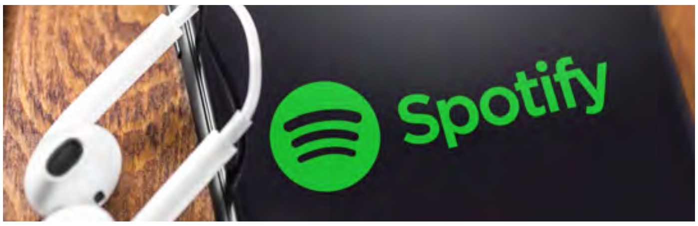
Why is this so? Is it what retail investors want or require? For sure, income has its uses and certainly companies can be tempted to over-invest in a declining future. But the critical problem is far less misjudged capital expenditure by individual companies than the risk and loss aversion of those who determine the overall framework for capital allocation. That is fund managers. The intermediation of the savings system by trained professionals is a recent phenomenon. At earliest it dates from after 1945 and its dominance from only the 1980s. But inserting the industry between savers and companies changes far more than we are accustomed to think or commentators are willing to examine. The only acknowledged impact is that of fees. There was once a famous book entitled Where are the Customers' Yachts? These days yachts are but minor trinkets to billionaire hedge fund managers.

The hidden issues are more warping. They are both practical and theoretical. They combine to deadly effect. The reality is that to stay rewarded and regarded in the profession a fund manager cannot afford to underperform indices for long. So the principal task for the individual and the fund management company is to preserve their job and the firm's assets by not underperforming the index. Big, safe cash-rich companies are built for this task. The ideologues of academic portfolio theory and their avid followers in the strange trade union that is the Chartered Financial Analyst (CFA) qualification then turn this into intellectual conformity by defining risk as volatility around an index measured over short-time historic horizons.

But it's clear that if a company is trying to build a great business for the future in a complex and uncertain world then it almost always needs to take large risks and endure extreme volatility of results and share price. The possibility of failure is inevitable, necessary and far from shameful. This is not just what economic progress requires but what produces stock market returns. I apologise for sounding like a broken record to some of you but the record is that stock market returns are dominated by the identification and compounding of a very small number of great companies. In the US since 1926 half the added return from equities has come from just 90 companies.

So what must we do? We have to pursue everything we can to help companies that we believe have even a slight chance of attaining a rarefied level of success. That's true at each stage of their evolution. We should only give up once this chance dissolves. We must ask ourselves if our presence makes or has made any difference.

There are some companies in our portfolio that might not have existed without our backing. Two examples are the digital advertising platform You & Mr Jones, which now seems to be finding its path, and Recursion, a candidate to eventually revolutionise drug discovery, which because of its youth has struggled to gain initial financing.



In other instances support at moments of difficulty is vital. This can translate into relationships and insights that are transformational. We've experienced this with companies that are now giants far beyond our imagining but are still happy to communicate with us. This applies to Alibaba, to Tencent and to Amazon. It applies to Illumina, which we defended from takeover and angst in difficult moments, and through which we have gained access to a world of genomic innovation. It applies to Zipline, which prefers us as a partner to SoftBank. It applies to Spotify in its attempts to demonstrate that a European company can dominate an online industry.

I'd like to make a few comments about such relationships. The objective is to be involved with people who are far more perceptive, far more knowledgeable and far better at seeing the future and building a business than us. We want to be learning not preaching. We have absolutely no belief that we could run any of our companies. At times we can help in communicating with capital markets and governance matters. Tesla provides an example of this on both sides – we may be able to assist but the notion that we can, or should, tell Mr Musk how to reinvent the world is laughable.

What we do provide is patient support in search of extraordinary opportunity, the understanding bad times will always happen and empathy in dealing with fate. This often involves accepting that there will be years of struggle before instant success. That's bad for our monthly volatility relative to indices but we believe it's powerful for long-term shareholders and might even assist in reviving economic progress.

Our top picks in the clothing retail sector

You could have made or lost significant amounts of money in this industry

Clothing is one of life's essential goods. We all regularly buy clothes and therefore one might assume it is a good place to invest. In reality, it is a highly competitive industry and historically there has been a wide gap between the best and worst performing shares in the sector.

This Christmas season, including the frenzied and fiercely contested Black Friday and Cyber Monday events in late November, could be tough for most clothing sellers.

Apparel purveyors are being clobbered by a combination of frail consumer confidence, political uncertainty, rising costs and the structural spending shift to the web.

As Helen Dickinson, chief executive of the British Retail Consortium, recently cautioned: 'Retailers embarked on an extraordinary period of discounting this October as they tried to entice shoppers into making purchases. Fashion shops were particularly active, helping non-food return to growth for the first time since July.

'Unfortunately, the long-term trend remains bleak with the 12 month average sales growth falling to a new low of just 0.1%. With Brexit still unresolved and a December election creating new uncertainties, retailers will be looking nervously at the months ahead.'

