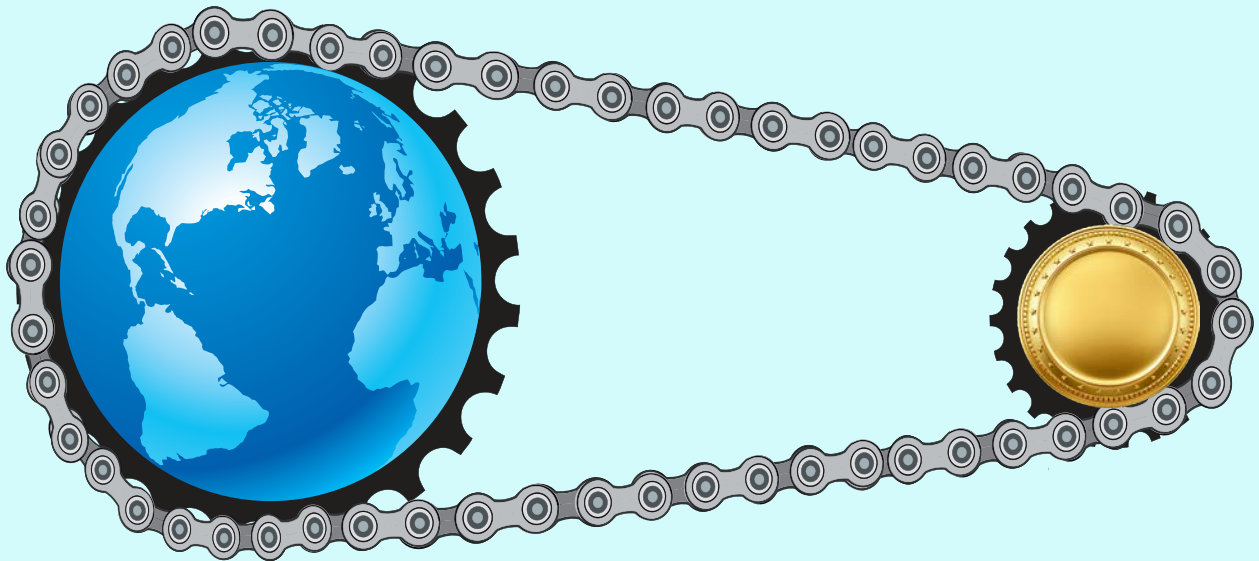


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Shell has opened the floodgates for dividend cuts



Investors will have to get used to a smaller pool of dividend-paying investments

Oil producer **Royal Dutch Shell (RDSB)** was meant to be the company that never disappoints when it comes to dividends. Sadly its decision to slash its payment by two thirds means other stocks effectively now have free rein to do the same.

The drastic actions by companies to preserve cash have now seen 309 London-listed stocks either cut, suspend or delay dividends, including 41 in the FTSE 100. Further cuts are widely expected.

In addition to Shell, many other supposedly reliable dividend payers have thrown in the towel to various degrees such as retailer **Next (NXT)** and insurer **Admiral (ADM)**, the latter having shelved its special dividend.

This is also bad news for a lot of investments funds as they could experience a much smaller stream of portfolio income from which to pay investors.

Approximately 160 retail funds and investment trusts in the UK have Shell as one of their top holdings.

One would hazard a guess that every single UK equity income fund will own more than one stock that has delivered bad news on the dividend front this year.

THE NEW NORMAL?

So is this a temporary or permanent phenomenon? 'The UK has been renowned for having a generous dividend yield, partially driven by growth in income funds and more people being responsible for their pension funds. Unfortunately companies have been over-distributing,' says Alan Custis, head of UK equities at Lazard Asset Management.

Companies may use the pandemic as an excuse to rebase their dividends so they are covered by a greater amount of earnings than historically. That implies lower yields going forward.

Any business using the Covid Corporate Financing Facility (CCFF) – where the Bank of England buys short-term debt from companies – is unlikely to return to paying dividends until they've repaid the debt.

That implies investors in **InterContinental Hotels (IHG)**, **Ferguson (FERG)** and **Rentokil (RTO)** shouldn't expect a return to dividends for some time as they are among the companies to have issued debt under the CCFF.

The financial sector could also come under renewed pressure if investors decide to sell out after widespread dividend suspensions. These are complex companies so why bother to own them if there are no dividends?

WHERE CAN YOU FIND DIVIDENDS?

Gervais Williams, head of equities at Premier Miton, suggests gold miners could be a more reliable place to source growing dividends. After all, many gold producers will be making decent profit margins at the current metal price.

Consumer goods companies like **Unilever (ULVR)** and **Reckitt Benckiser (RB.)** also look better placed than many to keep paying dividends, so do tobacco stocks.

In the broad healthcare and medical devices sector, a large number of London-listed stocks still intend to pay dividends including **Convatec (CTEC)**, **GlaxoSmithKline (GSK)**, **Hikma Pharmaceuticals (HIK)** and **Smith & Nephew (SN.)**.

However, as we always say, no dividend is guaranteed and Shell's actions have certainly shown that to be the case.



By **Daniel Coatsworth** Editor

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PAST PERFORMANCE

| | Feb 15 – Feb 16 | Feb 16 – Feb 17 | Feb 17 – Feb 18 | Feb 18 – Feb 19 | Feb 19 – Feb 20 |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|
| Net Asset Value | -0.8% | 46.6% | 3.4% | 0.9% | -6.9% |
| Share Price | -2.4% | 53.2% | 6.9% | 11.1% | -14.4% |
| MSCI AC Asia Ex Japan Index | -11.8% | 41.7% | 19.1% | -4.9% | 2.5% |

Past performance is not a reliable indicator of future returns.

Source: Morningstar as at 29.02.2020, bid-bid, net income reinvested.

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Investors need to be prepared for terrible second quarter results

The numbers are likely to get worse before they get better

A punishing first quarter results season with a wave of profit warnings, fundraisings and dividend cuts could be a prelude for the carnage to come when companies report on the three months to 30 June.

Widespread lockdown conditions, which have effectively paused global economic activity, were only really brought into force at the tail end of the first quarter.

While some countries are cautiously opening up their economies again, a record quarterly contraction in GDP is expected in Q2 – investment bank Morgan Stanley forecasts a 7.5% decline worldwide. In the UK the Office for Budgetary Responsibility has said GDP could fall by as much as 35% in the period.

This is likely to be reflected in companies' second quarter and first-half updates when they begin to be reported from July onwards. These grim announcements will be a test for the market, with its reaction likely to be dictated by how successfully the transition from containment measures to a 'new normal' is going at that point.

Morgan Stanley comments: 'The prospect of a record quarterly contraction in economic activity in Q2 2020 has already driven a record pace of earnings downgrades in Europe over the last month.'

'However, despite these downgrades consensus bottom-up forecasts look too optimistic to us with projections of a 20% fall in earnings per share this year and a 21% recovery in 2021.'

'Given that consensus generally lags in these fast moving situations the market is already likely expecting an outcome worse than these consensus numbers, however they nevertheless point to the risk of many more downgrades to come, especially for 2021 which is the year investors are arguably now focusing on.'

Q2 CARNAGE – SOME KEY ANNOUNCEMENTS

16 July – EasyJet trading update
 29 July – Next Q2 update
 30 July – Royal Dutch Shell H1 results
 30 July – Lloyds Banking H1 results

Companies will need to start quantifying Covid-19 impact

This may be necessary to continue to access financing

IN THE FALLOUT from the coronavirus pandemic companies have been praised for their honesty.

Excellent corporate communicator **Next (NXT)**, for example, conceded it can only look at scenarios which may play out, and isn't yet able to set out

guidance or forecasts.

But **Tesco (TSCO)** chief risk officer Jason Davies says markets will expect companies to talk about future trading 'in the coming months', otherwise their share prices and ability to access financing could

be affected.

In a podcast from the Cambridge Centre for Risk Studies, he said, 'There's a window where companies can say "we can't give any guidance", but at some point that window will close.'

Berkshire Hathaway builds cash to record levels, sells airline stocks

Warren Buffett is yet to find any bargains to buy

Investment sage Warren Buffett has sold his airline holdings and doesn't see any bargains in the market at present.

Those were the key headlines from a remotely streamed AGM hosted by Buffett after the global pandemic forced Berkshire Hathaway to cancel the annual pilgrimage to Omaha which usually attracts 40,000 devotees keen to take part in the 'Woodstock for Capitalists'.

He remains confident in the long-term outlook for the US economy and stocks, saying they had faced big challenges before, including serious pandemics such as the Spanish Flu in the aftermath of the First World War, yet had eventually delivered greater wealth and higher standards of living over time.

However he acknowledged the pandemic could significantly damage the economy in the short term.

One investor question was raised around share repurchases. In the final quarter of 2019 Berkshire spent \$2.2bn buying its own stock. Why hadn't Buffett continued buying shares when they traded 30% lower in March this year?



In typical Buffett fashion he used a quote attributed to famed economist John Maynard Keynes, saying: 'When the facts change, I change my mind, what do you do sir?' Effectively Buffett implied that his estimate of fair value for Berkshire had dropped more than the share price and is no longer trading at a discount.

Buffett has sold all of Berkshire's interests in airline stocks, calling his decision to buy them a mistake. Over the first quarter the company raised \$5.9bn of net cash resulting in a record \$137.3bn of available liquidity.

Berkshire hasn't made a large acquisition since 2016 but is apparently willing to make a transaction in the \$30bn to \$50bn range.

Orbis seeing 'most exceptional discounts' since the credit crunch

Contrarian fund manager flags 'truly remarkable' value

VALUE-ORIENTED FUND manager Orbis Investments says it is capitalising on 'the most exceptional discounts' it has seen since the bottom of the global financial crisis, with concerns over the impact of the

coronavirus on the global economy having been 'swiftly reflected in stock prices'.

Alec Cutler, manager of the **Orbis Global Balanced Fund (BJ02KY2)**, insists 'the value we are seeing in

markets at the moment is truly remarkable', adding 'this is easily the most attractive opportunity set I have seen in a decade' for long-term investors.

Stocks added to the fund in the first quarter included 'world-class businesses like Alibaba and Comcast at once-in-a-decade discounts', as well as Walt Disney, although Cutler warns the turmoil 'could still get worse, perhaps much worse.'

Why these stocks have just hit all-time highs

Various companies are doing well amid the pandemic

Despite the wider stock market's recovery still leaving it some way below its pre-crisis levels, some stocks in the FTSE 350 have hit record highs over the past month, especially in the healthcare and food sectors.

The largest company to hit this milestone is pharmaceutical giant **AstraZeneca (AZN)**, which recently £86.27 as it agreed to manufacture and distribute a coronavirus vaccine being developed by scientists at Oxford University.

The firm is one of just 11 in the FTSE 100 whose shares have risen so far in 2020, with its first quarter sales rising 16% year-on-year and earnings per share comfortably beating forecasts.

Another stock hitting an all-time high is food packing business **Hilton Food (HFG)**, which has been trending upwards since its 2019 results (7 Apr) revealed double-digit growth in revenue and profit.

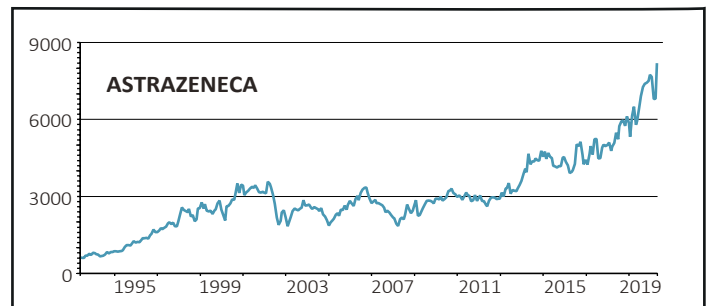
The company has also been able to carry on as usual during the current pandemic, with no impact on demand and its business continuity plans working well.

For similar reasons food producer **Cranswick**

(CWK) has also been a strong performer over the past month, though it is down a little from its own record high hit in February.

It's not just food and healthcare which have seen strong investor demand. Defence equipment and tech supplier **Avon Rubber (AVON)** is another in the FTSE 350 to have surged to an all-time high, having bagged a contract at the end of March with a US military agency potentially worth up to \$333m over the next three and a half years.

Stockbroker Peel Hunt notes the specialist in respiratory protection equipment should benefit from increased usage of this type of kit in the wake of the coronavirus.



Exit charge lowered on Lifetime ISAs as a temporary measure

The Government cuts the penalty to 20%

THE EXIT CHARGE paid when taking money out of a Lifetime ISA early has been temporarily cut from 25% to 20%, so as to help people who might need to access their savings during the pandemic.

