STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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SHARES

WE MAKE INVESTING EASIER

NEW CHINA, NEW ORDER

Why the country's rise matters to your investment portfolio

PLUS

THE **SECOND COMING** OF **SERCO**

WHY **UK-FOCUSED** INVESTMENT TRUSTS ARE **GEARING** UP

WHAT NEXT FOR **RIGHTMOVE** AND THE **HOUSING MARKET**

Could volatility return before the summer is out?

Investors should not be complacent but neither should they panic

It is always tricky for investors to work out what's coming next in the markets but it feels unusually difficult at the moment.

Several intertwined and competing factors are in play, including the coronavirus pandemic and its economic impact, tensions between China and the developed world and the support being offered by central banks and governments to prop up their economies and the markets.

Despite the unprecedented nature of the events of the last six months the MSCI World index, encompassing global developed markets, trades higher than it did at the beginning of the year.

However, the summer lull can often exacerbate volatility, with the thinner trading volumes seen when many traders are taking a break often leading to out-sized movements in stocks.

That was the case in August 2015 when another crisis which had effectively been 'Made in China', caused equities to wobble. Though on that occasion it was a debt bubble as opposed to a trade war and a pandemic that was behind the sell-off.

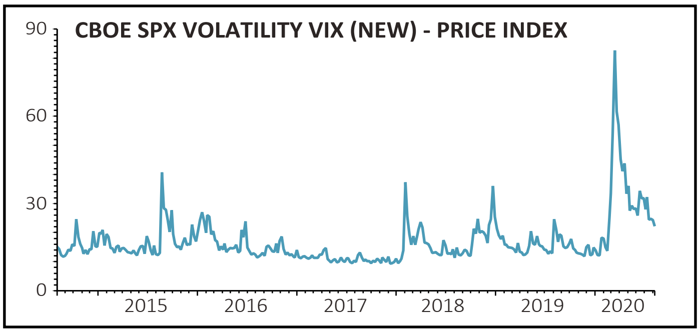
Those heady days five years ago saw the VIX 'fear index' hit its most recent high before the record levels seen during the height of the current crisis in March 2020.

This shorthand gauge of investor nervousness measures the market's expectation of 30-day volatility on the S&P 500, as implied by the prices of near-term options.

NO PLACE FOR COMPLACENCY

It remains relatively subdued for now but investors shouldn't be complacent about the risk of that changing given the factors discussed above.

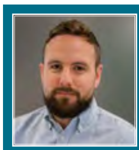
If and when there is a correction in the markets, investors should retain a long-term perspective. We have covered some of things you can do to prepare for a downturn in recent issues and we will cover any developments as and when they happen.



Market weakness also creates opportunities and we will be alive to these too.

Today the old adage, when the US sneezes the world gets a cold may equally be said to apply to China (and feels particularly apt in the current circumstances).

Everyone should have a handle on what is going on with the world's second largest economy and in this week's issue we go into depth on China's continuing rise and the threat posed to it by confrontations with the West.



By **Tom Sieber** Deputy Editor

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If you're a regular reader, you'll know that we often talk about dividends. That's because they can make a big difference to your long-term investments. Indeed, with more uncertainty in the area now, we invite you to revisit their role.

Making dividends work for you

If you're a shareholder in a company, you may receive a dividend from that company's profits – as a reward for entrusting it with your capital. As with all investment trusts, The Scottish's main source of income used to pay dividends to its investors are the dividends received from its portfolio of holdings. You may not be aware that we deliver one of the highest dividend yields in the AIC Global peer group. This is important because, in conjunction with share price movements, dividend income forms a substantial part of an investor's total return.

Compounding occurs as dividends are used to buy more shares which, in turn, earn dividends on their own. These reinvested dividends would then gain or lose in line with the movement of the share price. For example, over 25 years to 31 May 2020, the share price of The Scottish increased by 225%. The share price plus dividends taken as cash would raise this to 357% over the same period and, if those dividends had been reinvested, the total return would have been 497% (all before any dealing expenses). It's important to remember, of course, that markets can be volatile and shares (and the income from them) can go down as well as up.

Why a contrarian approach can pay dividends

As we've demonstrated, dividends can play an integral part in the return on your investments over the long-term. We're pleased to say that we've increased our regular dividend for the last 36 consecutive years which makes us a 'dividend hero' according to the AIC. Even in these unprecedented times, we stand firm in our intention to maintain our long track record of regular dividend growth, having recently announced that we will increase this year's dividend. However, as we have seen from many companies in the past few months, dividends are not guaranteed and they can fall as well as rise.

In this context, how does our contrarian style come into play? It guides us to look for what we call 'ugly ducklings' – unfashionable and unpopular investments. The share price of such investments typically reflects their 'unloved' status, often written off by other investors. By contrast, we research these companies to ascertain if they are ripe for improvement. Has there been a change in their business model, or to senior management? Are there nascent opportunities in the markets in which they operate? If we believe we can see a change, and the company presents a credible plan for recovery, we'll consider investing. However, we also take a 'belt and braces' approach to our investment – which brings us back to dividends.

One of the things we may consider before investing in an 'unloved' company is if it has sufficient cash to pay dividends throughout its turnaround. As our approach is based on long-termism and patience, a sustainable dividend may make it easier for us to hold the stock while the business is recovering. A good example of this is our investment in US telecoms group AT&T. Deemed unexciting by many, we view the steadiness of this business as a virtue. It fits our 'unloved' criteria, because investors' expectations are low. The company has a credible plan to improve its fortunes. As we wait for positive development, we can enjoy the dividend – the belt to the braces.

> "dividends can play an integral part in the return on your investments over the long-term"

What if a company doesn't pay a dividend?

If dividends are so useful, does that mean we'll shun companies that don't pay one? Not necessarily. When a company is putting its house in order, it might choose to stop paying a dividend, conserving its cash to allow it to improve the business (investing in new technology or changing its business model, for example). Indeed, this was the case with Tesco, which suspended its dividend before we invested. Tesco addressed areas of concern, made improvements to its business – then restarted its dividend. We see the reinstatement of a dividend as an important signal that a company's rehabilitation is underway.

As you can see, dividends can tell us a lot about a company's health – and its future prospects. We always pay close attention to a company's dividends when we're considering investing – both its ability to pay them and its track record of doing so, because dividends can make a tangible difference to long-term investors. ■

14 July 2020

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Housing market and Rightmove are resilient (for now)

Both the property site and the wider space are likely to be tested in the autumn

The resilience of the UK housing market has been one of the notable features as we moved out of lockdown and into the next phase of the pandemic.

This was reflected in recent first half results from property site **Rightmove (RMV)** which saw the company reveal that between the beginning of June and end of July demand for sales properties was 50% higher than the same period in 2019.

In lockdown there were predictions that estate agents would act on grumbles over Rightmove's increasing level of fees and use a period when the market was effectively in hibernation to leave the platform.

However, membership numbers for agency branches and new home developments combined were down just 3.3% since the start of 2020 to 19,158.

It seems rather than driving agents away, a period of housing market volatility may have reinforced the network effect which has helped underpin the company's impressive growth over the last decade or more.

Because the site has the most listings, it is therefore the one which prospective property buyers will go to when looking for their next home.

This reinforces its position as a must-have product for estate agencies and gives it significant pricing power when it comes to securing subscriptions from agencies.

Agents are arguably more reliant than ever on Rightmove's services and reach as they have to sell properties to stay afloat.

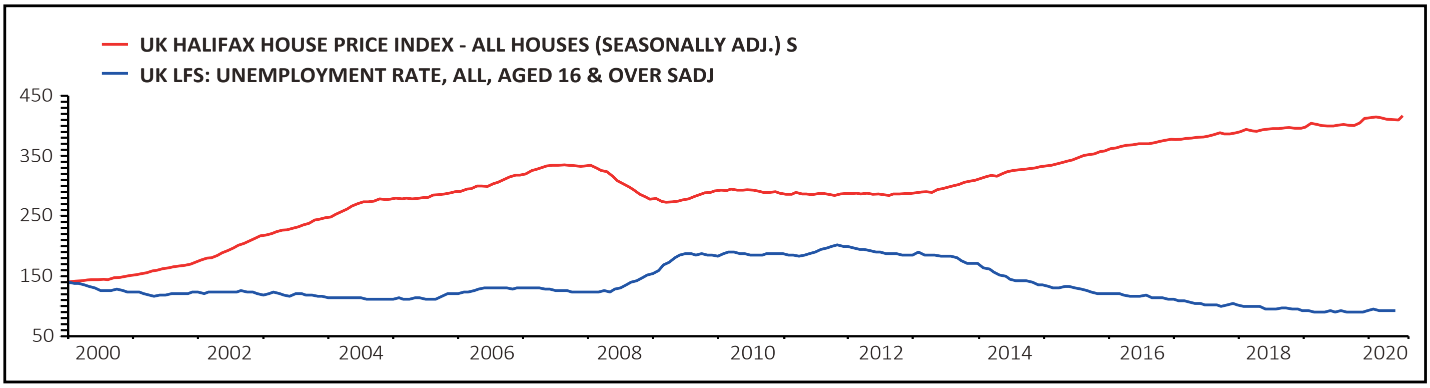
However, it will be interesting to see if this holds true if or when Rightmove looks to return to a pre-Covid pricing structure having offered discounts through the crisis.

Currently discounting has been extended until the end of September – although that month will see a reduction of just 40% compared with 75% when lockdown was at its height.

The foundations of the housing market may also come under pressure this autumn, assuming the furlough scheme comes to an end as planned in October.

This could lead to a material increase in levels of unemployment, which is likely to have a negative impact on demand for homes.

A look at house prices and unemployment over the last 20 years unsurprisingly indicates a significant negative correlation with house prices falling as unemployment rises and vice versa.



This ETF owns more gold than the Bank of England

Its rise comes as a study examines whether ETF investors are dictating the price of gold

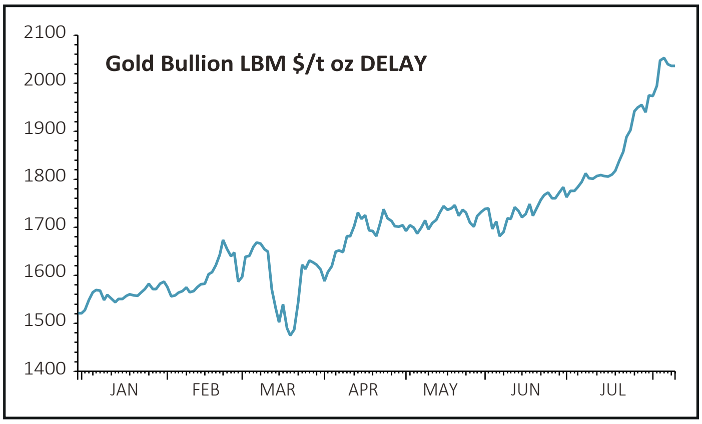
As investors flock to gold amid a wall of worries, one exchange-traded fund (ETF) has seen so a high level of inflows it now holds more gold than central banks including the Bank of England and Bank of Japan.

SDPR Gold Shares, run by American ETF giant State Street, now has $80 billion of investors' money and owns 1,258 tonnes of gold, more than four times of that held by the BoE and almost double that held by the BoJ.

It comes as the price of gold topped $2,000 an ounce, with the shiny metal's momentum currently showing little signs of slowing down.

The SPDR ETF is one of the cheapest on the market with an annual charge of 0.1% a year, and its success comes as other ETF providers try to lower their costs to entice investors lured by the gold rush.

Invesco Physical Gold ETC (SGLD), for example, this week reduced its fee from 0.19% to 0.15%, making it the cheapest available to UK investors when combined with its bid-offer spread, as it continues to tap in to investor demand.



But the rapid rise of both the gold price and gold ETF inflows has some questioning whether it's the high level of investor money being put into gold ETFs which is actually driving up the price so much.

Gold-backed ETFs saw an eighth consecutive month of inflows in July according to the World Gold Council, with just two ETFs, SPDR Gold Shares and **iShares Gold Trust** representing 61% of all global inflows.

A study by Campbell Harvey, professor of finance at Duke University and senior adviser at Research Affiliates, showed that as the two largest gold ETFs grew in assets between 2004 and 2020, so did the real price of gold.

The study found the average buyer of gold ETFs drives up the price of gold and a seller on average drives it down, suggesting a significant correlation between the real price of gold and the holdings in gold ETFs.