Share price	3 year returns	Year-to-date
JD Sports Fashion	145%	116%
Next	29%	65%
Boohoo	124%	63%
ASOS	-35%	37%
Sports Direct	0%	34%
N Brown	-40%	25%
Burberry	51%	23%
Associated British Foods (Primark)	-4%	20%
Joules	26%	0%
Superdry	-70%	-3%
Mulberry	-76%	-10%
French Connection	16%	-15%
Moss Bros	-80%	-25%
Marks & Spencer	-46%	-26%
Sosandar	n/a	-30%
Quiz	n/a	-49%
Koovs	-94%	-49%
Ted Baker	-84%	-74%
MySale	-96%	-81%

Source: Shares, SharePad, Data as at 15 Nov 2019

In recent months, women's value retailer Bonmarche and the UK arm of **Mothercare (MTC)** have gone into administration; shares in quirky fashion brand **Ted Baker (TED)** tumbled on yet another profit warning; while Nigel Oddy, the boss of privately-owned fashion firm New Look, warned retailers were experiencing a 'perfect storm'.

All of this suggests that anyone looking to invest in the fashion space needs to have nerves of steel and accept that share prices are likely to move up and down a lot – potentially more of the latter than the former.

RETAILERS RUN RAGGED

According to the BRC Springboard data for October, overall monthly footfall declined by 3.2% year-on-year, marking another month of declining footfall, not helped by colder, wetter weather.

Worryingly, footfall was down in both retail parks and shopping centres, but high streets were hit the hardest with wet and wintery weather putting off many consumers from venturing out to the shops.

All eyes are now focused on the important Black Friday (29 November) spending spree that coincides with workers getting paid at the end of the month. Apparel retailers will also have to contend with a general election less than two weeks before Christmas, which could potentially impact footfall on polling day.

CLOTHING SELLERS ON THE STOCK MARKET

The apparel sector includes a mixture of large and small companies, many of which are household names. Investors should note that a company with a strong brand isn't necessarily a good investment as they can still experience financial and operational challenges. You need to examine each business one-by-one.

Among the clothing sellers on the stock market is **JD Sports Fashion (JD.)** which has been one of the best performers in its sector.

The colder weather in October and into November bodes well for sales of warm clothing

£1,000 invested in JD Sports 10 years ago would today be worth £30,200 if all dividends had been reinvested

items including jackets, hoodies and knitwear which is the domain of **Superdry (SDRY)** and **Joules (JOUL:AIM)**.

Marks & Spencer (MKS) continues to struggle with the clothing part of its business, letting down customers by not stocking enough of the right sizes of clothes in demand. The company's gross margins remain under pressure in a highly promotional market and online sales growth through M&S.com remains frustratingly slow, crawling a meagre 0.2% higher in the six months to 28 September.

Associated British Foods (ABF) owns the budget clothing chain Primark, which celebrates its 50th anniversary this year. Interestingly, the latter isn't being held back by its lack of an online business. Primark continues to attract customers with its low prices and profit margins are being bolstered by savvy buying and tight stock control.

Next's online sales grew 9.7% in the third quarter to 26 October. The established trend of online sales growth outweighing stores' decline continued, which is encouraging given that analysts predict more than half of retail purchases will be made online in the next decade.

Other apparel specialists on the UK stock market include Jacamo-to-JD Williams brands owner **N Brown (BWNG)**. Offering a near-6% prospective dividend yield, the self-styled 'size inclusive' online clothing retailer is trying to recover from a difficult 2018.

DIGITAL DELIVERY

Other online pure-plays include **ASOS (ASC:AIM)**, **Boohoo (BOO:AIM)** and **Sosandar (SOS:AIM)**.

ASOS has coughed up a number of profit warnings over the past 10 months which has seen the shares slump from highs of £76 in the spring of 2018 to £31.22. Trading on 52.6 times forecast earnings, ASOS has a lot to do to justify its rating given a recent history of operational issues and with analysts still downgrading earnings forecasts.

Closest peer Boohoo isn't cheap either, swapping hands for roughly 50 times forward earnings, but we're confident the Manchester-based business can continue to make rapid in-roads into the global fashion e-commerce market.

Sosandar is currently spending a lot of money on marketing in an attempt to gain scale. This might drive revenue growth but the business isn't forecast to make a profit until the financial year ending March 2021 and we have no idea when it will turn cash flow positive.

HOW TO INVEST IN THE SECTOR

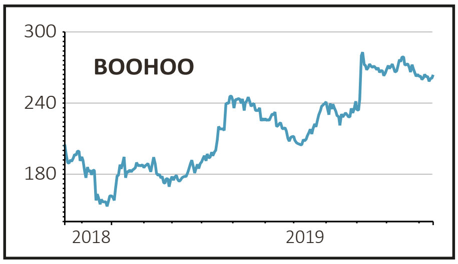
Investors have a choice of either investing in individual company shares or funds which have a stake in these companies.