The lower exit charge has been backdated to 6 March, with anyone affected by the 25% charge from

that date able to claw back the difference, and runs until April 2021.

Available to under-40s, an individual can put up to £4,000 a year into a Lifetime ISA, with the Government adding a 25% bonus to their savings up to a maximum of £1,000 a year until they reach 50.

The money cannot be accessed

without a penalty before the age of 60 unless it is used to buy a first home or the saver is critically ill.

The higher 25% penalty meant someone would be left with less money than they started with. For example, someone who had invested £4,000 and benefited from the £1,000 top up would have been left with just £3,750 if accessing all their funds early. Cutting the penalty to 20% means they are just giving up the Government bonus money.

Could we see a return of M&A due to the crisis?

Some sectors look ripe for consolidation while others may be a lost cause

We usually associate mergers and acquisitions (M&A) with bull markets and high levels of corporate cash flows, but could the coronavirus crisis force companies to huddle together for survival instead?

With share prices in some sectors – particularly smaller-cap, domestically-facing business areas – still struggling to recover from the sell-off, could we be about to see a wave of opportunistic bids?

THANKS BUT NO THANKS

There have already been a couple of examples of companies tentatively approaching rivals for ‘preliminary talks’ on getting together.



This week car dealership **Pendragon (PDG)** revealed it had held ‘outline discussions’ with rival **Lookers (LOOK)**, whose shares are down 56% year to date due to a fraud investigation, in order to explore a deal.

Sadly for Pendragon, which thought that ‘such an exploration would have proved beneficial’, Lookers wasn’t interested and Pendragon shares dropped 7%.

However there would seem to be some logic to M&A in the car dealership business, given the potential to cut costs through selling off duplicate sites, consolidating head office functions and joint marketing.

THE RETURN OF THE POISON PILL

Meanwhile, in mid-April, fund manager Harwood Capital launched an unsolicited bid for **Fulcrum Utility Services (FCRM:AIM)**, which was rebuffed. Fulcrum called the bid ‘opportunistic’ and urged shareholders not to accept.



In the US, several companies including energy company Chesapeake have deployed a ‘poison pill defence’ in order to deter would-be acquirers.

This involves issuing additional shares to existing shareholders at a discount if an acquirer triggers a certain limit, usually between 10% and 30%, thereby diluting them and making a takeover more expensive.

Given the collapse in the oil price and the 50% fall in the FTSE Oil Equipment & Services sector this year, we wouldn’t be surprised if this sector sees a spike in M&A both friendly and hostile.

OUT IN THE COLD

Industries which are sadly unlikely to see much M&A are clothing retail and pubs and restaurants. It’s no surprise that with high street shops shut for now there have been no buyers for once-illustrious brands such as Laura Ashley, Oasis or Warehouse.

For pubs and restaurants, however, the situation could be even more dire. With rules on social distancing likely to be in place for many more months, a huge number of firms – some in the industry put it as high as 80% – may no longer be viable meaning there is little sense in consolidation. Better to hunker down, preserve cash and hope that a vaccine comes along soon.

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Investments

AG Barr: time to put some IRN in your portfolio

The high-quality soft drinks group has ample liquidity to see it through the crisis

Investors seeking a high-quality, defensive recovery play should consider soft drinks group **AG Barr (BAG)**, the company behind iconic Scottish brand IRN-BRU that has demonstrated resilience in previous downturns.

The shares have lacked fizz of late, yet we believe the sell-off is overdone. Liberum recently upgraded the stock from 'hold' to 'buy', saying swift action by management and a transformation programme that started in September 2019 provides 'resilience and flexibility' for current times.

Shares is a long-term admirer of AG Barr, also a firm favourite of well-respected fund manager Nick Train, as it offers the potential for compounding growth for years to come thanks to its portfolio of iconic brands.

Besides biggest brand IRN-BRU, the carbonated drink whose recipe remains under lock and key, it owns Rubicon, Strathmore and cocktail mixers Funkin. It also sells brands such as Rockstar, Snapple and San Benedetto under licence.

Understandably given the impact on the economy, AG Barr has pulled earnings guidance, with earlier return to sales momentum halted by the COVID-19 crisis.

Following the start of the lockdown and the closure of the on-trade (pubs, hotels and

AG BARR  **BUY**
(BAG) 499.5p

Market Cap: £541m



restaurants) across the UK, the group has seen a material impact on the consumption of soft drinks.

Sales and earnings will take a hit near-term as pubs, bars and hospitality venues are shuttered, yet sales through supermarkets are resilient. An end to lockdown offers a positive sales catalyst and long term recovery should be achievable due to the company's strong market position and fortress balance sheet.

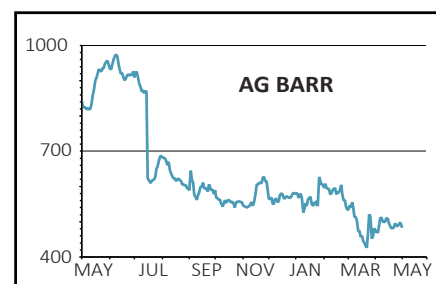
There is significant brand loyalty by customers to IRN-BRU

and AG Barr is a very well run business.

Risk factors to consider include a longer than expected COVID-19 pandemic and associated higher unemployment levels, sticky trends towards health and wellness – which would see consumers shunning fizzy drinks, even the low and no sugar ones – not to mention aggressive innovation by rivals in the market.

At the end of January 2020, AG Barr had net cash of £10.9m. Cash is being managed tightly, the dividend has been suspended and capital expenditure lowered, while it has fully drawn down a £60m revolving credit facility.

Liberum's analysis suggests AG Barr has enough liquidity, even in the unlikely scenario that the lockdown goes into the 2021 calendar year. The investment bank sees free cash flow recovering by the year to January 2022, suggesting dividend payments could be restored a year earlier than the January 2023 financial year it currently has pencilled in.

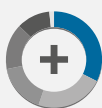
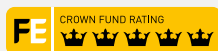




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Your capital may be at risk.

Past performance is not a reliable indicator of current and future results.

*Source: J.P. Morgan Asset Management as at 17 February 2020. Morningstar rating™: © Morningstar rating all rights reserved, as at 30 November 2019. FE Crown rating as at 30 November 2019. The methodology calculations use by companies that provide awards and ratings are not verified by J.P.Morgan Asset Management and therefore are not warranted to be accurate or complete.

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Asset Management

The growth fund beating the market and helping to improve the world

Baillie Gifford Positive Change Fund is among the ESG investments delivering superior returns

One of the best performing global funds over the past three years has deep roots in the world of ESG (environmental, social and governance).

Since the **Baillie Gifford Positive Change Fund (BYVGKV5)** emerged in January 2017 it has posted a 110% total return, versus 18.6% for the MSCI World index.

The Baillie Gifford fund has even outperformed this year during the global markets sell-off, achieving 10.7% positive total return in the year to 4 May 2020 versus a 9.7% decline in the MSCI World index, according to FE Fundinfo.

Financial Times recently cited analysis by Morningstar that found that nearly two thirds (62%) of global ESG large cap equity funds outperformed the MSCI World index in March, a period which encompassed the worst of the market collapse.

It quoted Hortense Bioy, director of passive strategies and sustainability research at Morningstar, as saying: 'ESG funds tend to be biased towards higher quality companies with a stronger balance sheet, companies that are run better and operate more efficiently.'

The Positive Change Fund

**BAILLIE GIFFORD
POSITIVE CHANGE
FUND**  **BUY**
(BYVGKV5)

Fund size: **£397m**

Yield: **0.4%**

certainty fits that bill. Its investment strategy bears all the hallmarks of Baillie Gifford's approach; a high-conviction, concentrated portfolio of exceptional growth businesses capable of producing returns that substantially beat market averages.

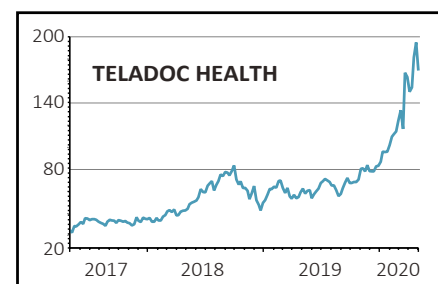
FOUR FOCUS AREAS

It invests in companies which can deliver positive social change in one of four areas: social inclusion and education, environment and resource needs, healthcare and quality of life, and addressing the needs of the world's poorest populations.

What makes this fund stand out from other Baillie Gifford funds, says Rosie Rankin, positive change specialist and a director at Baillie Gifford, is being the only one with twin objectives. The first is attractive returns and the second is to contribute to a sustainable, inclusive world.

For example, it invests in US healthcare company Teladoc Health which plays into the digital health shift, offering consumers the chance to talk with medical consultants via the internet.

'Teladoc is mainly focused on the US but has scope to expand into other regions, which we would like to see happen,' says Rankin.



You can see how virtual medical appointments could change lives in far flung places in Africa, parts of Asia and Latin America where physical access to medical professionals is very limited.

‘Teladoc’s user numbers have increased about 70% this year,’ says Rankin, a rise which she calls ‘incredible’. Its share price has already doubled in 2020 and is up nearly 600% in three years, despite the company not yet making a profit.

CONCENTRATED PORTFOLIO

The Baillie Gifford fund aims to hold between 30 and 50 stocks, and hang on to them for between five and 10 years, potentially longer.

It currently has investments in 31 stocks, drawn from across the globe, with nearly half the fund invested in North America (circa 45%), including well-known firms such as Tesla and Google-parent Alphabet. This concentration increases risks as well as returns potential.

As of 1 May it had just under £400m in assets and a 0.55% ongoing charge. Investors shouldn’t expect much in terms of dividends, with the fund yielding a mere 0.4%. You’ll make the bulk of returns through capital gains.

TECH WITH A SOCIAL CONSCIENCE

The fund only has a handful of London-listed stocks including FTSE 250 consultancy **FDM** (FDM) and Irish insulation firm **Kingspan** (KGP).

FDM’s long-run financial performance is outstanding while the shares have gone from 287p to 717p since returning to



BAILLIE GIFFORD POSITIVE CHANGE FUND’S TOP HOLDINGS

| Stock | % of portfolio |
|----------|----------------|
| DEXCOM | 7.2% |
| TESLA | 6.5% |
| ASML | 6.1% |
| ILLUMINA | 5.6% |
| M3 | 5.5% |

Source: Baillie Gifford

public markets in 2014 (the stock was over £10 pre-pandemic).

Rankin and her colleagues really like FDM’s recruitment policy, welcoming people returning to the workforce after an extended break (such as starting a family) and it also finds jobs for ex-services personnel, providing the IT skills and training needed for a second career.

PREMIUM RATINGS

As with the asset manager’s other funds and investment trusts, the Baillie Gifford Positive Change Fund has a distinct bias to more expensive growth-orientated stocks.

For example, fast growing

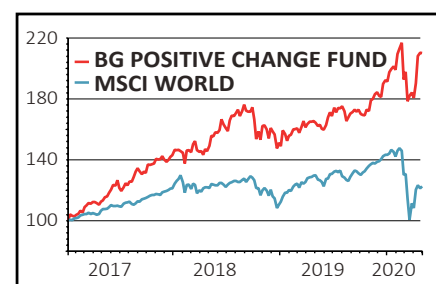
glucose monitoring technology developer DexCom, its largest stake at 7.2% of the portfolio, is trading on 155 times forecast earnings for 2020, while biogenetics equipment maker Illumina is trading on a price-to-earnings ratio of 50-plus.

Baillie Gifford pays little attention to short-term valuation fluctuations and isn’t overly concerned with short term reporting numbers.

Instead it takes a long view, believing that market ‘myopia’ is a persistent structural issue, but not all investors will be comfortable with such a strategy.

For those happy to pay up for companies that can make a difference, this fund does look like an excellent one to own for many years to come.

‘Philosophically, we believe that positive impact and share price performance go hand in hand,’ says Rankin.



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RECENT EPISODES INCLUDE:

The world of small caps, markets bouncing back, companies returning to work, changes to income funds, and free financial help



The slump in the oil price, retail investors locked out of share placings, and how to spread your money around in the current crisis

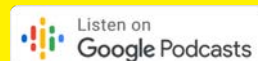
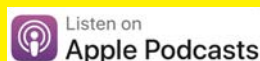
Safe haven funds in a crisis, mortgage holidays, the perils of pension withdrawals and inside AJ Bell's Covid-19 reaction



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ROYAL DUTCH SHELL

(RDSB) £12.72

Loss to date: 5.5%

Original entry point:

Buy at £13.47, 12 March 2020

WE WERE SURPRISED to see **Royal Dutch Shell (RDSB)** cut its dividend by two thirds given its strong track record paying out during good and bad times. However the move could help the business in the longer term.

While disappointment over the loss of income is natural, having ripped off the band aid with this drastic action on the dividend Shell can now move forward on a more sustainable footing. Its peer **BP (BP.)** may be left wishing it had done the same when it had the opportunity a couple of days before.

Shell should be able to stay within a 20% to 30% gearing range (ratio of debt to equity), yet BP has admitted it will be above this level for the remainder of 2020 at least.

Richard Buxton, head of UK equities at Merian Global, says Shell's new yield, at around 4%, still compares favourably to base rates and bonds.

'I'm more interested in adding to a holding in Shell now than when it was yielding more than 10%, a level in my view which was clearly unsustainable,' he adds.

The downside is a degree of uncertainty over what the company does next. Will it use the

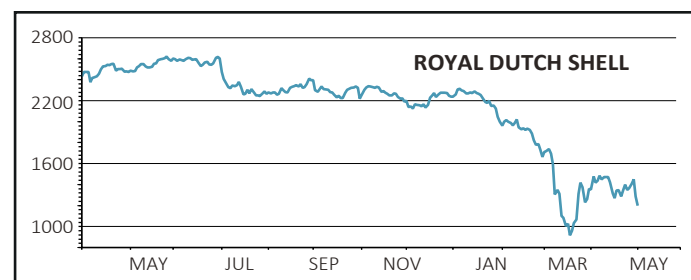
greater financial flexibility it enjoys without the burden of such a generous dividend to invest more heavily in renewables projects?

RBC Capital Markets thinks this could be the case. It comments: 'The move will allow Shell to pivot more easily through the energy transition and not be tied to a \$15bn dividend to service each year.'

This could be a long-term positive but there are questions over whether such a line of business will be as profitable as its traditional oil and gas operations.

In the shorter term though Shell should still be a good way of playing a recovery in oil. In our view an eventual rebound from these levels is likely.

Investment bank JP Morgan Cazenove comments: 'Market feedback points to generalists' "FOMO" (fear of missing out) in the sector which could trump the dividend cut as a buyers' market emerges at \$20 oil.'



SHARES SAYS: ↗

Shell has renewed flexibility and although the dividend cut is painful the stock remains a good way to play an oil recovery. Keep buying.



FUNDSMITH EQUITY

(B41YBW7) 461p

Gain to date: 12.2%

Original entry point:

Buy at 411p, 26 March 2020

TERRY SMITH-STEERED vehicle **Fundsmith Equity (B41YBW7)** continues to claw back the ground it lost at the height of the coronavirus-inspired market correction.

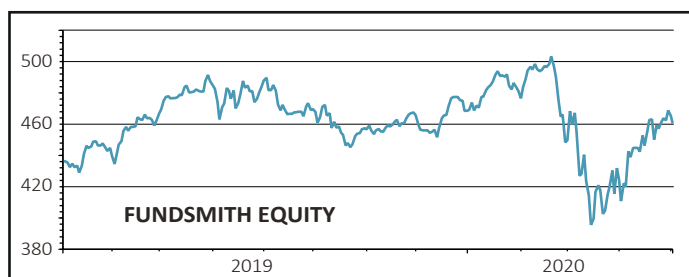
Its credentials of investing in quality stocks and holding them over long periods are apparently just as attractive to investors against a shaky market backdrop as they were when equities were enjoying a long bull market.

The fund has benefited from the market recovery in recent weeks. The top five contributors to its performance in April were Paypal, Microsoft, Facebook, med-tech firm Stryker and business software outfit Intuit.

Airline booking service Amadeus unsurprisingly took away from performance, as did testing specialist **Intertek (ITRK)**.

A position in US firm Clorox, which makes household cleaning and personal care products, was sold after performing strongly in the crisis. This was done to enable Fundsmith to take advantage of other investment opportunities thrown up by the pandemic.

Elsewhere Smith, whose investment approach prioritises capital gains over income, warned there could be more bad news to come on dividends after a series of cuts by companies around the world.



SHARES SAYS: ↗

By the end of April Fundsmith had recovered all of the losses year-to-date which should please the large number of individuals invested in the fund. Keep buying.

HOTEL CHOCOLAT

(HTOC:AIM) 322.5p

Loss to date: 23.8%

Original entry point:

Buy at 423.5p, 19 December 2019

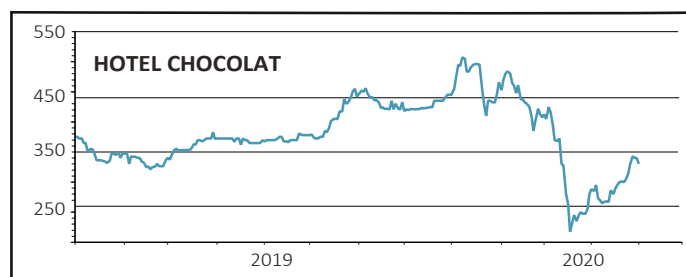


COVID-19 AND THE lockdown have created challenges for premium British chocolatier **Hotel Chocolat (HTOC:AIM)**, one of our '10 winning stocks for 2020' picks. Our bullish call is 23.8% in the red and dividends are off the menu for now, but we remain positive on the long-term potential of the brand and its scope for domestic and overseas growth, principally in the US and Japan.

In its latest update (4 May), the posh chocolates brand announced it had increased its banking facilities to help see it through the coronavirus crisis, building on an oversubscribed £22m placing in March to fund growth investment and provide operational headroom.

Hotel Chocolat conceded the closure of retail stores had a material impact on trading during the crucial Easter period. Thankfully, ravenous online appetite for the brand helped to cushion the impact, as consumers treated themselves via the internet to its affordable luxuries during lockdown.

Every day at Easter, the online demand exceeded the quantity of orders Hotel Chocolat could accept due to safe working requirements, while wholesale partners Amazon and John Lewis also saw strong trading as the coronavirus outbreak accelerated the online channel shift.



SHARES SAYS: ↗

We remain fans of well-capitalised Hotel Chocolat, whose market leadership in digital and subscription chocolate is now more valuable than ever, as reflected in a recent rally in the share price.

LATIN AMERICA: DISCOVERING NEW GROWTH

BLACKROCK LATIN AMERICAN INVESTMENT TRUST PLC

Latin American markets have been hit hard by the coronavirus outbreak. However, says Ed Kuczma, Co-Manager of the BlackRock Latin American Investment Trust plc, there may be opportunities amid the gloom.



Ed Kuczma

Co-Manager, BlackRock Latin American Investment Trust plc

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

In common with the rest of the world, the coronavirus outbreak is putting a major dent in Latin American economic growth. Markets have already seen significant falls and there may be further volatility ahead. The question for investors is whether markets fully reflect the economic impact. If they do, this may represent an opportunity for longer term investors.

Latin American markets always tend to suffer at times when global growth is under threat. Part of the problem is one of perception. Latin America tends to be seen as tied to the fortunes of the global economy, a legacy of its history as a commodities producer for the world and particularly to China. China has made up a significant part of the demand for Latin American commodities and its weakness threatens demand.

Undoubtedly, this still has some truth to it. China is a major destination for products from Latin America's largest economies. It remains the primary trading partner for Brazil, Chile and Peru¹. Its economy has been hit by the coronavirus outbreak and there may be further weakness ahead. However, there are two things to bear in mind. Firstly, the impact of the outbreak on China may ultimately be less than it is for the rest of the world as it went into and is coming out of the crisis first, as economic activity shows continued signs of normalisation. Secondly, Latin American economies have diversified, and this should mitigate the impact of these difficult conditions.

Although China has been the epicenter of the crisis, it has now substantially emerged from it and life is getting back to normal. We are seeing some signs of Chinese economy normalising and the authorities supporting the local activity. The Asian Development Bank predicts growth of 2.2%²



across Asian economies in 2020. This is substantially below initial estimates of 5.5% growth, but higher than for other major economies such as the US and Eurozone². Growth in Asia is expected to rebound to 6.2% in 2021². Asia's trading partners will benefit, and Latin America should be among them.

A WEALTH OF COMMODITIES

More important for long-term investors is the increasing breadth of Latin American economies. This diversification is both within the commodities sector and outside it. Brazil's economy, for example, is diversified across various commodities – covering the agriculture, metals and energy sectors³. While demand for metals may ebb and flow with economic growth (growing economies tend to spend more on infrastructure development, for example), the same cannot be said for coffee, cotton or wheat where demand is more stable³.

Mexico's main export commodity is oil, but it only makes up around 10% of its exports – areas such as car manufacturing and electrical equipment are far more important for its economy⁴. These sectors are undoubtedly feeling short-term pain, but unlike restaurants or leisure, this is spending that is likely to be deferred rather than cancelled. Longer term, Mexico may ultimately benefit from supply chains moving out of Asia.

DOMESTIC CONSUMPTION AND TECHNOLOGY

The growth of the domestic consumer has been a major driver of the Brazilian and Mexican economies in recent years. Within our portfolio, we hold a Mexican drinks and retail company, which incorporates both the largest independent Coca-Cola bottling group in the world and the largest convenience store chain in Mexico. We also have the domestic branches of major international shopping brands, such as Walmart.

Technology is another major area of growth. Internet use continues to expand in Brazil – over the past year, 8.5 million more Brazilians gained access to the internet, a growth of 6.0% in comparison year on year⁵. Today, more than 150 million out of the country's nearly 212 million inhabitants are internet users⁵. There are 140m active social media users in Brazil – rising at around 8% per year⁵.

ACTIVE INVESTMENT

As active investors, we are in a good position to reflect these emerging economic trends in our portfolio. While commodities still make up some of the major holdings in the index, our trust has the flexibility to move away from the index, uncovering new opportunities and finding tomorrow's areas of growth.

These are now priced much more competitively. Although our share price has been hit hard in this difficult period, as an investment trust, we have not been forced to sell to meet redemptions. We have been able to take advantage of falling market prices to add to favoured holdings.

This has been a painful time for investors, and we don't pretend to know when it will be over, or the likely impact. However, we believe much of the potential economic pain is now reflected in share prices across Latin America and we are finding plenty of new opportunities. Valuations are at historical lows, stock markets and currencies have corrected heavily and we believe Latin American equities offer attractive entry points for long-term investors.



The specific companies identified and described above do not represent all of the companies purchased or sold, and no assumptions should be made that the companies identified and discussed were or will be profitable.

For more information on this Trust and how to access the opportunities presented by Latin American markets, please visit www.blackrock.com/uk/brla

**TO INVEST IN THIS TRUST
CLICK HERE**



¹Americas Quarterly, February 2020 ²Asian Development Bank, April 2020 ³Americas Quarterly, April 2020

⁴The Balance, November 2019 ⁵Pag Brasil, February 2020

Risk Warnings

Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Trust Specific Risks

Exchange rate risk: The return of your investment may increase or decrease as a result of currency fluctuations.

Emerging markets risk: Emerging market investments are usually associated with higher investment risk than developed market investments. Therefore, the value of these investments may be unpredictable and subject to greater variation.

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

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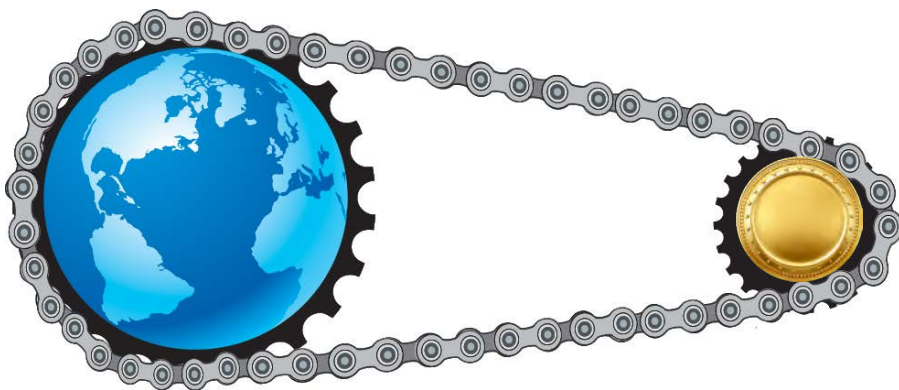
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THE **BIG** COMEBACK



**Markets
have rallied,
so what
about the
economy?**



By **Yoosof Farah** Reporter

In news reports covering the stock markets, certain phrases seem to be repeated more than anything else: ‘the FTSE rises despite...’, ‘the S&P surges despite...’.

There is a whole range of bad economic data to finish those sentences, and yet after hitting a low on 23 March markets have bounced back strongly.

A lot of economists have been busy trying to work out what ‘shape’ the global economic recovery will take, using the same models that apply whenever there is a recession.

In this article we will delve deeper into how the recovery from the coronavirus crisis might pan out and identify four stocks to fit different ‘shapes’ of recovery.

WHAT SHAPE WILL RECOVERY TAKE?

The recent performance of the markets seems at odds with what is happening in the economy, as unemployment claims soar on both sides of the Atlantic, growth is wiped out and all surveys of

how businesses are feeling point to an extremely pessimistic viewpoint.

The most commonly used terms when looking at recovery from a downturn are V-shaped, U-shaped, W-shaped and L-shaped recessions.

The markets appear to be pricing in a big, swift bounce back in the economy, what’s known as a V-shaped recovery.

Because the US is the world’s biggest economy, with a trading hub, i.e. Wall Street, that contains the biggest financial markets, what happens in America provides a big cue for investors in the UK.

Across the pond, analysts are still factoring in a V-shaped recovery in earnings, fired by the financials, consumer discretionary, industrials and energy sectors in particular, with further expected growth in the tech sector in late 2020 and 2021 providing additional support.

Estimates from FactSet imply US corporate profits will be growing again on a year-on-year basis by the first quarter of 2021.

For insight into why this is the case, George

Lagarias, chief economist at Mazars, says financiers are ‘natural optimists’.

For pessimism to prevail in markets, he says ‘a direct threat to the decision makers must become credible, like threats to their own lives’.

Lagarias adds: ‘Global finance reacts to what it sees as a threat to global finance. Traders hardly see companies and earnings any more. They see “risk assets” collectively, especially after the proliferation of passive trading.’

He says the sector to watch in order to understand markets in times such as this is finance.

‘Traders are eager to spend all the money central banks have printed, but prohibitively expensive bonds, stocks and gold give them pause,’ Lagarias continues.

‘Real assets may seem like a good option, but commercial real estate probably doesn’t feel too well these days, nor do commodities in the face of sapping demand. So they wait.

‘What can change that narrative? Bank layoffs, hedge funds and private equity vehicles failing, borrowing costs soaring, exactly all the things that quantitative easing (QE) seeks to prevent. So, for financial market sentiment to change, we would need to see pressure on the financial sector. As long as this does not happen, QE-backed optimism should prevail.’

THE FACTORS TO WATCH

According to analysts at investment bank Berenberg, the shape of an economic rebound will depend on four key factors: i) the shape,

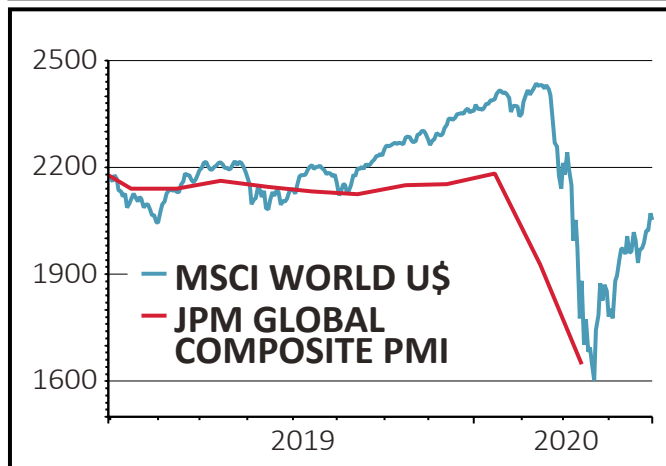


FUND MANAGERS EXPECT U-SHAPED RECOVERY

| | |
|----------|-----|
| U-shaped | 52% |
| W-shaped | 22% |
| V-shaped | 15% |
| L-shaped | 7% |
| Other | 3% |

Source: Bank of America Global Fund Manager survey, April 2020

ARE MARKETS BETTING ON A V-SHAPED RECOVERY?



depth and duration of the downturn, ii) the way in which lockdowns will be eased, iii) the reaction of demand to the easing of restrictions, and iv) the monetary and policy support.

The latest monthly survey of fund managers’ views by Bank of America has shown 52% expect a U-shaped recovery, with 22% expecting a W-shaped one and 15% believing we’re in a V-shaped bounce. Only 7% take the more pessimistic view that there’ll be an L-shaped economic recovery and 3% think there’ll be some other shape.

The base case scenario outlined by economists at ING also suggests there’ll be a U-shaped recovery. For this to happen, ING says lockdown measures need to begin to be relaxed across all countries toward the end of this quarter, while policy measures to support businesses need to have been effective, with a resumption in production and investment as well.

In another scenario where lockdowns resume this winter, the hit to demand lasts halfway through 2021, and recovery to pre-crisis levels of activity takes a further year, ING estimates.

A best case scenario, they say, sees lockdown measures lifted for good by the end of this quarter, allowing activity to bounce back strongly. A worst case scenario involves a deeper recession this year and recovery taking until 2023.

However, analysts at Berenberg are lot more upbeat. They expect a ‘tick-shaped’ recovery, namely a sharp downturn followed by a slightly flatter upturn that ultimately goes beyond the pre-coronavirus level of gross domestic product (GDP).

For every month of a harsh lockdown, Berenberg would subtract at least 2.5% from

annual 2020 GDP, while adding at least 1.5% to 2021 GDP due to base effects and a post-lockdown rebound.

It would also raise 2022 growth by up to 0.5% as the rebound continues, supported by the measures from governments and central banks.

The Berenberg analysts do acknowledge the rebound may be muted in many sectors because households and companies may hold back on spending as they are still scarred by the whole lockdown experience, and consumers may not dare to venture out again as much as before, adding that anecdotal evidence from China points this way.

'UNPRECEDENTED' POLICY RESPONSE

The rebound should be supported by the unprecedented policy response to the pandemic, with a lot of the stimulus still in the pipeline if and when the shock to the real economy starts to ease, while pent-up demand for many goods and some services will also help, says Berenberg.

This more upbeat position is echoed by **Stonehage Fleming Global Best Ideas Equity (BCLYMF3)** fund manager Gerrit Smit, who calculates that markets are 75% 'through the fear' associated with the pandemic.

Smit also says fears that today's recession is comparable to the global financial crisis are misplaced, as that was about a liquidity crisis created by a flawed banking system, which has since been reformed.

Whereas with today's crisis, as it involves human life, the responses from central banks and governments has been 'incredible', he adds, saying we're at the point where the worst is behind us.

Perhaps giving some insight into why the market has been rallying since 23 March, Smit explains, 'Compared to a few weeks ago we now have more information about better diagnostic testing, more testing capacity, potential anti-viral drugs and a number of vaccine results holding some promise.'

'We now also know that social distancing measures are effective in flattening the infection rate. We also know that if a second wave occurs, the market and authorities are pretty well informed of the risks we face and are in a better position to consider clearly how to manage the situation.'

'It is largely due to this increase in information and a greater understanding of the risks that the worst of the fear, it seems, may be over.'

ECONOMIES REOPENING

Some countries have started reopening their economies, including Germany. As the continent's largest economy, it is being seen across Europe as a test case with shops reopening again.



While this gives people hope of a swift recovery, it's worth noting what business owners are actually saying. In a *Financial Times* report on Germany's economy reopening, the manager of a small shop in Berlin selling espresso machines was quoted as saying: 'Our sales will collapse.... No-one really wants to go shopping right now. They're still too scared they'll get infected.'

Retail and other areas like tourism and leisure are expected to be the most impacted from the pandemic anyway, but an unwillingness on the part of the consumer to venture outside and buy things other than necessities would have much further-reaching consequences.

According to the aforementioned Bank of America survey of fund managers, 93% expect a global recession in 2020. Investors think global GDP cuts are largely over, but cuts to companies' earnings per share are just beginning, as recent results from Apple and Amazon are starting to show.

It's difficult to draw definitive conclusions about how economies will recover, particularly given that everyone is still learning about all aspects of this coronavirus. Epidemiologists are still discovering how the virus spreads, while virologists are still learning about its structure.

Economics and strategists are also continually adapting their forecasts, models and assumptions, as medical knowledge of the virus continues to evolve.

UNDERSTANDING THE DIFFERENT RECOVERY SHAPES

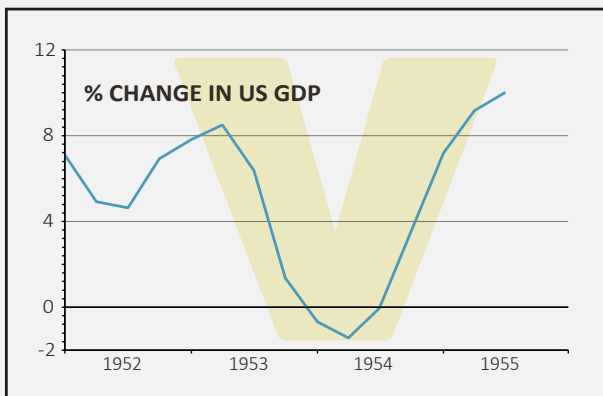
V-SHAPED RECOVERY

This is where the economy suffers a sharp but brief period of economic decline with a clearly defined trough, followed by a strong recovery.

V-shapes are the normal shape for recession, as the strength of economic recovery is typically closely related to the severity of the preceding recession.

HISTORIC EXAMPLE: V-SHAPED RECOVERY

In the early 1950s the US economy was buoyant and, fearing rampant inflation, the US Federal Reserve hiked interest rates. This briefly tipped the economy into recession before a sharp **V-shaped** recovery.



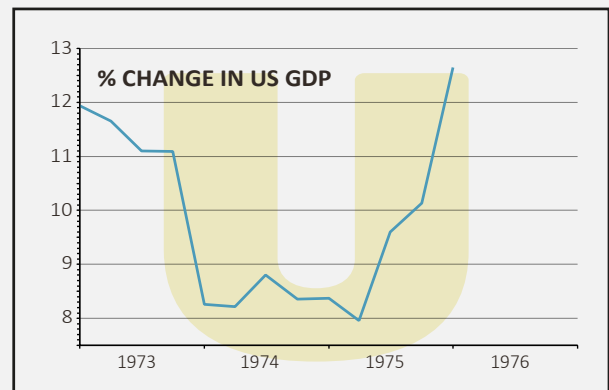
U-SHAPED RECOVERY

Longer than the V-shape, a U-shaped recovery has a less-clearly defined trough and GDP may shrink for several quarters, only slowly returning to growth.

Simon Johnson, former chief economist at the International Monetary Fund, describes it like a bathtub: 'You go in. You stay in. The sides are slippery. Maybe there's some bumpy stuff in the bottom, but you don't come out of the bathtub for a long time.'

HISTORIC EXAMPLE: U-SHAPED RECOVERY

In the mid-1970s the economic shock from a spike in oil prices and the fall of the Bretton Woods system of monetary policy resulted in a prolonged **U-shaped** recovery in the US and UK.

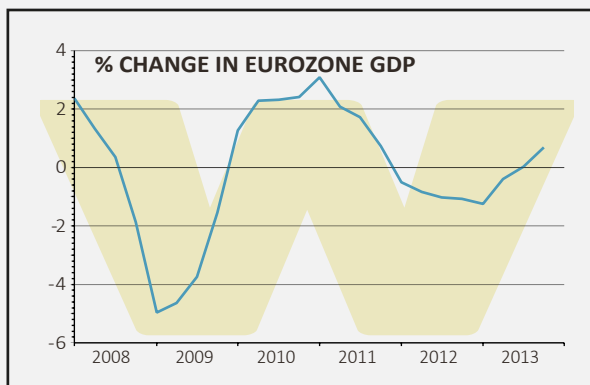


W-SHAPED RECOVERY

In this type of recovery, the economy falls into recession, bounces back with a short period of growth, then falls back into recession before finally recovering, giving a 'down up down up' pattern resembling the letter W. It is also known as a 'double-dip recession'.

HISTORIC EXAMPLE: W-SHAPED RECOVERY

The Eurozone endured a **W-shaped** recovery from the financial crisis as an initial bounce back was undermined by a mounting sovereign debt crisis. This even put the future of the euro in doubt before the then European Central Bank chief Mario Draghi came to the rescue with a pledge to do whatever it took to save the currency.



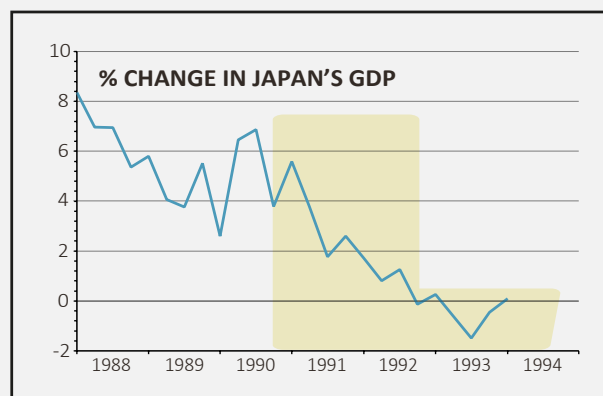
L-SHAPED RECOVERY

By far the most pessimistic outlook, an L-shaped recovery implies there will be a depression (a prolonged downturn in economic activity with a severe recession) and that economic growth will only return to normal many years later, if ever.

Classic examples include the Greek recession from 2007 to 2016, and the Japanese asset price bubble from 1986 to 1991.

HISTORIC EXAMPLE: L-SHAPED RECOVERY

In the late 1980s an asset price bubble developed in Japan and when this bubble burst the country fell into deflation and experienced years of sluggish growth – the dreaded **L-shaped** recovery.



STOCKS FOR EACH RECOVERY SHAPE

Here are some stocks to play each recovery theme. It's worth noting that all are solid companies, but certain stocks lend themselves better to a specific type of economic recovery.

V-SHAPED RECOVERY PICK: WINCANTON (WIN) 236P

The type of recovery everyone is hoping for. If we're in a V-shaped recovery demand in many parts of the economy should bounce back quickly. In this case, logistics company **Wincanton (WIN)** should be a decent option.

Expectations for the company are currently low with its shares trading on a price-to-earnings ratio of around seven times. This is because it has low margins and quite asset-intensive operations with warehouses and lorries.

But the company is the leader in its industry, and if demand gets back to normal soon it should be well placed to benefit.



U-SHAPED RECOVERY PICK: BUNZL (BNZL) £17.12

The most expected type of recovery is U-shaped, this is where demand will pick back up again but it will take time. Companies well-placed for a rebound but who have the balance sheet to withstand a longer downturn are likely to come out of a U-shaped recovery in decent shape.

One stock that could be a good option is outsourcing firm **Bunzl (BNZL)**. The company has a reputation for resilience to economic

cycles – which should come in handy if we're in for a prolonged economic downturn – achieved through diverse sector exposure and a granular client base.

Bunzl essentially supplies and manages items required to allow and service clients' customers before they 'come in the door', and to meet regulatory requirements.

Around 45% of its revenues come from healthcare, groceries, cleaning and hygiene, all areas which could even see growth in the current pandemic. Around 40% comes from food service and retail, which will be negatively affected.

Shore Capital analyst Robin Speakman comments: 'Our modelling suggests that, dividends aside, Bunzl should be well positioned to come out the other side of the Covid-19 economic shock in a strong position to resume its growth trajectory with cash generation underpinning prospects.'

'Visibility is difficult at present, but Bunzl's diversity and its capability to service clients' working capital efficiency management needs positions the group strongly for the future.'



**W-SHAPED RECOVERY PICK:
RECKITT BENCKISER (RB.) £66.60**

A W-shaped recovery implies a lot of volatility, with a sharp drop followed by a big bounce and then a sharp drop again before another big bounce.

Instead of trying to ride the wave and jump out at the top – a very difficult thing to do – a good way to play this type of recovery is to try to avoid that volatility.

Consumer goods giant **Reckitt Benckiser (RB.)** could be a good option. Its shares have gained 7.5% year-to-date, as the Dettol and Nurofen maker saw record like-for-like sales growth of 13.3% in the first quarter of this year.

The firm has long been seen as a defensive stock largely resilient to economic turmoil. Investors could also benefit from a turnaround story, with the company working to a recovery plan orchestrated by new CEO Laxman Narasimhan.



**L-SHAPED RECOVERY PICK:
COCA-COLA (KO:NYSE) \$45.89**

In this scenario, there's not that many winners given the economy could take up to a decade to get back to the level it was before, if at all.

But one company which might be worth buying is a well-known name whose products feature in our lives very frequently – **Coca-Cola (KO:NYSE)**.

Long seen as a 'safe-haven' stock across the pond, Coca-Cola boasts a strong balance sheet and high levels of profitability with an operating margin of 29% in 2019.

The drinks maker has been hit by the pandemic with sales falling 25% as restaurants, bars and cinemas all close. This has been reflected in an almost corresponding drop in its share price from around \$60 a few months ago to around \$46.

But that could make it an attractive buying opportunity. Never one for rapid growth, Coca-Cola would likely underperform slightly in a strong bull market, but fairly resilient demand and exceptional brand strength should see it do well if we're in for a prolonged bear market.



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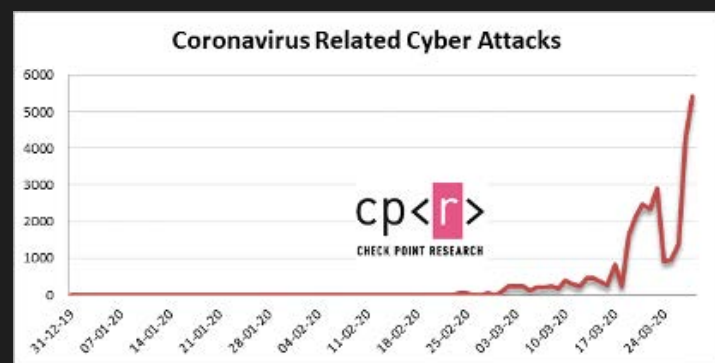
COVID-19 AND THE INVESTMENT CASE FOR CYBERSECURITY STOCKS

COVID-19 has changed our lives forever. Whilst we may like to think that most of this change is temporary, history tells us that periods of dramatic shock like these are followed by a greater permanence in habits and behaviours than what is generally priced into public expectations. Working remotely is an example. In just two short months, think how comfortable we've all become with teleconferencing platforms like Zoom and Houseparty which allow us to stay in touch with friends and loved ones. For those of us who weren't shopping online before, we certainly are now. And for companies, never before in history have they raced to digitise at the speed we're seeing today, adopting tools like Slack and ServiceNow at a rate only eclipsed by the rise of Bitcoin.

One area that we carefully watch is the Cybersecurity sector. As companies have energetically turned to digital technology to maintain continuity, in many cases ensure their own survival, it has exposed unforeseen vulnerabilities in our technological substructures. Vulnerabilities that we don't yet

fully comprehend. At the same time, cyber-attacks have multiplied. With warnings from the WHO, FBI and the ECB, cyber-criminals have been doubling down on their efforts, since the coronavirus outbreak, to exploit people's increased online activity and heightened proclivity to impulse-click on anything remotely related to COVID-19.

According to Check Point Software, a major US-based cybersecurity company, cyber-attacks increased by a factor of 25 in the short period between mid-March and the beginning of April. CrowdStrike, Mimecast and Proofpoint have released similar findings.



According to Statista, over the next three years, global cybersecurity spending is expected to grow by over 10% Year-on-Year to achieve a size of USD 250 billion by the end of 2023. It's worth mentioning that this prediction was made **before** the onset of the coronavirus.

For investors today, therefore, now represents an opportunity to get ahead and own the companies that most stand to benefit from this boost in spending. Cyber-attacks aren't going away, and the cybersecurity story is just getting started.

The Rize Cybersecurity and Data Privacy UCITS ETF invests in global cybersecurity companies that are heralding the crusade against cybercrime.

Financial promotion: Issued by Rize ETF Ltd, an appointed representative of Aldgate Advisors Limited which is authorised and regulated by the Financial Conduct Authority. The ETF is a "recognised scheme" pursuant to s.264 of the UK Financial Services and Markets Act 2000. The ETF replicates the Foxberry Tematica Research Cybersecurity & Data Privacy Index. An investment in the ETF is subject to the volatility of technology stocks and exchange rate risk and you may lose some or all of your capital. You should seek professional investment advice before investing. The prospectus and KIID are available in English on www.fundinfo.com and from Davy Global Fund Management Ltd, Dashwood House, 69 Old Broad Street, London.



Where next for US shares?

There seem to be three likely scenarios as investors react to the pandemic

Hard to believe as it may be, America's S&P 500 index is down by just 3% over the last 12 months, while the NASDAQ Composite is up by 7%.

This seems remarkable, give the COVID-19 outbreak and the economic fallout of the lockdown that is being used to fight it. Surely things cannot be just 3% worse than they were a year ago (when US stocks were already trading close to all-time highs) or 7% better for the tech and biotech stocks which populate the NASDAQ?

But stock markets are forward-looking mechanisms which try to discount, or price in, future events, not backward-looking ones.

Sharp falls amid the panic of February and March tried to factor in the hit to American economic activity and corporate profits and the subsequent rally is now trying to price in the future recovery as several nations, including the US, start to emerge from their lockdowns. The question now is have US stocks gone too far, too fast?

FOR AND AGAINST

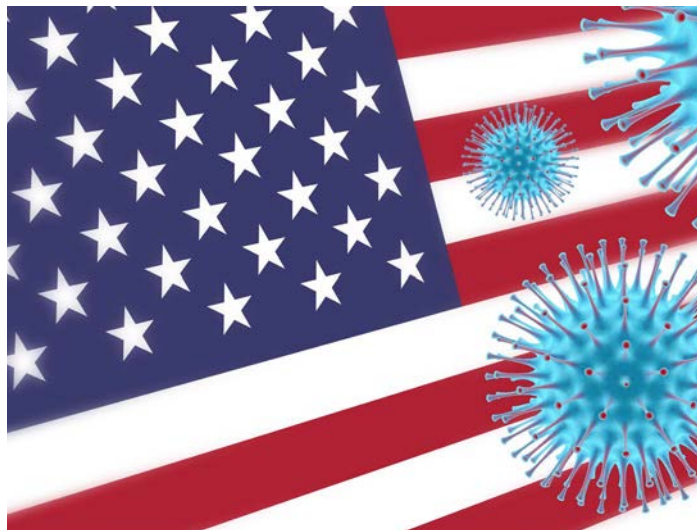
The arguments for and against further near-term gains in US equities can be summarised via three topics.

1. Corporate earnings

Case for: US earnings are receiving strong support from leading tech stocks, with the Technology sector forecast to generate 23% of 2020 earnings, according to IBES data from Refinitiv.

That in turn is underpinning consensus analysts' forecasts that are calling for a V-shaped recovery in corporate earnings, with the Financials, Consumer Discretionary, Industrials and Energy sectors also contributing strongly.

Bottom-up estimates from FactSet suggest US corporate profits will be growing again on a year-on-year basis by Q1 2021 and rise by 21% in 2021 as a whole.



Case against: In six weeks 30m Americans have lost their jobs. Not all of those jobs will come back at all, some may only come back slowly. This could crimp private consumption which drives 70% of US GDP and mean the rebound is much more modest than consensus forecasts suggest.

Additionally, a strong dollar, lockdowns elsewhere and any resumption of trade tensions with China may be unhelpful for exports at the same time. The consensus forecast of a 12% drop in earnings per share for the S&P 500 may not be enough, especially when company profits fell by

US MARKET IS PRICING IN A RAPID EARNINGS REBOUND IN 2021



Source: Factset



31% and 40% during the downturns of 2001 and 2008 respectively.

In addition, the US market is becoming ever-more skewed toward tech stocks. In the past 12 months, the S&P 500 has lost \$895bn in market value.

Facebook, Amazon, Apple, Netflix, Google-parent Alphabet and Microsoft have gained \$910bn between them. This sextet now represents 20% of the S&P's value on its own, up from 15% a year ago, so if any of them disappoint with their earnings this could have a disproportionate impact on the index.

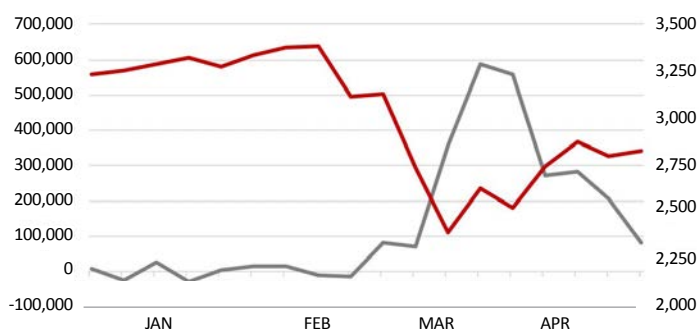
2. Fiscal and monetary stimulus

The case for: Even if US GDP were to fall by 10% in 2020, that would roughly equate to a \$2trn loss of output. The US government has already signed off a \$2.2trn fiscal stimulus programme and the US Federal Reserve, via the resumption of quantitative easing (QE), has already pumped more than \$2.5trn of liquidity into the financial system, more than covering that output gap.

That tidal wave of Fed cash may be the most powerful factor of all in the US stock market's bounce from the 23 March low and the hardest for sceptics of American equities to fight.

The case against: The Fed has begun to throttle back its QE programme, adding 'just' \$83bn to its asset purchases in the last week for which data is available, compared to the \$586bn peak run rate in late March.

US EQUITIES HAVE FEASTED ON FED CASH BUT RATE OF QE IS SLOWING DOWN



Source: FRED – St. Louis Federal Reserve database, Refinitiv data

Even that easing of stimulus has seen US equities' recovery lose a little pace. If the rally really is relying on abundant central bank-provided liquidity then that is a brittle set of foundations, as the Fed cannot print forever.

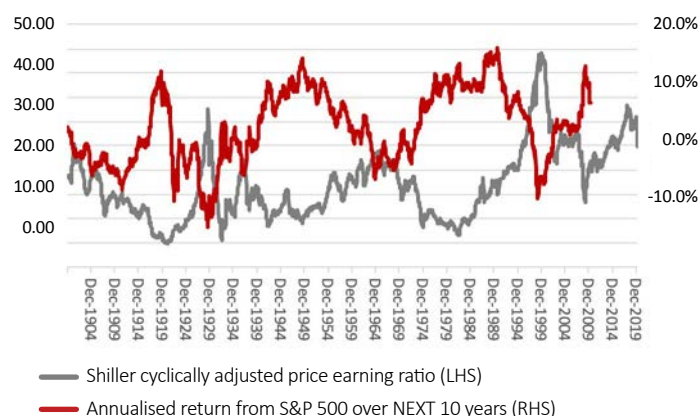
3. Valuation

The case for: The consensus EPS estimates of \$174 and \$200 for the S&P 500 put the index on 16 times and 14 times earnings for 2020 and 2021 respectively, hardly expensive for a market which is laden with leaders in their chosen industries, notably tech, where a rapid earnings rebound is expected and where the central bank is pouring money into supporting it.

The case against: Those tempting earnings multiples could prove misleading if earnings disappoint. Moreover, the Shiller cyclically-adjusted price earnings ratio (CAPE) still suggests the US equity market is very expensive relative to its history, using inflation-adjusted earnings from the last 10 years as its basis, rather than variable (and dare one say unreliable) earnings forecasts.

The S&P 500 has rarely traded above the current 26-times level using CAPE and when it did, 10-year compound annual returns from the index were negative, as seen after 1929 and 1999.

US STOCKS HAVE RARELY TRADED AT SUCH LOFTY CAPE MULTIPLES FOR LONG AND WHEN THEY DID SUBSEQUENT LONG-TERM RETURNS WERE POOR



Source: <http://www.econ.yale.edu/~shiller/data.htm>



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SHOULD WE BE WORRIED ABOUT FOOD SECURITY?



We look at the stresses on the UK's supply chain and the potential for food prices to keep rising

Food prices are likely to go up as a result of pressure on the food supply chain linked to the coronavirus pandemic. Companies who can get food products to the consumer, either manufacturers supplying retailers or supermarkets being able to provide adequate stocks, could be winners from an investment perspective.

We'll discuss the situation in this article along with two stock ideas to play the theme.

WHAT'S HAPPENING?

According to Global Food Security, the UK cross-government programme on food security research, of the 4m people working in the food supply chain around 500,000 are directly involved in farming and fishing, with another 400,000 employed in food manufacturing.

The supply chain is extremely sensitive to environmental and economic events. Too much or too little rain can ruin harvests, while disease can devastate livestock herds. Climate change has raised the threat of more frequent catastrophic weather and the spread of disease.

On top of these threats, an unprecedented sudden surge in demand as experienced in March this year can result in the system grinding to a halt as stores struggle to replenish shelves stripped bare by panic buying.

MEMORIES OF 2008

Early 2008 saw the culmination of a 12-month surge in fresh and ambient food prices which

brought to an end decades of falling relative prices of food in the UK.

Triggered by a global shortage, rice prices increased by 75% and wheat prices by 130%, even though the UK produced a record crop of 17m tonnes of wheat. Fruit and vegetable prices increased by up to 30% and some processed foods increased by more than 40%.

Fast forward to today, with restrictions on social mobility across Europe and many parts of the world, getting food from the farm to the plate is likely to mean prices rise again.

LABOUR ISSUES

In Europe, the governments of France, Germany, Italy and Spain have appealed for up to a million seasonal workers to pick fruit and vegetables.

In Belgium, the government has asked the population to eat an extra portion of 'frites' at home every week to avoid farmers having to destroy an estimated 750,000 tonnes of surplus



potatoes caused by the closure of restaurants and the food-service industry.

The UK farming industry has asked for 80,000 British fruit and vegetable pickers, but the recruitment drive failed spectacularly after just 112 people out of 50,000 applicants took up roles.

The harsh reality of weeks of back-breaking work picking crops in all weathers for minimum wage clearly didn't appeal. Instead the UK Government has flown in hundreds of experienced pickers from Romania, who are typically more efficient, but there is still nowhere near the amount of labour needed.

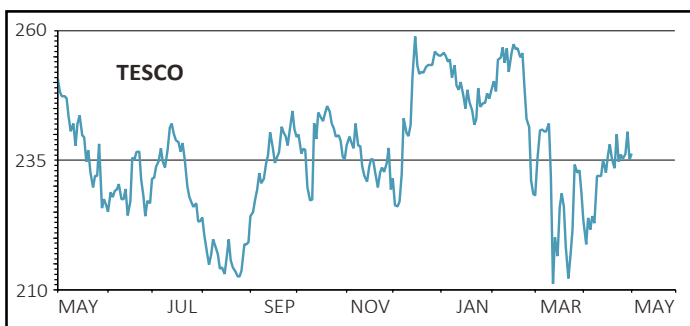
Alan Guindi, managing director of Richard Hochfeld, one of the UK's leading growers and importers of fruit, points to 'a steady decline in seasonal workers since 2016, which is getting worse'.

The firm has taken extraordinary measures to guarantee supplies, the most drastic of which has been vertical integration. 'We have become the source,' says Guindi. 'We have invested in farms in other countries, formed joint ventures with existing suppliers and invested in farmland and innovation all to ensure supply. For the rest of our supply we have had to offer advances to growers, or lose product to countries also procuring the food we need.'

HOME COOKING

It's hard to overstate the scale of the shift to in-home consumption of food since the lockdown and the closure of restaurants and other eateries.

Supermarket giant **Tesco (TSCO)** reported a 50% jump in food sales in March and although the rate of increase has moderated, demand is still substantially higher than it was pre-crisis.



According to consultant Kantar Worldpanel, out-of-home consumption would typically have accounted for 30% to 40% of the UK's calorie consumption, with over half of the population eating lunch outside of home.

With the lockdown, Kantar estimates that the

amount of in-home meals is set to increase by almost 40% or more than 500m, resulting in an increase in spending of over £670m.

Increase in UK spending on eating at home per week under lockdown



| Meal occasion | Increased number of meals | Increased spend |
|---------------|---------------------------|-----------------|
| Breakfast | 32m | £20m |
| Lunch | 163m | £277m |
| Dinner | 113m | £227m |
| Snack | 195m | £146m |
| Total | 503m | £670m |

Source: Kantar Worldpanel

While we may be making fewer trips to the supermarket under lockdown, spending on food has risen more than 50%, offsetting the lower footfall.

Also, despite the success of 'Veganuary' and the trend towards meat alternatives, the demand for meat and poultry is rising with more meals being prepared and eaten at home.

SUPPLY DISRUPTION

In the US, the meat industry is in crisis after coronavirus caused the shutdown of meat processing plants, creating shortages at grocery stores.

Almost a third of pork capacity is down, leading to huge price rises in ham, bacon and even hot dogs. John Tyson, chairman of Tyson Foods, warned that 'the food supply chain is breaking'.

The party line from the British Retail Consortium (BRC) and the supermarkets is that, despite the lack of fruit and vegetable pickers and problems in other countries, there is no food security issue in the UK.

Andrew Opie, director of food and sustainability at the BRC, says: 'The Government is working with major UK growers to ensure the availability of essential workers and a continued supply of fresh fruit and vegetables in the coming months.'

Tesco has absorbed the oversupply of a number of products which would normally go to the fast-food or restaurant industry, such as eggs, poultry and potatoes, and has promoted UK and Irish beef to help suppliers manage their inventories.

TWO STOCKS TO BUY

CRANSWICK (CWK) £36.38

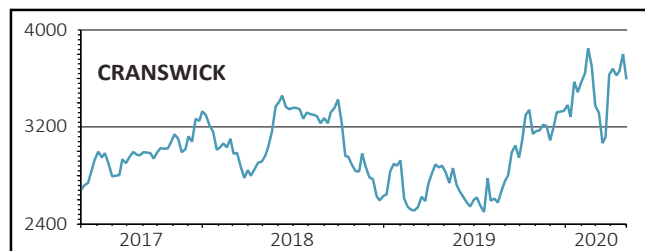


THE PREMIUM MEAT producer is ideally placed to benefit from the trend towards in-home consumption and increased spending on quality treats. Consultant Kantar Worldpanel estimates that in-home meals will rise by 38% to 503m per week during the period of lockdown.

One of the key attractions for retailers and consumers alike is the provenance and security of Cranswick's supply chain, which reflects many years of investment aimed at improving animal welfare and protecting the environment.

The pork-to-poultry supplier is expected to produce strong results on 23 June with sales growth of 14% for the year to 31 March forecast by analysts.

With strong cash flows, Cranswick is well positioned to grow and to maintain high returns on capital in the 18% to 20% range.



HILTON FOODS (HFG) £11.64



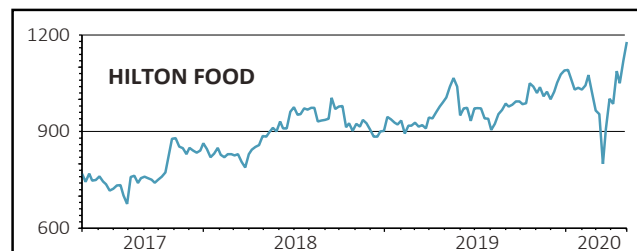
INVESTOR APPETITE FOR this global food packer has proved ravenous since the world entered lockdown, reflecting its ability to keep supermarket shelves stocked with meat and fish and consumers fed.

Shares believes Hilton's resilience and robust balance sheet will see it thrive during the coronavirus crisis.

Hilton packs proteins for retailers including Tesco, Ahold Delhaize and Woolworths in Australia at state-of-the-art plants using automation and robotics.

The global pandemic has emphasised the strength of its relationships with major retailers, with Hilton's global sourcing capabilities enabling confidence in the supply chain.

Furthermore, a focus on pre-packed products means the company should benefit from a shift away from counter serving to packaged foods, as retailers recognise the benefits of lower costs, less waste and fewer cases of contact with consumers.



Morrisons (MRW) tells *Shares*: 'More than two thirds of the food we sell is British; that includes all of our fresh meat and we have 18 food manufacturing sites producing British food. Additionally, we are the largest supermarket customer for British farmers.'

Gareth Davies, chief executive of agricultural supplies firm **Wynnstay (WYN:AIM)**, believes there is a strong argument for improving the UK's food self-sufficiency, after the coronavirus pandemic 'highlighted the potential problem of global supply chains'.

A FUTURE OF RISING PRICES

In a sequence of events which no-one could have predicted, the sudden fall in oil prices forced many bioethanol plants to stop production as the market



price fell below their output cost.

This created a shortage of distillers grains, a byproduct of bioethanol used in animal feed, sending prices soaring, which in turn sent rapeseed meal prices up.

Similarly, the government lockdown in Argentina – one of the world's major producers of soya, another important animal feedstock – combined with strikes

at some ports, saw prices spike on world exchanges.

According to Richard Whiting, chief executive of feed, food and fuel distribution group **NWF (NWF:AIM)**, the pandemic caused a great deal of strain on supply chains, and the additional cost of adopting social distancing measures has been significant across the food industry.

While the ambient food supply chain is now well placed to handle any future shocks, the great unknown for fresh food producers and distributors – and ultimately consumers – is what happens post-Brexit.

Wynnstay's Davies says: 'After Brexit there will be no issue in receiving food or goods from Europe because supply routes will remain open, but any form of additional delay or regulation will add to costs. This will either be absorbed by the end user or the primary producer.'

Hochfeld's Guindi agrees, commenting: 'The weak pound, more checks on products at ports – which will slow down the supply chain and impact shelf life – together with higher transport and logistics costs mean inflation is inevitable. The consumer will bear the brunt of it.'



Whiting at NWF says if the UK wants to maintain its 'current high standards of food safety and animal welfare', and refuses to compromise in pursuit of new trade deals, prices will have to rise.

Looking beyond Brexit, as China and other developing countries become more affluent and their consumers demand products of a similar standard to developed nations, competition for goods will increase, putting yet more upward pressure on prices.



By Ian Conway Senior Reporter



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How does short selling work and do funds specialise in it?

We explain how to bet on falling share prices and why it doesn't suit novice investors

I am quite new to investing and my portfolio is invested in shares and funds. I am interested to know how shorting a share works. I don't really understand it so I'm not willing to try it. Could you explain it and also if there are any funds that attempt to cover this kind of trade?

Helen Howe



James Crux, Funds & Investment Trusts Editor replies:

Novice investors should not be tempted by short selling or 'shorting' due to the risk of losing more money than they originally put down. It is only suitable for experienced investors, and even then it requires a lot of nerve and money they can afford to lose.

Short selling involves selling a borrowed asset in the hope its price will go down and buying it back later for a profit.

Borrowing the asset comes at a cost, normally a small percentage of the asset's price. If the share does drop after selling, the short seller buys it back at a lower price and effectively returns it to the lender, thus closing out the bet. The difference between the original sell price and the final buy price is the profit or loss.



When a 'normal' investor buys a stock (or 'goes long'), they stand to lose only the money that they have invested. Yet if an investor short sells, theoretically they could lose an infinite amount of money because technically the price of a share can keep rising forever.

HOW SHORTING WORKS

Let's say an investor believes hypothetical Company A, trading at £100 per share, is grossly overvalued, or that its shares will decline when it reports earnings in the future.

The investor borrows 100 shares from a broker while short selling those shares to the market. They go 'short' on 100 shares of Company A in the hope the share price will decline and they can close out the bet to

make a profit. The initial cost of the trade is £10,000.

One week later, Company A's price falls to £90 after it announces disappointing earnings. The investor decides to close the short position, so they buy 100 shares of Company A from the open market at £90 each and returns those shares to the broker, making a profit of £10 per share, or a total of £1,000 for the whole transaction (not including commission and interest).

However, if the share price increases to £120 and the investor decides to close the short, they will need to buy stock to cover the 100 shares from the open market at the current price of £120. The loss for this short sale transaction would be £20 per share or a total loss of

£2,000, since the shares were bought back at a higher price.

LEVERAGED TRADING

The aforementioned method of short-selling is more common among institutional investors. Retail investors are likely to go for leveraged trading where they trade financial instruments called derivatives. They speculate on the market price rather than borrow shares from a broker.

There are two main ways of placing a short trade via derivatives. The first is spread betting which gives an individual the same outcome as a traditional short-selling position. The second is CFD trading where an individual buys a contract to exchange the difference between the opening and closing price of a stock.

Leveraged trades might be 10:1, which means the investor can control 10 times as many shares as they could with a traditional trade. They have to put up a deposit, such as 10% of the trade, which is the margin. If the price of the stock being shorted goes up by a certain amount, the investor has to provide additional margin cover, so put up more cash to keep the bet open, or they could be forced to close out the position at a loss.

WHY IS IT CONTROVERSIAL?

Short selling has frequently courted controversy, particularly when it involves targeting very weak companies which subsequently go bust. The idea of profiting from the failure of a business when shareholders and creditors lose out financially



leaves many ordinary people and investors feeling queasy.

However, shorting by institutional investors can help raise awareness of companies with weak spots. The FCA publishes a list daily showing short positions by big investors.

Short sellers have often done the hard digging to expose corporate fraud, for example. They can be seen as the market detectives, although there is also the potential for individuals to spread lies in order to drive down a share price for their own financial gain.

FUNDS USING THIS STRATEGY

Some investment funds embrace short-selling, such as helping them to hedge risk. They include absolute return funds such as **Janus Henderson UK Absolute Return (B5KKCX1)** and **Jupiter Absolute Return (B5129B3)**. It is worth noting that absolute return funds in general have a [poor track record of late](#).

Certain investment trusts also have the ability to take short positions to enhance returns; one successful exemplar is the Dan Whitestone-managed **BlackRock Throgmorton (THRG)**.

DO YOU HAVE ANY QUESTIONS ABOUT MARKETS AND INVESTING?

Let us know if we can help explain what's going on with certain activity in the markets, how markets work or anything else to do with investing. We'll do our best to answer your question in a future edition of *Shares*.

Email editorial@sharesmagazine.co.uk with 'Reader question' in the subject line.

Please note, we only provide information and we do not provide financial advice. We cannot comment on individual stocks, bonds, investment trusts, ETFs or funds. If you're unsure please consult a suitably qualified financial adviser.

Short-selling is complex and comes with a high risk of losing money rapidly due to leverage.

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Are the rules on holding residential property in a SIPP going to change?

Pensions expert Gareth James debates what might happen

Are there any signs that the ban on holding residential property in a SIPP may be relaxed? There will be an awful lot of vacant/non income-producing properties currently held in SIPPs within the bar/restaurant/hospitality/retail sector as a result of the current crisis which would be very suitable for conversion to residential use.

Neil McAndrews



Gareth James
AJ Bell's Head of
Technical replies:

The possibility of directly holding residential property in SIPPs was, for many, one of the most exciting potential outcomes of the simplification of pension rules which took effect from April 2006.

Unfortunately for those who were looking forward to this process, the Government U-turned on the idea just a few months before the new rules were due to go live, fearing that billions of pounds of tax relief would be spent sheltering second homes in pension schemes.

SIPPs can directly hold commercial properties such as offices, shops or industrial units, but residential property is effectively banned because holding it is subject to penal tax

charges of up to 70% of the value of the property.

There are a few wrinkles in the rules which allow specific types of residential property to be held. For example, a SIPP is allowed to hold a residential flat above a shop if it is being used in connection with the business premises which are also held by the scheme.

Another current wrinkle is that SIPPs can hold commercial property with a view to converting it to residential property. However the SIPP must sell the property before it is used, or suitable for use, as a residential dwelling to avoid the penal tax charges.

All of these wrinkles are tightly controlled by HMRC, and challenging to administer, so many SIPP firms prefer to steer clear of property containing any residential element.

Since 2006 calls have been made to relax the restrictions on residential property, most notably

during the 2008 economic crisis. It was suggested the money locked up in pensions could be used to reignite the faltering residential property market.

Similar calls are to be expected once we're through the worst of the pandemic-related problems, but I'd still be surprised if the Government listened given its prior concerns.

Perhaps more likely is the prospect of fund managers designing investment funds to buy vacant properties with a view to converting them into residential property. The funds could be offered to retail investors, including those with SIPPs.

Provided the funds were structured correctly they could be offered to SIPP investors, as well as to other retail investors, as the investments held within them would be considered sufficiently diverse to meet HMRC's requirements.

(Tom Selby returns next week).

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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Debt and savings crisis looms in coronavirus lockdown

People are already facing serious financial challenges amid the pandemic

Research shows 20m Brits have already had to dip into their savings as a result of the crisis, after seeing their income hit.

A survey of 2,002 adults in the UK by AJ Bell shows that younger people have been hit the hardest, with more having to dip into their savings or take on debt just to make ends meet, when compared to older people.

SIGNIFICANT AGE DIVIDE

Overall 30% of people have had to use their savings to pay bills, rent and mortgage and other

essentials so far in the crisis. But within this there is a significant age divide, with 44% of those aged 18 to 34 having to use their savings compared to 18% of those over the age of 55.

Many younger people work in industries that have been harder hit by the lockdown and business closures, such as retail, hospitality, the arts and freelance work.

Two-fifths of people have seen their finances hit in the current coronavirus crisis, with the most common reason being that they've been furloughed in their job – and so seen their income fall.

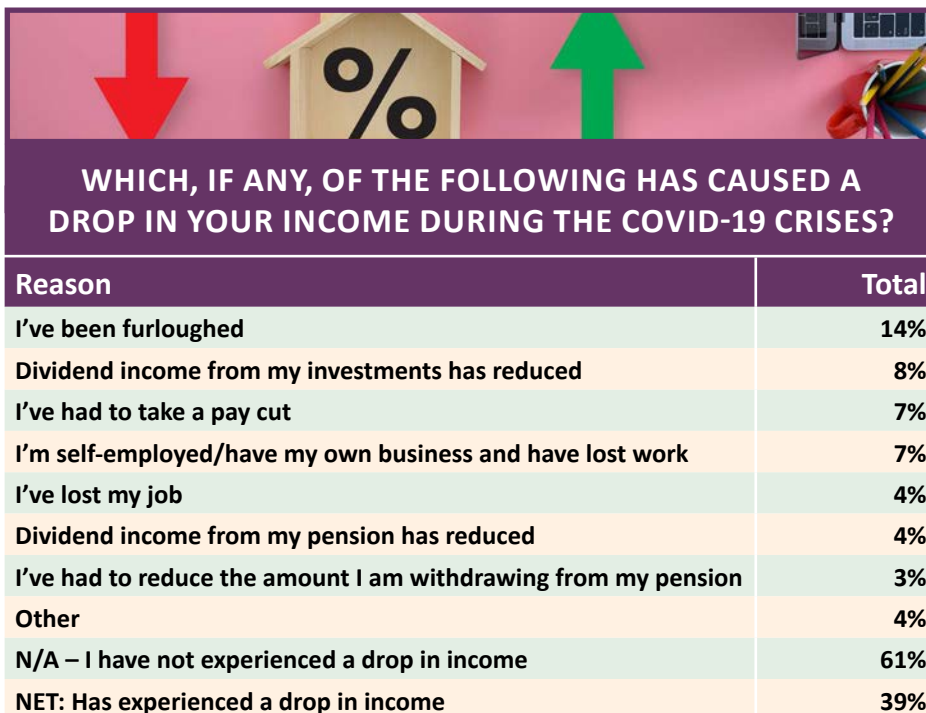


Of the 40% of people who have seen a drop in income, where people could pick more than one answer, just over a third say it's because they've been furloughed while a fifth have had to take a pay cut.

A third of those who've seen their income hit say it's because their income from investments or pensions have reduced, with men more likely to be affected by this than women – 40% of men say this has impacted them compared to 23% of women.

INCOME CHALLENGE AS DIVIDEND CUTS BITE

Another one in 10 people says they have reduced their pension withdrawals as a result of the crisis. Income payouts from companies have dropped, hitting income-seeking investors and those reliant on the income to fund their lifestyle, while market



Source: AJ Bell



WHICH, IF ANY, OF THE FOLLOWING DEBT HAVE YOU TAKEN ON DURING THE COVID-19 CRISIS?

| | Total |
|------------------------------------|------------|
| Credit card | 10% |
| Bank overdraft | 7% |
| Loan from family | 6% |
| Loan from friends | 4% |
| New mortgage | 3% |
| Pay day loan | 3% |
| Increased mortgage | 3% |
| Other | 0% |
| N/A – I have not taken on any debt | 79% |
| NET: Has taken on debt | 21% |

Source: AJ Bell

falls means people are wary of taking large capital sums from their pensions.

Almost two-fifths of people who've seen their income fall say they have seen their income cut as a result of being self-employed or owning their own

business and have lost earnings as a result of the crisis, while 11% of people say they've lost their job. Another 4% say they have lost income due to other reasons, predominantly that their partner or spouse has seen their income fall.



HOW CONCERNED ARE YOU ABOUT EXPERIENCING FINANCIAL DIFFICULTIES DURING THE COVID-19 CRISIS?

| | Total |
|---|------------|
| I have already experienced financial difficulties | 7% |
| Very concerned | 21% |
| Slightly concerned | 32% |
| Not very concerned | 24% |
| Not at all concerned | 17% |
| NET: Concerned | 52% |
| NET: Not concerned | 41% |

Source: AJ Bell

Lots of people don't have money to fall back on should they see a drop in income. A large number of households have no emergency savings, meaning one fifth of the population has already taken on debt in order to pay their bills and for other essentials.

TURNING TO DEBT

So far 10% of people have put more debt on their credit cards, while another 10% have taken a loan from family or friends and 7% have taken on more overdraft debt. These figures are likely to soar in the coming months as people get their first reduced pay cheques since being furloughed and more people lose their job or see their incomes cut.

People are also braced for more financial hits as a result of the pandemic, suggesting that the numbers accessing their savings or taking on debt might rise. More than half of respondents say they are concerned about getting into financial difficulties in the current crisis, while more than a quarter have already seen a hit or are 'very concerned'.

Again, younger people are more likely to be worried, as they tend to have lower savings to fall back on and are in more precarious job roles, with two-thirds of 18 to 34-year-olds saying they are worried about future financial difficulties compared to 35% of those aged 55 or over.



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

What does a rapid build-up of debt mean for economic growth?

The UK and Germany are adopting more loan-based emergency measures compared with the US, which potentially lowers future debts



According to the International Monetary Fund (IMF) the total cumulative amount of global liquidity injections, in the form of government spending packages and central bank stimulus measures, adds up to a whopping \$14trn.

This represents around 17% of the value of global gross domestic product (GDP), a common measure of the value of all goods and services produced within an economy.

Whichever way you look at the present economic response to the pandemic, the amount of public and private debts are mounting up and could eventually be bigger than at any other time, outside of the two world wars.

The IMF has said it seems likely that the current crisis will be several times more costly than the global financial crisis of 2008 and have far longer effects.

Whether higher debts affect

the potential future growth rate of the UK economy, or possibly stir inflationary pressures, are questions being asked by many investors and economists, and here we attempt to lay out some of the issues.

WHAT ACTIONS HAVE BEEN TAKEN SO FAR?

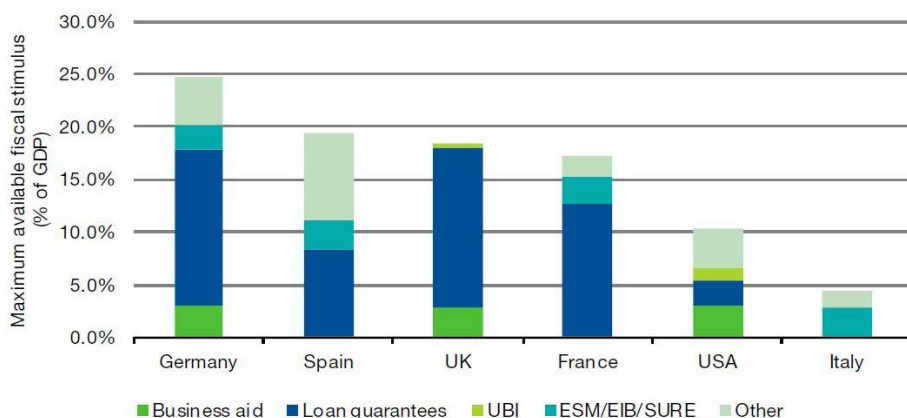
In contrast to the uniformity of action across the major countries, there has been a varied response in terms of the

types of support provided.

For example, the US government has preferred to go down the direct bailout route with only \$540bn of the total \$2trn package containing business loans that will ultimately need to be repaid. The remainder are direct payments that will immediately add to state debts.

This is a different to the route taken during the global financial crisis, when the US

FISCAL STIMULUS BY COUNTRY



Source: Liberum, US Department of Treasury, HM Treasury, European Commission

launched the Troubled Assets Relief Programme (TARP), which amounted to \$700bn or 4.7% of GDP. By the end of 2010 half the money lent had been paid back and five years later 99.7% had been repaid.

The US approach this time contrasts with the UK where £330bn of the £400bn of support is in the form of business loans that need to be repaid. Similarly in Germany €580bn of the €830bn spent so far could be recouped when the economy recovers, when the loans get repaid.

These different routes might have important effects on the national debt of each country in the future. According to projections made by the IMF and OECD, the UK's debt to GDP ratio by 2030 is expected to be around 88% compared with 84.2% before the pandemic.

This assumes that companies will pay back their emergency loans quickly as happened with the US TARP experience. In the US, debt to GDP is projected to rise to 135% of GDP compared with 125.5% today.

HIGHER DEBTS SLOW ECONOMIC GROWTH POTENTIAL

Data from a study conducted by the Bank for International Settlements (BIS) in 2017 showed a strong link between low interest rates and bank lending practices. As interest rates approached zero, banks lent less and that behaviour remained in place even after the global economy started to grow strongly.

The reason is related to the way banks make money which relies on interest rates in the future being higher than they

are today. Banks use short-term customers' deposits, and lend that money for longer periods to corporates at higher interest rates, earning an interest rate spread.

Central bank action has had the effect of reducing interest rates right across the maturity spectrum, and effectively removed the profit margin for the banks, making them more reluctant to lend.

In the parlance of economists, a major 'transfer mechanism' has been broken by the quantitative easing policies pursued by central banks since the global financial crisis.

A 2019 study of 118 international banks showed that as interest rates declined banks shifted their business away from traditional interest bearing activities into fee-based business. In other words, lowering interest rates had the unintended consequence of reduced bank lending, starving the economy of liquidity and lowering growth.

CROWDING-OUT EFFECT

One effect of rising debt levels is well understood due to the pioneering work of two economists, Ken Rogoff and Carmen Reinhart. Their work showed debt-to-GDP levels above 90% reduced growth rates significantly.

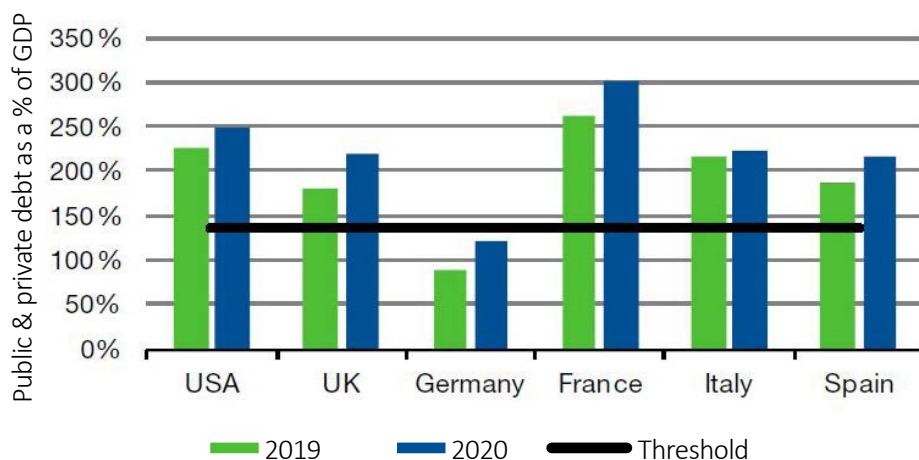
A more recent study by Mehmet Caner showed that if combined public and private debt reached a threshold of 137% of GDP, every subsequent 10% increase would reduce real, inflation-adjusted GDP growth by 0.25% over the following five years.



The main reason is the crowding-out effect, which essentially means that private borrowers have to pay higher rates of interest in order to attract investors, increasing borrowing costs and lowering the amount of investment that otherwise would have been made.

The UK and US are already above the threshold rates which will lead to a significant drag on economic growth over the next five years according to investment bank Liberum.

TIPPING POINT FOR PUBLIC DEBT AND PRIVATE DEBT



Source: Liberum, Bloomberg, Caner et al. (2018)

A STOCK FOR A LOW GROWTH ENVIRONMENT

In a low growth and persistently low interest rate world, earnings growth of any kind will probably trade at a premium, while defensive earnings unrelated to the growth in the economy will also be sought.

Around 90% of **Go-Ahead's (GOG)** revenues are derived from contracts where there is no

direct revenue risk from changes in underlying travel demand. The transport company was recently awarded a new contract to keep running the Southeastern rail franchise which runs to October 2021.

The Government has removed exposure to changes in passenger demand and costs because of the pandemic, making the new Southeastern arrangement a

management contract rather than the old one which saw the franchise operator's revenue primarily generated through passenger fares.

Around 90% of Go-Ahead's revenues are now derived from contracted markets where there is no direct revenue risk from changes in travel demand.

The company has been cutting costs and has suspended the dividend. It has £110m of cash and £134m of unutilised facilities, with net debt of £306m.

The Government has provided £167m of funding to bus operators for at least 12 weeks. When the lockdown ends and business eventually goes back to relative normality, Go-Ahead will be in a good position to reinstate dividends, which have grown around 4% a year over the last five years and provided an average yield of 5%.

GO-AHEAD GROUP (GOG)

Price: **£12.61**
 Market Cap: **£563m**
 5-year average return on equity: **55%**
 2021 forecast EPS: **167p**

Source: Stockopedia



By **Martin Gamble**
 Senior Reporter

Everything you need to know about picking ETFs

How ETFs work, the costs, choices and popular products among retail investors

Exchange-traded funds (ETFs) are a good starting point for investors looking to gain low-cost exposure to a broad range of financial markets.

They enable you to track various groups of companies, bonds or commodities from around the world. Ultimately ETFs can provide the building blocks of a diversified portfolio.

ETFs can be much cheaper than a traditional investment fund that uses a fund manager to pick the holdings. ETFs simply follow an index; the companies, bonds or commodities that go into each index are chosen based on specific rules. For example, a FTSE 100 index would track the 100 largest companies by value on the London Stock Exchange.



ETFs are known as passive investment vehicles. The typically lower fee is really important because charges for an investment can make a material difference to long-term returns.

A key point to consider is that an ETF will only track the market rather than outperform or underperform, which is what

you might see with an actively-managed fund.

WHAT ARE ETFs?

Like a fund, ETFs diversify an investor's money across a range of underlying holdings thus spreading the risk. But in addition they are traded on the stock market, meaning they can be traded online at a live market price throughout the day, just like regular shares.

The sheer breadth of options available can be overwhelming and some of the key points of comparison that investors typically use, such as index composition, fees, replication method and whether the fund is accumulating or distributing, may seem tricky to navigate at first. However, it shouldn't take long to understand how it all works.

RANGE OF OPTIONS

Some ETFs track a basket of investments based on certain criteria such as income from



WHAT'S THE DIFFERENCE BETWEEN PHYSICAL AND SYNTHETIC REPLICATION?

These terms refer to the method by which an exchange-traded fund achieves its tracking of a market.

Physically-backed products trade directly in the underlying stocks and shares in an index to replicate the performance of a market, while synthetic ETFs employ a swap-based method of replication.

The latter can be a bit complicated to understand but fortunately most ETFs just use physical replication.

dividends. Others might focus on a theme such as robotics companies or a sector like healthcare.

However, the most popular ETFs are more straightforward products which are simply seeking to replicate as closely as possible the performance of an stock index like the UK's FTSE 100 or S&P 500 in the US.

UNDERSTANDING COSTS

It is also worth looking at how consistently a product has tracked its benchmark. As a rule of thumb – and assuming otherwise perfect tracking – an

ETF should underperform its benchmark by an amount equal to its ongoing charges figure (OCF) on an annual basis.

The OCF gives a guide to how much of your investment is taken up by costs – an OCF of 0.3%, for example, would mean that for every £100 you invest, 30p is lost to costs.

Most ETFs are exempt from the stamp duty you pay when trading shares.

As with other listed entities you should look at the bid/offer spread, which is the difference between the price you pay to buy an ETF and the price you would get for selling it.

Another thing to consider is the amount of assets in an ETF – the higher the level, the less likely it is to close due to lack of interest and the more likely it is to be easily traded and low cost. A good rule of thumb is to look for ETFs with more than £100m in assets.

HOW ETFS ARE RATED

Financial information providers Morningstar and Trustnet both provide rating services for ETFs which are available for free on their websites. These can be good places to start your research.

For the Trustnet service, ETFs will be awarded between one and five 'Passive Crowns', based on their ability to track their index over a three-year period. The Morningstar rating offers a measure of an ETF's performance versus its peer group and is based on a 1 to 5-star rating.



EXAMPLES OF ETFs

Investors seeking exposure to the UK stock market have lots of choice including **iShares Core FTSE 100 (ISF)** which has an ongoing charge of 0.07% and tracks the 100 largest London-listed stocks.

An example of an ETF providing global exposure to equities is **HSBC MSCI World (HMWD)**; it tracks a basket of companies in 23 developed markets for an OCF of 0.15%.

For gold exposure **WisdomTree Physical Swiss Gold (SGBX)**, backed by actual gold bullion, is among the cheapest options with a 0.19% charge.

Other ETFs include **Invesco GBP Corporate Bond ETF (IGCB)** which invests in bonds issued by big companies such as banks and utility providers.

Lyxor Core MSCI Japan ETF (LCJP) is a good example of an ETF which tracks the performance of large and medium-sized companies on the Japanese stock market.

For those seeking exposure to bricks and mortar, a relevant product is **iShares UK Property ETF (IUKP)** which tracks a basket of real estate companies.

MORE INFORMATION ON ETFs

Further details on ETFs can be found in these useful articles:

[BUILD A PORTFOLIO WITH JUST THREE ETFs](#)

[DON'T SIMPLY PICK THE LOWEST COST ETF](#)

[SMART BETA ETFs](#)



By **Tom Sieber**
Deputy Editor

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- **AIM**
- **Investment Trust**
- **Fund**
- **Overseas**
- **ETF**

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Full year results

11 May: Novacyt. **12 May:** Inspects, Land Securities, Vodafone. **13 May:** British Land. **14 May:** Checkit, Minoan, Premier Foods, Westminster.

Half year results

11 May: Diploma, RDI REIT. **12 May:** Treatt. **13 May:** Compass, Marston's, Sage, Stock Spirits. **14 May:** Countryside, Grainger, Ten Lifestyle, Titon.

Trading statements

11 May: Centrica, Hiscox. **13 May:** Spirax-Sarco. **14 May:** Arrow Global, Gresham Technologies, Indivior.

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