Harvey said, 'The ETF financialisation of gold ownership, in which the real price of gold may be correlated with the amount of gold held by gold-owning ETFs, could possibly lead to higher peaks and lower troughs for the real price of gold relative to the experience of the past.'

He added that 'passive massives', referring mostly to the aforementioned SPDR and iShares ETFs, appear to have created gold demand-pull inflation, driving the price up further.

European Assets sticks to dividend after quality shift

The market selloff in March provided 'rare opportunity' to add quality stocks says manager Sam Cosh

Small and mid cap European equity investment trust **European Assets (EAT)** has stuck to its generous dividend payout after shifting to quality names which were heavily sold in the market correction earlier this year.

In its half yearly results, the trust's board committed to paying a fourth interim dividend of 1.755p per share in October, sticking to its policy of annual payouts totalling 6% of net asset value (NAV) at the end of the last year.

On the basis of the October payout, the trust is set for a dividend yield of 6.9%, nearly three times more than the second highest paying trust in its sector, **TR European Growth (TRG)**, which yields 2.4%.

The trust's total return during the six months to 30 June was -3.5%, in line with its EMIX Smaller European Companies (ex UK) benchmark, which also fell by -3.5%. With the share price discount to net asset value increasing to 10.6% at the period end in comparison to 5.2% at 31 December 2019, the share price return for the period was -8.6%.

Manager Sam Cosh conceded it had been a 'challenging period' but added that 'from an investment point of view it has been productive', having used the coronavirus crash in March to invest in quality names.

Many of these stocks had been kept out of the portfolio for years due to 'challenging valuations', which Cosh said were amplified by low interest rates and the stocks' 'abundant liquidity'.

'The market fall provided a rare opportunity to invest in some great businesses at exceptionally attractive prices,' he added.

Stocks which were added to the portfolio included Swedish stock market darling Avanza, the country's largest stockbroker. After hitting a low of 68.90 SEK in March, it has more than doubled to change hands at around 163 SEK.

Other new names added which contributed to performance included German-listed meal kit provider HelloFresh, which has enjoyed a steady rise over the past year and since dropping to €18.46 on 13 March now trades at around €46.50, equating to a historic price to earnings ratio of a whopping 100.8 times according to Google Finance.

Cognac and Cointreau liqueur maker Remy Cointreau was also added in the selloff, with its share price rising over 58% since March as lockdown drinking boosted its outlook for the year.

Other names in the portfolio which performed well over the 'entirety of the period' were German housing portal Scout24, online food delivery firm **Just Eat Takeaway (JET)**, and Dutch semiconductor manufacturer ASM International.

European Assets Top 10 Holdings

Gerresheimer	3.8%
Vidrala	3.5%
Scout24	3.3%
Ringkjoebing Landbobank	3.2%
Simcorp	3.1%
Wizz Air	3.1%
IMCD	2.9%
Just Eat Takeaway	2.8%
Karnov Group	2.8%
Tecan	2.7%

Source: BMO

Alarm bells ring for retail as UK sheds 730,000 jobs

Shopkeepers are cutting costs to align themselves with a cautious, cash-strapped and socially-distanced consumer

According to the latest Office for National Statistics (ONS) unemployment data (11 Aug), the number of people in work in Britain has suffered the biggest drop since 2009, while the coronavirus will take a heavier toll on the labour market as the government winds down the furlough scheme.

The grim reality is many furloughed workers no longer have jobs to go back to and that has massive implications for the retail sector, where leading companies are announcing swingeing job cuts to align costs with flagging sales which are likely to worsen as consumer purchasing power erodes.

The ONS revealed that 730,000 jobs were lost across the first four months of the pandemic, based on the number of pay as you earn payrolls – a 114,000 increase in June alone. There was also a worse than forecast claimant count change reading for July with an extra 94,400 people now seeking unemployment-related benefits.

So while the UK unemployment rate remains below 4%, the true picture is distorted by a furlough scheme that is keeping people technically employed.

RETAIL JOBS BLOODBATH

Against this backcloth, the wave of job cuts across the retail and hospitality industries we are seeing is inevitable.

UK retail footfall decreased by 42% year-on-year during July, marking a 20.5% improvement on the 63% slump observed in June, according to the British Retail Consortium (BRC) and market research outfit ShopperTrak. Store visits temporarily picked up, yet retail footfall remains significantly south of levels seen before the pandemic and the outlook for many brick and mortar stores is precarious.

Ailing Debenhams is to cut a further 2,500 jobs, dealing the latest blow to the sector. The department store joined the likes of **Dixons Carphone (DC)**, **Marks & Spencer (MKS)** and books-to-stationery specialist **WH Smith (SMWH)** in announcing job cuts, not to mention John Lewis and Boots.

In addition, the BRC-KPMG Retail Sales Monitor (RSM) for July revealed total sales up 3.2%, marking the second consecutive month of growth since the start of the pandemic. However, over the three months to July, non-food sales declined by 4.3% overall.

As Shore Capital explains: 'The consumer outlook remains cautious with perhaps more targeted with less impulse purchases, as a result of the social distancing measures in place.

'We have concerns around the consumer economics for the second half of the year with rising unemployment and as the UK plunges into a consumer recession which will impact the already fragile consumer confidence.'

Why Ford should motor under new management

Unloved US car giant is cheap and could reward a patient investor

Investors should buy into recovery potential at **Ford Motor Co**. In the middle of a multi-year restructuring, Ford is blessed with an iconic brand, is pushing forward towards electrification and has the potential to turn itself around.

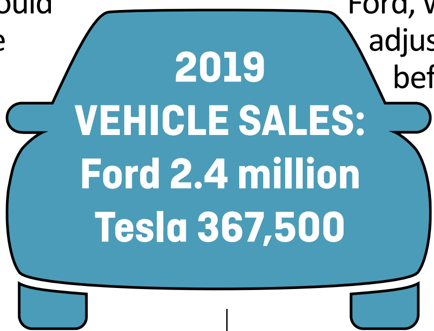
Car use may well get a boost coming out of the pandemic as people become more reluctant to travel on public transport due to the risks of infection.

The carmaker could also be among the beneficiaries if a Covid-19 vaccine arrives, as this could trigger a rotation away from hyped-up story stocks such as Tesla towards consumer cyclicals and drive a re-rating of Ford, currently trading on single digit price-to-earnings ratios for 2021 and 2022 and at or around one times book value, according to Refinitiv data.

It's market cap is also less than a tenth of Tesla's despite selling more than six-and-a-half times as many vehicles in 2019.

ROADBLOCKS TO NAVIGATE

Detroit-based Ford makes, markets and services Ford cars, trucks, sport utility vehicles and Lincoln luxury vehicles and is attempting to pivot towards electric and autonomous vehicles.



FORD MOTOR CO

BUY

$6.99

Market cap: **$27.3 billion**

The $27.3 billion cap also provides financial services through Ford Motor Credit Company.

Admittedly, the coronavirus has delayed the recovery at Ford, which reported an adjusted $1.9 billion loss before interest and tax for the second quarter, expects to lose money this year due to the pandemic and suspended the dividend in March.

You need to be aware of the risks, as vehicle sales will take time to recover to pre-coronavirus levels, Ford needs to invest heavily in electrification and tensions between the US and major car market China are unhelpful.

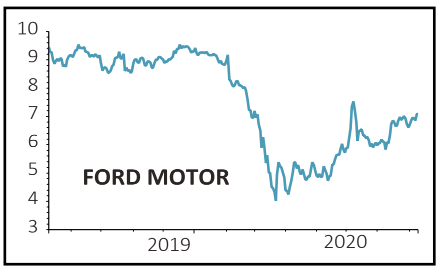
Nevertheless, forecasts compiled by Refinitiv point to a return to profit at the pre-tax level in 2021 and 2022. Furthermore, we like the fact Ford now focuses on light-truck models in the US, which the analysts at Morningstar believe is the right move given light trucks speak for more than 70% of US industry new light-vehicle sales.

As the pandemic subsides, Ford should benefit from a demand uptick as Americans (and other nationalities) get back to work and travel around in their millions, using vehicles as their own personal form of protective equipment.

FARLEY'S TAKEN THE WHEEL

Another catalyst is that chief operating officer Jim Farley will succeed chief executive Jim Hackett from October. This accelerated management change comes at a pivotal time for Ford as it attempts to execute an $11 billion restructuring plan and launches key new products including the Ford Bronco SUV.

Wall Street number crunchers expect enthusiastic 'car guy' Farley, who joined Ford from Toyota in 2007, to bring a greater sense of urgency to the transformation at Ford, which described him as a 'very key' executive in saving the company during the last downturn, one that bankrupted General Motors and what was Chrysler at the time.



Spirent is a 5G stock to buy and hold

Uniquely placed at the heart of a multi-year connectivity upgrade cycle

If you are excited about 5G connectivity, UK-listed telecoms and connectivity testing kit manufacturer **Spirent (SPT)** is one of the most direct ways to invest.

With 5G next generation mobile networks around the corner and new, faster ethernet broadband technology in the pipeline, Spirent has been on a hiring binge to meet client demand, adding a slew of new managers and building out its sales and marketing teams.

As we explained in our recent feature on the topic, 5G promises exponentially faster mobile download and upload speeds, much greater bandwidth to send the explosion of data volumes, and latency (time lag) all but eradicated.

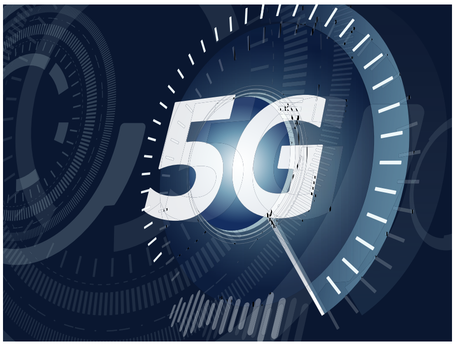
The company has earned long-standing and trusted customer relationships built over many decades, and its global engineering, operational footprint combine with a strong balance sheet that provides a healthy safety net through uncertainty, and flexibility to meet emerging opportunities head-on.

It should have around $230 million (£175 million) of net cash on the books by year end.

Investment in 5G networks might have been put on the backburner through the Covid crisis, yet this has not been the case. This is partly explained by the mission critical nature of its network and security kit and services supplied to the US military, space agencies, life sciences organisations that go far beyond the mobile network operators.

SPIRENT
BUY
(SPT) 301p

Market cap: **£1.86 billion**



Even during the teeth of the lockdown the company was able secure key orders to support customers across its portfolio despite most of its China-based workforce working from home.

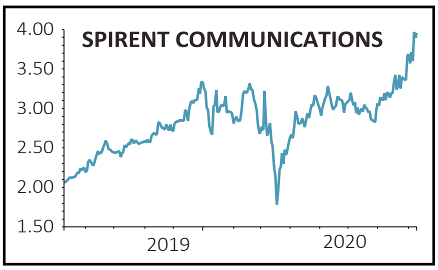
Though Spirent saw softness in some areas in April and May, US defence for example, demand recovered strongly in June and into the third quarter. As a result, the company seems to be seeing healthy momentum into the second half of the year across all its businesses.

Since joining as chief executive in May 2019, Eric Updyke has also steered Spirent on a course towards greater recurring revenue streams. The hope is that this will help smooth out what has historically been unpredictable, project-based revenue, one of the risks that investors associate with the business.

Beyond that, Sprient has also developed its sales and marketing structure to make them more effective at exploiting the firm's leading technologies. This is part of the margin improvement story.

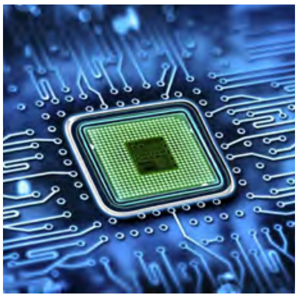
Better gross margins were a key highlight of recent half year results that saw the company outstrip forecasts. Spirent reported a gross margin of 73.4%, well above the 71.9% forecast of analysts at Liberum.

Spirent is a key supplier to a multi-year connectivity upgrade cycle. Trading on a 2021 price to earnings multiple of around 25, the stock may not make huge waves immediately, but over the medium to long term, this an exciting returns value builder to own.



LAM RESEARCH
(LRCX) $375.76

Gain to date: 20.3%
Original entry point:
Buy at $312.30, 25 June 2020



MICROCHIPS EQUIPMENT designer **Lam Research** continued the impressive second quarter reporting run of major tech stocks, sending our *Great Idea* stock to a 20%-plus paper profit in barely two months. That's twice the return of the supercharged Nasdaq's 10% gain since 25 June.

As a reminder, the Silicon Valley-based business designs specialist equipment that helps semiconductor manufacturers improve yields, lower costs, shrink processing time and reduce defects on microchips. Customers include Intel, Toshiba, Samsung and Micron Technology.

After a similarly upbeat second three months to 30 June for microchip kit peers ASML and Texas Instruments, Lam posted quarterly earnings per share (EPS) of $4.01 that outstripped consensus expectations of $3.81 and topped last year's second quarter EPS of $3.87. So much for Covid!

All of the same health warnings remain at this stage for Lam, such as customer concentration, competition etc, as do the original virtues, like its long-term client relationships, reputation for operational excellence and a rating that remains inexpensive compared to the wider market even after such a strong run.

SHARES SAYS: ↗
A solid start from an excellent business. Still a buy for the longer term.

ITV
(ITV) 64.3p

Loss to date: -15.4%
Original entry point:
Buy at 76p, 30 April 2020

OUR HOPE THAT people's increased engagement with **ITV (ITV)** through lockdown would begin to translate into increased advertising revenue is not yet in evidence.

The company may have seen increased viewing figures but first half results (6 Aug) also showed the worst quarterly drop in advertising on record as the impact of Covid-19 came through.

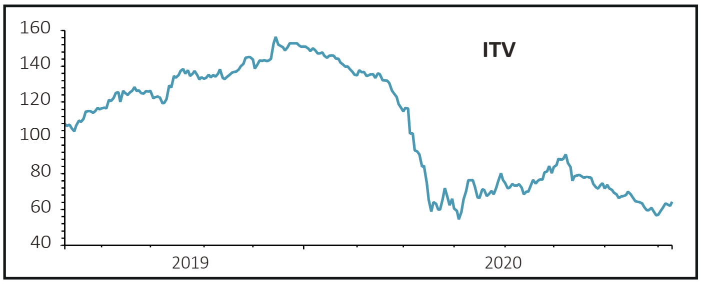
For the six months to 30 June, pre-tax profit plunged to £15 million from £222 million on-year as revenue fell 17% to £1.45 billion.

The company reported a 'significant' decline in demand for advertising across most categories with advertising revenue down 43% in second quarter and down 21% in the first half.

Traditional summer advertisers, most notably the travel and leisure industries, have been particularly exposed to coronavirus and ITV was also deprived a big sporting event after the Euro 2020 football championships were postponed by a year.

ITV Studios revenue dried up as most shows were put on hold through lockdown. However, there were some signs of recovery with July's ad take being down a more modest 23% as car companies and retailers begin spending more.

On the production side, 70% of the 230 shows suspended at the height of the pandemic have resumed.



SHARES SAYS: ↗
We are keeping the faith for now.

TOUCHSTONE EXPLORATION

(TXP:AIM) 73p

Gain to date: 40.4%

Original entry point:

Buy at 52p, 25 June 2020

OUR POSITIVE call on Trinidad oil firm **Touchstone Exploration (TXP:AIM)** has performed strongly with the main catalyst being an updated reserves report on its Cascadura natural gas discovery (20 Jul).

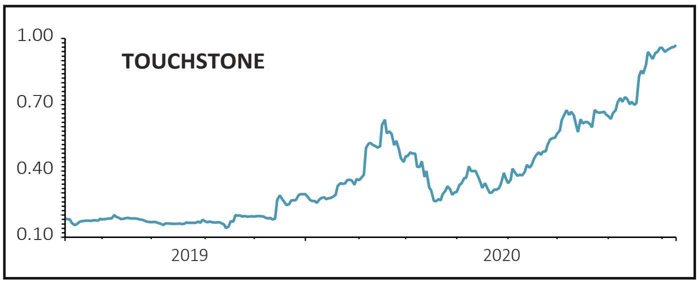
The independent report on Cascadura identified proved and probable (2P) reserves net to Touchstone of 45 million barrels of oil equivalent, which was larger than most analysts' forecasts.

As Canaccord Genuity's Charlie Sharp commented: 'The Cascadura reserves report confirms 2P reserves 29% higher than we had previously modelled.

'The reserves report is another significant moment for Touchstone, demonstrating the value of successful and meaningful exploration, in a location where it anticipates rapid conversion to cashflow generation following a low cost development programme operated by the company.'

Sharp expects peak production from Cascadura alone to be more than 10 times the current output of around 1,500 barrels of oil equivalent per day, with first output anticipated mid-2021.

And with an agreement on gas sales and more drilling on another exploration well, Chinook, expected imminently there is plenty of news flow to help underpin the momentum behind the stock.



SHARES SAYS:

We remain excited about the potential here as production looks set to increase substantially in the next 12 months or so.

NEW CHINA, NEW ORDER

Why the country's rise matters to your investment portfolio

By **Yoosof Farah** Reporter

In one way or another, China has come to dominate the conversation in financial markets.

Whether it's insatiable Chinese demand for everything from steel to corn to luxury handbags, or its never-ending ding-dong with the US, or whether or not you believe its GDP figures, China seems to be a big part of most stories in the financial world.

And that seems to be the way its leaders like it. A recent report by the London School of Economics' foreign policy think tank says China is set on pursuing globalisation, but with 'Chinese characteristics.'

According to the report, globalisation is starting to fade with key figures like the US 'decoupling' as they aim for economic self-reliance, but while the US under President Donald Trump appears to be moving away from its long-held place as a global leader, China apparently wants to be seen as the rightful replacement.

Whether or not China does end being up being the new world leader, one thing is clear – you should care about China.

The country's global influence is expanding rapidly, and in time it will enter our lives in the way all things Americana do today. But perhaps more importantly for investors, the returns today can be compelling – but only if you understand how China works, and you know what you're doing.

BUMPER RETURNS

As an example of the returns on offer, take a fund like **Matthews China Small Companies (B6T1MX2)**. It has returned more than 64.6% so far this year, has an annualised three year return of 27.3% and annualised five year return of 19.8%.

Most of the gains have come from some of its top holdings, which include technology stocks like Silergy, Jiajiayue Group and China Youzan. All of these companies have seen their share price double in the past year.

These types of companies are typical of what China is trying to become, a modern economy based on innovative businesses which are tapping into both the country and the world's growing digitalisation, and catering to the growing middle classes both in China and abroad.

Let's be clear, it's important not to romanticise China too much and hold up its growth trajectory as the absolute, definitive model for the rest of the developing world, given its systematic crackdown on dissent and its alleged human rights abuses, which deserve to be recognised.

ESG CONCERNS

A significant number of its companies also have many environmental, social and governance (ESG) issues to resolve, particularly around environmental concerns and corporate governance.

A more belligerent attitude from the West towards China may also be a threat to growth, with the recent introduction of a new security law in Hong Kong drawing fire from the UK and US governments and leaders in Europe too. Trump's recent attack on Chinese tech concerns like TikTok is just the latest example of this trend.

But it is a country with a clearly defined plan for growth and prosperity for its people, and the rapid expansion of high growth sectors like IT, pharmaceuticals, robotics, aerospace and automation are no accident – it's all part of Made in China 2025, the strategic plan issued by Premier Li Keqiang in 2015. All of which makes this country fertile ground for investors.

China has young and therefore volatile financial markets, with many inefficiencies. This is after all is a country that in 1979 was poorer than Uganda. To put in another way, the London Stock Exchange was first set up in 1571. The

Selected China funds performance

Fund	Performance year-to-date
Matthews China Small Companies	64.6%
Veritas China	41.1%
JPMorgan China	35.9%
Allianz All China Equity	35.2%
New Capital China Equity	34.3%
Baillie Gifford China	30.5%
First State All China	27.5%
Invesco China Equity	26.9%
Templeton China	24.3%
Blackrock Global China GBP Hedged	20.9%
Threadneedle China Opportunities	19.9%
Liontrust China	15.0%
Janus Henderson China Opportunites	15.0%
Aberdeen Standard Chinese Equity	13.6%
Fidelity China Focus	-3.0%

Source: Morningstar, 7 August

550 million

the potential size of China's middle class by 2022

Source: McKinsey

New York Stock Exchange was established in 1792, while the Tokyo Stock Exchange originally began in 1842. The Shanghai Stock Exchange by comparison, started in 1990.

'STOCK PICKERS PARADISE'

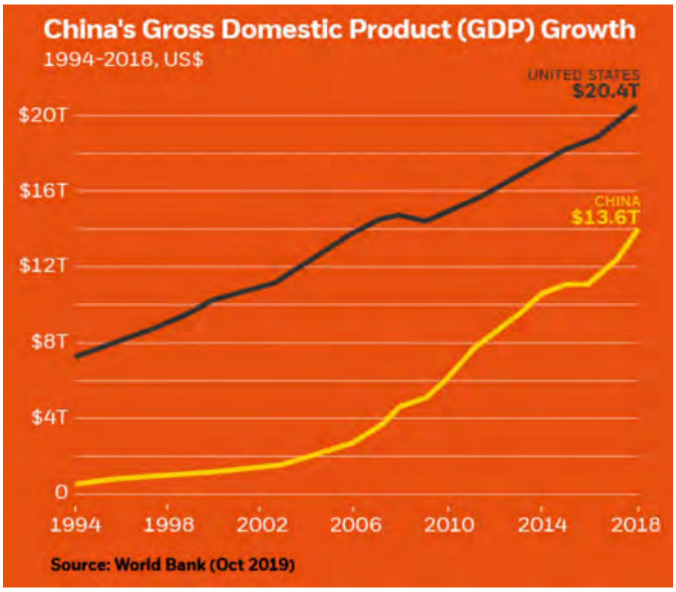
Combined with China's support for its 'national champions' in the aforementioned growth industries, the inefficiencies in its stock markets have led investors to label China a 'stock pickers paradise'.

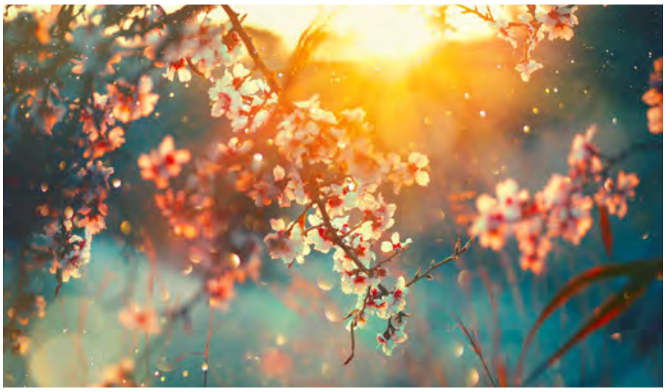
'China has some of the world's most innovative companies, but it's also is one of the most inefficient markets globally,' says Roderick Snell, manager of **Baillie Gifford Pacific (0606323)**. 'It is a very good market for a stock picker.'

While more institutions are now coming on board as access opens up, Snell points out that China's stock markets up until now have mainly been driven by retail investors, who on average tend to hold stocks for only two or three months. This gives an edge to professional investors who understand the country and how it works.

Despite the potential returns on offer however, you can't just throw money at any old fund, and certainly not any Chinese stock, and always expect a decent return. There are still plenty of risks given the relative youth of China's equity markets, and not all sectors of the Chinese economy necessarily have growth ahead of them. Picking the right fund is important.

For example, many Chinese equity funds





available to UK investors have sizeable allocations to some of China's big four banks, like Bank of China and China Construction Bank, which have shown virtually no share price growth at all in the last decade and have more challenges ahead as bad loans rise as a result of the coronavirus crisis.

BUBBLE WARNING

While just last week, **Fundsmith Emerging Equity Trust (FEET)** manager Michael O'Brien warned a 'bubble' could be developing in Chinese stocks, with the government through state-sponsored media encouraging a 'healthy bull market', as it has a tendency to do when it goes through a period of economic weakness.

But stripping out short-term noise, big opportunities do lay ahead if you pick the right sectors.

A sign of China's rise, and a notable step forward in its financial reform, was the establishment of the Science and Technology Innovation (STAR) board on the Shanghai Stock Exchange in June 2019.

According to Anthony Wong, a Chinese equity portfolio manager at Allianz Global Investors, it's these types of companies on things like the STAR board which will be one of key drivers of growth.

He says that one year since its launch, 140 companies have listed on the STAR board, raising a total of $31 billion, with the listings including companies in high tech areas including semiconductor manufacturing, artificial intelligence and biotech.

GROWING MIDDLE CLASS

It's also impossible to talk about China without mentioning what's underpinning its potential. One of the biggest investment stories to play out over the next couple of decades – and one which has almost all fund managers investing in the region excited – is the domestic consumption story related to the growth of China's middle class, which is the largest in the world.

In fact a 2019 report from consultants McKinsey suggested that in the next three years, China's middle class could total 550 million people – one and a half times the whole population of the US.

Adrian Lim, portfolio manager of **Asia Dragon Trust (DGN)**, believes this is a story which could play out for the next two or three generations, and says it's not just new economy companies that could benefit.

He explains: 'It's about catering to this growing Chinese demand for many things. So you have new economy businesses like Tencent, creating an ecosystem of applications, payments, gaming, email, etc. But also traditional businesses as well, like the whiskey and liquor makers.'

Indeed as the Chinese become more well-to-do and increasingly seek out the finer things in life, it's not just areas like tech and healthcare which are set to see major growth. China is seen as the great untapped market when it comes to things like whiskey for example.

A colourless liquor called baijiu is currently the most popular spirit in China, consumption of which is seems to be de rigueur at parties or gatherings. According to analysis by global drinks market researchers IWSR, 1.2 billion nine-litre cases of baijiu were consumed in China in 2018—three times more than global vodka consumption, the next largest category.

Yet according to that analysis, the country only imported 1.3 million cases of whiskey for example in 2018, equating to 1,000 times less whiskey purchased than baijiu, showing the sheer size of the potential market gains available as tastes of the Chinese consumer change over time.

US TENSIONS SIMMER

One factor tempering all this excitement however is China's tensions with the US. It's important to note that this extends a lot further than some fight Donald Trump has decided to pick over trade.

As Lim says, 'The tensions with the Americans would've always been there even if we had a Clinton administration, because here we've got two big powers trying to protect their sphere of influence.'

$31 billion

amount raised by 140 companies on the tech and innovation section of the Shanghai Stock Exchange

Source: Allianz Global Investors

A quick way to see the friction between the two countries is to simply Google 'Made in China 2025'. The first result that comes up is an article from a New York-based think tank, the Council on Foreign Relations. It immediately asks whether Made in China 2025 is a 'threat to global trade'.

It's no secret that both the US and China have long since had plans to extend their strategic reach beyond their own borders and even their own continents, and China's current rise needs to be put in historical context going back to the 1940s.

Straight after the end of the Second World War in 1945, the US stood alone as an economic power. It accounted for 50% of the world's GDP and effectively controlled 80% of the world's money reserves.

For most of the intervening period in the last 75 years it has remained top of the tree, the world's largest economy, a success story for prosperity epitomised by the American dream.

But now China, a country with communist values that capitalist America has always railed against, has risen to become the second largest economy, and with its GDP still growing at a significantly faster rate than that of the US.

Lim is among those who doesn't foresee any meaningful resolution to the tensions between the countries anytime soon, but believes trade between the two could be 'far more predictable, far less volatile' if only they could 'agree on a framework for how to compete.'

While Winnie Chwang, co-manager on **Matthews China (B4627Y0)**, says the trade war has actually appeared to help China's domestic economy, though stresses there will still be an 'overhang' on the economy overall.

She explains, 'Late in 2018 when the trade war started, certainly we saw a lot of uncertainty from companies, there was a pullback in capital expenditure, businesses were less willing to invest.

'But in 2019 there was more of an adjustment to a new normal, a realisation in China that the economy needs to move forward, and for example there was a lot of domestic companies in the technology sector doing what they could to become self-sufficient in double quick time.'

CHANGING PERCEPTIONS OF CHINA

While the tensions and their unpredictable implications rumble on, what has become clear is that over the next decade or two the world will certainly view China differently than it does today.

For years China has been seen as a country of imitation based on me-too business models, Wong says, and becoming the low-cost factory to the world. Turn over any cheap toy and the label 'Made in China' was ubiquitous.

'It will, therefore, take a long time for this perception to change', he adds. 'The reality, however, is that things on the ground are already changing fast. China is moving rapidly from a culture of imitation to innovation.'

64%

YTD return of the top performing China fund

Source: Morningstar

A sign of how things are changing, China now accounts for almost half the world's patent filings. Wong highlights Alibaba, which became a household name as a pioneer in things mobile payments, cloud computing and e-commerce, and believes a lot more Chinese companies 'will also become well known as global leaders in due course.'

Over the next 10-20 years China is widely expected to become the world's largest economy. In line with that, Wong explains, China will have significantly bigger financial markets.

'Indeed these will be an important step in paving the way for sources of funding for 'new infrastructure' growth areas, such as 5G networks, industrial internet, inter-city transportation and inner-city rail systems, data centres, artificial intelligence, and new energy vehicles.

'As a result, China will likely play a much bigger role in people's savings and investment portfolios than they do today.'

One last point worth considering, when thinking about the growth on offer in China, is that the country shouldn't be seen simply as one big emerging market country. Instead, it has something of all development stages every country goes through.

As Lim explains, 'Asia always goes through waves of this. At one end you have Singapore, South Korea, Japan – very developed. Then you have developing countries, like Thailand. After that you have frontier markets, like Sri Lanka and Pakistan, very volatile, the infrastructure is not as developed, there is not a clear path to growth.

'We look at China as one country but it has all of these stages. The coastal regions are first world but go 100 miles in and you have all the stages of development. China's growth story will take decades to play out.'

THREE WAYS TO PLAY CHINA

CHINA IS A BIG, diverse country with many different angles to it, and as such there are many different ways to play China.

INVESCO CHINA EQUITY

(BJ04HS1) 641.7p

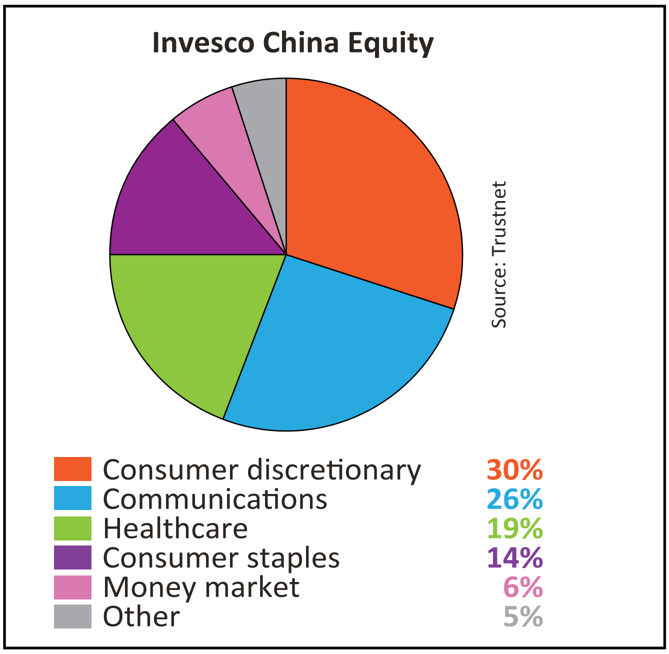
For those looking for good exposure to the country's overall growth story from an active fund manager, but with the peace of mind of potentially lower volatility, **Invesco China Equity (BJ04HS1)** could be the way to go.

The fund has had a good year so far returning 27.38% year-to-date, while it has an annualised three-year return of 15.05% and annualised five-year return of 17.26%, and has a reasonable ongoing cost of 0.89% a year.

In the past five years it has only lost money once, in 2018 when it fell 9.22%, but this was still better than the 13.83% drop recorded by its MSCI China benchmark.

According to Citywire, the fund is the best over five years (the minimum period you should be investing) when it comes to maximum drawdown, i.e. the most a fund would have lost if bought and sold at the worst possible times, with a figure of just -15.6%.

Like a lot of funds, its top holdings include Alibaba, Tencent and China's other big online retailer JD.com. But it also has decent exposure to China's fast growing healthcare sector with stocks like pharmaceutical companies Jiangsu Hengrui Medicine and Sino Pharmaceutical, and medical device maker MicroPort. All three stocks, which are in the top 10 holdings, have either doubled or almost doubled since the start of 2019.



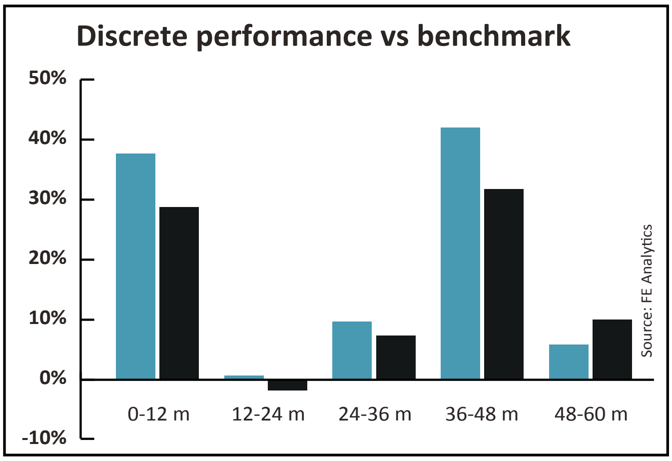
MATTHEWS CHINA SMALL COMPANIES

(B6T1MX2) $21.81

But if you're looking to tap into the compelling, though riskier, growth story of the country's rapidly expanding small and mid-caps, which are all part of the Made in China 2025 strategic plan, the aforementioned Matthews China Small Companies could be a good option.

The returns so far have certainly eye-catching, and going forward the fund looks like it could be well-placed to continue capturing that growth.

It definitely isn't for every investor,



particularly with a pricey ongoing cost of 2.25%, but for a patient investor who's willing to take the rough times with the smooth, the potential long-term rewards could be compelling.

Three of its top five holdings are fast growing domestic tech stocks, and if reports are to be believed, this is an area of the economy which could gain further support from Beijing if US-China tensions – heightened by Microsoft's talks to buy the American operations of TikTok owner Bytedance – continue to rise.

Despite the growth already enjoyed, the fund's price-to-earnings ratio of 16.5 times – compared to over 20 times for larger cap China funds – also indicates the possibility of further growth ahead.

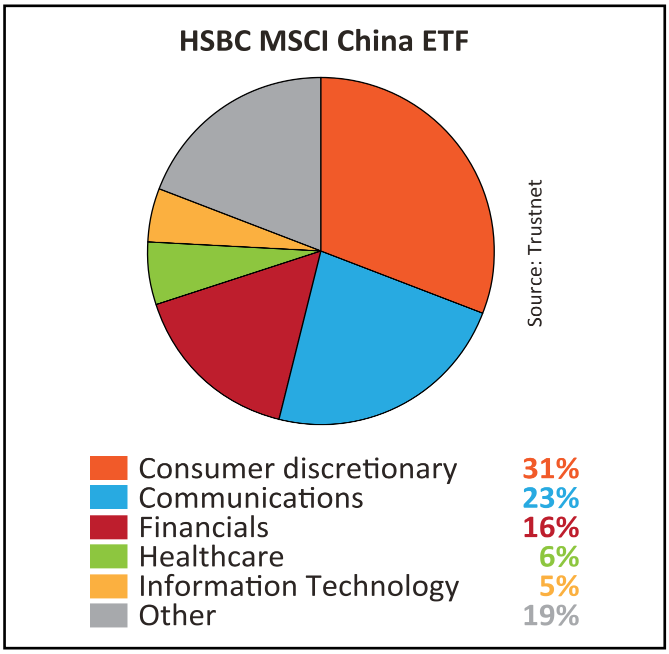
HSBC MSCI CHINA ETF

(HMCH) 746.8p

China's equity markets are both vast and relatively nascent, and so finding a good, reliable exchange-traded fund (ETF) to get a simple, broad exposure to the country's stock market isn't as easy as it seems.

But one option definitely worth considering is **HSBC MSCI China ETF (HMCH)**, which has a total expense ratio of 0.6% a year. This ETF has been going significantly longer than some others in the market, and unlike some of the more needlessly complicated options simply tracks the performance of the MSCI China index.

It's worth noting over 30% of the index is made up of Alibaba and Tencent, but other names you'd get exposure to include JD.com, Meituan Dianping – whose shares have gained over 150% since March – and finance giant Ping An Insurance.



WHAT IF YOU WANT TO AVOID CHINA?

As tensions between China and the rest of the world rise, some investors may be nervous about putting money to work in the People's Republic. However the wider Asia-Pacific region entirely, has favourable fundamentals including a youthful population and low financial services penetration.

Those interested in investing in the region without overloading on China exposure can find options among emerging markets-focused investment trusts, or in the Investment Association's Asia Pacific ex-Japan sector.

In the latter camp are funds with less than 20% of their assets listed in China, and less than 30% in the increasingly troubled Hong Kong, which would limit your exposure to China.

They include **BNY Mellon Asian Income (B8KT3V4)**, which had just 6.05% exposure to Chinese equities as at 30 June and 14% exposure to Hong Kong, according to FE Fundinfo. Also meriting mention is **Jupiter**

Asian Income (BZ2YND8), the £719 million unit trust managed by well-regarded stockpicker Jason Pidcock.

As of the end of June, its China exposure sat at a reasonably modest 13.9%, although Hong Kong was significant at 20%, but balanced out by significant allocations to Australia, Taiwan, Singapore and South Korea. Top holdings do include China's Tencent, although there is also exposure to Korean handsets-to-freezers maker Samsung Electronics and contract chipmaker Taiwan Semiconductor.

RUSS MOULD
AJ Bell Investment Director

Insightful commentary on market issues

Infrastructure could offer welcome shelter

Why the asset class has appeal in the current environment and the risks to consider

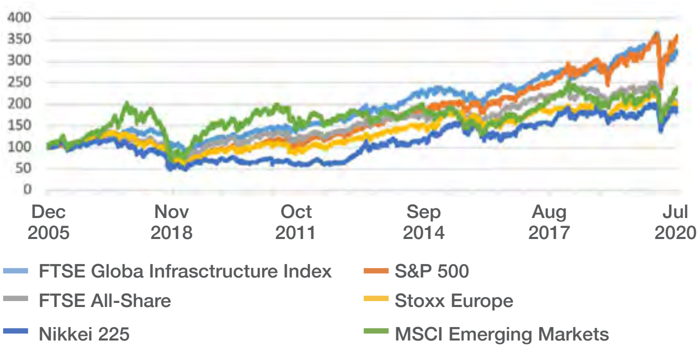
Traditional portfolio asset allocation tends to start with equities and bonds, with a bit of a cash buffer thrown in, before thoughts move to areas that are designed to provide some diversification, in the theory (or hope) that their performance does not correlate with (or mirror) that of the other options.

These 'alternative' areas can include commodities, commercial property or even private equity funds but one area which may still be flying a little under the radar is infrastructure.

This is surprising in some ways, since infrastructure, as an asset class has performed well for a decade or more. Looking at it from the perspective of only listed firms in this field, infrastructure stocks have outperformed all of the major geographic indices bar the super, soar-away US, which continues to benefit from the barnstorming run generated by Facebook, Alphabet, Amazon, Apple, Netflix and Microsoft.

While we must all accept that past performance is no guarantee for the future, the past 15 years' data may give investors some confidence that infrastructure is at least no flash in the pan. In addition, the asset class has several other facets which means it may be worthy of consideration as a part of a balanced, diversified portfolio, especially for those investors who have a long-term time horizon and are seeking income.

Listed infrastructure plays have performed well in a global equity context



Source: Refinitiv data

FOUR FACTORS

A selection of companies, held directly or via a fund, that own or operate assets which can range from ports to airports, toll roads to pipelines and essential water and electricity utilities may not appeal to everyone – the thought of owning a stake in an airport in particular right now could leave many investors feeling green at the gills.

But, beyond the tempting past performance record, which appears to show strong total returns over the past 15 years and with lower volatility than most equity benchmarks, there are four other reasons why infrastructure may suit the overall strategy, target returns, time horizon and appetite for risk of certain investors.

• **The rise of environmental, social and governance factors.** The COVID-19 outbreak, a global recession and resulting collapse in the oil price that leave investors contemplating this year's dividend cuts from **BP (BP.)** and **Royal Dutch Shell (RDSB)** are all good near-term reasons which explain the poor share price performance of the oil majors.

But on a longer-term basis, many investors are now steering clear of 'Big Oil' not just for financial reasons, and concerns over peak demand and the risk of stranded assets, but ethical ones and issues relating to carbon footprint. Infrastructure funds can help here, as there several specialists in the area of renewables and battery or energy storage technology, notably among UK investment trusts.

• Fears of inflation. Some investors may not be convinced by talk of inflation, at a time when the pandemic is still weighing on the jobs market and consumer confidence and demand destruction and a period of weak economic growth remain clear risks.

But central bank money-printing schemes, ballooning government deficits, supply-chain disruption (if production is brought back home from China, for example) and firms jacking up prices to cover extra Covid-related costs could yet combine to create a surprise.

The US five-year forward inflation expectation indicator is ticking higher, for example, especially if you adjust for the five-year US Treasury yield. This would be a game-changer, as the last 30-40 years have all been about disinflation, and would perhaps make investors appreciate the index-linked nature of many infrastructure firms' revenue streams.

Inflation expectations are slowly creeping higher

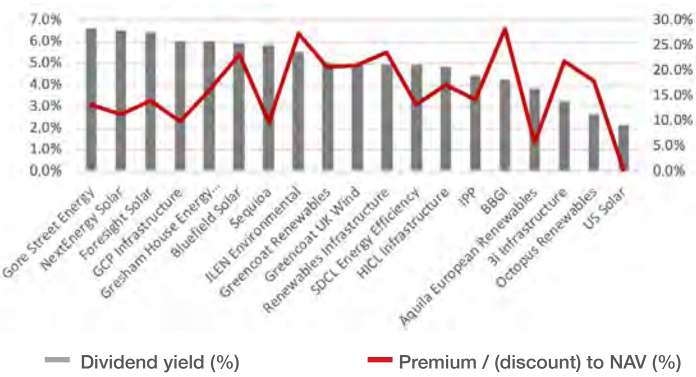
Source: Refinitiv data, FRED – St. Louis Federal Reserve database

• Property woes. Commercial property has long been seen as a useful and welcome source of portfolio diversification. Some investors may now fear, however, that the relentless rise of online shopping and the pandemic's effect upon office working and gatherings at leisure sites like restaurants, bars and clubs are going to deal rental incomes and asset values a severe blow.

• The reach for yield. Several REITs have cut their dividend and over £40 billion of cut, cancelled, suspended or deferred dividends in the UK stock market alone since March leave income-seekers in a bind, especially as government bonds offer little joy either. Infrastructure could again play a role here, as shown by the investment trusts which specialise in this area – though it must be noted that there are open-ended funds which operate here, too, and even a couple of passive, exchange-traded funds (ETFs) which track the performance of a basket of listed infrastructure stocks.

Note the yields on the investment trusts range from 2.1% to 6.6% for renewables specialists and from 3.2% to 6.2% for infrastructure experts.

Yields on offer from infrastructure investment trusts



Source: Refinitiv data, Association of Investment Companies for the Infrastructure and Renewable Energy Infrastructure categories

RISKS

As ever, however, there is no free lunch. Infrastructure stocks (and the collectives which own them) need to offer a yield to compensate investors for the risks involved, which can include regulation, political interference and top-line growth that is usually modest at best. In addition, the UK-listed investment trusts come with an annual fee and they also currently trade at lofty premiums to their net asset value.

At least some of their potential is factored into valuations already and, by paying that premium, investors are effectively giving away some of their future returns. Patience will therefore be required if anyone does feel infrastructure is a suitable option for them, once they have done their own research.

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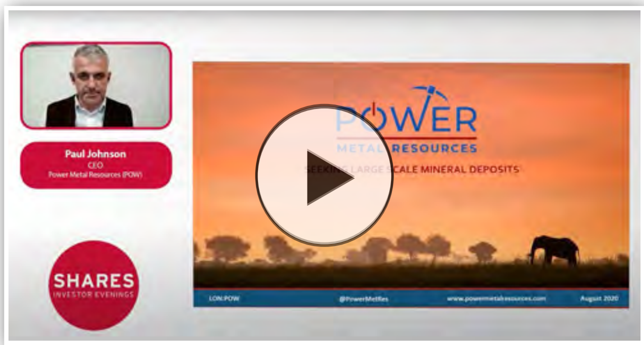

Paul Johnson, Chief Executive Officer - Power Metal Resources (POW)

Power Metal Resources (POW) is an AIM listed metals exploration and development company seeking a large scale metal discovery. The Company has a global portfolio of project interests including gold exploration in North America and Australia together with base metal exploration in Africa.

Cathal Friel, Executive Chairman - Open Orphan (ORPH)

Open Orphan (ORPH) goal is to become Europe's leading rare disease and orphan drug focused pharma services company. Its management team have extensive industry and financial expertise. Open Orphan is actively involved in the fight against COVID-19.

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The second coming of Serco

Outsourcing firm returns to form after years 'in the wilderness'

Public sector service companies such as **Serco (SRP)** have had something of an historic image problem. As governments around the world sought to procure more services for less money, corners were inevitably cut resulting in some high-profile failings.

Security firm **G4S (GFS)** made the headlines in 2012 after it bungled a £238 million government contract to provide security for the London Olympics.

Serco was fined £68.5 million after admitting it had fraudulently billed the government between 2010 and 2013 for tagging prisoners who had died.

> "…the work that Serco does is important to the lives of millions of people."

The crisis in the sector came to a head when Carillion, which employed 20,000 people and specialised in big public sector works like hospitals and the HS2 high speed rail line, as well as private sector projects such as the Anfield stadium expansion, collapsed in 2018 with £1.5 billion of debts.

However, we now think Serco at least has got its house in order and the shares are worth buying for long-term investors.

NEW BEGINNING

For Serco, the road back to respectability has been long and not always smooth. Current chief executive Rupert Soames arrived in 2014 from **Aggreko (AGK)** with a brief to restore profitability but just as importantly to restore the firm's credibility.

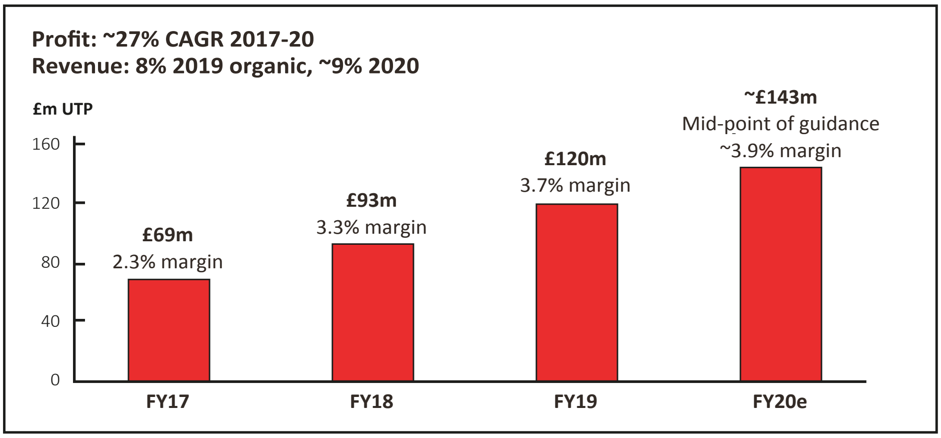
Soames, who had grown Aggreko's market value by nearly ten times, was a popular choice with investors but he was quick to acknowledge the scale of the task at hand.

'I am aware that the company has experienced significant recent difficulties but the work that Serco does is important to the lives of millions of people and I believe that we can find a way through to a bright future.'

There was no quick fix, and as Soames often said when presenting the firm's results to analysts, there were more than a few 'bumps in the road.'

Key to getting the firm back on an even keel was dealing with contracts which had been poorly structured, many of which left the company exposed to cost over-runs even when they were out of its control.

Altogether the firm identified close to £450 million of contracts which it classed as 'onerous' and began putting aside provisions to cover potential losses. Happily, in its first half results (6 Aug), the firm revealed that onerous contract provisions had dwindled to just £1.7 million compared with £42.1 million in the first six months of last year.



Source: Serco

KEY PRINCIPLES

In order to avoid a repeat of this scenario and improve the reputation of outsourcing firms, the firm established four principles which it wants governments and suppliers adopt.

These are greater transparency, preferably using open-book accounting, on non-sensitive contracts, together with an 'orderly exit' clause which allows either party, on payment of an agreed break fee, to exit a contract at pre-determined intervals.

Governments and suppliers should sign up to a mutually-agreed code of conduct which would prevent the former from imposing punitive terms or transferring 'unmanageable state risk' onto the latter.

Finally, firms undertaking sensitive work should lodge a 'living will' with the government in order to avoid the kind of chaos which followed the Carillion collapse.

BUSINESS SPLIT

Serco operates in the defence sector, health sector, citizens services, immigration, justice and transportation. Just over 40% of its revenue comes from the UK and Europe, where revenue in the first half of this year grew by 19% on an organic basis.

This figure was boosted by asylum accommodation contracts and a surge in Covid-19 work like drive-through and mobile virus testing centres and support for NHS trusts and Public Health England.

The Americas, which make up 30% of turnover, had a truly exceptional first half with revenue up 46% thanks to 8% organic growth, a 3% currency gain and a 36% boost from its

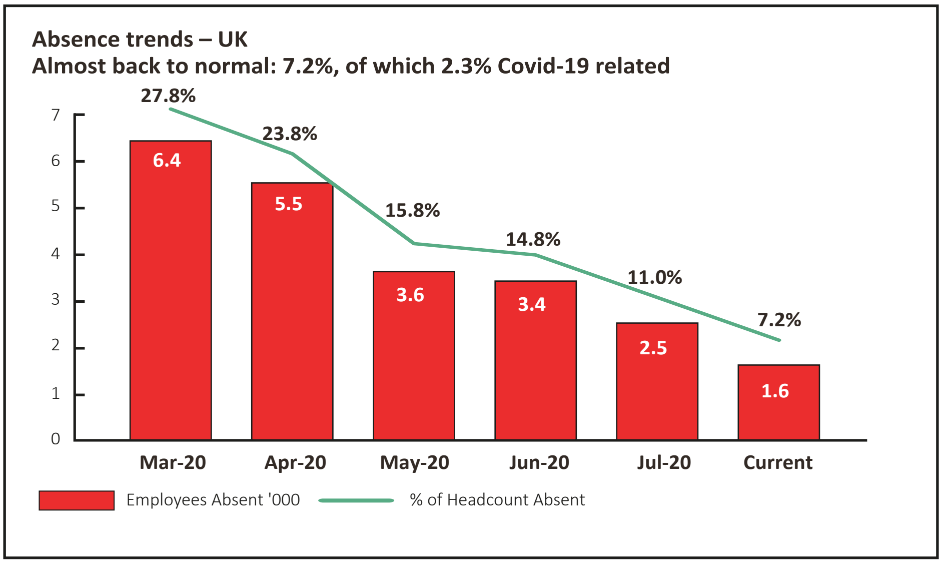
A FUND MANAGER'S VIEW

Christian Diebitsch, manager of the Heptagon European Equity Focus Fund – which gained 38% last year compared with a 26% increase in the MSCI European Total Return Index in sterling terms, and is up 6.2% for the year to 31 July against a 14% fall for the benchmark – is a firm believer in Serco's staying power.

He points to the company's 'superior organic growth rate compared with the rest of the market and its drive to 'clean up' the market for public services in the UK.'

He also believes the firm was 'right to defer the symbolic 1p per share final dividend as it utilised the government's furlough scheme and deferred VAT payments.'

While growth in revenue and earnings in 2021 will be below 2020's 'exceptional level', as he points out it will be from a higher base.



Source: Serco

newly-acquired Naval Systems Business Unit (NSBU), which designs ships and submarines and supplies engineering services and support to the US Navy.

The rest of the firm's revenue comes from Australia, the Asia Pacific region and the Middle East. Of these areas, only the Middle East grew revenues by less than 10% in the first half of this year, due to lower air traffic and navigation systems revenues and a drop in activity in parts of its transport portfolio without any offsetting Covid work.

FOUR FORCES

Serco has identified four 'forces' which it believes will continue to drive public sector demand for privately-supplied services. Governments will have more debt – especially post-pandemic – while deficits will need to be stabilised, higher taxes will remain unpopular and the public will rely more on public services. Therefore, governments will need to keep delivering more and better services, for less.

It sees these forces creating a worldwide market growing at between 5% and 7% per year in revenue terms with trading margins of between 5% and 6%.

On top of this growth, Covid has brought extra work, some of which may last beyond this year. The firm registered £130 million of additional revenue in the first half, which was partly negated by £50 million of contract cancellations.

It's worth pointing out that this net £80 million of revenue was profit-neutral – meaning the firm didn't benefit from the pandemic at the expense of the taxpayer – yet the overall gross margin on turnover rose from 3.4% to 4.3% as more profitable contracts came through and the firm managed its costs.

STRONG OUTLOOK

As well as an impressive jump in first half earnings, the firm brought in more new orders than revenues - £1.9 billion against £1.82 billion – despite Covid disruption to the sales and bidding process.

The largest contract was £450 million to continue operating the Northern Isles Ferry Service. Two more contracts had a total value above £200 million each, and over 20 awards were worth more than £10 million each.

Roughly 60% of the orders were rebids and extensions of existing work while 40% comprised new business. Encouragingly, the win rate by value for new work was 43% against an historic average of 30%.

The company confirmed the financial guidance it gave in June, with underlying trading profits for 2020 at similar levels to pre-pandemic expectations. It admitted that Covid-19 work was by its nature short-term and may not continue much into 2021, but it also highlighted that 90% of its employees are front line workers. Moreover, the crisis has amplified the four forces driving government demand for its services.

There was disappointment among investors that the firm delayed a decision on whether to pay the final 2019 and interim 2020 dividends until after it had repaid its deferred taxes, but Soames was unapologetic, describing it as 'inappropriate' to take government support and then pay out millions to shareholders.

In response to the share price reaction – a 15% fall on the day of the results – Soames was equally forthright, saying 'Those who mind don't matter, those who matter don't mind.'

By **Ian Conway**
Senior Reporter

Investment trusts pull lockdown borrowing levers

Big jump in gearing in UK-only sector at odds with approach taken by global trusts

Investors are understandably preoccupied with the ongoing Covid-19 pandemic and what a potential second wave and lockdown return might mean for the economy and individual savings and investments.

On 6 August the Bank of England said the economic shock triggered by the coronavirus crisis will be less than initially feared but the bounce-back will take longer and inflict lasting damage on jobs and growth.

The Bank's governor, Andrew Bailey, now expects UK GDP to decline 9.5% in 2020, and while this was an improvement on the 14% economic shock anticipated at the end of May, the UK economy may continue to struggle for pre-pandemic growth rates until 2023.

But while investors might have expected to asset managers to put on their tin hats, UK-focused investment trusts have substantially increased borrowings during lockdown in the hope of picking up stocks on discounted valuations.

Fidelity Special Values (FSV), run by the popular Alex Wright, and **Mercantile Investment Trust (MRC)** are among a number of trusts in the Association of Investment Companies' (AIC) All UK Companies sector to have pulled gearing levers to take on extra borrowings since the outbreak sparked a plunge in global stocks in February.

HOW TRUSTS BORROWING HAS CHANGED THROUGH 2020

	UK All Companies average gearing	Global average gearing
31 Dec 2019	4%	8%
31 Jan 2020	5%	8%
28 Feb 2020	8%	8%
31 March 2020	9%	9%
31 April 2020	9%	8%
31 May 2020	8%	7%
30 June 2020	11%	7%
7 August 2020	11%	6%

Source: AIC

BIG JUMP IN UK GEARING

Average gearing across the AIC's All UK Companies sector jumped by more than a third between the end of February and 7 August, rising from 8% to 11%. The sector average at the end of 2019 was 4%.

This is in stark contrast to investment trusts with a global remit, where managers have been reeling back on borrowings since March. This can partly be explained by the UK's relatively sluggish stock market recovery compared to the S&P 500 in the US, where AIC Global sector investment trusts typically have the majority of their assets.

The FTSE 100 remains 18% down on its pre-pandemic levels, compared to the S&P 500, which has now recovered all of its Covid losses.

Gearing undeniably increases risk for investors because borrowings will exacerbate overall asset and share price performance.

'Gearing is a unique feature that investment trusts have in their toolkit, and they should use it,' said analyst William Heathcoat Amory at investment trust researcher Kepler.

But all leverage isn't equal. Some use fixed rate borrowing, others prefer more flexible arrangements. 'We call fixed rate borrowing structural gearing,' said Heathcoat Amory. The advantage is that interest rates stay the same and so repayments can be managed more easily, versus the risk that you end up with expensive debt if interest rates fall, as has happened in recent years.

More flexible, or 'tactical gearing' has been favoured by **Henderson EuroTrust (HNE)**, which is very focused on opportunistic stock valuation-driven ideas. Manager Jamie Ross typically runs the portfolio of a 'one in, one out,' rule says the Kepler analyst, and gearing can be used to buy new stocks even when he is reluctant to sell a current holding.

HORSES FOR COURSES

Alternatively, **Dunedin Income Growth (DIG)** uses a hybrid approach, typically tapping longer-term and lower-cost structural gearing, with the additional flexibility to employ flexible gearing on to this.

'The managers are reluctant to apply tactical gearing unless they deem there to be particularly compelling opportunities to do so,' said Kepler's Heathcoat Amory. 'The recent market sell-off provided just such an opportunity to increase exposure to high-quality names, which they believed to have seen unwarranted reductions in their share price relative to their ongoing prospects and operational performance.'

'The style in which trusts employ gearing should ideally match the style in which managers invest,' he said. 'We believe managers who are more valuation-agnostic might be best suited to structural gearing. On the other hand, managers who invest with strong price discipline, in both buying and selling, might suit a more tactical use of gearing.'

UK ALL COMPANIES

	Share price performance*	Gearing, 7 August
Mercantile Investment Trust	-29.7%	17%
Invesco Perpetual Select UK Equity	-24.5%	13%
Fidelity Special Values	-33.0%	12%
Keystone Investment Trust	-25.4%	12%
JP Morgan Mid Cap Investment Trust	-36.3%	9%
Henderson Opportunities Trust	-20.0%	8%
Artemis Alpha Trust	-20.4%	0%
Aurora Investment Trust	-36.5%	0%
Baillie Gifford UK Growth	-12.3%	0%
Independent Investment Trust	-23.4%	0%
Jupiter UK Growth Investment Trust	-38.2%	0%
Schroder UK Mid Cap	-33.5%	0%

Source: AIC, FE Analytics *since 21 February 2020

AIC GLOBAL SECTOR

	Share price performance*	Gearing, 7 August
Majedie Investments	-21.1%	12%
Witan Investment Trust	-19.0%	11%
AVI Global Trust	-6.7%	10%
F&C Investment Trust	-11.6%	9%
Brunner Investment Trust	-18.5%	9%
Scottish Mortgage Investment Trust	41.1%	7%
Alliance Trust	-7.2%	4%
Monks Investment Trust	11.3%	4%
Martin Currie Global Portfolio Trust	-0.9%	1%
The Bankers Investment Trust	-1.4%	0%
EP Global Opportunities Trust	-9.8%	0%
JP Morgan Elect	-14.2%	0%
Lindsell Train Investment Trust	8.8%	0%
Manchester & London Investment Trust	4.9%	0%
Mid Wynd International Investment Trust	4.1%	0%
Scottish Investment Trust	-7.2%	0%

Source: AIC, FE Analytics *since 21 February 2020

By **Steven Frazer**
News Editor

Accessing small caps through ETFs

The potential upsides and drawbacks to a passive approach to smaller company investing

Exchange-traded funds (ETFs) are often associated with the largest, most liquid stocks in the market, but in fact you can use them to gain exposure to small companies too.

But why would you want to hold them through ETFs, what are the risks, and what are your options when it comes to choosing a fund?

Looking at all the London-listed ETFs with at least 50% of their portfolios in small caps, you can see a mix of geographies and indices, as well as growth and value styles.

HOW IS A SMALL CAP DEFINED?

How a small cap company is defined will vary depending on where in the world you are looking.

In the US, for example, companies tend to be bigger, so the definition of what constitutes a small company will be much larger than its UK equivalent.

One of the issues with using ETFs to invest in small caps is that the indices are market cap-weighted, which means the total market value of a company's shares determines its weighting within the index, and therefore how big its position in your ETF portfolio.

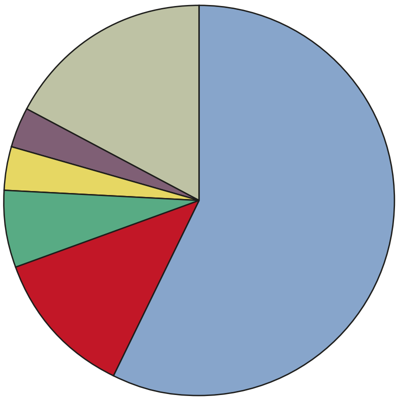
Because of this, you can become quite concentrated in certain markets and sectors. The MSCI World Small Cap index, for example, has 57% in the US, 12% in Japan and 6% in the UK, and has a lot of retailers and banks, plus more than 20% exposure to real estate, which you might not want in the current environment.

AVOIDING THE FROTH

Market weighting means you could also end up with a lot of fashionable stocks that have been bid up to high levels, warns Rob Burgeman, divisional director, investment management at Brewin Dolphin. 'In some ways it's risker to invest in small caps through ETFs because it's a blunt tool – weightings are entirely based on market cap so you'll naturally gravitate towards larger companies and you lose the ability to cherry pick,' he says.

He pointed to soft drinks maker **Fevertree (FEVR:AIM)** – for a while it was everyone's favourite small cap stock, going from around £4 a share in 2015

US dominates global small cap index



Source: MSCI

to £39 in 2018 before falling back down to £9 again.

'It would have been a major constituent of small cap indices at that peak,' explains Burgeman. 'If a stock gets a bit faddy and carried away with itself, its weighting goes up and then you are going to fully participate in the downside.'

Does that mean it's better to invest in small caps through an active fund where managers can be more choosy and avoid the froth? 'Small cap is a space that lends itself to active management. However, it's also true to say that there are a lot of active managers who haven't demonstrated that they've added a lot of value in small caps,' notes Burgeman.

REAL COST SAVINGS?

A major argument for going down the passive route is that you can invest at a low cost. However, fund charges in small cap ETFs tend to be higher because the cost of dealing in those markets is higher, and sometimes there isn't a huge gulf between their ongoing charges figure (OCF) and those on active funds.

If there is not a big price difference, it could be worth choosing an active manager 'for the intellectual capital of somebody actually checking these companies and picking the ones they think are the best ones,' advises Burgeman. 'ETFs are not always as cheap as you think they are.'

For example, the $1 million **First Trust US Small Cap Core AlphaDEX ETF (FYX)** charges 0.75% and has returned 3.4% over the last three years. For the same level of fee, you could buy the smaller companies-focused **Edinburgh Worldwide Investment Trust (EWI)**, which has 60% of its portfolio in the US and has delivered a return 114% over the same period. Or, if you wanted a more comparable fund, **Artemis US Smaller Companies (BMMV576)** charges a little more at 0.89% and has returned 52% over three years.

DO YOUR HOMEWORK

So what should you look for when choosing a small-cap ETF? It's important to know what the index that the ETF tracks actually does, says Ben Seager-Scott, head of multi-asset funds at Tilney Group. 'Research into the index is often overlooked in ETFs, some people think look at the name and that tells you all you need to know,' he says.

'Go online, look at the index methodology, see what they consider to be large and small companies because some can be considerably smaller than the others. Look at the makeup by region and sector, compare and contrast and make sure you understand what you are buying.'

If you wanted to invest in, say, US small companies, there are a handful of options available. Here is a quick comparison of two London-listed ones.

Invesco Russell 2000 ETF (RTYS)	iShares MSCI USA Small Cap ETF (CUSS)
Benchmark is the Russell 2000 (the 2,000 smallest companies in the Russell 3000 index)	Benchmark is the MSCI USA Small Cap index (has 1,728 companies)
Constituents include Deckers Outdoor Corp, Novavax and Eastgroup Properties	Constituents include Etsy, Zendesk and HubSpot
$39 million in assets	$479 million in assets
OCF 0.45%	OCF 0.45%

Source: iShares, Invesco, Shares

If you instead chose a global small cap ETF such as the iShares MSCI World Small Cap ETF, you'd have 57% exposure to the US, with smaller positions in other developed markets.

Of course, you are not restricted to either active or passive when looking for exposure to smaller companies. Seager-Scott suggests buying a mid cap ETF and combining it with a small and micro cap active fund to get a broader spread of companies while still benefiting from the size factor.

By **Hannah Smith**

How can I get my pension under control?

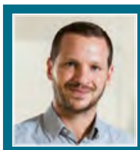
Our resident expert helps with a question on consolidating retirement savings

I started paying into a pension in my 20s when I worked for a phone company. I left after about a decade to join the civil service and am a member of its pension scheme, which I understand is generous.

However, when I was younger I just paid in the minimum as I was prioritising other things like paying the mortgage, house maintenance, cars and the kids. Pensions were a bit of a blind spot to be honest!

I'd like to know how to find my pensions, and how to bring them all together. I would also like to work out when I can retire and what I will need to have.

Ryan



Tom Selby
AJ Bell
Senior Analyst says:

You're being far too hard on yourself Ryan! Lots of people will have failed to save anything at all in a pension in their 20s (particularly before auto-enrolment was introduced), so the fact you did something – even if your contributions were relatively small – is a great starting point.

Furthermore, the Civil Service Pension Scheme you are now a member of will provide a very generous 'defined benefit' pension based on the number of years you are employed there and your average salary during that period.

Bringing your old pensions together is a sensible idea, partly because it may allow you to lower charges and partly because it will be easier for you to manage.

To help with a search for old pensions you can go here assuming you have the name of your provider or employer.

Assuming these are 'defined contribution' pensions – where you build up a pot of money which you can access from age 55 – combining them with a single provider should be straightforward.

You'll just need to choose a provider you want to consolidate your pensions with and get the details of the pension you want to transfer over. Once you've provided the relevant details to your new provider they should do all the legwork for you.

Before transferring any old pensions you should check there aren't any valuable benefits attached which you may lose, or exit charges that will be applied. Your provider should be able to tell you if this is the case.

HOW MUCH SHOULD YOU BE SAVING?

A very rough rule of thumb for people saving in a defined contribution pension is to aim to contribute around half the age you started saving as a percentage of your total salary each year.

If this sounds unmanageable, don't worry – any money saved in a pension will be a sound investment in your financial future.

Because your current employer operates a defined benefit scheme you will simply need to contribute a set percentage of your salary in order to build up or 'accrue' pension benefits in the scheme. Your employer will be able to tell you how much you need to pay in and what you will accrue.

For example, take someone who accrues a 60th of their average salary for every year they are a member of the scheme.

If they are a member for 30 years and had an average salary of £30,000, this would provide a guaranteed, inflation-protected income worth £15,000 a year from their scheme's 'normal pension age'. This would be in addition to the state pension, which currently pays just over £9,000 a year.

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 information 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.

Born in the 80s? You're set for the biggest inheritance yet

We flag some tips for limiting the tax bill when leaving money for your loved ones

People are expected to inherit increasing sums as their parents have more wealth and they have fewer siblings, new research shows.

And with more Millennials in line for a big windfall we use this article to look at ways of reducing the tax bill associated with an inheritance.

GOOD NEWS FOR CHILDREN OF THE 1980s

Data from the Institute for Fiscal Studies shows that people born in the 1980s will on average inherit more than those born in the 1960s.

For example, it found that the parents of people born in the Eighties have average household wealth of £370,000, compared to £250,000 for parents of those born in the Seventies, when they were at the same age.

What is more, as people are having fewer children there are fewer people to split this inheritance between – as usually the bulk of someone's wealth gets filtered down to their children or grandchildren, although not always.

This means that on average someone born in the 1980s is expected to inherit £136,000 on average, compared to £66,000 for people born in the 60s.

However, it may well be that because parents of those born in the 80s have more money they are inclined to spend more of it during their lifetime, and so leave less for their children.

With people set to inherit more, how can parents reduce their inheritance tax bill?

LONGER TO WAIT

While there is more money for the 80s generation to inherit, they will get that later in life as we're all living longer. The IFS found that the average age of someone born in the 1960s when their last parent dies is 58, compared to 64 for those born in the 80s.

Many people will receive the bulk of their inheritance when their last parent dies, although some will get it throughout their lifetime.

Make use of gifts: Everyone has a set of allowances they can use each year to remove money from their estate for inheritance tax purposes. You can give away up to £3,000 a year per person, so £6,000 for a couple, and you can use any unused allowance from last year.

On top of this you can gift £250 per person – and do this as many times as you want. You can also gift money out of your income – and so long as you can show it hasn't affected your lifestyle can be unlimited. There are also other gifts for certain occasions, like weddings, gifts to charities and paying to help with an elderly relative or minor's living costs.

Don't get caught in the residence small print: Everyone now gets an additional inheritance tax-free allowance if they leave a property as part of their estate. In the current tax year this is £175,000 and is on top of the usual £325,000 nil rate band for inheritance tax.

It means an individual leaving a home can leave an estate worth £500,000 entirely inheritance tax free, or £1m for a couple. But, you only get the extra home allowance if you leave the money to certain people, classed as 'direct descendants'.

So this is children, grand-children or step versions of those. If you plan to leave money to people outside of those individuals you should structure your estate carefully. For example, let's assume someone had a £500,000 estate made up of £250,000 in investments and a £250,000 property.

If they wanted to split the estate between their daughter and their niece, they should leave the property to their daughter, meaning it qualifies for the residence nil rate band, and the investments and savings to their niece.

By doing it this way there would be no inheritance tax due, whereas if they left the property to the niece they wouldn't get the additional £175,000 allowance and so there would be an IHT bill due on the estate.

Don't needlessly take money out of your pension: Pensions are now very tax efficient when it comes to inheritance tax. Any money left in a pension is not considered as part of your estate for inheritance tax purposes. This means that if you don't plan to spend the money you should leave it in your pension for as long as possible.

Everyone can take 25% of their pension pot free from income tax, meaning that many people think they should automatically take this sum when they retire. However, once you've withdrawn this money it sits outside your pension and so would be counted as part of your estate for inheritance tax purposes. If you don't need access to it right away then you could be better leaving it in your pension until you do.

Invest in small companies: Investments in companies listed on the AIM stock market are exempt from inheritance tax so long as certain criteria are met.

If you've got a large estate and are willing to take more risk with your investment portfolio, this can be a way of sheltering some money from IHT.

In a nutshell, if you invest money in AIM shares that meet certain criteria set by the taxman for at least two years, that money can be passed on upon your death without that windfall cash being subject to IHT. Though to avoid putting money in shares which don't qualify this may be best left to specialists which will pick the investments for you.

Leave money to charity: Any money you leave to charity is free from inheritance tax, but if you leave enough to charity you can reduce your remaining IHT bill.

If you leave 10% of your estate to charity you will only have to pay 36% IHT on the remainder of your estate above your nil rate bands, rather than the usual 40%.

Inheritance expectations by decade

Decade of birth	Percentage of people who expect to receive an inheritance	Percentage of parents who expect to bequeath an inheritance
1960s	72%	75%
1970s	80%	83%
1980s	81%	90%

Source: IFS

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

How do I buy a share?

We explain the mechanics of making a stock transaction

You have decided you are comfortable with the risks involved in investing in shares and are ready to begin constructing your portfolio. So what are the actual mechanics of buying a share?

First you will need to open an investment account, a stocks and shares ISA or a SIPP (self-invested personal pension) with an online investment platform or a traditional stockbroker that still works face-to-face or over the phone.

Before the world went digital, you would receive a paper share certificate to prove part-ownership of a particular company, but these days most shares are held on what is known as a 'nominee' basis.

This means the investment service you have an account with will hold them digitally on your behalf, although you still own them; it just makes the process of investing in shares simpler and means you can trade almost instantly.

OPENING AN ACCOUNT

To open an investment account, you will need to provide your name, address and National Insurance (NI) number and then pass an identity check.

A lot of brokers don't provide advice, leaving the novice to make their own investment decisions. These are often called self-directed or execution-only services

PAMELA PLACES AN ORDER

Pamela is a 29 year old graphic designer who has followed the markets from afar, but never felt confident enough to take the plunge, until now. She has finally opened a stocks and shares ISA with an investment platform, which will levy an annual shares custody charge of 0.25% of the value of the shares in her account and charge Pamela £9.95 per share deal.

She has carried out thorough research on a few companies she would like to invest in by using information provided by the platform, including the companies' financial and dividend histories. She also cross-referenced key bits of information on financial websites including Morningstar and *Shares*' own website.

Dealing online, she gives her broker an 'Order', an instruction to buy the share she had selected. Pamela was offered a price she felt comfortable with and could afford, clicked a button to 'deal now' and shortly afterwards, receive a contract note.

Before dealing, Pamela had double checked there were sufficient funds in her online account to cover the cost of the transaction, including the applicable brokerage fees.

and tend to offer the simplest, cheapest way to buy shares.

Typically, you will pay a one-off charge for buying and selling shares. If this is a fixed amount (say £10), it becomes more economical on larger share purchases. Alternatively, some brokers charge a percentage of the assets that you hold on their particular platform.

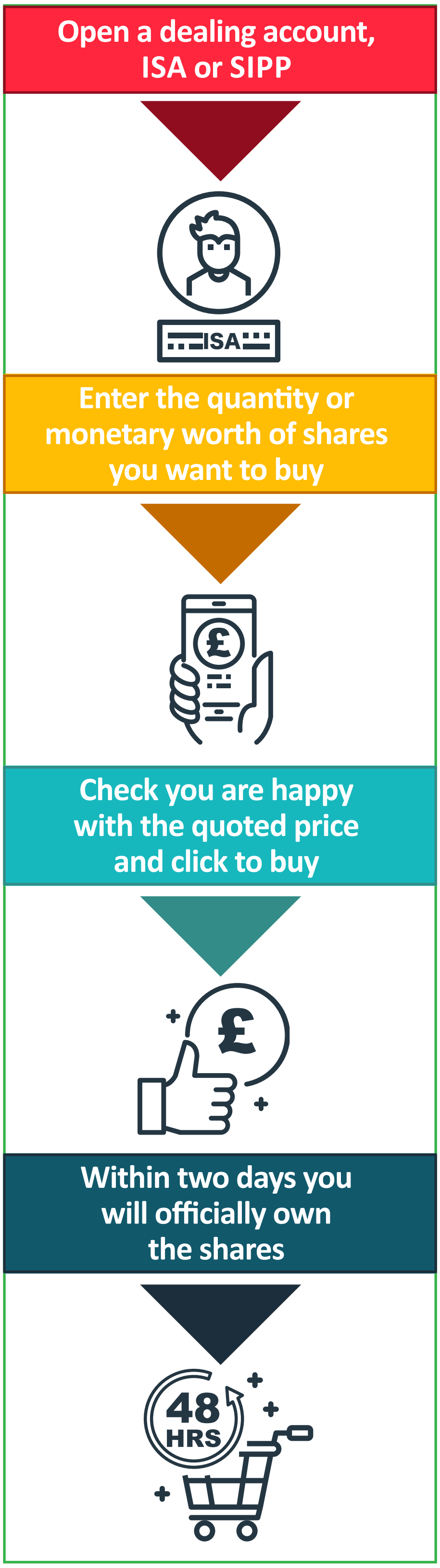
To buy a share, you either enter the number of shares you want or the monetary amount you would like to spend. The latter option will figure out how many shares you can buy at the current price. You should be able to specify whether you want dealing charges included or excluded as part of this figure.

There is no recommended amount of shares you should buy in a company, although you should bear in mind the dealing costs you can incur. It would not make sense to buy one share costing 500p, for example, as you could pay twice that amount as a transaction fee.

BID OFFER SPREAD & BUYING WITH A DELAY

Novice investors should also familiarise themselves with the distinction between the bid and offer price. The former is the price you'll achieve if you sell (i.e. what you will be bid for your shares), the latter represents the purchase price (i.e. the price that you will be offered).

If you are unsure about the price you are paying for a share, you can set a limit order, which is essentially a price point at which you would be happy to buy stock. For example, if Company Y is currently priced at 100p and you wanted to buy at a cheaper price, you can specify 90p as your limit. Should the shares hit this price, an instruction is automatically sent to buy the stock at the best available price.



There is a catch as limit orders are often only valid for a short period, such as up to 90 days, so you may need to put through another order if it does not go through during this period. Once you have entered all the information on a normal trade, you will be presented with a countdown. This is a quote for a price that is only guaranteed for 15 seconds due to the fast-moving nature of the market.

If the quote expires, you need to request another, which could be higher or lower than the previous price offered. After you have entered your order, the money and shares need to be exchanged in the marketplace through a process known as 'settlement', which takes two working days for standard shares.

The date you enter your order is known as the 'trade date', and the date that the money and shares change hands is known as 'settlement date'; the difference between these dates is often known as the 'settlement cycle'.

You will often see abbreviations such as 'T+1' and 'T+2' used – this refers to the days between trade and settlement date (for example, T+1 means the trade will settle on the first working day after trade date). On settlement date, you will become the beneficial owner of the shares. This is also the day that you become a shareholder of record and therefore entitled to any dividends.

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

Managing your pension in your 40s

Why its never too late to start investing for your retirement

When it comes to saving for retirement many of us bury our heads in the sand and it is easy to leave it so long that you fall into the trap of feeling it is too late to start.

However, this is not the case and in the second part of this series, we looks at some of the key things savers in their 40s should be thinking about as they build their retirement pot.

IT'S NEVER TOO LATE TO START

Although ideally you would have already started saving in a pension by your 40s, this won't be the case for everyone.

In fact, in many ways people in their 40s are most at risk of falling short of their retirement aspirations, having by-and-large missed out on the glory years of generous guaranteed defined benefit pensions (unless you work in the public sector of course) and with less time to benefit from 'automatic enrolment' reforms which now require employers to offer workplace pensions to staff.

Nonetheless, if you are employed your workplace pension is still the first place to start when saving for retirement. At a minimum your personal auto-enrolment contribution will be 4% of 'relevant earnings', with your employer matching up to 3% and a further 1% coming via pension tax relief. For 2020/21 'relevant earnings' include all salary between £6,240 and £50,000.

Bear in mind that if you opt-out of your auto-enrolment scheme you'll effectively be refusing free money, so make sure you stay in if you can afford to.

One very rough retirement rule of thumb is to aim to set aside half the age at which you started saving as a percentage of your salary each year. For example, if you're 40 this would mean you need to save 20% of your salary.

Such a level might be beyond your means, but the principle should be to put as much as you can into your retirement savings.

DON'T PANIC

If you are in your 40s and haven't started saving for retirement yet, don't panic – you are not alone. Lots of people at this stage of life will have spent most of their 20s and 30s saving for a house or raising young children.

Furthermore, millions of people – including low earning employees and the self-employed – are not included in the auto-enrolment. If you consider the self-employed – representing around 5 million workers at the last count – roughly one-in-seven are saving in a pension at the moment.

Remember that even if you don't qualify for a matched employer contribution through auto-enrolment, pension tax relief still provides a strong incentive to save for retirement.

This will automatically convert an £80 contribution into a £100 in a pension, while higher and additional-rate taxpayers can claim back extra tax relief from HMRC. Some workplace schemes – such as salary sacrifice pension arrangements and 'net-pay' schemes – will pay this tax relief automatically provided your contribution comes from salary taxed at 20% or higher.

Because of this generous tax treatment, annual pension contributions are capped at £40,000 for most people (or 100% of your UK relevant earnings if this is less than £40,000).

Furthermore, 25% of your fund will be available tax-free from age 55 (this is due to rise to 57 by 2028) and you'll also have total flexibility over how you take an income from this point onwards.

A nest egg for your kids

For lots of savers in their 40s the focus isn't just on their own savings but building a pot of money tax efficiently for their children as well.

Your kids may be moving through the school system with the task of providing for higher education getting closer. There are two 'junior' versions of traditional savings wrappers you can consider.

You can save up to £2,880 on your child's behalf in a Junior SIPP and it will be topped up automatically via pension tax relief to £3,600. The mechanics of tax relief are exactly the same as for an adult saver, just with a lower annual contribution limit.

In all other ways a Junior SIPP works in exactly the same way as a regular SIPP, with 25% of the pot available tax-free from age 55 (due to rise to age 57 in 2028) and the rest taxed in the same way as income.

The other main option is a Junior ISA. Junior ISAs received a significant boost at the latest Budget, with the annual allowance more than doubling from £4,368 to £9,000. Once your child reaches age 18 their Junior ISA will convert into an adult ISA and they will be able to access the money-tax-free.

MAKE A PLAN (IF YOU HAVEN'T ALREADY)

For most people in their 40s there will be a number of competing financial priorities. For example, many will have their sights set on paying off debts, saving for a first home or building a pot of money for their children's further education.

Try and block out a wet Sunday afternoon when you can write down your outgoings and incomings. This is a good start in terms of understanding what you truly can afford to set aside for later life. Even if you're concerned you've already left it a little late, don't let that be an obstacle to starting now, the earlier the better.

If you haven't already, it also makes sense to build up a decent-sized 'rainy day' fund in an easy access cash account you can access quickly in case of emergency. Aiming to have around three months' fixed expenses in this emergency account is a good place to start, and make sure you shop around for the best interest rate you can find.

THE RIGHT INVESTMENT STRATEGY

Getting the right investment strategy in place is a crucial part of retirement planning. This will be determined by a number of things, including your attitude to risk and investment time horizon.

If you're in your 40s, in most cases you won't be planning to access your retirement pot for 20 or even 30 years. This is a lengthy time horizon in anybody's book, and should provide scope to take some investment risk.

Your employer picks your auto-enrolment pension for you. The 'default' investment fund, assuming you do nothing, benefits from a cap on charges currently set at 0.75%. This fund will not aimed at the broad scheme membership rather than being tailored to your risk appetite and needs.

If you're choosing your own investments in a product like a SIPP, once you've established the level of risk you're happy with it is crucial to keep your costs as low as possible.

Over times costs can really eat into the value of your pension, particularly when you are dealing with a time frame which runs into decades.

In terms of cost, active funds tend to have higher charges than passive (although active managers say this charge is justified because they have the skill to deliver higher returns).

It's also important to ensure your investments are spread or 'diversified' around different sectors and countries so you don't have all your eggs in one basket. If you aren't confident in doing this yourself, you can pay a fund manager to do it for you.

When the more complex parts of the retirement system could become a factor

For a relatively small section of the population, the more complicated parts of the pension system – namely the lifetime allowance and tapered annual allowance – could creep into play as they reach their late 40s.

The lifetime allowance is a cap on the amount you can save in a pension over the course of your life and is set at £1,073,100 for the 2020/21 tax year. If you go over the lifetime allowance when accessing your pension you will pay a tax charge designed to return the tax relief you have received.

The annual allowance taper is one of the most complicated parts of the pension system.

While most people enjoy a £40,000 pensions annual allowance, those with 'threshold' income above £200,000 and 'adjusted' income above £240,000 have their annual allowance reduced by £1 for every £2 of adjusted income earned above £240,000, to a minimum of £4,000 for those with adjusted income of £312,000 or more.

Note that both income measures include not just salary but other taxable income too. Threshold income also deducts any personal pension contributions, while adjusted income adds employer contributions.

Those with generous defined benefit entitlements, such as senior doctors, have been among those caught by the complexity of the taper. Again, if you breach your allowance the taxman will come for any tax relief you have received over and above your annual allowance.

Having reached the point where you are comfortable and satisfied with the risk profile and individual components of your investment portfolio then you should be able to more or less sit tight until you are somewhere around five or 10 years from retirement. Most of the time the last thing you want to do is trade too often as this will layer on extra costs with no guaranteed benefit.

COMING SOON

Don't miss next week's pensions article, looking at what people in their 50s should do with saving for retirement.

By **Tom Selby**
AJ Bell
Senior Analyst

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KEY

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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

18 August: BHP. **20 August:** Van Elle.

Half year results

14 August: Verona Pharma, Westminster, Yew Grove REIT. **17 August:** BATM Advanced Communications, Horizon Discovery. **18 August:** KAZ Minerals, Marshall Motors, Mears, Persimmon. **20 August:** Capital Drilling, Churchill China.

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