Unfortunately there isn't a specialist fund solely focused on clothing retailers, neither is there an exchange-traded fund tracking an index of the sector.

The only way you'll get exposure via funds is to pick a product that will have retailers alongside investments in other sectors. We've produced a table showing examples of funds and investment trusts where a retailer is one of their top holdings.

BUY OUR TOP PICKS BUY

BUY BOOHOO AT 261.2P



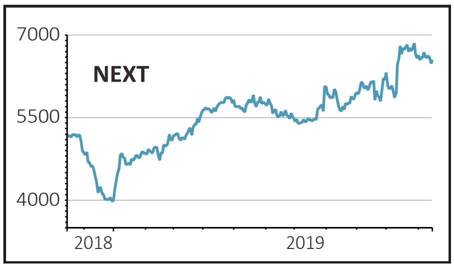
Online fast fashion seller Boohoo is a social media-savvy company offering exposure to the global structural spending shift to the web.

While the shares aren't cheap on a punchy 50 times Liberum Capital's 5.2p earnings per share estimate for 2020, Boohoo continues to deliver earnings upgrades and its financial performance and momentum is all the more impressive given the apparel market backcloth and the travails of sector peer ASOS.

Generating strong growth across all geographies, Boohoo recently acquired MissPap, Karen Millen and Coast, adding to its successful Boohoo, Pretty Little Thing and Nasty Gal brands.

Annual sales now exceed £1bn and a cash generative model and £207.4m net cash pile at last count mean Boohoo can reinvest back into the business and acquire new brands that can be plugged into its core infrastructure.

BUY NEXT AT £65.88



While clothing colossus Next isn't a fast growth stock like Boohoo, it is a slow and steady provider of functional clothing which is able to keep growing full price sales. That's a welcome quality in a sector awash with discounting.

Run by a best-in-class management team led by chief executive Simon Wolfson, online is now the growth driver for Next, helping to offset declines in the physical store estate which forms a key component of its successful click and collect service.

A drop in temperatures boosted Next's October sales and while management does not believe sales growth for the rest of the year will be as strong as last month's, we believe it should have a fairly robust Christmas.

EXAMPLES OF FUNDS WITH CLOTHING RETAILERS IN THEIR TOP 10 HOLDINGS

FUND	HOLDING	% OF PORTFOLIO
Allianz UK Mid Cap	ASOS	4.4%
Edinburgh Investment Trust	Next	4.3%
Merian UK Mid Cap	Boohoo	8.8%

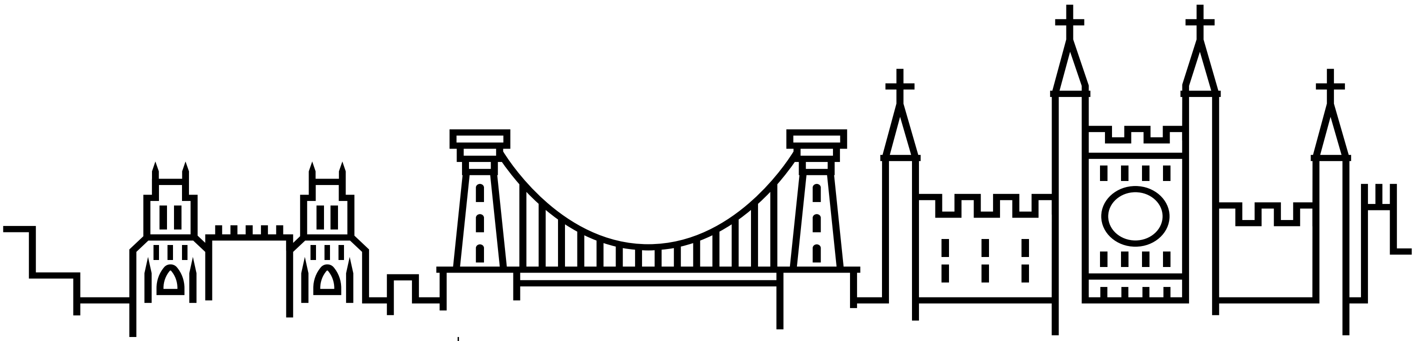
Source: FE Fundinfo

By James Crux
Funds and Investment Trusts Editor

HOW I INVEST:

The switch from day trading to long-term investing

This Bristol-based doctor is aiming to beat the returns on cash by investing in shares and funds



'I'm a nervous investor who had dreams of beating the market,' says John, a 40-year-old doctor from Bristol.

Having first become interested in investing five years ago, his journey began with the study of chart patterns. Books were bought on the subject and he subscribed to an online course.

'I dipped my toes into the world of day trading and quickly lost money. I soon realised I would never beat the big guys who have sophisticated computers and researchers to guide decisions,' he says.

John soon decided to try a contrarian approach and pick stocks that looked as if they were cheap compared to historical valuations. He had mixed success and so now invests based more on third party information and his own research such as checking levels of corporate debt.

'I would like to say I'm now fairly cautious about my approach considering how I've been burnt in the past. I look at my portfolio daily and smile a bit when it goes blue and switch it off fast when it goes red.'

NEW INVESTMENT GOAL

John says his new goal is to beat the levels of return one might get from cash in the bank. So far he's on target with 18% return over four years. An average 4.5% return per year is higher than the best-buy rates on cash ISAs and fixed-rate accounts which are currently in the region of 1.5% to 2%.

'If I get a big win at any stage, I might treat myself, otherwise this is my retirement fund,' he says.

The West Country resident's portfolio is currently structured 70% shares and the rest in funds including one that tracks the FTSE 100 index and a corporate bond fund. 'I am also one of the Woodford losers, having been attracted initially to the superstar status and now have money locked away in his income fund.'

BEST AND WORST PERFORMERS

The Bristol investor's current portfolio includes shares in oil producer **Royal Dutch Shell (RDSB)**, student accommodation provider **Unite (UTG)**, train station and airport food and drink specialist **SSP (SSPG)** and computer games developer **Sumo Digital (SUMO:AIM)**.

John says his best performing investment has been media group **Entertainment One (ETO)** where he made a 120% gain, capped off by the company receiving a £3.3bn takeover bid from toy maker Hasbro in August.

'There was a bit of a shock when the share price dropped

One of John's origami creations

massively around four years ago. Thankfully I didn't use a stop loss and remained a holder. Entertainment One asked for more money in the form of a rights issue and this was a nervous moment as things weren't looking pretty,' explains John. 'I took the plunge and bought more shares. With a bit of patience, I've seen it rise quite nicely.'

His worst investment has been construction services group Carillion, which collapsed in 2018. He thought the company's responsibilities to look after numerous properties would mean it would be in business for a long time. 'When it dropped in price, I still believed in it, and the same when people were saying to sell. This was a valuable lesson in not relying on self-conviction which is based on nothing but a self-perceiving importance of a company.'

This incident has made John pay more attention to the number of people who are short-selling stocks and he says he now realises that companies can still fail regardless of their size.

SPENDING HABITS

He recently bought a house and says he has a 'fairly large' mortgage to pay off. 'The range of mortgages is quite restrictive so I don't think I'm on the best offer, but I'm much better than the previous situation of renting. At least this money goes into my property… and I can drill holes in the walls!'

John confesses to being a 'hopeless spender' where he buys stuff on a whim that ends up collecting dust in a cupboard. For example, his last major purchase was a set of three self-sterilising water bottles for £250. He justifies this 'investment' in the belief that one day he might need them backpacking along the Amazon and would need clean water to drink.

He's more satisfied with his equity and bond investments, saying dividends have gone up and stock valuations have also mostly risen. 'There is a temptation to go for higher returns. Thankfully the rational brain kicks in and reminds me that higher returns usually mean higher risk. And when we're talking higher risk with no true fundamentals to back it up then that's just gambling.'

In his spare time, John has a passion for origami where he makes complex 3D dragons out of folded paper. Such a hobby requires an attention for detail and patient approach which goes hand in hand with investing.

By **Daniel Coatsworth**
Editor

WOULD YOU LIKE TO FEATURE AS A CASE STUDY IN SHARES?

We are looking for individuals or couples who can discuss their experience with investing and some details about their portfolios.

Anyone interested should email **editorial@sharesmagazine.co.uk** with 'case study' in the subject line.

Please note, we do not provide financial advice and we are unable to comment on the suitability of any investments you have made. If you're unsure please consult a suitably qualified financial adviser.

KEY

- Main Market
- AIM
- Investment Trust
- Fund
- Venture Capital Trust

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

25 November: Cerillion. **26 November:** Compass, Paragon, Ten Lifestyle, Treatt, UDG Healthcare. **27 November:** AB Dynamics, Britvic, Grainger, Marstons, On the Beach. **28 November:** Premier Miton, Urban & Civic

Half year results

25 November: Cake Box, D4t4 Solutions, Sirius Real Estate, Sysgroup. **26 November:** Augmentum Fintech, Cranswick, Draper Esprit, GB Group, Imimobile, LXI Reit, Schroder Real Estate, Victoria. **27 November:** Iomart, LondonMetric, Sosandar. **28 November:** Amigo, Discoverie, Ince, Motorpoint, Redcentric

Trading statements

26 November: Intertek. **28 November:** Jadestone Energy

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