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TECH AND GOLD: IS WARREN BUFFETT STEPPING BACK AT BERKSHIRE HATHAWAY?

THE FTSE 100 FIRMS WHICH HAVE DELIVERED **A DECADE OF NEGATIVE RETURNS**

Mattik | Nice, 2018

Slow and steady wins the race when it comes to Diageo

Pedestrian growth hasn't stopped the drinks giant from serving up tasty rewards for shareholders over the years

Much focus is given by investors to companies which either have the fastest earnings growth, best performing shares, highest quality characteristics or cheapest valuation.

In doing so, they often forget to look at the middle ground which can still contain decent businesses that might be growing at slower speeds, but which are still providing attractive returns to investors over time.

Diageo (DGE) is the perfect example. It is often viewed by investors as a business slogging through mud, finding it harder with every step to grow at the same pace as younger, more vibrant consumer goods companies.

It started 2020 with disappointing news that organic net sales growth would be at the lower end of its 4% to 6% guidance range. The setback was blamed on volatility in India, Latin America and the Caribbean as well as its travel retail business.

Diageo has subsequently had to contend with the leisure sector going into reverse during Covid-19 which has affected its sales to pubs, restaurants, hotels and venues (the 'on-trade'), not forgetting further pain for its travel retail operations.

Yet its latest trading update would suggest resilience, reflected in good US trading and investments in the spirits sector paying off. The at-home drinking market in various parts of the world remains robust and Diageo says the on-trade market is starting to recover.

Investors taking a long-term view of the business should be reassured by the update and the £27 share price looks a good opportunity to buy into a business with a rich portfolio of brands.

In January Diageo was trading around £33 so the stock has since fallen by more than a fifth in value.

Some of that valuation change is justified by the sales growth being knocked off course. Analyst forecasts imply the FTSE 100 company now won't surpass pre-pandemic revenue levels until its financial year ending June 2023.

However, investing is about taking a long-term view of a company's capabilities, not what it might do in the short-term. Diageo is big in spirits and that market has an attractive growth outlook.

Talking to Morningstar recently, Lindsell Train fund manager Nick Train said: 'Diageo is the best collection of alcoholic beverage brands in one company that exists anywhere in the world.

'Diageo shares today are down something like a quarter from their peak. That's an incredible opportunity to invest in brands of the calibre of Guinness, Johnnie Walker or Tanqueray, because those brands are going to be around not just next year, but in fact, probably in 50 years.

'And that's sort of permanence and durability, that's how you protect wealth and you continue to get rich steadily.'

Slow and steady can be better than fast and furious, particularly if a company is generating strong cash flows that can be reinvested back into the business to keep it competitive.

Diageo has delivered 11.5% annualised total return over the past 10 years, according to SharePad. That's not only better than the 5.1% annualised total return from the FTSE All-Share on the same timeframe, but also beating the S&P 500's 11.1%. A good whisky should be savoured and not gulped down for instant gratification. Much the same as Diageo as an investment.

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Stakebuilders swoop on troubled firms including Sainsbury's and HSBC

Big investors are buying stakes in well-known names at seemingly discounted prices

Various well-known stock market names with distressed share prices have attracted interest from third parties, potentially as a precursor to pushing for a change in strategy or making a takeover approach.

Stakebuilding is a popular tactic used by large shareholders before making an offer for the company. It also reduces risks if there is a bidding war and the share price rises, as the shareholder building a stake can sell at a profit if they aren't successful with a takeover.

On the flipside, there is also concern that it can deter rival bidders and potentially deprive investors of higher offers.

Shares in banking giant **HSBC (HSBA)** surged at the start of this week after Chinese insurer Ping An upped its stake in the business to 8%, from 7.95% previously.

HSBC shares hit a 25-year low in September as concerns grew over the bank's vulnerability to any fallout from worsening geopolitical tensions between China and the US, while it has also struggled with significantly reduced profitability amid low interest rates and more quantitative easing by central banks.

Supermarket **Sainsbury's (SBRY)** saw a smaller share price bounce on news that investment vehicle Vesa Equity has acquired a 3% stake in the business.

Vesa, which has also built a 13.1% stake in **Royal Mail (RMG)**, is now the fourth-largest shareholder in Sainsbury's after taking a £125 million bet on the shares. In a statement Vesa called the business 'an attractive investment opportunity for the long-run'.

Value investor Pzena has also appeared on Sainsbury's shareholder register, disclosing a 5% stake taken in August. Sainsbury's shares are trading at depressed levels as it battles with a lack of consistent growth.

Property developer **British Land (BLND)** has been the subject of takeover speculation after Canadian investor Brookfield Asset Management increased its stake in the firm to 9.2%, up from 7.3% previously.

Mainly owning Central London office blocks and regional retail property, two property sectors seemingly hit hardest by the coronavirus pandemic, British Land shares have almost halved year-to-date. The company now has a £3.2 billion market cap, but the value of its property portfolio stands at £11.2 billion.

Brookfield has previous form when it comes to making offers for distressed landlords. It was involved in a bid to take shopping centre owner Intu private in 2018 but ditched the proposal amid uncertainty over the outlook for the retail sector.

Fellow property firm **Great Portland Estates (GPOR)**, which also owns Central London offices, has been in the sights of opportunistic investors too with private equity firm KKR snapping up a 5.4% stake in late September.

There's also talk Kuwait's sovereign wealth fund is looking to buy a stake in struggling aircraft engine-maker **Rolls-Royce (RR.)** as part of its £2.5 billion cash call.

Greggs shares at two-year low as sales boost fails to convince

Investors remain uncertain about the retailer's near-term prospects

An improvement in trading during September wasn't enough to convince the market that **Greggs (GRG)** can recover quickly from the pressures of Covid-19. Its shares fell 3% on 29 September, leaving them languishing at a two-year low.

The retailer is adding back items to its menu after only selling a limited range during the crisis. It is also pressing ahead with plans to open new stores. To save money and avoid widespread job losses Greggs is thinking about cutting the opening hours for its stores.

The risk of more localised lockdowns, and even the potential for another nationwide one, is a major obstacle for Greggs' recovery plans. It could see reduced footfall to its stores and put an end to recent positive sales momentum.

Greggs says delivery orders now account for 2.6% of company-managed shop sales. Even if delivery orders trebled it may not be enough to offset the loss of in-store earnings in a tougher lockdown environment.

Shore Capital analyst Clive Black says: 'Greggs, through no fault of its own, has had its world turned upside down.' He says the ongoing lack of earnings guidance from Greggs means it is impossible for him to issue any forecasts.

'We believe it may not be until (calendar year) 2023 before the Group can return to a) CY2019 earnings levels and b) maybe even later still for prior medium-term pre-coronavirus forecasts to be reached, noting the material slowdown in store openings,' adds the analyst.

Novacyt starts to live up to the hype as contracts roll in

Unlike some examples there is validity to pandemic-linked excitement at this diagnostics specialist

WHENEVER A BUSINESS announces anything linked to a treatment, vaccine or test for Covid-19 their shares go ballistic, and there appears to be substance behind global diagnostics play **Novacyt's (NCYT:AIM)** progress in this area.

The company enjoyed strong gains on 29 September with the shares reaching a record high of 585p after it announced a second major contract to supply the UK Department of Health and Social Care (DHSC) with its Covid-19 testing equipment.

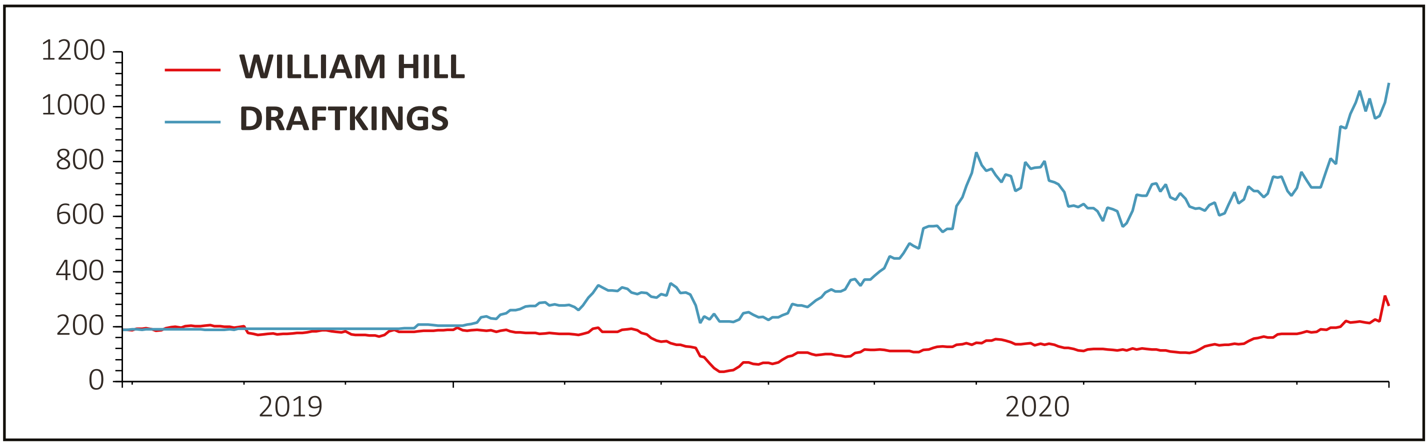
In the first phase of the deal Novacyt's wholly-owned subsidiary Primerdesign will supply 300 of its polymerase chain reaction (PCR) instruments for up to six months with an initial minimum contract value of £150 million for the first 14 weeks. Depending on the outcome and demand for the products, a further £100 million could be expected for the subsequent 10 weeks.

The second phase, which is at the discretion of the DHSC, allows for the supply of a further 700 PCR instruments, related kit and support services as well as additional Covid-19 products from the company's portfolio.

The second phase could generate 'considerably more' sales than phase one, says Novacyt. The value of the contracts, which can be delivered from existing capacity, compares with revenue of a little over £60 million in the first half of 2020.

A bidding war looks unlikely for William Hill

The company's attractions lie in a US joint venture which could end if partner Caesars doesn't get its way



Investors went full tilt on 25 September when they pushed **William Hill's (WMH)** shares up 44% to 312p after the company confirmed it had received separate takeover interest from private equity group Apollo and gambling business Caesars Entertainment.

The enthusiasm proved short-lived and on 28 September Caesars tabled a 272p all-cash proposal. The shares sank 12% to 272p, adjusting to Caesar's potential takeout price. A day later William Hill's board recommended a formal offer.

Even if shareholders were to hold out for a higher price the possibility of a bidding war has been effectively quashed by Caesars saying it would terminate its joint venture with William Hill should it be taken over by Apollo.

William Hill owns 80% of the joint venture, which includes a 25-year partnership and a profit share on Caesars' retail sports books.

There is much to play for with Caesars estimating that the enlarged US sports and online gaming group could generate between $600 and $700 million of net revenues in the 2021 fiscal year.

Analysts at Shore Capital believe the 272p per share offer low-balls the potential value of William Hill's share of the US business which they calculate is worth at least 300p based on a long-term market share of 15% with another 100p thrown in for the non-US businesses.

Jefferies analyst James Wheatcroft notes that only the William Hill board have so far given support to the takeover, with no letters of intent from big shareholders which suggest the latter are hoping for a better price.

The potential market opportunity in the US which some analysts put at between $30 billion to $35 billion has not been lost on stateside investors whose recent enthusiasm for gambling stocks can be seen in the five-fold increase in the shares of fantasy sports betting group Draftkings since coming to the market last year.

It now sports a market capitalisation of $19 billion despite only having revenues around $520 million while it is still loss making.

UK gambling stocks have so far missed out on the party, but the arbitrage opportunity is clear and might explain the interest of private equity in William Hill, looking to unlock value through buying the group and then floating the US business separately. But William Hill is in the driving seat and could achieve this outcome itself.

As Shore Capital says: 'For Caesars, a cash purchase, a subsequent merger of US sports and iGaming assets, followed by an eventual demerger of these assets could help unlock significant value.'

Rising costs could cause problems for Boohoo

The scandal-striken fashion retailer is having to spend more money to improve its business, but will customers end up paying?

Extra costs in multiple areas of the business present a headwind for fast-fashion retailer **Boohoo (BOO:AIM)**.

First-half results on 30 September failed to excite the market as better than expected sales growth was overshadowed by guidance for lots of extra spending.

Customers returning fewer clothes helped boost the gross margin but Boohoo is now guiding for return rates to drift back to historic levels. Delivery costs have become more expensive for overseas markets and marketing spend is going up. The retailer will spend more on improving operations and IT.

There are also extra costs relating to actions from the recent review of its supply chain. Boohoo has pledged to improve its governance and be more focused on supply chain compliance, all of which will cost time and money.

These costs will either have to be passed onto shoppers via higher prices or absorbed by Boohoo, potentially to the detriment of its margins.

A key appeal of Boohoo is its relatively low prices so the management team is going to have to weigh up whether the retailer can absorb extra costs to avoid alienating customers or push up prices, which could cause demand to fall.

Shore Capital reiterated its 'sell' rating on Boohoo, despite the current momentum, seeing potential pressure on gross margins and rising central costs following the company's admission that it needs to change its approach to the Leicester textile industry. It added: 'We look for further clarity on potential wider investigations by other authorities before giving the company a clean bill of health.'

Upon publication of its supply review on 25 September, investors were relieved as the probe concluded Boohoo did not deliberately allow poor conditions and low pay to exist within its supply chain.

While the report identified 'significant and clearly unacceptable issues' in the supply chain, it stated that the company had already taken the steps to remedy problems identified in Leicester nearly a year ago.

Boohoo said it pledged to implement recommended improvements outlined in the review and stressed the costs of improved oversight and governance should not affect financial forecasts, although the share price rally was anything but an exoneration of Boohoo.

Alison Levitt QC's damning report uncovered excessive hours, life-threatening conditions and illegally low pay across much of its supply chain.

No-one on the Boohoo board, where co-founder, executive chairman and 12.5% shareholder Mahmud Kamani holds sway, has resigned. That is surprising since the report confirmed that a company heavily dependent on a raft of dirt-cheap suppliers for its business model didn't run a proper supplier-monitoring department, proving that Boohoo has questionable ESG qualities and has work to do to make amends.

This defensive growth fund is very appealing

ICG Enterprise is a great way to access outsized returns from private equity

The 29.2% discount to net asset value at **ICG Enterprise (ICGT)** represents an excellent opportunity to gain targeted exposure to the private equity space.

The trust has typically traded at a discount to reflect its exposure to unlisted assets which do not have a daily market value. However, given its long-term track record and a compelling strategy the current gap between the NAV and share price looks anomalous.

In early 2017 the running of the fund was handed to specialist asset manager **Intermediate Capital Group (ICP)** which has more than €34 billion in assets under management and a footprint in more than 14 countries.

While the overall returns from private equity have been strong, as Intermediate's head of private equity fund investments Oliver Gardey explains, there is quite a big difference in the showing of top tier funds and bottom tier funds.

To reduce levels of risk ICG focuses on buyouts, where an underperforming or undervalued company is bought to be turned around, rather than areas like venture capital or distressed debt where the risk of loss is higher.

There is also an emphasis on mid-market and larger deals in developed markets and, applying the experience gathered over its near 40-year existence, the really top managers.

ICG ENTERPRISE
BUY
(ICGT) 770p
Market cap: **£747.5 million**

Nearly a quarter of ICG's portfolio is in the healthcare and education space

Nearly a quarter of ICG's portfolio is in the healthcare and education space, with a further 16% in consumer goods and services, and 15% equally in industrials and TMT (tech, media and telecoms).

The trust's 'secret sauce', as Gardey describes it, is that it invests directly in some high conviction ideas alongside the private equity managers with whom it places its money.

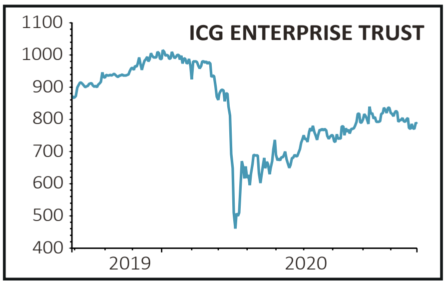
To qualify for investments, companies must be profitable, have a strong competitive position, growth drivers unlinked to the economy, high recurring revenue, high margins, strong cash flow and low customer concentration.

Gardey sums this up as 'defensive growth' and says it encompasses areas like healthcare, business services and software as a service.

In the 12 months to 31 January 2020 the investment portfolio saw returns of 14.6% in sterling terms, with £149 million worth of realisations or sales from the portfolio at an average uplift of 37% to book value.

Covid had an impact but first quarter performance was resilient with net asset value down 4.1% compared with an 18.8% decline in the FTSE All-Share over the same period.

Gardey says the trust has sufficient liquidity to go two years without any realisations from the portfolio, a scenario he suggests is extremely unlikely. The ongoing charge of 1.37% is not exceptionally high given the extra costs and complexity involved in managing a private equity portfolio.



Industry price hikes mean now is the time to buy Smurfit Kappa

Positive supply and demand factors are creating a strong tailwind for the FTSE 100 packaging group

FTSE 100 packaging group **Smurfit Kappa (SKG)** has numerous factors working in its favour which could lead to brokers upgrading their earnings forecasts in the coming weeks.

The shares have yet to reflect the improving fundamentals and trade on an undemanding 13 times next year's earnings while also offering an attractive 3.5% dividend yield, covered three times by earnings. Now is the time to buy.

SMURFIT KAPPA
BUY
(SKG) £29.40

Total assets: £6.9 billion

THREE LEGS TO THE STORY

The picture started to look more positive in August, when two of Smurfit's competitors, SCA and UPM, announced capacity cuts equivalent to around 9% of the European installed base.

Meanwhile Lee & Man, China's second largest containerboard producer, announced it had abandoned plans to add a new 300,000-tonne recycled containerboard machine at one of its plants in China, switching the planned capacity to tissue instead.

This month several leading US packaging companies including International Paper and Packaging Corporation of America announced the first increase in containerboard prices since 2018 with other players expected to follow suit.

The increase is in response to very strong box shipment data which grew 4% over the last three months leading to declining inventories. Along with other European players Smurfit announced plans to increase recycled containerboard prices by €50 per tonne from 1 October.

According to stockbroker Davy, Europe is a net importer of approximately 1 million tonnes of kraftliner, most of which comes from the US, so rising import prices will justify lifting prices in the continent.

BENEFITS TO SMURFIT

If implemented, the better pricing environment could amplify the earnings benefit due to Smurfit's past self-help measures which have reduced costs and increased efficiencies.

A good indicator of the improving state of the business was the 29 July decision to pay a dividend of 80 cents a share after deferring the decision in April.

Despite first-half EBITDA (earnings before interest, tax, depreciation and amortisation) dipping 13% from last year to €735 million, the company generated free cash flow of €238 million in the first-half, which was up almost 50% on the same period last year.

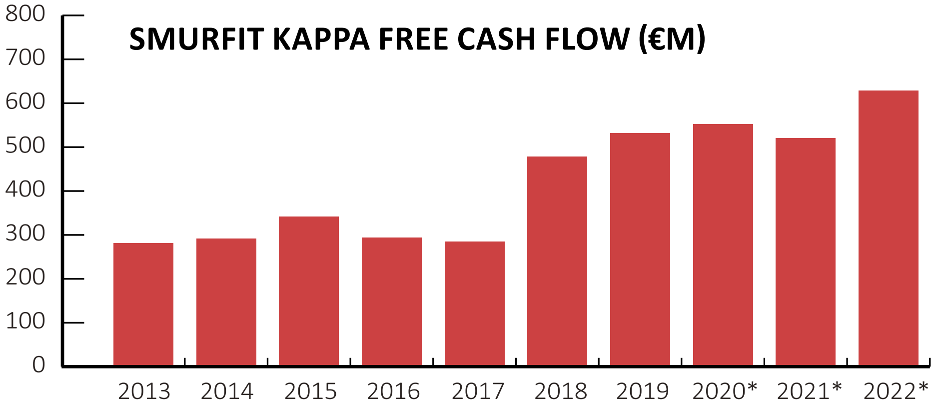
One surprising characteristic given the capital-intensive nature of the packaging industry is that Smurfit has grown free cash flow at a compound annual growth rate of almost 10% since 2007.

STRUCTURAL GROWTH

Smurfit has capacity to manufacture 7.6 million tonnes of papers annually for the packaging industry. It designs, makes and supplies paper-based packaging to package, promote and protect its customers' products.

It is a globally diversified business servicing over 64,000 customers from 350 production sites across 35 countries. The company has a clear strategy to selectively expand its market positions in Europe and the Americas while maintaining a disciplined approach to capital allocation with a strong focus on cash generation.

The firm's scale, expertise and global footprint give it an edge to meet increasing customer demands, such as responding to Ebay UK's request for 5 million boxes to be delivered in 10 days.



Source: 2013-2019 data SharePad, *2020-2022 forecast data Refinitiv

SMURFIT KAPPA EARNINGS PROFILE

	2019	2020	2021
Revenue (€m)	9048	8463	8721
Net profit (€m)	476	515	584

Source: Stockopedia. 2019 = actual figures, 2020/21 = forecast figures

Corrugated paper shipments have grown consistently since 1990 averaging 5.5% a year and are expected to reach $317 billion in value by 2023 according the company.

Future growth will be driven by e-commerce, discount retailers and corrugated as a sustainable, renewable, bio-degradable solution.

ESG CREDENTIALS

Investors concerned about the carbon footprint of packaging companies will be pleased to discover that Smurfit has been publishing sustainability reports for over 13 years and holds a leading position in third party sustainability rankings.

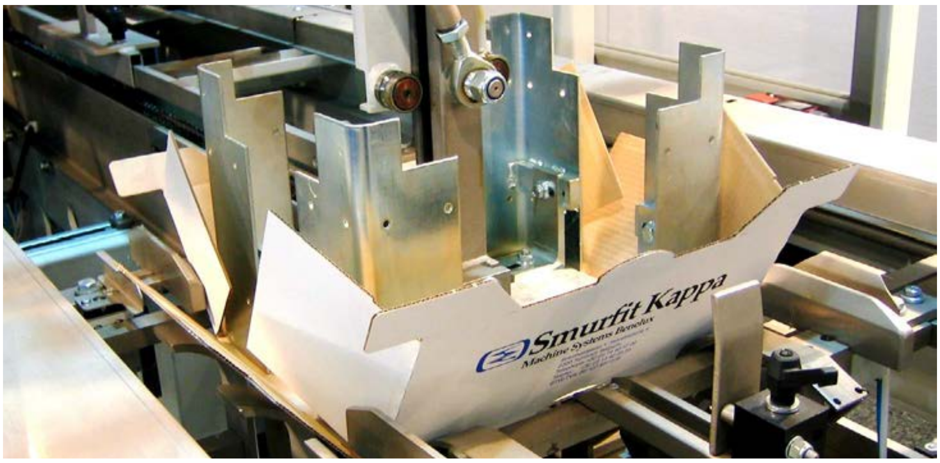
Smurfit helps customers to create efficiencies and reduce their carbon footprint by using sustainable paper resources and eliminating single use plastics.

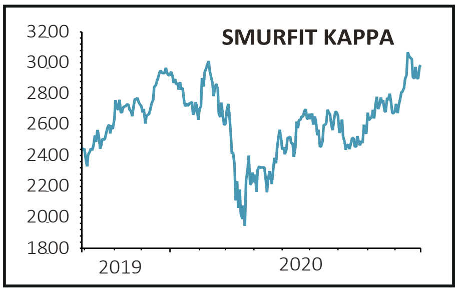
A good example is Bike Fun International which was able reduce the number of its different packaging types by 60%, allowing it to cut waste and double packing speeds to meet increasing demand.

Smurfit notes that 55% of consumers purchase a product because it has reusable or biodegradable packaging and management puts sustainability at the core of the business.

The company replaces the natural resources it uses by recycling over 6 million tonnes of fibre annually and managing 68,000 hectares of forests. The group is listed on the FTSE4Good index as well as the Stoxx Global ESG Leaders register.

Take advantage of the cheap valuation and get ahead of analyst upgrades.





MICROSOFT
(MSFT:NDQ) $209.54

Gain to date: 21.3%
Original entry point:
Buy at $165, 9 April 2020

MICROSOFT IS paying $7.5 billion for video game company ZeniMax, in a move which strengthens its position in the increasingly competitive – and lucrative – cloud gaming sector.

ZeniMax makes online multiplayer franchises which importantly for Microsoft are subscription-based games where users pay a monthly fee to play.

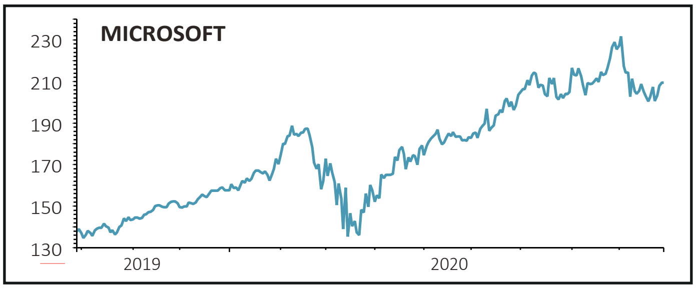
It's estimated such cloud-based gaming models could become more popular than discs and consoles in the next five years, as people subscribe to games instead of buying them and which are played on any device with an internet connection.

Microsoft also foresees gaming very quickly heading towards the direction of film and TV where box office hits and original content drive revenue, making its acquisition of a gaming studio with proven hits look like a very shrewd move.

Gaming made up 7.7% of Microsoft's revenues in 2019 and is an important area for the company. Chief executive Satya Nadella sees gaming as a high growth sector and calls it the 'most expansive category in the entertainment industry'.

Consoles like its Xbox machine have a lifespan of around five to 10 years, which means its gaming sales can dip between the release of new versions.

Adding ZeniMax to the mix and its popular titles like Elder Scrolls and Fallout also means Microsoft can potentially plug the gap in sales over the short-term, while benefitting longer-term from structural change in the sector.



SHARES SAYS:
Keep buying.

HOTEL CHOCOLAT
(HOTC:AIM) 345p

Loss to date: 18.5%
Original entry point:
Buy at 423.5p, 19 December 2019

DESPITE A rebound since March, shares in **Hotel Chocolat (HOTC:AIM)** are still 18.5% below our original entry price.

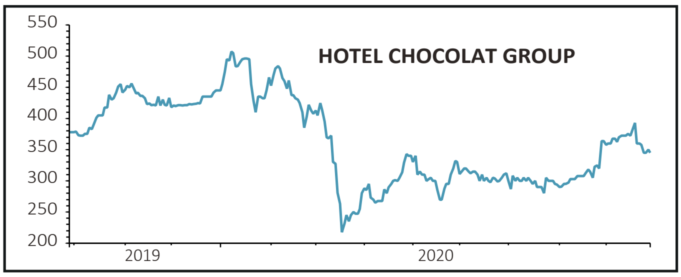
A strong brand with global aspirations and huge online potential, Hotel Chocolat has ample liquidity to navigate through the remainder of the crisis and could be a winner this Christmas as buying a nice box of chocolates via the internet is an easy present idea.

Results for the year to June reflected the disruption to second-half trading caused by the pandemic, which led to the closing of all UK retail locations for 12 weeks including the busy Easter period and an eight-week factory shutdown.

Adjusted pre-tax profit of £2.4 million was better than the £1.8 million forecast by some analysts.

As at 20 September, it had net cash of £16.5 million and liquidity headroom of £51.5 million.

Digital demand is said to be up over 150% over the first 12 weeks of the new financial year and the US and Japan, two of the world's largest gifting markets, 'look to be progressing nicely' according to broker Peel Hunt, 'which is testament to the fact that the brand travels'. The US is experiencing strong digital growth and this should be accelerated by a new e-commerce partnership signed with **The Hut (THG)**.



SHARES SAYS:
We're staying positive on Hotel Chocolat for its global and online growth allure and strong liquidity buffer.

SUPERMARKET INCOME REIT

(SUPR) 107.25p

Gain to date: 2.1%

Original entry point:

Buy at 105p, 2 April 2020

WHILE WE ARE not yet seeing material gains from our positive call on **Supermarket Income REIT (SUPR)** we see plenty of reasons to be encouraged.

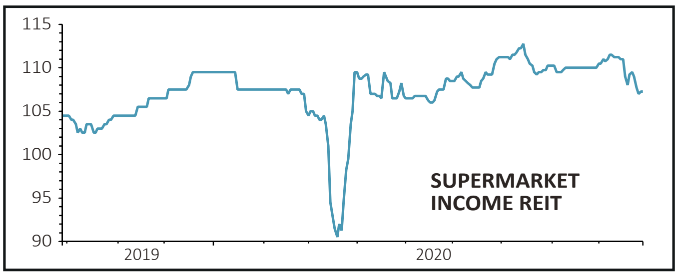
On 17 September the company announced a strong set of results for the 12 months to 30 June – which showed it had collected 100% of rent, delivered a total shareholder return of 11.6% and increased the dividend by 3.8%.

The portfolio's weighting towards 'so-called' omni-channel supermarkets – located in good geographies and with the ability to fulfil online orders and service shoppers in-store – has proved a solid strategy post-Covid.

Ben Green, from the REIT's investment adviser Atrato Capital, notes there has been 'five-to-10 years of expected growth' in online groceries in a matter of months thanks to the pandemic.

He observes: 'You can't do online groceries from centralised automated hubs in the same way as non-food products. Food is perishable and you really need to be within 15 minutes of the customer and omni-channel is well positioned for that.'

The company continues to look to expand, announcing alongside the results a £150 million fundraise to invest in new assets – with property funds having to meet redemptions one source of deals. The target is to get to £1 billion to £1.5 billion in assets from £539.4 million as at the end of June.



SHARES SAYS: ↗
Keep buying.

IG DESIGN

(IGR:AIM) 420.2p

WINNING STOCKS FOR 2020

Loss to date: -39.7%

Original entry point:

Buy at 697p, 19 December 2019

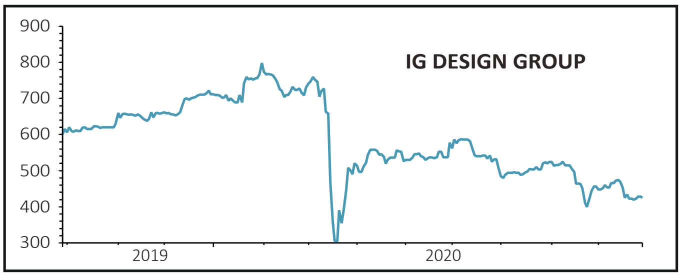
CORONAVIRUS HAS NOT been kind to our bullish stance on greetings card firm **IG Design (IGR:AIM)**.

While initial concerns centred on its supply chain – with some of the group's manufacturing base in China – the pandemic's spread led to increasing concern about demand for the group's products which span everything from gift packaging, greetings cards, stationery and design-led giftware.

A trading update on 21 September at least confirmed the company would hit expectations for the 12 months to 31 March 2021.

Revenue is expected to be up year-on-year – albeit thanks to its £89.7 million acquisition of CSS, a deal which doubled the size of its footprint in the US.

The company also said it had started to deliver on its $500 million pipeline of orders and is building on this pipeline with new orders. Investors can expect more details in a planned update for mid-October.



SHARES SAYS: ↗
We hope the October trading statement can help improve sentiment towards the stock. Stick with the shares for now.

Tech and gold: is Warren Buffett stepping back at Berkshire Hathaway?

Recent investment decisions are against odds with the legendary investor's approach

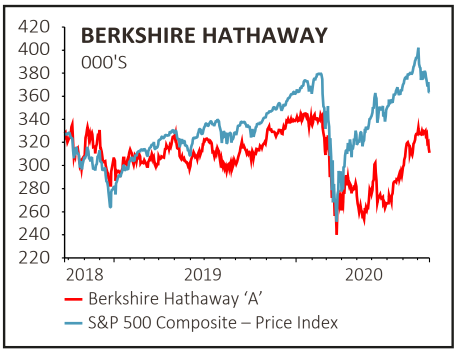
Cloud-based data warehousing technology firm Snowflake listed in the US on 16 September in the biggest ever software initial public offering (IPO), with its shares up 111% on the first day of trading, valuing the company at £96 billion.

Given investor appetite for cloud-based businesses, perhaps this wasn't too surprising even though the average first-day rise for an IPO has historically been 16% according to a study by University of Florida professor Jay Ritter.

The real surprise is the involvement of Warren Buffett whose Berkshire Hathaway investment vehicle purchased a $570 million stake in Snowflake.

It was surprising for various reasons, not least because only four years ago Buffett said in 54 years, Berkshire has ever bought into an IPO.

His disdain for buying companies when they first list was made clear during the dotcom bubble of the late 1990s when he commented: 'A bubble market has allowed the creation of bubble companies, entities designed more with an eye to making money off investors rather than for them.'



NOT KNOWN FOR TECH

Observers have previously called into question Buffett's investing acumen, citing his refusal to buy technology stocks, and instead sticking with old economy firms, which last year caused Berkshire to underperform the S&P 500.

Despite being a close friend of Microsoft founder Bill Gates, who sat on the Berkshire board for 16 years, Buffett has until recently resisted the temptation to own technology businesses.

Buffett's rationale is simple; he claims he doesn't understand technology as well as his beloved insurance businesses and one of his core investing principles is to stick to areas of known expertise, or what he calls a 'circle of competence'.

He once quipped: 'If you don't know who the patsy is at the poker table after observing a few hands, the chances are, you are the patsy.'

BREAKING THE RULES

Snowflake is less than a decade old and has made cumulative losses of over $870 million since it was founded, in stark contrast to some of Berkshire's long-term holdings such as Coca-Cola which has 122 years of pedigree and has cumulatively made billions of profits.

Maybe Buffett was swayed to some degree by the huge success of Berkshire's investment in the IPO of Brazilian e-commerce and digital payments firm StoneCo two years ago.

Berkshire spent $340 million to purchase an 11% stake despite the company being unprofitable at the time. Today that stake is worth close to $700 million and last year StoneCo reported profits of $150 million. Still, priced at over 100 times this year's expected earnings, it is hardly a value proposition one would associate with Buffett.

Another un-Buffett-like characteristic is the fact his latest investment, Snowflake, operates in highly competitive markets with large established rivals such as Amazon's web services division AWS which has deep pockets. Snowflake certainly doesn't appear to easily fit with Buffett's preference for businesses with strong economic moats.

INVESTORS MIGHT BE LOOKING IN THE WRONG PLACE

Perhaps observers are attributing the two technology investments to Buffett when in fact they originated from his two investment lieutenants Todd Combs and Ted Weschler, the former hedge fund managers that Buffett hired to look after parts of Berkshire's portfolios.

In addition to managing money both Combs and Weschler sit on company boards where Berkshire holds significant stakes. Over the last decade they have increasingly influenced Buffett's investments.

For example, Buffett credits Combs with Berkshire's $32 billion acquisition of Precision Castparts admitting he had never heard of the company before Combs brought it to his attention.

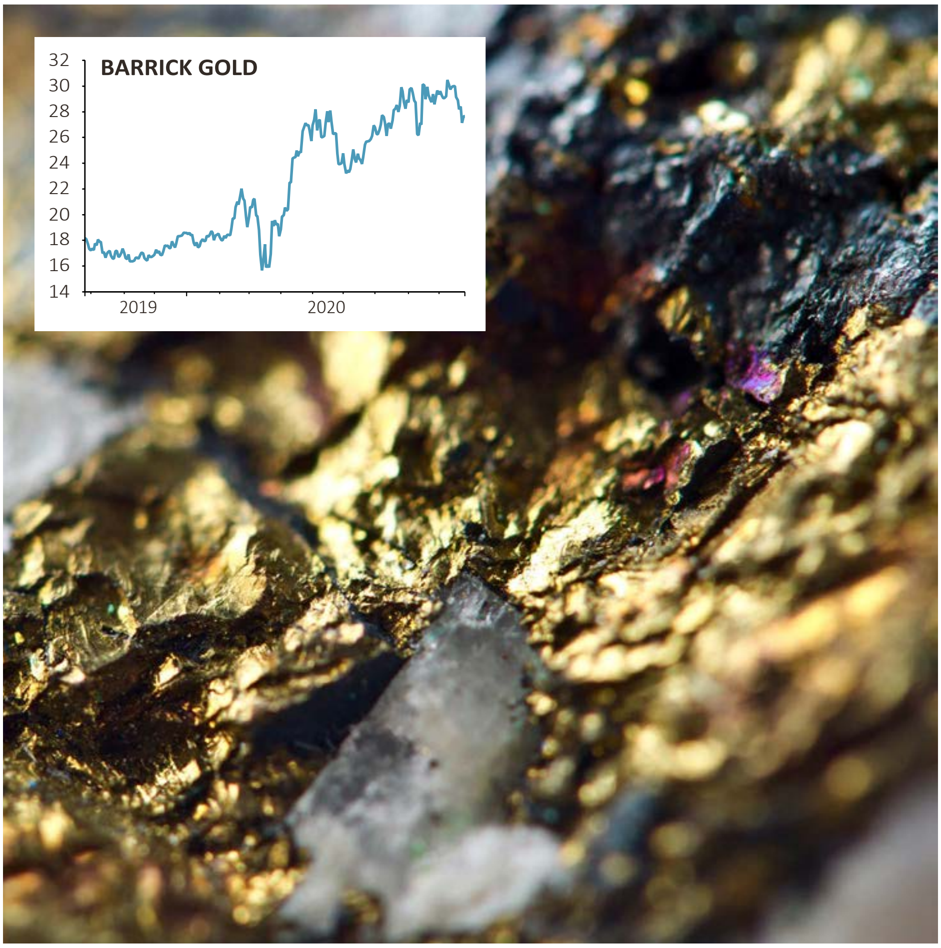
BANKS OUT, GOLD MINING IN

It could be the same story with the news that Berkshire had sold its holding in Goldman Sachs and trimmed back most of other its bank holdings, albeit adding to its Bank of America position. It has recycled some of the proceeds into buying shares in precious metals miner Barrick Gold.

In the past Buffett has been dismissive of the idea of holding the yellow metal saying: 'Gold gets dug out of the ground in Africa... Then we melt it down, dig another hole, bury it again and pay people to stand around guarding it. It has no utility. Anyone watching from Mars would be scratching their head.'

While Berkshire hasn't purchased gold explicitly, the fortunes of Barrick are intimately tied to the price of gold and how much profit it can turn by digging the stuff out of the ground.

Some observers have noted an increase in the number of small portfolio changes for Berkshire in recent months, something more akin to traditional portfolio management actions rather than Buffett's 'buy and hold' style of investing.



THE BUFFETT INDICATOR

Buffett doesn't often make comments of the US stock market or talk about valuations at the macro level, but 1999 was one such time when he warned investors that the market was looking expensive.

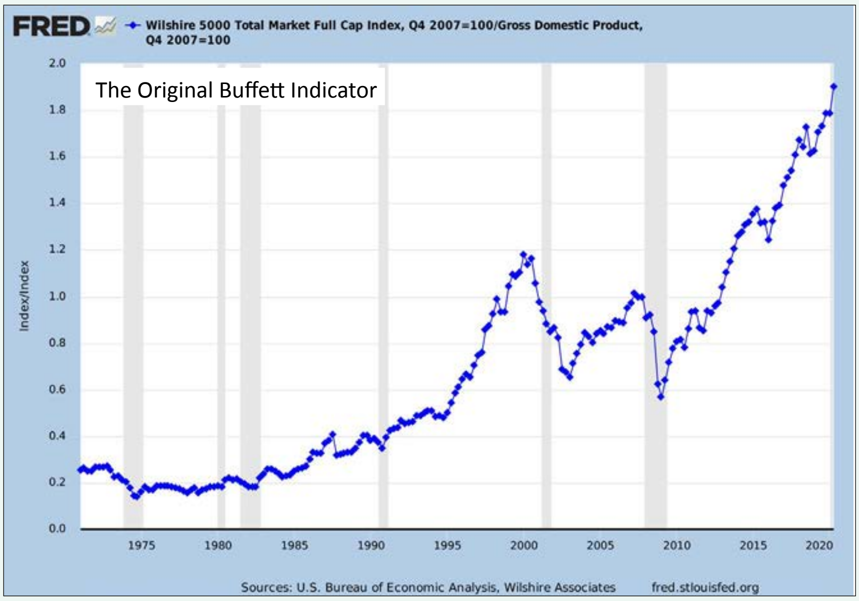
He said stock returns would struggle to keep providing double-digit returns as they had in the prior decade. He referenced a ratio that has since become known as the Buffet indicator.

The investor caveated his analysis by saying that valuing the market was not the same thing as predicting it. Buffett described a measure which he thought was the best single measure of where valuations stand at any given time.

> The Buffett indicator = The total market value of all US stocks as a ratio of gross domestic product (GDP).

In 2000 the ratio reached 1.2 times, way above the 0.85 times historical average. Today the same ratio sits at 1.8 times, 50% higher than the 2000 level.

The premise behind the ratio is that over time corporations in aggregate cannot grow faster than the economy, so the higher the market goes relative to the size of the economy, the more expensive stocks become.



Source: Federal Reserve Bank of St. Louis

CLASSIC BUFFETT

Berkshire recently invested $5 billion into five of Japan's large quoted trading houses, taking a 5% stake in each of Mitsubishi, Marubeni, Sumitomo, Mitsui & Co and Itochu.

Nick Schmitz, analyst at hedge fund Verdad, has calculated that collectively Buffett's Japanese investments trade at a 30% discount to the broader Japanese Topix index and a 79% discount to the S&P 500, on a price to book basis.

The dividend yield on these companies is around three times higher than the US market and double the Japanese market.

In addition to trading below book value, Bloomberg analysts reckon the combined group produce annual free cash flow yields of around 10%. With interest rates stuck close to zero that looks like a bargain. Having taken around a year to build the stakes, Berkshire has indicated that it is in it for the long haul.

What the recent flurry of activity at Berkshire shows is that it is becoming more difficult to separate the investment decisions of Buffett from those of Combs and Weschler.

Investors may have to get used Berkshire making different types of investments to the past as the pair take on even more responsibility. After all, last month Buffett turned 90, becoming a nonagenarian along with his long-time business partner Charlie Munger.

By **Martin Gamble**
Senior Reporter

MOMENTUM INVESTING

When to buy a winning stock

By **Ian Conway** Senior Reporter

One of the oldest sayings in the stock market is 'the trend is your friend', which means if a share price has been rising for some time, all else being equal, it's likely to continue rising for the foreseeable future. Likewise, if it's been falling for some time, it will likely keep falling until the news flow or sentiment changes.

In this article we explain how buying stocks that hit a 12-month high can be a winning strategy. While there are no guarantees of success, history suggests it can work a lot of the time.

It is important to stress this method is different to the normal long-term investment strategy of analysing fundamentals and it won't suit everyone.

Momentum investing is a proven way of making money from the markets. Read on to learn more about this approach and to find out which stocks are approaching a 12-month high, thereby giving you a head start in finding potential investment opportunities using this strategy.

A SIMPLE MOMENTUM STRATEGY

- Buy stocks which keep making a 12-month high
- Sell them if they hit a three-month low

This technique means you latch onto winners and the exit strategy means you've exhausted the full extent of the uptrend without selling out early. The downside is that this strategy can involve high turnover and trading costs.

IT'S BEEN DONE FOR YEARS

The idea riding a rising trend isn't new. In his book on behavioural finance, Daniel Crosby cites an 1838 account of the successful trading strategy of economist David Ricardo: 'Mr Ricardo amassed his immense fortune by a scrupulous attention to what he called his three golden rules. Never refuse an option when you can get it, cut short your losses, and let your profits run on... By letting profits run on he meant that when prices were rising, he ought not to sell until prices had reached their highest and were beginning to fall.'

Letting winners run is sound advice but the temptation to sell is strong and knowing when a share price has reached its peak and is about to fall is fiendishly difficult, if not impossible.

MOMO OR FOMO?

Private investors are repeatedly told not to chase performance, and few professional managers would admit to using a momentum strategy, yet it's a fact that price trends – both up and down – can continue for much longer than most of us expect.

Watching other people getting rich as prices go up while you sit on your hands waiting for a pullback in the market is one of the most frustrating aspects of investing and one of the biggest drivers of price momentum.

The fear of missing out means that each time a stock or an index makes a new high, more investors buckle and are pulled in from the sidelines, creating more demand, which leads to higher prices and so on.

Whereas growth investing needs little explanation, and value investing is buying with a 'margin of safety' in the hope of mean reversion, momentum investing is counter-intuitive because it means buying shares as they make new highs, or at least running your winners way past your comfort zone, in the hope of exploiting the delay before mean reversion occurs.

At its most extreme, momentum investing can turn into a mania as it did during the South Sea Bubble in 1719-20, on Wall Street in the late 1920s and in the tech bubble of the late 1990s, all of which were ultimately the result of momentum investing. Collective fear of missing out, combined with greed, pushed stock valuations to levels that were unsustainable.

Stocks trading just below their 1-year high

Name	Price vs 52 week high %
PZ Cussons	-0.8
Kingfisher	-1.0
Hastings	-1.5
Ocado	-2.2
Focusrite	-2.4
Croda International	-2.6
Plus500	-2.7
Future	-2.8
DiscoverIE	-2.8
Intertek	-3.3
Spirax-Sarco Engineering	-3.4
First Derivatives	-3.7
Bunzl	-3.8
Frontier Developments	-4.1
Avon Rubber	-4.2
Computacenter	-4.3
Segro	-4.7
Unilever	-4.7

Source: Stockopedia, data as of 22 September 2020

'MAKING MORE ON THE STRAIGHTS'

Given that picking precise inflection points is almost impossible, many momentum investors are happy to jump aboard a trend well after it has become established and ride it beyond its peak because they know that by sticking with the trend for longer and not selling out early they will capture more of the upside and outperform their peers.

As one momentum manager explained, by staying invested for the full duration of the trend and not selling until prices have started to fall, 'we make more on the straights than we lose on the curves'.

Of the five classic factors used in investing – value, size, profitability, beta and momentum – momentum has the best long-term track record, even if there is no fundamental basis for it to work so consistently.

As the fathers of the efficient market hypothesis, Eugene Fama and Ken French, put it: 'The premier market anomaly is momentum. Stocks with low returns over the past year tend to have low returns for the next few months, and stocks with high past returns tend to have high future returns.'

EXPERT OPINION

Given this anomaly, it's no surprise that there has been a great deal of academic research into exactly why investing with a momentum strategy is so successful.

In a paper written in 1967 called *Relative strength as a criterion for investment selection*, Robert A. Levy showed that buying stocks with prices which were substantially higher than their average price over the previous six months produced 'significant abnormal returns'.

In their paper of 1993, *Returns to buying winners and selling losers: implications for stock market efficiency*, authors Narasimhan Jegadeesh and Sheridan Titman analysed the performance of US stock returns between 1965 and 1989. Their study found that momentum was indeed a significant factor, capable of generating outperformance of as much as 1% per month, but it wasn't a permanent driver of share prices.

A portfolio constructed on the basis of returns realised over the previous six months, as per Levy's suggestion, generated an average cumulative return of 9.5% over the next 12 months, but lost more than half of this return in the following 24 months.

A 2008 paper by Elroy Dimson, Paul Marsh and Mike Staunton called *108 Years of Momentum Profits* looked at stock returns in the UK market from 1900 to the end of 2007 and found that the premium or outperformance of momentum was substantial, not just across the whole market but even more so within certain sub-sets of the market.

Most businesses today have more intangible assets like brands and databases than tangible assets such as plant and machinery.

'Momentum, or the tendency for stock returns to trend in the same direction, is a major puzzle,' they admitted. 'In well-functioning markets, it should not be possible to make money from the naïve strategy of simply buying winners and selling losers. Yet there is extensive evidence, across time and markets, that momentum profits have been large and pervasive.'

Moreover, Dimson, Marsh and Staunton showed that a portfolio of momentum winners, comprising of stocks within a top given percentage of returns, consistently beat a portfolio of losers when held over a period of anywhere between one month and 12 months, meaning buying winners and selling losers was a profitable and self-financing strategy.

MOMENTUM WORKS BOTH WAYS

Just as positive momentum begets more positive momentum, pulling in buyers from the sidelines desperate not to miss out on gains, so negative momentum has the same effect as investors scurry to avoid losses.

Just as we tend to sell our winners too early, we tend to hold onto our losers too long in the hope that they will get back to where we bought them and we can exit scot-free.

However, simple mathematics means that if a stock has fallen 25% it needs to rally 33% to get back to break-even. If it falls 50%, it needs to double to get back to break even, which is highly unlikely. Yet plenty of stocks which have lost 25% go on to lose 50%, inflicting heavy losses on shareholders. We just don't seem to learn from the experience.

At this stage it's worth remembering one of the oldest market adages, 'the first cut is the cheapest'. Investors who cut their losses early typically outperform those that don't. As the stock price keeps falling, more investors end up throwing in the towel and selling, which can have the effect of depressing the share price, prompting more selling and creating a downward spiral.

It's precisely this type of behaviour which leads to panics and crashes as investors – aware that their gains are only paper profits until they try to sell their shares – rush for the exit when markets get the jitters as they did in late 2018 and earlier this year.

MOMENTUM IS EVERYWHERE

As Dimson, Marsh and Staunton point out, almost all investors – wittingly or unwittingly – employ momentum in their investment style. Those who window-dress their portfolios at the end of the financial year, clearing out losers for example, 'are de facto momentum traders'.

Whether they like it or not, institutional investors are also momentum traders. They are evaluated relative to a size-based benchmark, such as the FTSE 100. In this example, they tend to buy stocks as they drift above the size threshold for large cap index membership, and to sell those that drift below the size threshold; they unwittingly benefit when there are momentum effects in the market.

The effect of momentum in the S&P 500 index is obvious for all to see. As a handful of the biggest stocks keep outperforming and become a bigger proportion of the index, so investors who are benchmarked against the index have to keep increasing their position sizes or risk falling behind in performance terms. This creates concentration risk, which in turn creates volatility as we have witnessed this year.

IDENTIFYING UK MOMENTUM STOCKS

In May of this year, analysts at investment bank Liberum created two baskets of UK and European stocks with positive price momentum over the previous one, three, six and 12 months.

The baskets, made up of stocks the bank nicknamed 'Invincibles', were dominated by cyclical companies including miners, business services, capital goods and software.

In the four months from their inception, the baskets have outperformed their respective benchmarks for three months running as of 17 September and more importantly generated positive absolute returns every month, including June and July when the market posted negative returns.

Liberum 'Invincibles': Top Five Best Performing Stocks in Last Month

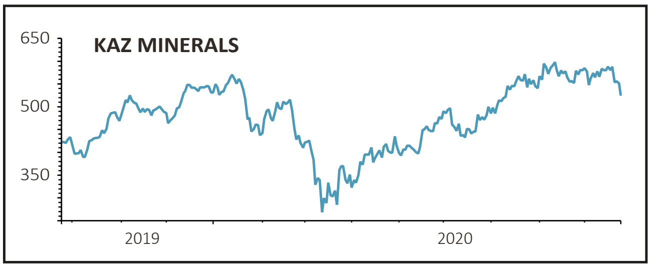
Stock	1m Perf	3m Perf	6m Perf	12m Perf
Greatland Gold	78.8%	12.1%	296.0%	658.0%
Petropavlovsk	23.1%	13.9%	99.2%	219.0%
Shanta Gold	19.0%	43.2%	73.1%	87.5%
Avon Rubber	19.0%	14.8%	66.1%	110.4%
Clipper Logistics	17.3%	28.4%	89.8%	76.5%

Liberum 'Invincibles': Top Ten by Market Value

Stock	Market Value	1m Perf	3m Perf	12m Perf
AstraZeneca	£112.8bn	2.6%	1.2%	22.1%
Rio Tinto	£85.6bn	9.2%	5.0%	6.3%
Reckitt Benckiser	£54.1bn	2.3%	7.0%	18.7%
London Stock Exchange	£31.7bn	4.3%	8.4%	14.9%
Experian	£27.1bn	6.6%	1.4%	12.4%
Flutter Entertainment	£18.9bn	1.5%	10.7%	62.1%
Ocado	£18.5bn	6.3%	20.3%	72.7%
Ferguson	£16.5bn	3.6%	17.6%	14.7%
Ashtead	£13.0bn	7.8%	11.3%	15.1%
Rentokil	£10.1bn	3.1%	9.0%	21.5%

Source: Liberum, Shares Magazine. Data correct as of 17 September 2020

Drilling down into the constituents of the UK basket, miners **Shanta Gold (SHG:AIM)** and **KAZ Minerals (KAZ)** have been top performers for a while.



Two thirds of the stocks in the UK basket are miners: half are platinum or gold miners while the other half are mostly copper miners, which suggests that copper and gold are driving the rally in materials.

A second group of stocks with strong momentum are software companies such as **Keywords Studios (KWS:AIM)**.

A third group consists of capital goods stocks, which suggests investors are betting the current cyclical recovery lasts – backed up by Liberum's 'Early Cycle Indicator' – and we don't get a repeat of the global shutdown which impacted both output and demand for industrial goods in the second quarter.

Re-running the screen in September produced a sharp increase in the number of UK stocks qualifying for inclusion, from 56 in August to exactly double that number. Liberum put the spike down to 'the sideways movement of stock markets in June and July' meaning many companies posted slightly negative returns, while the upward momentum of September meant performance turned positive and stocks re-entered the list.

This exercise throws up one of the biggest drawbacks of momentum investing – turnover. Typically, building a momentum portfolio involves high turnover over short periods of time which can lead to higher costs and lower profits.

BEWARE MEAN REVERSION

Besides the high concentration of cyclical stocks, there was no obvious size bias in the Liberum screen towards large cap, mid cap or small cap companies, nor was there a statistically significant 'quality' bias in terms of trailing 12-month return on equity.

In fact, several stocks had double-digit negative returns on equity, including familiar names such as online grocery retailer **Ocado (OCDO)**.

Instead there was a marked bias towards highly priced stocks, with only a handful of companies trading on trailing 12-month price to earnings (PE) ratios of less than 10, and the average PE of the basket was somewhere between 20 and 30.

This is because positive momentum forces prices upwards even when earnings are static, a phenomenon known as PE expansion.

However, in stock markets as in business, the ultimate cure for high prices is high prices. As Jegadeesh and Titman suggest: 'Investors who buy past winners and sell past losers move prices away from their long-run values temporarily and thereby cause prices to overreact.'

The further prices deviate from their long-run values, and the more stretched PE ratios become, the greater the risk of disappointment and sudden losses as share prices – and therefore valuations – revert to their long-run mean.

As Dimson, Marsh and Staunton conclude, momentum portfolios tend to have 'a marked exposure to outperforming and underperforming sectors and involve taking positions in companies that have been in the news for their deviant performance. They buy (belatedly) into appreciated stocks, and avoid the losers that are sought by contrarian investors hoping for a reversal. The momentum portfolio would be unsuitable for individuals of a nervous disposition.'

RUSS MOULD
AJ Bell Investment Director

Will Suga stoke returns from Japanese stocks?

The case for and against Japan after a change of leadership

Following the departure of prime minister Shinzō Abe for health reasons in September and his replacement by right-hand man and Liberal Democratic Party stalwart Yoshihide Suga, investors with exposure to Japan now have several questions to ponder.

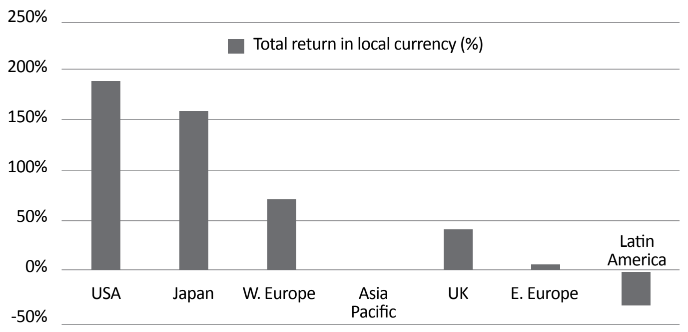
After all, the 'Abenomics' era, which began in December 2012 when Abe returned to power five years after his first term ended with a sudden resignation, saw Japan's headline Nikkei 225 index offer a total return including dividend reinvestment of 158% in local currency terms.

That ranks Japan in second place out of the seven major geographic options available to investors over that time span, behind only the rampant US equity market.

Suga has a lot to live up to, and not just because he is replacing Japan's longest-serving modern-day prime minister. The 'three arrows' of 'Abenomics', fiscal stimulus, monetary stimulus courtesy of interest rate cuts and quantitative easing from the Bank of Japan (BoJ), and widespread structural reform, are seen as having provided huge amounts of support to the Tokyo market.

Investors will be wondering whether the new PM will keep on firing them, or whether he gets chance, since his term as leader of the LDP and prime minister only runs to September 2021, when elections are due on both fronts.

Japan has been a strong performer during the Abenomics era



Source: Refinitiv data. