STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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SHARES

WE MAKE INVESTING EASIER

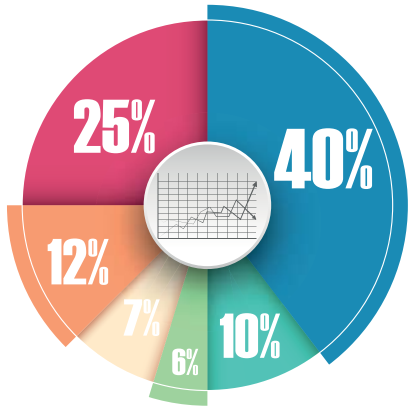
CORPORATE DEBT CRISIS:

The stocks you shouldn't own

INVESTMENT TRUST BARGAINS CREATED BY THE MARKET SELL-OFF

HOW THE BUDGET AFFECTS YOUR FINANCES

Has diversification saved your portfolio?



Anyone holding bonds as well as equities may be feeling less annoyed with their portfolio performance this year

Asset diversification should have been one of the few saving graces for investors in recent weeks, potentially reducing the losses.

Having a mixture of stocks, bonds and property means you spread your risks across different assets – each of which behave somewhat differently in terms of market dynamics and price trends.

Anyone fully invested in equities – another term for stocks and shares – at present will rue the day they didn't bother to create a well-diversified portfolio. Equities have plummeted in value this year including an approximate 18% decline in UK stocks, as measured by the FTSE 100 index.

In comparison if you'd had a good proportion of assets in bonds, your performance may well have been much better on a relative basis. For example, **Vanguard LifeStrategy 60% Equity (B3TYHH9)** is split 60% in stocks and 40% in bonds – so far this year it has delivered a 7% negative return, so significantly outperforming the FTSE 100.

Having such a high weighting to bonds may not suit someone seeking large capital gains as equities have delivered significantly better growth over the long term. It is also important to stress that bond prices can fall when interest rates go up, so if you sell a bond before maturity in that environment, you may end up doing so at a loss.

Yet in volatile market conditions such as now, diversification is the ticket to a better night's sleep.

SPREADING THE RISKS

Even though equities have been badly hit this year, diversification can still help even in an equities-only portfolio as there is a lot to be gained from spreading risks around different industries and geographies.

Investment trust **Alliance Trust (ATST)** only invests in equities and last week said it had achieved 23.1% net asset value total return versus 21.7% for its benchmark, the MSCI All Country World index, over its past financial year.

While that period doesn't include the current global markets sell-off, diversification is certainly a key reason why some of its mistakes haven't hurt badly.

Its stake in TV-based shopping specialist Qurate Retail delivered a 58% negative total return. It also suffered double-digital losses on stocks such as nutrition group **Glanbia (GLB)** and tech firm Baidu.

Fortunately these losing trades only had a small impact on its portfolio as they were just a handful of stocks among a broad portfolio of approximately 160 names. In contrast, a portfolio with only a small number of holdings, such as 10 or 20, would have really felt the pain if two or three of its stocks did very badly.

WHAT TO DO NOW

Anyone now seeking to restructure their portfolio to be more diversified must consider that selling any equities now in favour of buying bonds could mean crystallising losses just at the wrong time.

We aren't trying to call the bottom of the market sell-off, yet it does feel as if so much pain has been inflicted that some sort of market recovery could happen fairly rapidly.

We suggest sitting tight and thinking about diversification once markets have stabilised as history suggests corrections will happen time and time again in the future. Rejigging your portfolio would make you better positioned next time we have a difficult patch for investments.

By **Daniel Coatsworth** Editor

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What the Budget and UK rate cut means for markets and investors

Higher infrastructure spending and support for small businesses are key themes

The Bank of England and the Treasury managed a one-two punch on 11 March as interest rates were cut by 50 basis points to a record low of 0.25% and hundreds of billions of pounds of new spending was announced.

This did little to boost sentiment in the wider market as ongoing coronavirus fears and a sell-off in the US overshadowed the news, despite the provision of £30bn for coronavirus relief in the Budget.

However, some sectors and stocks did get a boost. Companies with exposure to the infrastructure space look to be big winners. **Kier (KIE)** and **Balfour Beatty (BBY)** enjoyed double-digit gains as, in a widely expected move, significant outlays were announced on roads, rail, hospitals and broadband.

Motorway crash barrier manufacturer **Hill & Smith (HILS)** was in demand, while companies with exposure to the broadband space like **BT (BT.A)** and **Spirent Communications (SPT)** also advanced.

The abolition of VAT on digital books boosted publishing firm **Bloomsbury (BMY)**, up 6.7% to 239p as investors priced in a potential boost to sales from the move.

The plans announced by new chancellor Rishi Sunak also represented a significant shift in policy for the Conservatives with £175bn in total in new expenditure over the course of the next five years.

PwC chief economist John Hawksworth says Sunak is taking a calculated risk by committing to significantly higher spending now when there are many economic uncertainties ahead 'not just in relation to Covid-19, but also the UK's future trading relationship with the EU and the wider global economic environment'.

There were also changes to investment tax breaks. While the annual allowance for adult ISAs will remain at £20,000 in the new tax year, families will be able to save more into Junior ISAs and Child Trust Funds where the allowance more than doubles from £4,368 to £9,000.

Selected Budget winners

Balfour Beatty	14.8%
Kier	10.0%
Bloomsbury	6.7%
Hill & Smith	4.7%
BT	3.6%

Source: SharePad, intra-day moves on 11 March

Pension tax breaks will be more generous for higher earners. The income threshold at which tax relief on pension contributions starts to shrink will rise from £110,000 to £200,000. The standard tax-free annual allowance on pension contributions is currently £40,000 and starts to taper down to £10,000 for those earning more than £110,000.

Raising the threshold is particularly beneficial to senior doctors, many of whom have been turning down extra shifts for fear of high tax bills.

However, the changes in the new tax year will also see the minimum level to which the annual allowance can taper down reduced from £10,000 to £4,000 for individuals with total income including pension accrual over £300,000.

Taking stock of Black Monday which caused severe market damage

Shares and oil prices have since started to recover but a recession still looks plausible near-term

At the worst point on Monday 9 March, the FTSE 100 traded 8.4% lower, recording its fourth biggest one-day drop on record. Only two days during the 1987 crash (12.2% and 10.8%) and in the 2008 global financial crisis (8.8%) were worse.

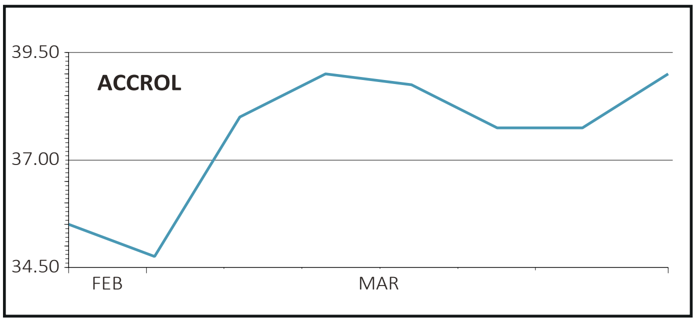
The oil sector bore the brunt of the latest sell-off with an estimated £61.5bn wiped off UK oil stocks, with **Premier Oil (PMO)** and **Tullow Oil (TLW)** seeing the biggest percentage drops, off 54% and 29% respectively.

The following day (10 March) saw the oil price rebound by 8% to $37.15 per barrel, gold slip back in value after briefing touching $1,700 per ounce a day earlier, and most stock markets around the world tried their best at starting a recovery rally.

Despite the doom and gloom, a few stocks stand out from the crowd. With the media highlighting shortages of toilet paper and hand sanitisers in the shops as people panic-buy, shares in toilet roll manufacturer **Accrol (ACRL:AIM)** have risen by 12% so far in March.

One stock which had bucked market weakness in February was funeral company **Dignity (DTY)** as investors predicted a potential upturn in demand as a result of coronavirus increasing the death toll in the UK. However, the shares slumped on 11 March amid disappointing results.

Economists have been studying past health



epidemics like SARS and Ebola to help guide possible scenarios for the current outbreak of coronavirus, although the current epidemic is slightly different and seems to have engendered more public concern globally.

In the past, once the virus was contained there was a tendency for economic activity to bounce back quickly, leading to what economists call a v-shaped recovery.

Analysts at banking group ING point out that unlike past events, today there is the potential for both a supply and demand shock. Supplies have been disrupted by factory closures while fewer trips to the shops and restaurants mean a hit to consumer spending.

Targeted fiscal support like the income tax forbearance suggested by US president Donald Trump and suspension of mortgage payments as put forward by the Italian authorities can help mitigate some of the financial effects.

Meanwhile banks are more capitalised than ever, enabling them to deploy emergency cash flow funding in specific sectors. All this suggests the most likely worse-case scenario is a sharp, short recession, according to ING.

Is the latest sell-off history repeating itself, and if so what can we expect next?

The best and worst performers in the 2020 sell-off look familiar to previous corrections

They say that history doesn't repeat, but it certainly rhymes because this year's large market sell-off has seen most sectors perform bang in line with their performance in previous sharp sell-offs.

As we previously explained, the past decade has seen three sharp in declines in stocks – in mid-2011, mid-2015 and the final quarter of 2018 – which all happened for different reasons but which all caused markets to fall by more than 10%.

Weighing up the damage

Index	Loss since crash began*
Dax (Germany)	-20.2%
S&P 500 (US)	-17.7%
FTSE 100 (UK)	-17.1%
Nikkei 225 (Japan)	-15.0%
SSE (China)	-3.2%

*21 Feb 2020 market close to 10 March 2020

Markets this year have experienced another sharp jolt downwards, caused by economic fears around the coronavirus and the sudden collapse of the oil price.

Since 21 February just before coronavirus went global and the market closing level on 9 March, the FTSE 350 index fell by 18.6%.

Individually, the internationally-exposed FTSE 100 lost approximately 17% while the more domestically-focused FTSE 250 lost 16%.

Worst performing sectors in latest sell-off

Sector	% change*	avg 3 prev falls
Industrial Metals	-37.0%	-37.3%
Oil Equipment, Services & Distribution	-35.3%	-34.3%
Automobiles & Parts	-33.1%	-31.5%
Oil & Gas Producers	-29.8%	-20.3%
Mining	-26.9%	-27.0%

Source: Sharepad, Shares. *Closing prices 21 Feb to 9 March 2010.

Bottom of the pile this time – completely in keeping with their performance in each of the three previous sell-offs – are automobiles and parts, oil equipment and services, and industrial metals, which have all racked up losses of 30% or more.

Meanwhile the best-performing sectors – utilities, pharmaceuticals, personal goods and tobacco – are also entirely consistent with past sell-offs.

Best performing sectors in latest sell-off

Sector	% change*	avg 3 prev falls
Food & Drug Retailers	-5.5%	-14.3%
Pharmaceuticals & Biotechnology	-7.0%	-9.8%
Gas, Water & Multiutilities	-10.0%	-6.9%
Tobacco	-10.2%	-10.5%
Personal Goods	-10.5%	-9.8%

Source: Sharepad, Shares. *Closing prices 21 Feb to 9 March 2010.

SPOT THE DIFFERENCE

As always there are a few sectors which have bucked the trend for obvious reasons, but in other cases the moves look overdone.

No-one will be surprised that travel and leisure stocks such as airlines and hotels have performed much worse than usual as the coronavirus has directly impacted global travel.

Similarly, oil stocks have performed much worse than usual, first on fears of a global slowdown and more recently on the risk of a global glut of crude as Russia and Saudi Arabia tear up their production agreement.

On the other hand food and drug retailers, which typically lose as much if not more than the market during sell-offs, have barely missed a beat this time as investors have reacted to stories of shoppers stockpiling.

BIG OUTLIERS

Forestry and paper stocks, which are usually dumped by investors along with other commodity sectors during big sell-offs, have held up as demand for toilet roll sees supermarket shelves stripped.

In contrast, defensive sectors such as food and beverages have performed much worse than usual this time round, presumably as a read-across from the fall-out in travel and leisure stocks.

Fixed-line and mobile telecoms have also performed far worse than usual in this sell-off, possibly due to concerns over their high levels of financial leverage and the need to refinance their debt at some point.

WHAT HAPPENS NEXT?

We aren't soothsayers, but typically when the market falls this much the rebound is at least as strong with many of the worst-hit sectors gaining the most over the next six months.

Sectors that could potentially rebound the most

Sector	% change*	avg 6m rebound**
Industrial Metals	-37.0%	68.8%
Mining	-26.9%	36.9%
Construction & Materials	-17.3%	29.7%
Industrial Engineering	-16.7%	39.3%
Electronic & Electrical Equipment	-14.2%	33.8%

Source: Sharepad, Shares. *Closing prices 21 Feb to 9 March 2010.
**Based on 3 previous market sell-offs.

Industrial metals, the biggest faller this time round, is also typically the biggest gainer during the recovery, according to how markets behaved following the last three sell-offs. The sector includes miners **Anglo American (AAL)**, **Antofagasta (ANTO)**, **BHP (BHP)** and **Rio Tinto (RIO)**.

Construction and materials is typically another big gainer following a crash, according to history. This sector includes names such as **Balfour Beatty (BBY)**, **CRH (CRH)**, **Ibstock (IBST)** and **Marshalls (MSLH)**.

There is no guarantee these sectors will rebound as predicted and investors must understand that what's happened in the past may not necessarily follow the same pattern in the future.

Extraordinary movements on the bond market

Yields are crashing as investors bid up prices in parts of the fixed income market

Bond markets have been on an extraordinary run this year, judging by the move in US long-term government bonds (known as Treasuries) where prices are up 25% so far in 2020.

In the UK, yields went negative for the first time on 9 March with bonds of maturities up to seven years dipping below zero. The 10-year benchmark yield touched an all-time low of 0.08%. Yields fall as prices rise.

What's driving prices is the fear of a global recession as the coronavirus spreads around the world, and more countries are forced to follow in the footsteps of China and Italy and lock down entire cities, temporarily halting economic activity.

The US Federal Reserve has made its first emergency rate cut (3 March) since Lehman Brothers collapsed during the financial crisis. Rather than soothe equity markets, the move had the opposite effect, sending shares lower and bond prices even higher.

10-year Treasury yields traded as low as 0.3% while the long-dated 30-year bond plummeted to 0.7%, breaching 1% for the first time in history.

On 24 January the 10-year Treasury had a yield of nearly 2%. All US government bonds, from three months to 30 yields are trading below 1%.

According to a poll by Reuters, economists believe the Fed will cut a further 0.25% later in the month (17-18 March) and potentially again in April.

Some commentators argue the Fed emergency cut was unwise yet the central bank may be taking its cue from bond markets which are pricing in a bigger hit to global growth than equity markets.

Other central banks including Bank of Canada, the Reserve Bank of Australia and Central Bank of Malaysia eased rates last week with others expected to follow soon.

It may sound counterintuitive for companies to be feeling the pinch when interest rates are at historic lows, yet disrupted supply chains and cancelled travel plans impact short-term cash flows and debts need to be serviced.

Some $200bn of maturing debt needs to be financed before June in the most exposed sectors, according to Pegasus Capital.

Signs of corporate stress are already starting to appear in Europe. An index that tracks default insurance at 75 of the highest risk European companies has hit its highest level in four years at 3.74%, almost double the levels seen at the end of 2019.

One glimmer of hope for value investors is that the dividend yield on the S&P 500 is trading around 1% higher than the 30-yield US government bond yield, which is a record and eclipsing the levels seen during the financial crisis.

Rare chance to buy Shell cheaply and get 11% yield

The shares have only traded at these levels on a few occasions in the last two decades

While this isn't a trade for the faint-hearted we think the weakness in **Royal Dutch Shell (RDSB)** following the oil price crash looks overdone and represents a compelling buying opportunity.

As we write, and based on consensus forecasts for 2020, Shell offers an 11% dividend yield. A yield of 7% or more is often seen as a signal that a payout will be slashed but reassuringly Shell has not cut its dividend since the Second World War and we believe this status will be preserved.

For the foreseeable future the company should have the capacity to ride out oil price volatility either by taking on more debt or resorting to scrip dividends as it did in the wake of the 2014-2016 oil crash, giving investors the option of receiving dividends in new shares instead of cash. Having spoken to Shell's investor relations team UBS analysts believe 'Shell can and will defend its dividend through this period of cyclical weakness'. They add that avoiding a scrip dividend would be 'an important input into the quality of the payout'.

The company's other actions in the wake of the previous oil downturn, namely reducing spending and increasing efficiency, arguably make it better placed to weather the current storm.

ROYAL DUTCH SHELL
BUY
(RDSB) £13.47

Market value: £107bn

In the immediate aftermath of this latest oil price slump, triggered by Saudi Arabia's market share grab, Shell's shares hit £12.4. Looking back over the last 20 years the stock has only traded at these sorts of levels on a handful of occasions.

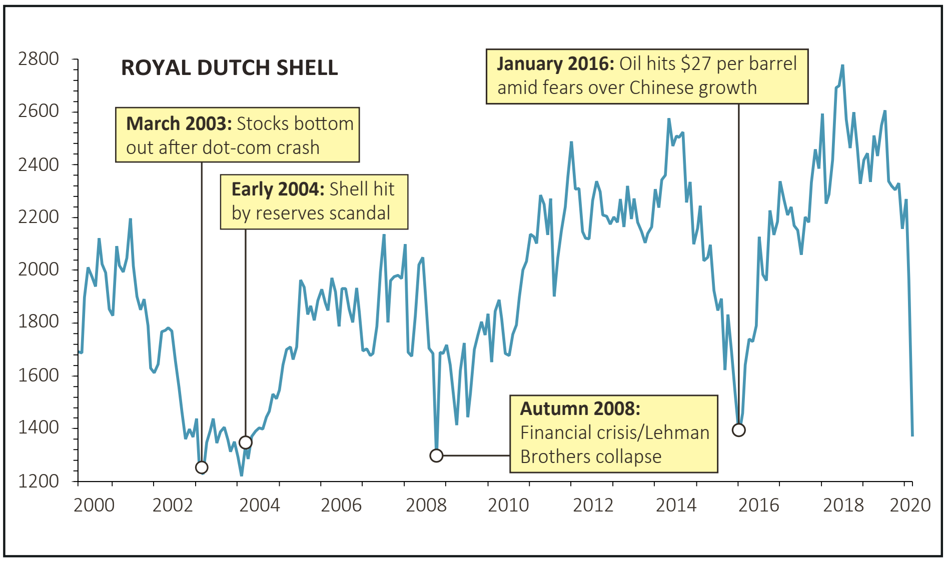
This includes in 2003 at the tail-end of a bear market for stocks driven by the dotcom crash; in 2004 during a scandal over mis-stated oil reserves; at the height of the global financial crisis; and in 2016 when oil prices last bottomed out.

At $37.50, brent crude is currently trading higher than the $27.67 per barrel it reached in the last oil sell-off.

Shell's shares delivered a total return (capital gains and all dividends reinvested) of 134% from its mid-January 2016 low to its most recent peak above £28 in May 2018.

While there remains considerable uncertainty over how Saudi Arabia's actions will play out and just how severe the hit to crude demand from the coronavirus will be, we think so much bad news is already priced in to Shell's shares.

Concerns over how the company will be affected by the issue of climate change mean this is not necessarily an investment for the long term. However, history suggests that by being brave and investing now you could achieve strong returns over the medium-term.



Capital Gearing is a master at protecting and growing investors' money

The investment trust has a superb track record of holding up during market sell-offs

In a market experiencing wild share price swings, wouldn't it be great if there was a fund or trust in which you could put some money without fearing for the worst? Say hello to **Capital Gearing Trust (CGT)**.

This investment trust's stated objectives are to preserve shareholders' real wealth (i.e. accounting for inflation) and to achieve absolute total return over the medium to longer term.

Admittedly that does mean the trust could have a few periods with little growth and where it feels like returns are going nowhere.

But it also means that when there's a market crisis, your money could be in good hands. In the year ending April 2008 when the global financial crisis was unfolding, the trust's share price rose 3.6% and net asset value per share rose 5%. In the following year when the crisis was causing widespread damage its share price rose 11%.

Its share price during the dot-com bubble shows it weathered that storm pretty well too.

Remarkably, the trust has only ever had one year of negative performance in NAV terms, when it lost 2.5%. In the past 37 years, the trust has delivered double-digit annual gains 22 times.

Part of the reason for its reliable performance is its mix of assets, put together by experienced investment manager Peter Spiller, who has been running the trust since 1982.

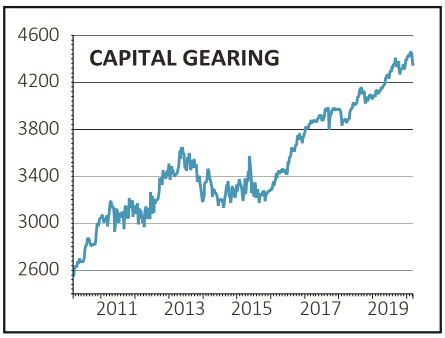
CAPITAL GEARING TRUST BUY
(CGT) £42.90

Market value: £492m

Its current underlying assets are split roughly into three main areas: equities (via other investment trusts and exchange-traded funds), index-linked government bonds, and cash and short-duration bond-like securities. The latter includes zero dividend preference shares and corporate bonds.

Capital Gearing has a 1% allocation to gold. The low size of the allocation is perhaps perplexing given gold's safe haven qualities and its rally over the past year – its peer **Ruffer Investment (RICA)** has around 7.7% in gold and gold miners' shares – but Spiller argues the commodity is 'very difficult' to value and doesn't protect against inflation if you pay too much for it.

The trust has a 0.68% ongoing charge. According to the Association of Investment Companies, this is the third lowest – alongside **RIT Capital Partners (RCP)** – in the 'flexible investment' sector in which Capital Gearing resides, with only **Aberdeen Diversified Income and Growth (ADIG)** and **Hansa Trust (HAN)** coming out cheaper. These two have been more volatile than Capital Gearing and delivered a significantly lower total return over the past 20 years.



IG DESIGN

(IGR:AIM) 705p

Gain to date: 1.1%

Original entry point:

Buy at 697p, 19 December 2019

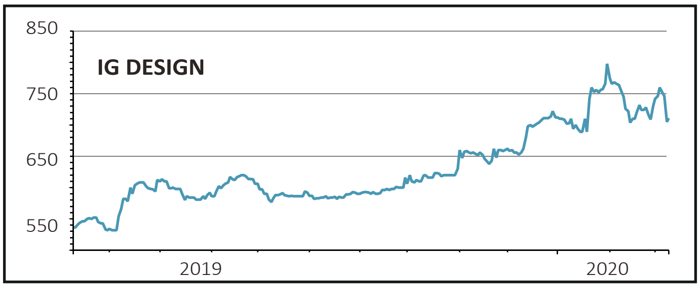
SHARES IN GREETING cards, gift packaging and creative play products maker **IG Design (IGR:AIM)** have held up well amid the market carnage with investors cognisant of the group's excellent long-term growth prospects.

Following the seasonal trading period and the completion of its CSS acquisition, IG Design assured (4 Mar) it is on track to meet market expectations and is closely monitoring the developments regarding coronavirus and its potential impact on the business.

'With the current known scale of the outbreak, it is not expected that there will be a material impact to the group's current forecasts,' assured IG Design, whose China factory is operating, with production volumes expected to increase over the coming weeks.

IG Design also explained: 'We continue to work with our suppliers in China to ensure deliveries of our customers' orders are managed through this period, including as necessary, mitigating strategies such as alternative sourcing arrangements and using existing inventory reserves.'

Having wrapped up the takeover of CSS on schedule, IG Design is pressing ahead with integrating an acquisition that doubles the size of its US business and dovetails nicely with previous purchase Impact Innovations.



SHARES SAYS: ↗
We remain enthused by IG Design, the CSS deal looks a positive purchase and the company appears to be doing well in dealing with the coronavirus situation.

CARETECH

(CTH:AIM) 435p

Gain to date: 11%

Original entry point:

Buy at 391p, 31 October 2019

THE SHARES HAVE done reasonably well against the backdrop of the recent market turmoil, despite having given back around 13% over the last two weeks. This makes intuitive sense as the company is relatively insulated from the problem areas affected by coronavirus.

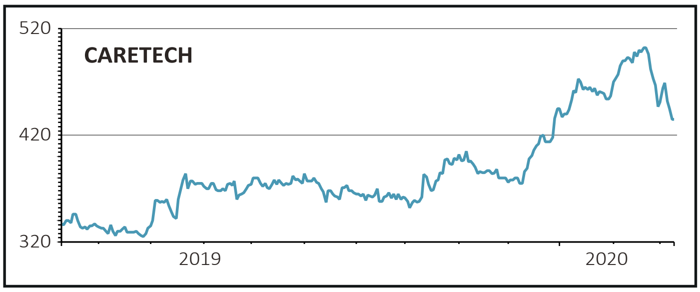
Moreover the company, which provides social care and education services for adults and children, delivered what we described as 'flawless execution' when it reported full-year results on 12 December, beating analysts' expectations.

Like-for-like growth of 6% was ahead of the market while earnings before interest, tax, depreciation and amortisation (EBITDA) margins improved and are well on the way towards the medium-term goal of 16%.

On 5 February the firm completed an investment in the United Arab Emirates (UAE) by securing a 51% interest in the largest provider of private outpatient mental health services in the country for £7.2m.

As well as providing growth capital the firm will leverage its 25 years of operational skills applied in the regulated UK market.

Meanwhile the £15bn UK market still offers a significant growth opportunity for the company, driven by the continuing trend for local councils to outsource in this niche sector.



SHARES SAYS: ↗
The growth opportunity remains intact and isn't fully priced in. Keep buying.

CLOUD COMPUTING:

THE DISRUPTIVE "SHIFT TO CLOUD" FOR THE LONG-TERM INVESTOR

The cloud computing space has been generating massive amounts of attention. From a growth perspective, this makes sense[1]:

+ **Overall Size of Market**: The public cloud services market is expected to total more than $214 billion when the figures for 2019 are finalised.
+ **Growth of Market**: The Infrastructure-as-a-Service (IaaS) segment of cloud is expected to have grown nearly 30% during 2019. If you haven't heard of "IaaS", just think of "Amazon Web Services" or "Microsoft Azure", some of the biggest players in IaaS. In 2019, the US Department of Defence even entered into a $10 billion contract with Microsoft Azure to move to the cloud, offering yet another proof point on the perceived convenience and security of using cloud-based infrastructure[2].

In August of 2011, Marc Andreessen, a prominent Silicon Valley venture capitalist, wrote the phrase "software is eating the world" within a Wall Street Journal article[3]. Even then, now more than eight years ago, the case was clear that companies in Silicon Valley were relying less and less on delivering a physical "product" and more and more on delivering some type of software over the internet.

A particular trend that we find exciting regards large, established companies changing their business models and shifting to the cloud. In fact, we'd challenge anyone reading this article to think of a software company today that doesn't use a cloud-based delivery model. There are important benefits for the customer and the software company.

+ The **customer** doesn't pay as large an up-front cost and instead can choose to subscribe to software that will be used over time. Sometimes, payments can even be tied to usage.
+ The **software company** receives more regular revenue streams based on subscriptions instead of needing to convince customers to continually buy new versions of products.

Here are two large companies that have touched and continue to touch the lives of millions of consumers that have transitioned to cloud-based delivery models.

ADOBE[4]

The software company, that achieved great success with their PDF file viewing format, began to shift its strategy to Cloud in 2009. The company took a risk after a series of acquisitions, launching its Creative Cloud software in 2012, where customers would pay monthly to have access to the platform. By May of 2013, Adobe's cloud software had more than 700,000 paid subscribers, massively outperforming the company's expectations.

MICROSOFT

I remember the excitement around the release of Windows '95, when you would come home with some disks and instruction manuals to hopefully install the software. Microsoft was in a tough position at this time, needing to convince customers to continually upgrade every few years to ensure the software would continue to work for their needs. Today, many laptops don't have built-in disk drives, and subscribers to Microsoft's Office 365 receive automatic updates and troubleshooting.

When customers get better services and businesses stabilise their revenues, the cloud clearly represents the future of software delivery and we believe investors may want to make the "shift to cloud" in their portfolios as cloud companies may be an avenue for more specific exposure to technology with a different set of growth prospects going into the next decade.

- **For more insights about disruptive technologies, please visit: The WisdomTree BLOG**
- **To access a list of relevant thematic products within the AJ Bell Youinvest platform, please visit: AJ Bell Youinvest - Thematics**

[1] Source: For both bullets, "Gartner Forecasts Worldwide Public Cloud Revenue to Grow 17.5% in 2019." Gartner Press Release. 2 April 2019.
[2] Source: Lardinois, Frederic. "In a Victory over Amazon Microsoft wins $10 billion JEDI Cloud Contract." TechCrunch. 26 October 2019.
[3] Source: Andreessen, Marc. "Why Software is Eating the World." Wall Street Journal. 20 August 2011.
[4] Source: Gupta, Sunil and Lauren Barley. "Reinventing Adobe." Harvard Business School. 20 January 2015.

CORPORATE DEBT CRISIS:

The stocks you shouldn't own

By **Ian Conway** and **Martin Gamble**

Coronavirus presents a big risk to corporate earnings if world trade is affected and companies' supply chains are interrupted. While investors have begun to factor this risk into company valuations over the last month, when companies say they no longer have visibility over earnings it makes the job of valuing them a great deal harder.

Now, as the virus continues to spread, some investors are beginning to ask whether it could cause cash flow problems among businesses. Companies may find it hard to keep up debt repayments, potentially leading to collapse.

Just as coronavirus can kill people with health issues, it could potentially do the same to companies with underlying health problems.

To put it bluntly, you do not want to own any stocks at present which have very large debt positions relative to the value of their business and the scale of their earnings.

DAMAGE LIMITATION

Currently the number one priority for governments around the world is to try to stop the spread of coronavirus, for public health and economic reasons.

However, as events in China have shown, to really contain the spread of the virus entire populations have to be isolated for weeks at a time, and there is a heavy economic price to pay.

The 'soft data' from China in the form of industrial surveys has given us a taste of what is to come: the February manufacturing purchasing managers' index (PMI) collapsed to its lowest ever level, while new orders fell at the fastest rate on record.

Now some of the hard data is emerging: car sales in China, which is the world's biggest market, tumbled by more than 80% last month due a combination of fewer vehicles being manufactured and a lack of buyers.

Analysts have rushed to downgrade their growth forecasts for the Chinese economy while at the same time pencilling in a sharp 'V-shaped' recovery later this year or early next year.

However, even if the Chinese economy does recover sharply, the rapid spread of coronavirus outside China is becoming a bigger threat to global growth.

RISKS MOUNTING

Without the political or logistical means to follow China's example, countries around the world have adopted piecemeal strategies for containing the virus, with most asking the populace to 'self-isolate' rather than restricting movement.

Inevitably, these different approaches have met with differing results, and a view is forming among medical experts and politicians that rather than containing the spread of the virus the best they can now hope for is to delay its spread.

The director of the UK's Centre for Global Infectious Disease Analysis has admitted that while the world 'tried very hard to stop this virus, you can see from the statistics that the battle is really over'.

England's chief medical officer has also said that an epidemic in the UK was now 'highly likely' and that the UK Government's objective is now to mainly delay the spread of the virus.

The IMF has cut its fairly ambitious global growth target for this year from 3.8% to 2.9%, while the OECD has lowered its forecast from 2.9% to 2.5% and acknowledged that growth could be lower still.

In a worst-case scenario, the OECD has warned that several countries could be pushed into recession, meaning their economies contract, including Japan and countries in the euro area like Italy.

BEWARE OF GEARING

While markets have factored in a degree of risk from the spread of the virus, they still seem complacent about the potential long-term economic damage it could bring, especially in terms of company cash flows.

'The speed of the market repricing has obviously been dramatic, however markets have only gone from pricing in no risk to a moderate risk,' says Mike Riddell, manager of the **Allianz Strategic Bond Fund (B06T936)**.

Dozens of companies in the UK and overseas have already warned of a downturn in revenues and a squeeze on earnings in the first two months of the year due to the spread of the virus.


Games Workshop is a company with high operational leverage

The casualties haven't just been manufacturing firms: a great many are service sector firms which are suffering from a drop in demand.

For firms which are operationally geared, meaning they have high fixed costs and need a certain level of income to generate profits, a fall in revenue is a major worry.

For firms which are not just operationally geared but also financially geared, meaning they have lots of debt which needs servicing, a fall in revenue could be catastrophic.

WHAT IS OPERATIONAL LEVERAGE?

When a company has low fixed costs relative to its revenues, for example items such as rent, utilities and general administrative expenses which are necessary for it to operate, it can be said to have low operational leverage. When a company's fixed costs are high, it has high operational leverage.

While a company is growing, operational leverage is a good thing as an increase in revenues doesn't cause an increase in fixed costs which means more of the income turns into profit.

A good example of a company with high operational leverage is **Games Workshop (GAW)**. In its half-year results to 1 December 2019, revenue increased by 18.5% to £148.4m. However operating profit jumped by 37%, twice as much, to £48.5m. This was the result of operating expenses only increasing by 12%, allowing more of the increase in revenue to turn into profit.

Including royalties, which cost Games Workshop nothing to make and are therefore all profit, total

Flybe is one of the first corporate victims linked to coronavirus

operating profit grew an astounding 45%.

However, high operational leverage works in reverse too. Here, even a slight fall in revenue is magnified at the operating profit level. At the extreme a company may not generate enough cash to 'cover' its fixed costs, resulting in an operating loss.

WHAT IS FINANCIAL LEVERAGE?

When it comes to funding their business, companies have a choice. Traditional ways of raising money are to borrow from a bank or sell shares on the stock market, but today there are also plenty of 'non-bank' lenders prepared to offer money privately.

There are advantages and disadvantages to using debt. In legal terms, debt ranks higher than equity which means if things go wrong banks and bondholders can take over a company at the expense of shareholders. This can happen when financial covenants are breached, which was the case at retailer Debenhams, which is now owned by its lenders.

Covenants are designed to prevent companies from overstretching themselves financially and to protect debtholders. A typical requirement would be a ratio of net debt-to-earnings before interest, tax, depreciation and amortisation (EBITDA) of less than four times.

Using debt responsibly can help companies pay lower taxes as interest payments reduce taxable profit, and can boost returns on equity. However too much debt can spell trouble for shareholders as their interests are put at risk from claims by lenders.

BIG PROBLEMS AHEAD

In its latest global financial stability report the IMF ran a simulation which showed that in a

AA: the pains of financial leverage

ROADSIDE ASSISTANCE COMPANY **AA (AA.)** came to the stock market having been owned by private equity and 'loaded up' with borrowings. The company has struggled ever since to reduce its mountain of debt.

AA has a staggering £2.7bn of net debt while this year's EBITDA is expected to be £347m according to data from Refinitiv, which gives the company a net debt-to-EBITDA ratio of 7.8 times. Any ratio above four times is considered a red flag for rating agencies and investors.

The firm's financial leverage is so high that annual interest costs are equivalent to two thirds of operating profits, money that otherwise would end up in shareholder's pockets.

recession only half as severe as the last crisis, companies with $19trn of outstanding debt would have insufficient profit to service their borrowings.

The collapse of UK airline Flybe is a textbook example of what can happen when a company which is operationally *and* financially geared suffers an unexpected drop in revenue.

Airlines have high fixed costs – for example leases on aircraft and staff costs – as well as large variable costs such as fuel.

They also tend to have high levels of debt, while all of their working capital comes from ticket sales. If the money from ticket sales falls – for example, because of an increase in competition or a fall in consumer confidence – they struggle to meet their operating and financial costs.

In the case of Flybe, which had been struggling financially for some time, a sudden drop in passengers due to fears over coronavirus proved to be the straw that broke the camel's back.

However it is unlikely to be the only loser in the sector. The International Air Transport Association (IATA) has warned that coronavirus could cost the global airline industry over $110bn in lost revenue this year alone, more than three times the amount it estimated in February.

To put that in perspective, global airline industry revenues were $838bn last year according to the IATA.

WILL RATE CUTS REALLY HELP?

Part of the reason for the complacency among investors is the feeling that, as in previous crises, central banks will have the markets' back in terms of their ability to cut interest rates to stimulate demand and underpin share prices.

However, when the Federal Reserve Bank cut interest rates by 0.5% last week as a signal that it was ready to help indebted companies, US stocks actually went down.

This may have been the first sign that investors have started to realise that the damage to stocks may be greater than they first thought, and that rate cuts may not be the 'silver bullet'.

According to the OECD, global debt levels are at all-time highs relative to global output, and most of the debt issued by non-financial companies since the financial crisis has been low grade.

As David Jane, multi-asset fund manager at Premier Miton points out, 'the problem with high debt levels is they reduce resilience to shocks, and what seemed sensible, even clever, when times were good can be terminal in the event of a shock'.

In the UK, the volume of low-grade corporate debt – rated BBB, the lowest level which still qualifies as investment grade – has ballooned since the crisis thanks to low interest rates and demand from bond fund managers for higher-yielding debt.

Analysts at asset managers BlackRock and Vanguard, and at UK bank Barclays, were voicing concerns late last year about the risks of the surge in BBB bond issuance.

Due to the size of the market and the fact that the balance sheet quality of many BBB-rated companies has deteriorated, the risk of defaults and downgrades is actually higher than at the start of the financial crisis.

Diamonds are not forever?

SHARES IN DIAMOND producer **Petra Diamonds (PDL)** are sinking fast as it grapples with very high levels of debt and ongoing weakness in the diamond market.

Its latest half year results revealed a 6% drop in revenue to $194m, higher costs and a $37m jump in net debt to $596m. It has $650m of loan notes that mature in two years' time. The market value of the business is now only £24m ($31m).

> The risk of defaults and downgrades is actually higher than at the start of the financial crisis

Moreover, today's stock of corporate debt has lower overall credit quality, longer maturities, worse protection for buyers – including the same 'payment in kind' clauses which were prevalent during the financial crisis – and higher payback requirements.

According to analysts at BlackRock, in the last three major downturns – 1989 to 1991, 2000 to 2003 and 2007 to 2009 – between 23% and 45% of investment-grade bonds were downgraded to junk.

'If downgrade rates were to remain at such levels, the next downturn could see $600bn of BBB bonds consigned to junk status,' they add.

WHO ARE THE BIGGEST BORROWERS?

In the UK, corporate net debt – that is total borrowings less cash – rose for the eighth year in a row to hit a record £443bn in 2019, almost 70% above the low in 2011 when UK companies were cutting debt after the financial crisis.

Most of the increase in UK corporate debt has happened in the last three years, with the oil sector seeing the fastest growth in net debt.

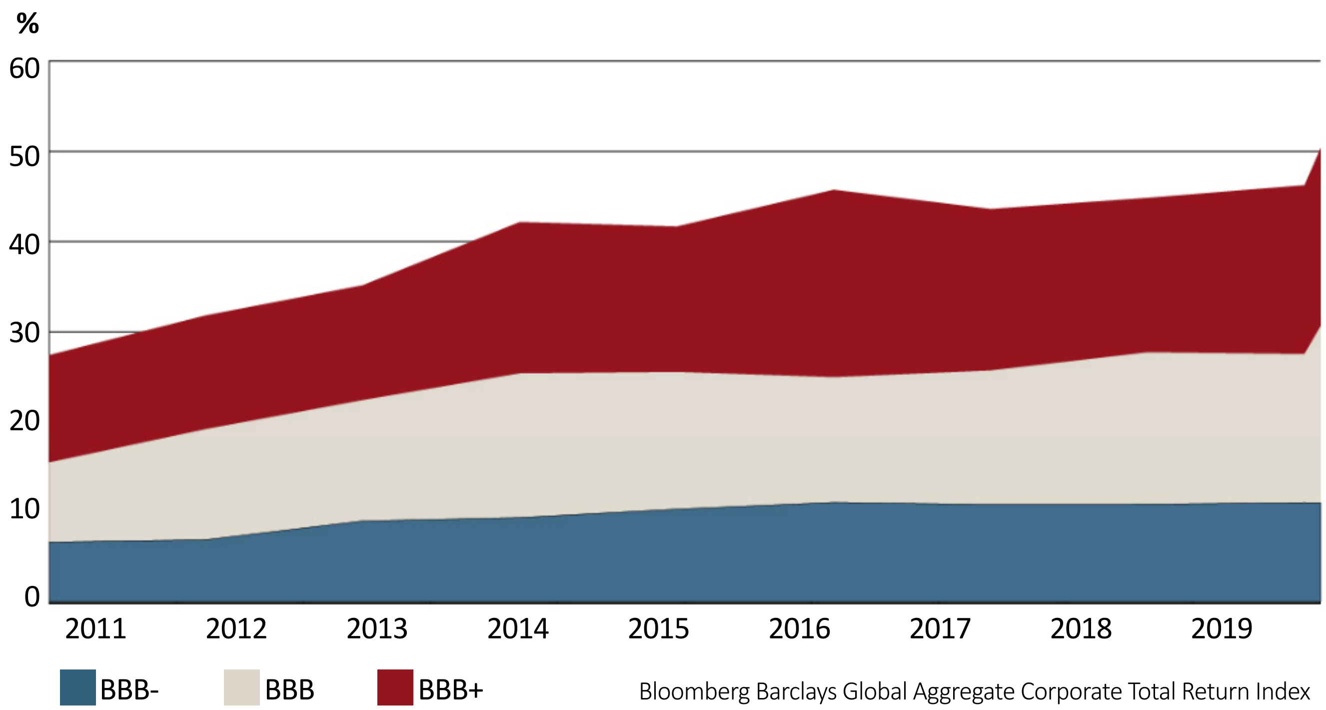
In 2018, oil majors **BP (BP.)** and **Royal Dutch Shell (RDSB)** accounted for an astonishing £1 in every £7 of UK plc's net debt, according to Link Group's Debt Monitor.

As the oil price collapsed in 2015, both firms undertook major restructurings and took on debt to help maintain their dividends while profits fell.

Another sector with high levels of net debt is consumer goods, with **British American Tobacco (BATS)** and **Imperial Brands (IMB)** accounting for three quarters of the total.

Further examples of consumer companies with high levels of net debt are **Reckitt Benckiser (RB.)** and **Unilever (ULVR)**.

RISING PROPORTION OF LOW GRADE INVESTMENT BONDS



Source: Bloomberg, Vanguard. Chart is shown from 2011 as the index data was not broken down prior to this date

HERE'S THE TIPPING POINT

With supply chains disrupted and corporate earnings at risk if the spread of the virus is not checked, there is a danger that late payments to suppliers will push weak companies close to, if not into, insolvency.

Late payment has been described as the equivalent of 'crack cocaine' for large companies because many rely on it to finance their working capital without having to pay interest to banks or pay dividends to shareholders.

Therefore investors need to avoid companies that have weak cash flows, weak balance sheets, high levels of operational and financial gearing and 'recovery' or 'special situations' funds that invest in such companies.

WHO ELSE IS EXPOSED?

While most of the build-up in corporate debt has been outside the banking sector, there is no doubt that an increase in defaults would damage banks' balance sheets, shrinking their capital.

At the same time, interest rate cuts by central banks will heap more pressure on net interest margins as it gives banks less room to eke out a profit on their lending.

Bond funds with a high proportion of BBB-rated or high-yield corporate debt could suffer if defaults and downgrades rise as a result of pressure on company profits.

WHAT TO AVOID

- ✗ Companies with weak cash flow
- ✗ Companies with weak balance sheets
- ✗ Companies with high levels of operational and financial leverage
- ✗ Recovery or special situation funds that invest in these types of companies

FALLING YIELDS ON LOW GRADE UK INVESTMENT BONDS

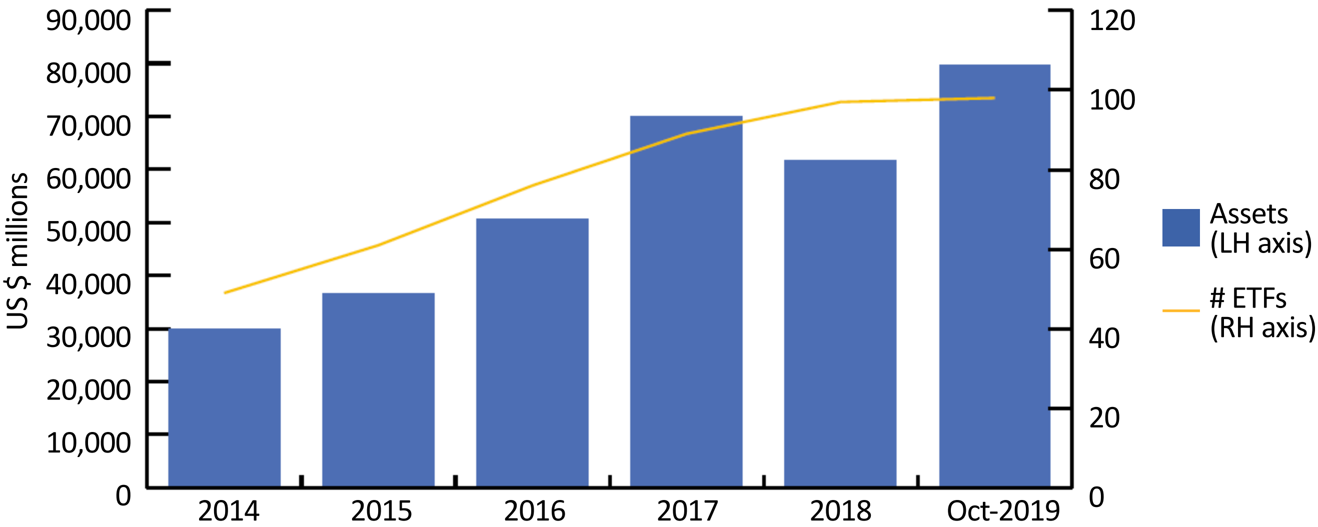
Source: Standard & Poors

S&P UK BBB investment grade corporate bond index

Investors also need to take care with European corporate bond ETFs which have grown to more than $100bn in value in the last five years. Funds with a high proportion of lower-grade bonds should be avoided.

Finally, investment trusts and funds with exposure to private debt and private equity may also be at risk depending on the quality of the assets and the level of protection assigned to the debt.

GROWTH IN EUROPEAN CORPORATE BOND ETF PRODUCTS



Source: ICMA analysis using data provided by ETFGI, ETF/ETP Providers, and Bloomberg

FOUR STOCKS YOU MUST NOT OWN

ASTON MARTIN LAGONDA

The case for not owning **Aston Martin Lagonda (AML)** shares seems fairly open and shut. Sales have gone into reverse, profits have vanished and now it is facing a major downturn in demand in China, one of its biggest markets, together with supply chain issues.

With falling revenue, the last thing the company needs is a pile of very expensive debt, yet net borrowing at the end of last year was £876m compared with a market value of £678m and forecast EBITDA this year of £223m, which is likely to be downgraded.

It has struck a deal to raise £500m of new money but that might not be enough if its problems get worse.

ROLLS-ROYCE

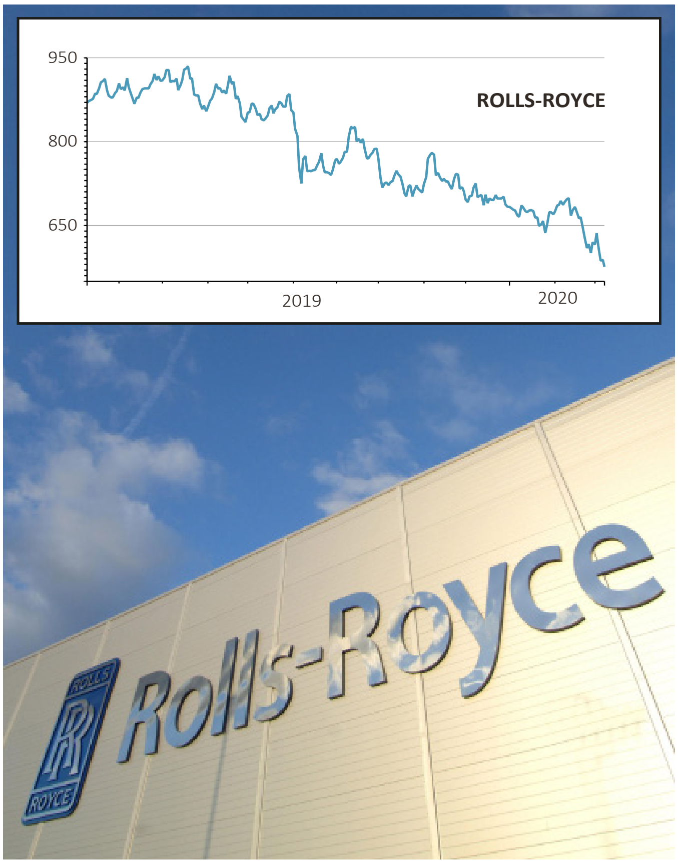
Aircraft engine maker **Rolls-Royce (RR.)** may not seem an obvious stock to avoid given that one day last month it was the only gainer in the FTSE 100, but the challenges facing it give us cause for concern in the present climate.

Problems with its Trent 1000 engine are well documented, leading to another £1.4bn exceptional charge in last year's results and leading long-standing customers such as ANA to switch suppliers to rival Pratt & Whitney, depriving it of sales and lucrative after-market service revenue.

Less well documented is Rolls' operating leverage – sales and operating costs eat up 95% of revenue, meaning a drop in turnover from customers switching or, say, its end-clients the airline operators cutting back on capacity, could wipe out earnings.

Meanwhile the company's debt pile has increased due to new rules on lease accounting and there is £1bn of off-balance sheet financing in the form of 'factoring facilities' which it claims is standard.

Now feels like the wrong time to own such an operationally geared company.



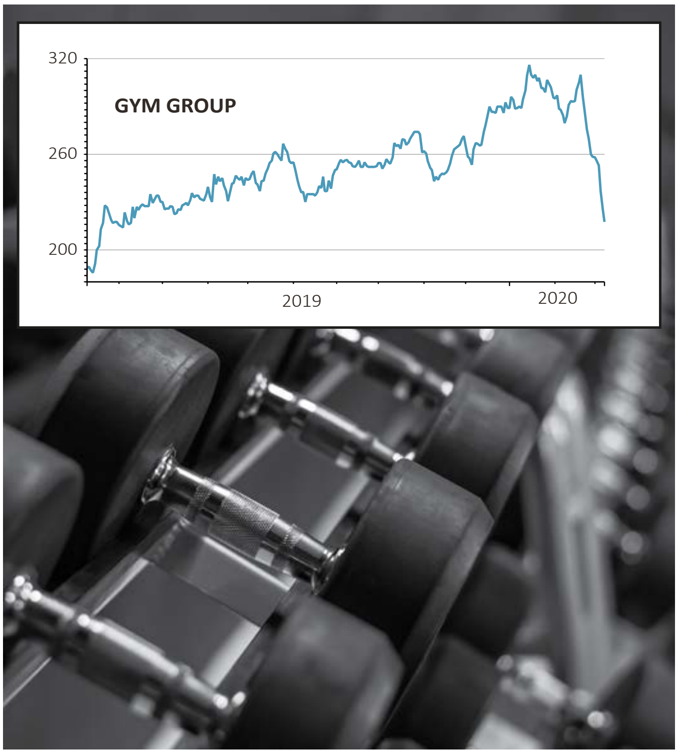
GYM GROUP

The timing of the coronavirus outbreak was unfortunate for gym operators as it gives members a valid reason to quit the gym at the time of the year when operators typically sign up a large number of new members.

In addition, there is an increasing risk that businesses will temporarily close offices, requiring staff to work from home in an attempt to stop the spread of the virus. A fair number of gym goers will be lunchtime or after-work users of a gym near to the work place, potentially impacting membership.

Gym Group (GYM) has grown rapidly; opening 15 to 20 sites a year, and made some significant acquisitions, notably Lifestyle and EasyGym.

As a result, net debt-to-EBITDA has reached a high 4.7 times, although some of this debt is backed by a property portfolio. The business may be vulnerable to a sudden drop or slowdown in revenue growth. Debt interest consumes two thirds of operating profit.



CINEWORLD

Global cinema operator **Cineworld (CINE)** increased its already high financial leverage on the eve of the outbreak of the coronavirus. Shareholders approved the debt-financed $2.8bn (£1.6bn) takeover of Canada's Cineplex on 11 February.

Buying Cineplex adds $2.3bn, or £1.7bn, of extra debt. That takes net debt to $5.6bn (approximately £4.19bn), tipping the gearing level to four times earnings before interest, tax, depreciation and amortisation (EBITDA). Statistically, this level significantly increases the chances of default.

Management intends to reduce leverage towards three-times by 2021, but this ambition was articulated before the current epidemic appeared.

Cineworld was already weighed down by significant debt as a result of buying Regal Entertainment in the US. Adding even more debt with the Cineplex deal looked like madness, in our view. We've been long-term fans of the business but the latter acquisition was a tipping point and made the stock unappealing because of the debt. Now the coronavirus has made the situation even worse.

The company says it hasn't seen evidence of admissions falling, but there is a risk that people become more circumspect about spending a couple of hours sitting next to complete strangers, when they can safely stream content directly into their homes.

Italy has closed its cinemas across the country in an attempt to curtail the spread of the virus, and the release of the new James Bond film has been postponed worldwide until much later this year which suggests that Hollywood is very nervous about cinema demand near-term.

People working from home and shunning leisure experiences aren't going to go out twice as much once the coronavirus scare dies down. This is lost revenue for leisure companies which they won't get back at a later date.

Market sell-off presents great opportunity to buy quality funds and stocks

We look at some fund managers' quality processes and reveal names that should reward over the long-term

Given the scale of the global market sell-off, now could prove an opportune time to buy quality stocks or to invest in funds with a quality tilt. We cannot say for certain that they will be good investments in the short-term, yet we're much more confident they will provide generous rewards in the long-term.

'Stocks are simple,' says Warren Buffett. 'All you do is buy shares in a great business for less than the business is intrinsically worth, with managers of the highest integrity and ability. Then you own those shares forever.'

A 'great' business tends to be one capable of managing short-term uncertainties and volatility to prosper in the longer run to deliver what many investors call 'sustainable growth'.

Take health, safety and environmental technology kit supplier **Halma (HLMA)**, for example. It is often used as an example of a well-run, high quality business and this is evidenced in its impressive share price appreciation over the years.

Yet like any company, it has come in for flack during times of stock market stress. Halma's shares lost more than a third of their value in the teeth of the

dot.com boom/bust, only to bounce back and recover all of those losses and more before the end of 2000.

It was a similar story in the global financial crisis, dropping to the 150p level in early 2009 before more than doubling in price by the end of 2010.

WHAT TO LOOK FOR

There are common measures of profitability, stability and financial health sought by many of the smartest professional investors.

These include gross and operating margins, return on equity (ROE), return on invested capital (ROIC), the volatility of revenue and earnings growth, debt, and the strength of cash generation measured by free cash flow (FCF).

There are also more esoteric factors to consider such as strong brands that can defend profit growth even in the face of increasing competition. For example, this might be **Diageo's (DGE)** drinks brand Guinness, or **Reckitt Benckiser's (RB.)** disinfectant Dettol.

It could also be intellectual property. For example, Google's internet search algorithms are so effective that the website has become the de-facto way to find stuff online, which pulls in piles of advertising money.

The network effect enjoyed by **Rightmove's (RMV)** property portal is another great example. It has built the scale that make it the first place home buyers look, so no property vender can afford to ignore it, thus drawing even more home buyers to its listings. That's a network effect.

Generally speaking, high quality firms are consistently profitable, growing, and have solid balance sheets.

This is as true overseas as it is in the UK. 'We focus on what we regard as higher quality stocks and tend to avoid loss-making companies and are wary of businesses that are over-reliant on debt,' say Cormac Weldon, manager of **Artemis US Select Fund (BMMV510)** and **Artemis US Smaller Companies Fund (BMMV576)**.

SEEKING SUSTAINABLE GROWTH

Whether it was stocks like Coca-Cola, American Express or Apple, investor Warren Buffett has always focused on the long-term. He and Berkshire Hathaway partner Charlie Munger have always sought firms with 'economic moats' that had durable competitive advantages and the capacity to compound returns over long periods from sustainable growth.

This concept was first outlined in a book called *The New Buffettology*, written by David Clark and Mary Buffett, a divorced former daughter-in-law of Warren Buffett. It looks for all the classic features that Buffett likes in a 'consumer monopoly' type of business. These include:

- Strong and growing earnings
- Conservatively financed
- Earns high rates of return on shareholders' equity
- Generates a consistently high return on capital
- Limited requirement for new cash
- Shares offer good value

In this strategy, a key part of assessing whether the stock is good value is to consider the growth rate a company can sustain without having to take on debt or issue new shares.

Retail investor website Stockopedia has a pre-set 'Buffettology-esque Sustainable Growth Screen', whose results include Rightmove, promotional products group **4imprint (FOUR)** and kitchen seller **Howden Joinery (HWDN)**.

FUNDS WITH A QUALITY TILT

Fundsmith Equity / Smithson Investment Trust

Terry Smith, the former City accountant and founder of fund management company Fundsmith, has his own pocket-sized strategy for buying great companies. This is used in both the **Fundsmith Equity Fund (B41YBW7)** and **Smithson Investment Trust (SSON)**.

FUNDSMITH'S STRATEGY:

- Buy good companies
- Don't overpay
- Do nothing

Fundsmith sees a high quality business as one that can sustain a high return on operating capital employed and which generates substantial cash flow, as opposed to only creating accounting earnings.

If a company reinvests some of this cash back into the business at its high returns on capital, Fundsmith believes the cash flow will then compound over time, along with the share price.

Earning higher returns on capital requires companies to show the ability to continue out-competing rivals that are trying to take a share of their profits.

This can come in many forms, but Fundsmith looks for companies that rely on 'intangible assets' such as strong brands, patents, customer relationships, distribution networks, installed bases of equipment or software which provide a captive market for services, spares and upgrades, or dominant market shares.

Smithson's top holdings

Stock	Return on capital employed (5 year average)
Rightmove	1567.8%
Ansys	16.8%
Verisk Analytics	16.4%
Masimo	14.2%
Equifax	9.8%

Source: Smithson, SharePad

Lindsell Train Investment Trust

Lindsell Train Investment Trust (LTI) remains hugely popular among retail investors despite the steep share price decline since July. It has delivered superb returns over years from the high quality stock formula implemented by managers Nick Train and Michael Lindsell.

'We are guided by four investment beliefs when constructing and managing portfolios for our clients,' says Train. These are:

- Investors undervalue durable, cash generative business franchises
- Concentration can reduce risk
- Transaction costs are a 'tax' on returns
- Dividends matter even more than you think

'At the heart of the process is our conviction that inefficiencies exist in the valuation of exceptional quoted companies,' the trust states. This boils down to Lindsell Train's belief that most investors are typically poor judges of companies with great brand franchises that throw off heaps of free cash flow that will compound over years to create enormous value for shareholders.

It uses various investment metrics and approaches, but admits that the most important is a discounted cash flow calculation. This is one of the more tricky models for retail investors to get their head round because it relies on making fairly accurate assumptions about future cash flows and cost of capital of a business.

The investment team spend most of their time analysing facts and figures and crunching spreadsheet numbers in the hope of identifying potential investments from its stock universe. 'We find the majority of our candidate investments in a select group of broad industry categories, such as consumer branded goods, internet, media, software, pharmaceuticals and financials,' they say.

The same process is used in other funds run by Lindsell Train including **Finsbury Growth & Income (FGT)**, **Lindsell Train UK Equity (B18B9X7)** and **Lindsell Train Global Equity (B644PG0)**.

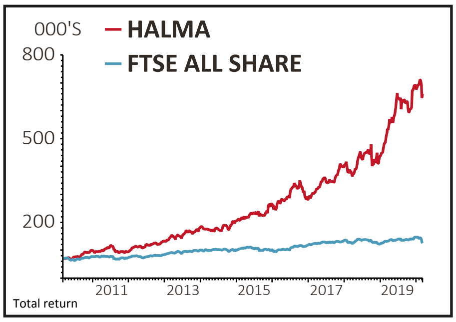
Lindsell Train's top holdings*

Stock	Return on capital employed (5 year average)
Unilever	22.6%
Diageo	15.7%
Paypal	12.7%
London Stock Exchange	10.9%
Nintendo	n/a

Source: Lindsell Train, SharePad *Quoted holdings only. Nearly half of the portfolio is held in the unquoted Lindsell Train asset management business

FOUR QUALITY STOCKS TO BUY AND (PROBABLY) NEVER SELL

Halma (HLMA) £19.49

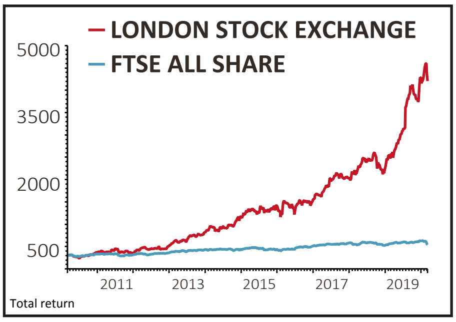


Halma is a great quality business that operates in secular growth markets with long-term drivers. The designer of health, safety and environmental electronics equipment provides solid, reliable growth, month after month, year after year.

Increasing health and safety regulations, demand for healthcare services in developing economies, and demand for life-critical resources allows Halma to earn strong operating profit margins of around 20%.

Smithson fund manager Simon Barnard calls Halma a 'very rare breed in the corporate world' due to its strong acquisition track record, and values the firm for its 'ability to continually invest incremental capital at very attractive rates of return by adding more small companies to its group each year'.

London Stock Exchange (LSE)
£72.18

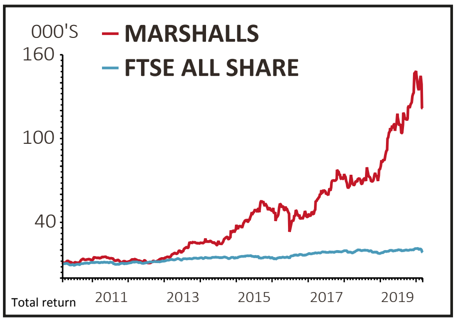


Whether markets are rising or falling, London Stock Exchange can reliably grow its revenue and profit thanks to transaction volumes both in equity markets and through its London Clearing House operations.

In addition its FTSE Russell index business continues to grow, with revenue up 10% last year, and the newly-acquired Beyond Ratings business has broadened its ESG (environmental, social and governance) appeal to bond investors.

Assuming the regulators approve the $27bn acquisition of analytics and data firm Refinitiv, the deal could transform LSE into the world's leading financial markets services company and ensure continued growth for many years to come.

Marshalls (MSLH)
669.5p

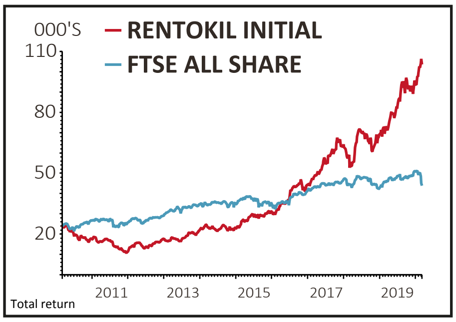


This building products firm specialises on landscaping products like bollards and paving slabs. It has a very consistent track record and over the last decade has delivered a total return to shareholders of 775% despite significant uncertainty in the wider construction space.

The company is good at finding the right places to achieve growth and recently refreshed its strategy out to 2023 to focus on areas like housebuilding and transport infrastructure.

The green light for the HS2 rail scheme should boost demand for its paving products. The company also continues to invest in innovation and improvements to its digital platform.

Rentokil (RTO)
475.6p



Pest control and hygiene services may be unglamorous businesses but that is exactly what makes Rentokil the kind of stock that allows investors to sleep soundly at night.

As the world becomes more urbanised, demand for Rentokil's services is only going to keep growing, and the coronavirus outbreak is a perfect demonstration of the need for hygiene in work and public places.

The firm reported record revenue growth last year and its leading global position allows it to generate strong operating profit margins – typically 30% higher than the FTSE 100 average – making it a stand-out long-term investment.

Disclaimer: Editor Daniel Coatsworth owns shares in Smithson

By **Steven Frazer**, **Tom Sieber** and **Ian Conway**

Kepler Trust Intelligence

Lessons from the coronavirus: keep things simple when it comes to investment

THERE ARE A multitude of investment products now on the market. But, for investors seeking to achieve long-term active returns from their investment portfolios, the multiplicity of funds can be confusing and a barrier to investment. Each of the world's markets and asset classes has very different risk profiles from the other – meaning that the context in which they are most likely to experience losses varies greatly. Balancing these risks across a portfolio overall can require both knowledge and continual monitoring.

Full of surprises

At the same time, trying to anticipate key risks is fraught with danger. In 2020 already, markets have faced two profound shocks. In early January, a US drone strike killed Iranian general Qassem Soleimani, prompting professional investors to flood into bond funds and away from equities in a bid to find an investing safe haven in the event of war. While the immediate effect was short lived, the incident demonstrated how quickly professionals react to these events and how ordinary investors are left to catch up.

The impact of the coronavirus epidemic is unlikely to have such a short lifespan. The scale of these events was unprecedented and could have an impact on global markets for some time to come, as the virus continues to spread.

Both Iran and the coronavirus have reminded us once again that 'black swan' macroeconomic events are impossible to predict, despite their significant implications, and near impossible to factor into investment decisions. As a result, investing heavily in a particular region, sector or investing style means you may be overexposing a portfolio to unforeseen risk.

Keeping things simple

While there is a place for allocating to multiple funds across different categories, for many investors seeking steady growth in their capital over the long term a more straightforward approach makes sense.

Funds like **Alliance Trust (ATST)** offer investors a carefully-balanced portfolio, which targets an active return from the best companies available across global stock markets. By avoiding over or underweights to any single sector, country, region or investment style, Alliance Trust seeks to reduce the risk of investors experiencing losses as a result of unexpected macroeconomic shifts or events – and equally does not look to politics or macroeconomics to drive its portfolio returns.

Instead, returns are driven through the skill of the ten fund managers who each run a 'best ideas' portfolio of their 10-20 most favoured companies, which collectively make up the ATST portfolio. This approach is grounded in the notion that, over the long term, high-quality companies will continue to generally do well regardless of the broader context.

To keep the portfolio balanced in aggregate, Alliance Trust's investment manager Willis Towers Watson, which selects and oversees the trust's underlying portfolios, monitors the overall portfolio's exposure to different regions, sectors and investment styles. While it seeks to keep the trust's exposures close to the MSCI, it does not overengineer it to match that. Instead, where exposures may be veering too far off balance, it will allocate more resources to a portfolio that redresses the balance.

Insightful commentary on market issues

RUSS MOULD
AJ Bell Investment Director

The fear index reading could be good news

The VIX has hit an important level which has historically been followed by a market rally on many occasions

When Franklin D. Roosevelt was inaugurated in 1933, America was battling the effects of the Great Depression and the country's 32nd president attempted to rally Americans round by declaring that 'the only thing to fear is fear itself'.

In the narrow context of financial markets this column does wonder whether there can be more than a grain of truth in that, especially as broader sentiment has switched from greed to fear in less than two months.

Indeed, it has taken the FTSE All-Share just 52 calendar days to fall by more than 20% from its January high and tumble into bear market territory.

Ultimately, no-one has a crystal ball and investors are left weighing up probabilities. This can be done via valuation and also, in a crude, short-hand form, via the VIX index.

WHAT IS THE VIX?

The so-called 'fear index', which can be tracked for free via the internet, measures expected future volatility in the stock market (there is a UK equivalent but the US version has a longer trading history so this column will focus on America this week).

The VIX was launched in 1990 and it has averaged a reading of 19 over its history, with a low of 9.1 in November 2017 and a high of 80.86 in November 2008.

The 30 highest VIX readings ever all date from 2008 when the great financial crisis reached its zenith.

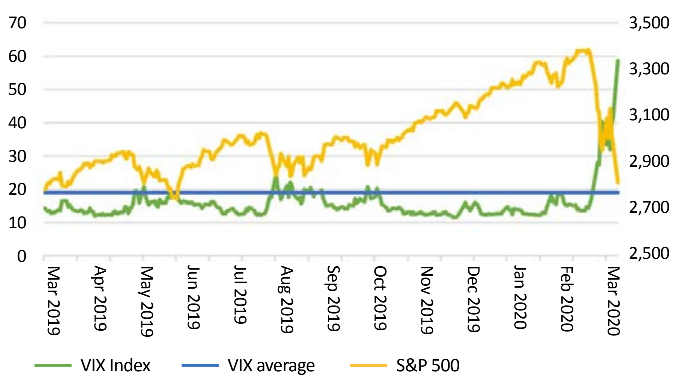
The eagle-eyed will immediately note that the VIX hit a low as a bull market was in full flow and reached a peak as bears were in charge and share prices were collapsing in the wake of Lehman Brothers' collapse.

It is tempting to think that the VIX may be more useful as a contrarian indicator than as a lead indicator – after all, to repeat one this column's favourite mantras from Warren Buffett, investors should look to be 'fearful when others are greedy and greedy when others are fearful'.

PANIC BUTTON

At the time of writing the VIX has just jumped to a reading of 58.75, within the highest 1% of all VIX readings since 1990, so everyone sounds pretty frightened. This begs the question of whether now is the time to panic along with everyone else and run for cover or be contrarian and start to research possible purchases.

VIX HAS SPIKED TO ITS HIGHEST LEVEL SINCE DECEMBER 2008



Source: Refinitiv, AJ Bell

The fear index has moved above 40, more than twice its historic average, just 12 times, including this week. It should therefore be instructive to look at how the S&P 500 has performed ahead of such spikes in the VIX and then how it has fared after them.

Analysis of how the VIX performed in the run-up

to a move above that 40 level shows that markets had already begun to fall hard by the time fear really took over.

The S&P 500 lost more than a fifth of its value in the six months preceding a reading of 40 four times out of 12. In fact what is odd about the two occasions this year is how calm markets were beforehand, perhaps because the viral outbreak was just impossible to forecast.

Note also how markets tend to rally after the VIX hits 40, to again support the thesis that it is a contrarian indicator. After a move above 40, the VIX tends to peak on average barely 20 days later, to suggest that by the time the VIX hits this mark the worst may already be behind us.

CAPE FEAR

As with any trends there are exceptions to the rule. The S&P was lower still 12 months after the 40 mark was crossed in 2001 as the tech bubble burst and 12 months after it got there in September 2008. In both cases, there were two factors at play:

- a lengthy recession
- valuations that peaked at historically lofty levels

The first of those two pre-conditions for an extended period of volatility and further market drops remains open to question now, although it is clearly what investors currently fear.

The second, unfortunately, was very much in place, using the cyclically adjusted price earnings (CAPE) ratio devised by Robert Shiller. Before the latest sell-off, the CAPE multiple of 31.5 times had only been exceeded twice in the S&P 500's history, 1929 and 2000, and neither of those periods ended well at all.

It is tempting to think that the VIX is telling us that investors have panicked thanks to the unknown threat to economic activity posed by the coronavirus outbreak and noise created by the collapse in oil prices and that markets are oversold as a result.

However, the valuation starting point was so extreme in the US that a slide into recession could still leave the S&P 500 exposed so investors will need to keep a close eye on macroeconomic data and company news flow in the coming weeks and months.

MARKETS TEND TO HAVE ALREADY FALLEN AS THE VIX HITS 40 AND RALLY AFTER

	BEFORE				AFTER				
When	6 months	3 months	1 month	1 week	1 week	1 month	3 months	6 months	12 months
31-Aug-98	-8.6%	-12.3%	-14.6%	-12.0%	1.7%	6.2%	21.6%	29.1%	37.9%
17-Sep-01	-11.3%	-14.0%	-10.6%	-4.9%	-3.4%	3.7%	9.2%	12.2%	-15.9%
02-Aug-02	-23.0%	-19.5%	-9.4%	1.3%	5.1%	6.0%	4.2%	-1.0%	13.4%
19-Sep-02	-26.9%	-16.2%	-10.0%	-4.9%	1.4%	4.9%	4.9%	3.8%	22.9%
29-Sep-08	-16.4%	-13.6%	-13.8%	-8.3%	-4.5%	-15.9%	-21.4%	-28.8%	-4.1%
07-Jan-09	-27.2%	-7.9%	-0.3%	0.4%	-7.1%	-4.2%	-9.0%	-3.0%	25.9%
06-Apr-09	-20.9%	-9.9%	22.3%	6.1%	2.8%	10.1%	7.6%	24.5%	42.4%
20-May-10	-2.1%	-3.2%	-11.2%	-7.4%	2.9%	4.3%	0.4%	11.7%	24.4%
10-Aug-11	-15.2%	-16.5%	-15.1%	-11.1	6.5%	3.0%	9.7%	20.5%	25.2%
24-Aug-15	-10.3%	-11.0%	-9.0%	-10.0%	4.2%	2.4%	9.0%	2.8%	15.5%
28-Feb-20	0.9%	-5.9%	-9.8%	-11.5%	0.6%	n/a	n/a	n/a	n/a
06-Mar-20	-0.2%	-5.5%	-10.9%	0.6%	n/a	n/a	n/a	n/a	n/a
AVERAGE	**-13.4%**	**-11.3%**	**-7.7%**	**-5.1%**	**0.9%**	**2.0%**	**3.6%**	**7.2%**	**18.8%**

Source: Refinitiv, AJ Bell

Investment trust bargains created by the market sell-off

Discounts on many investment trusts have widened significantly this year

INVESTMENT TRUSTS: MANY DISCOUNTS TO NAV ARE WIDENING

Trust	Code	Average 12-month discount	Discount now
Artemis Alpha Trust	ATS	16.9%	18.1%
Majedie	MAJE	16.0%	17.4%
Strategic Equity Capital	SEC	18.6%	15.0%
JPMorgan Japanese	JFJ	9.8%	14.3%
Montanaro UK Smaller Companies	MTU	13.4%	14.3%
Fundsmith Emerging Equities Trust	FEET	7.1%	12.4%
Scottish Investment Trust	SCIN	11.0%	11.7%
JPMorgan Emerging Markets	JMG	7.4%	8.9%
JPMorgan Mid Cap	JMF	1.3%	6.5%
Diverse Income Trust	DIVI	2.5%	6.0%
Witan	WTAN	3.4%	4.4%
Scottish Mortgage	SMT	0.5%	4.0%
F&C Investment Trust	FCIT	2.0%	2.9%

Source: Winterflood Investment Trusts. Data as of 10 March 2020

The global markets sell-off has more than doubled the average discount to net asset value on investment trusts, moving from 3.8% at the end of 2019 to 9.3% at the end of February, according to the AIC. That presents an opportunity for investors with an appetite for risk to consider buying trusts that interest them at much cheaper prices.

Several sector discounts have widened by a greater amount, notably commodities and natural resources, as well as Asia-focused sectors and growth-oriented ones including private equity, UK smaller companies and technology. In contrast, the average premium of biotechnology and healthcare has risen by 1.5 percentage points on hopes the sector will profit from products to combat coronavirus.

TRUSTS ON SALE

The AIC's analysis uses data that is now two weeks old. Markets have subsequently seen more wild swings so we've run the numbers again using data from Winterflood on a selection of trusts (as of 10 March) to get a more up-to-date picture. You can get the latest numbers by checking the AIC's website and looking at individual trusts.

According to Winterflood, **Scottish Investment Trust's (SCIN)** discount has widened out from a 12-month average of 11% to 11.7%. Managed by contrarian investor Alasdair McKinnon, this diversified portfolio of international equities seeks to achieve dividend growth ahead of UK inflation and it has grown the regular dividend for 36 successive years.

Elsewhere within the sector, the sell-off has also hit the Nick Train-managed **Lindsell Train (LTI)**, where the massive average premium of 47.4% over the past 12 months, heavily influenced by the perceived undervaluation of the holding the trust has in the asset manager Lindsell Train Limited, has narrowed to 4.6%.

In the UK All-Companies universe, **Artemis Alpha Trust (ATS)** is trading on a steep 18.1% discount. The trust's portfolio has been repositioned toward higher quality companies which enjoy competitive advantages in industries with supportive dynamics and are steered by excellent management teams.

Among small caps, **Montanaro UK Smaller Companies (MTU)** trades on a 13.4% NAV discount that belies its track record and generous dividends, while the discount on the **River and Mercantile UK Micro Cap (RMMC)** has widened out from a 12-month average of 15.1% to 18.9%.

SECTOR-SPECIFIC CHANGES

Sector	Weighted 12-month average discount	Discount now
Flexible Investment	7.1%	12.8%
Japan	5.6%	11.3%
Global Smaller Company	3.2%	4.9%
UK All Companies	4.3%	3.9%
Global	1.5%	3.2%
UK Mid Cap	9.9%	2.8%
UK Equity Income	3.9%	1.0%

Source: Winterflood. Data as of 10 March 2020

OVERSEAS INVESTMENTS

The coronavirus sell-off has also affected funds that put money to work away from UK shores. For instance, the discount on country specialist **India Capital Growth (IGC)** has widened out from 15.9% to 23%, while investors seeking broader exposure to names in developing economies should note **Fundsmith Emerging Equities (FEET)**, where the discount has more than doubled from 7.1% to 12.4%.

The discount on **JPMorgan Japanese (JFJ)** has widened out from 9.8% to 14.3%. Its holdings include Uniqlo-owner Fast Retailing, factory automation equipment maker Keyence and iconic gaming name Nintendo.

Multi-manager investment trust **Witan (WTAN)** has seen its discount widen to 4.4% from a 12-month average of 3.4%. Its nearest peer, **Alliance Trust (ATST)** has over the past year traded on a small discount, averaging 5.8%, however that's now narrowed to 5.3%.

By **James Crux**
Funds and Investment Trusts Editor

THIS IS AN ADVERTORIAL

Allianz Global Investors

Investment Insights from Silicon Valley

A changing competitive landscape

There has been considerable merger and acquisition in the technology sector. Whereas once the major companies were siloed and therefore had a captive market, today their businesses are starting to overlap. For example, Salesforce.com has teamed up with Tableau Software, an arch competitor of Microsoft. Increasingly, these companies do not have an open target for future growth but are bumping up against other equally capable and successful companies.

This may mean slower growth; sales people may need to work harder and some of the larger companies are already shedding market share. For some, the conclusion is that they will need to explore new markets. This could take the problem somewhere else. We are already seeing competitive hiring. Google has recently poached senior sales executives from Salesforce to spearhead Google Cloud's sales revamp.

UNICORNS EXPOSED

Spoiler alert: the problem with unicorns is that they aren't real. For the technology unicorns, it is their profits that have proved illusory. To date, many of these $bn businesses have justified their high valuations in the private equity market by suggesting profitability is just round the corner. The public markets have proved more sceptical.

Many analysts have been suggesting for some time that valuations in the private markets looked ambitious. This was exposed in 2019 as companies such as Uber, Lyft, Zoom and Crowdstrike came to market. Even those companies that have been executing well on their

business plans and are sustaining strong growth have seen their share prices perform poorly. For the valuation to make sense, many would have to see 50-100% growth for years into the future. They may do it, but it doesn't leave a lot of room for share price appreciation. To our mind, the price is determined by optimists.

These ambitious valuations create problems for the companies themselves. Many employees hold stock options struck at the IPO price and the allure of a lump sum payout has kept them at the company. If the share price is 30-50% below the IPO price – and yet they are facing taxes on those stock options – they've been working for free. Morale drops and people may ultimately leave for companies where they believe they can make money. In a competitive market for talent, that's a real problem. As such, these companies are under tremendous pressure to raise the share price.

The IPO market has been functioning poorly and valuations remain too high. It may have a painful period of readjustment ahead as the market moves from a focus on revenue growth to profitability.

This article was taken from Walter Price, co-manager of the AllianzGI Global Technology Team's regular "*Investment Insights from Silicon Valley*" piece. To discover more about Allianz Technology Trust, visit **www.allianztechnologytrust.com** where you can register for updates.

What does the coronavirus market turmoil mean for my pension?

The key points people in or saving for retirement should consider

What are the implications of the coronavirus outbreak on people like me who have a significant sum invested in the FTSE 100 via their pension?
Paul

Tom Selby
AJ Bell
Senior Analyst says:

The most important thing to do in the face of what is an unexpected and uncertain period for investors is not panic. We have seen extremely volatile stock markets in recent weeks and it is impossible to say when markets will recover.

While fear and worry is understandable – particularly as the outbreak led to the biggest daily drop in the FTSE 100 since the financial crisis – if you are saving in a pension you should be thinking in terms of decades rather than months or even years.

At most, those building a retirement fund should use this as an opportunity to review their investments and make sure they are happy with the risks they are taking. Recent events also highlight the importance of diversifying your investments across different assets and countries, so you aren't a hostage to fortune of one region or industry.

But you should avoid trying to second-guess what is going to happen or making significant trades which will cost you money and may not have a positive impact on long-term performance. If anything this is just a timely reminder that markets can and will go down as well as up, particularly in the short-term.

RETIREMENT INCOME RISKS

If we see a protracted period of negative investment returns, perhaps those most affected will be people taking an income from their pension pot through drawdown.

Anyone taking a significant withdrawal from their pension while also taking a hit on their underlying investments will struggle to make the money back, meaning they may have to reduce their income now or face the prospect of running out of money sooner than expected.

Again, there is no need to panic – at this stage we do not know what the long-term implications of coronavirus could be. That said, anyone in drawdown should review their investments and withdrawals to make sure they aren't risking retirement ruin.

As a very rough guide, a withdrawal rate of more than 4% for a 65-year-old – so £4,000 a year from a £100,000 fund – is generally viewed as potentially unsustainable.

If you are thinking of securing an income by purchasing an annuity, the recent volatility shows the importance of gradually reducing the risk in your portfolio as you approach your expected purchase date. Doing this provides greater certainty over the secured income you can expect to generate from your fund.

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.

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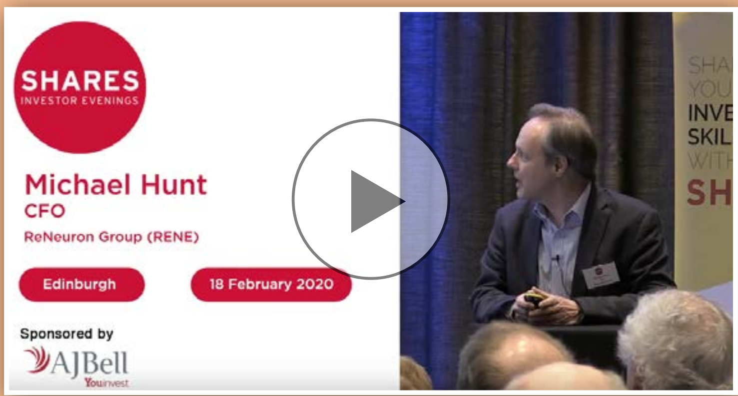
Trevor Phillips, CEO
Open Orphan (ORPH)

Open Orphan our goal is to become Europe's leading rare disease and orphan drug focused pharma services company by a management team with extensive industry and financial expertise.

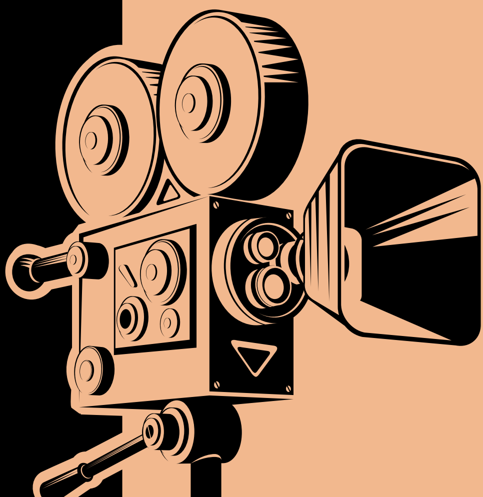


Michael Hunt, CFO
ReNeuron Group (RENE)

ReNeuron Group It's principal business involves the research and development of stem cell technology for the treatment of motor disabilities and blindness-causing diseases. A UK-based global leader in the development of cell-based therapeutics.

Dr. Rob Quinn, CFO
Silence Therapeutics (SLN)

Silence Therapeutics a leader in the discovery, development and delivery of novel RNA therapeutics for the treatment of serious diseases. It uses its RNA technology to develop drugs to address genetic disorders.



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The tax quirks that mean you pay up to 200,000% … and how to avoid them

Here's how to ensure the taxman doesn't take the lion's share of any pay rise you get

The tax system has become so complicated that many people find they are paying far more than the top rate of tax, as a £1 pay rise can mean certain benefits or allowances are whipped away.

The highest rate of income tax in the UK is 45% for anyone earning £150,000 or more. But some people on far lower incomes are facing tax rates many multiples higher – in the most extreme cases an effective tax rate of 200,000%.

It means that many people find a small pay rise can actually end up costing them money as they lose Government help or tax breaks. The good news is that some smart planning can help to mitigate the effects. So what are the main culprits and how can you mitigate them?

PERSONAL SAVINGS ALLOWANCE

The personal savings allowance was introduced in 2016 and gives basic rate taxpayers their first £1,000 of savings income tax free, while higher rate tax payers get a £500 limit. However, once you move into the additional rate tax bracket you lose that entire allowance. This means if you move into a new tax bracket you'll see your tax bill rise.

If you go from earning £50,000 to £50,001 you'll see the allowance cut in half. If you previously had £1,000 of savings income covered by the allowance you'll now face an extra tax bill of £200.

And if you go from earning £150,000 to £150,001 you'll lose the allowance. In that situation if you had £500 of savings income that was previously tax free, you'll now be taxed at 45% on it – equating to £225 of tax. That makes the effective tax rate on your £1 salary increase 22,500%.

Anyone who is nearing the threshold for the next tax bracket should think about sheltering their savings income from tax by using an ISA. This means they would avoid paying the tax bill and their money could continue to grow tax free.

CHILD BENEFIT

All parents are entitled to child benefit but as soon as one of them earns more than £50,000 they will see the amount they get whittled away. The benefit is completely wiped out when they earn £60,000 or more.

A parent with two children will get £1,788.80 a year in child benefit, but for every £1,000 they earn over £50,000 they will lose 10% of their child benefit. For example, someone seeing their salary rise to £51,000 would get £178.88 less from

their child benefit.

These earnings will be in the 40% income tax bracket and once the loss of child benefit is factored in their effective tax rate is 57.89%. This is because the 40% income tax of the £1,000 extra income will equate to £400, plus the loss of £178.88 of child benefit means they are paying £578.88 on that extra £1,000 salary, which equates to 57.89%.

However, parents who haven't tipped too far over the threshold can get around this by increasing their pension contributions.

What's counted for the purposes of the child benefit 'High Income Charge' is your salary after any pension deductions. This means if you contribute enough to your pension to get your salary back to £49,999 then you'll get the full child benefit again. Another option is to make charitable donations with the income over the £50,000 limit, which you'll need to declare to HMRC on your tax return.

The frustrating factor for many parents is that the rule applies if one parent is earning more than £50,000, regardless of their partner's income. So you could have both parents earning £48,000 each and have no problem, but if one earns nothing and the other earns £60,000 then you'll lose the benefit. While there are ways around the charge, ultimately some people will struggle to contribute enough to their pension to bring their income down below the £50,000 limit.

MARRIAGE ALLOWANCE

Married couples are eligible for a tax break so long as one of them earns less than the personal allowance – £12,500 for this tax year – and the other half earns the basic rate of tax, so less than £50,000. It means that the lower earning partner can transfer up to £1,250 of their unused personal allowance to their spouse – with a maximum saving of £250 in a tax year.

However, once the higher earning partner earns more than that £50,000 they can't use the tax break, and it means the couple lose it entirely. Assuming someone is getting the full £250 tax break a year and gets a pay rise from £50,000 to £50,001, the effective tax rate is 25,000% (£250 of tax because of £1 of extra income).

PERSONAL ALLOWANCE

Only around 3% of the population have income of £100,000 a year or more, but that group face a massive tax on the money between £100,000 and £125,000. This is because these earners lose their tax-free personal allowance, at a rate of £1 for every £2 they earn over £100,000.

For example, someone who gets a pay rise from £100,000 to £110,000 will lose £5,000 of their

personal allowance. They will be taxed at 40% on their £10,000 pay rise, amounting to £4,000, and then taxed at 40% on their lost personal allowance, amounting to £2,000. This means they pay £6,000 on the £10,000 pay rise – an effective tax rate of 60%.

> You can get up to £2,000 a year per child towards childcare

To get around this high rate you can increase your pension contributions. If you make sufficient contributions to bring your salary down to £100,000 then you won't lose any of your personal allowance. By doing this your personal allowance will be reinstated and you'll get 40% tax relief on your pension contributions too.

TAX-FREE CHILDCARE

The tax-free childcare system is intended to make the cost of childcare cheaper and means you can get up to £2,000 a year per child towards childcare, with the Government paying £2 for every £8 you pay in – effectively giving you basic rate tax back.

However, the scheme is only available for couples where both have an income of less than £100,000 – anyone earning more than this is cut off from using it. As with the child benefit rule above, a couple with income of £99,000 each would be eligible, but a couple where one earns £15,000 and the other earns £101,000 wouldn't be.

In the most extreme example, if your income rises to £100,001, you'll lose the £2,000 benefit, which equals a tax rate of 200,000%. Anyone earning over the £100,000 limit can use pension contributions or gift aid to reduce their income below the threshold.

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

How much should you invest?

We also look at the difference between lump sum and regular investing

Many people are unsure whether they have enough money to start investing. Fortunately there are only a few simple steps to follow to establish whether you are in a good position to begin putting money into the markets.

First you need to think about all of your finances and prioritise paying off expensive debt and building up an 'emergency' cash pot. Read more here.

Once you've got those things sorted you can start investing with as little as £25 a month.

You need to think about the impact of fees if you're investing small sums, so it's sometimes better to wait until you have a slightly larger amount.

For example, if you invest £25 and pay £1.50 to buy a fund with it, you've spent 6% of your initial investment just on trading fees.

That means you need to see a 6.4% return on your investment in order to get back to your original £25, let alone make a profit. However, you needn't think that you must have £1,000 to start investing – you can start much smaller.

SHOULD I INVEST REGULARLY OR IN A LUMP SUM?

Different people choose to invest in different ways, and there's no right answer.

Some people prefer to save up and then invest a lump sum once they've reached a certain amount – whether that's £500 or £1,000, or more. Other people prefer to invest small amounts each month.

Regular investing (such as every month) can help to smooth out your returns, is a great way to get into the savings habit and can give you good discipline. But you need to be mindful of charges, as we mentioned above.

If you're investing £50 a month and paying £9.95 in trading costs each month, you'll rapidly use up your savings on charges.

Lots of platforms have a regular investing service, which has a cheaper price tag. For example, AJ Bell Youinvest charges £1.50 if you set up regular investing, which means a set amount of money goes into the same investment on a set date every month. Many investment platforms will allow you to start with as little as £25 or £50 a month.

KEEP INVESTING WITHOUT ANY EFFORT

A big advantage to regular investing is that you don't have to remember to invest your cash each month, as often it can be easy to plan to invest money but forget to do so.

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, meaning if markets fall you could panic and decide not to buy.

Regular investors also 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 your volatility.

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 shares or units when they are cheaper.

WHAT IF I'VE GOT A LUMP SUM?

If you have the money ready to invest on day one then you might be better investing it straight away, as it will benefit from having more time invested – assuming markets rise.

For example, if you have £1,200 to invest and do so in a lump sum on 1 January it will be invested for 365 days of the year. But if you break it into £100 a month and invest it on the first of each month, then the final £100 will only be invested for one month, and only £100 will be invested for 365 days.

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.

HOW DOES THIS WORK IN PRACTICE?

To illustrate these points, we'll run through two examples comparing lump sum versus regular investing in different market conditions.

HOW MUCH TIME DO I NEED TO SPEND ON INVESTING?

It depends which investments you choose as to how much time you need to spend researching and monitoring your portfolio.

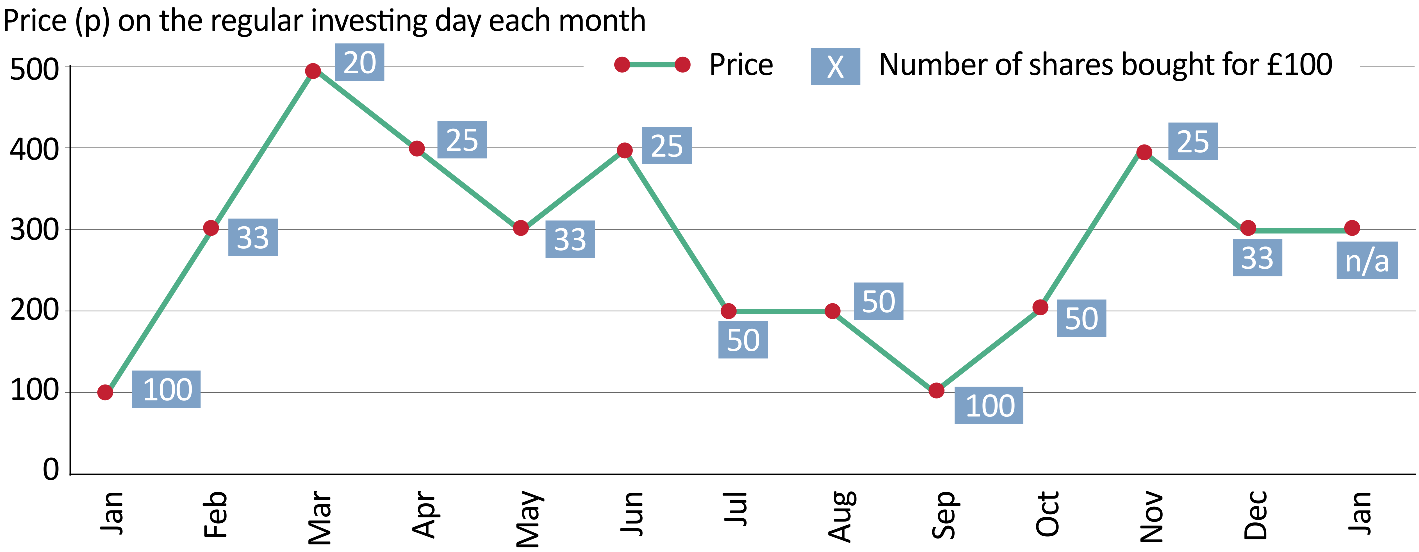
If you decide to pick individual stocks you'll need to spend more time researching the companies initially, monitoring their financial statements and performance, and looking out for any red flags that might indicate you should sell.

Some people find the subject matter fascinating and consider investment research to be a proper hobby. You don't necessarily need to be as committed that you spend all your spare time on research – a simple check on a regular basis may suffice.

If you pick funds then you're outsourcing that research and monitoring to a fund manager and so can spend less time on your investments.

You still need to check the performance of the fund. You must also check that the manager is investing as you expected and whether anyone new has taken over the running of the fund. Fortunately you would only be monitoring one fund and manager, rather than lots of different stocks.

EXAMPLE 1



EXAMPLE 1

The first example looks at shares in Company X which started the year at 100p and ended the year at 300p.

Investing a £1,200 lump means you could buy 1,200 shares (£1,200 / 100p). After 12 months your investment would be worth £3,600 (300p x 1,200).

If you could only afford to invest £100 a month, you would have invested the same amount after a year as the lump sum investor (£1,200) yet bought a different number of shares.

Accounting for the ups and downs of the market and the fact your £100 would buy different a number of shares almost every month, after one year you end up with 544 shares worth £1,632 (300p x 544). That is less than half if you'd invested the lump sum.

The shares saw lots of ups and downs but ended the year higher than the starting point.

WHAT PROTECTION DO I HAVE?

The risk with investing is that you could lose money and if that's as a result of an investment performing poorly you have no protection. That's just the tough part about investing. Obviously you hope that you have more winners than losers and that overall you come out with a profit, but that's not guaranteed.

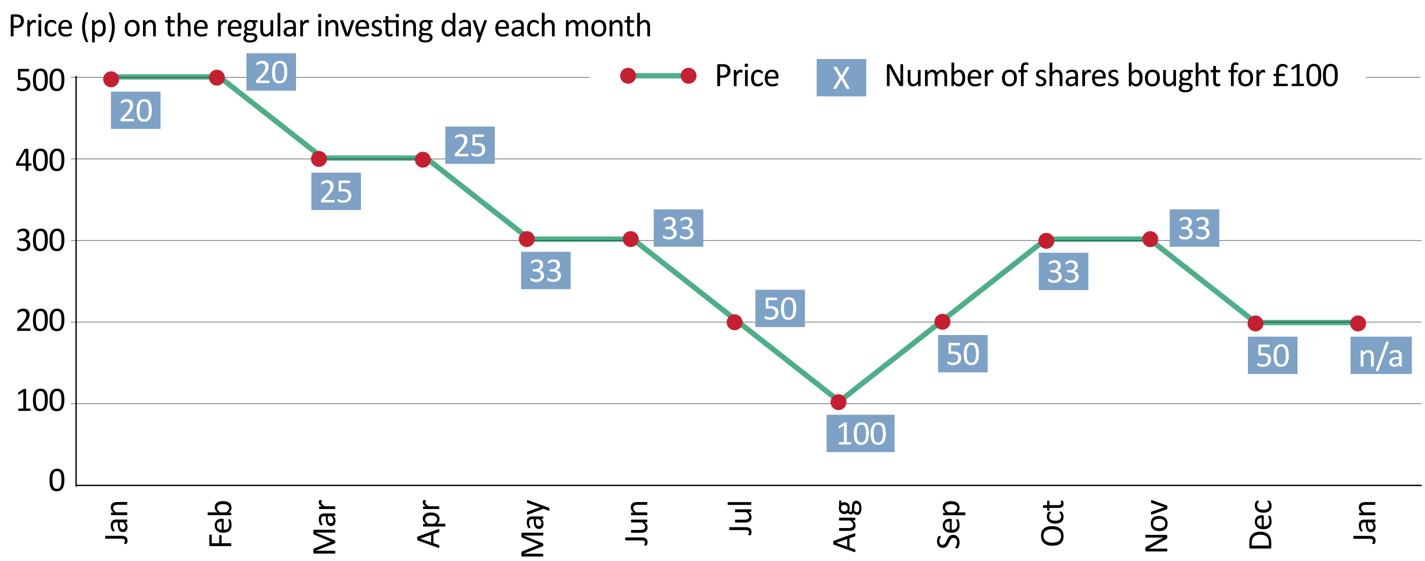
In the worst case you could lose all your money if you invest directly in a stock that goes wrong. Just look at Thomas Cook where investors who held stock in the travel agent saw their investment become worthless.

However, you will get some protection from the Financial Services Compensation Scheme (FSCS) in certain circumstances.

If your investment platform provider goes under, you will qualify for FSCS protection worth up to £85,000 if you can't get back the full value of your investment.

This applies per person, per authorised firm. So if an authorised firm gave you bad advice or was negligent in its management of your investments, you would be covered. But if a fund or stock in your portfolio just performed poorly you wouldn't be covered.

EXAMPLE 2



EXAMPLE 2

The second example looks at Company Y whose shares started at 500p and ended the year at 200p. Investing the same £1,200 lump sum would get you 240 shares (£1,200 / 500p) if bought at the start of the year. At the end of the year they would be worth £480 (200p x 240).

Going down the regular investing route at £100 a month would mean you buy more shares for your money as the year progresses, thanks to the share price falling. You would end the year with 472 shares worth £944 (200p x 472). That's nearly twice as much as the lump sum route.

Unfortunately no-one knows how share prices will behave in the future so it is impossible to say with accuracy which method is better.

By **Laura Suter** and **Daniel Coatsworth**

KEY

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

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

13 March: Eurocell, Triple Point Social Housing. **16 March:** Diaceutics. **17 March:** ContourGlobal, Gamma Communications, Genel, Harworth, Polypipe, Smart Metering, TI Fluid, Tritax Big Box, Vectura. **18 March:** Centaur Media, Curtis Banks, Emis, Empiric Student Property, Empresaria, Ferrexpo, Judges Scientific, Morrisons, Pendragon, Science In Sport, Strix, Tribal. **19 March:** Capital Drilling, Energean Oil & Gas, Everyman Media, Gym Group, Hurricane Energy, Next, Portmeirion, Safestyle, Sanne, T Clarke.

Half year results

16 March: Cap-XX, Ceres Power, Volution.
17 March: ScS, Softcat. **18 March:** MJ Hudson

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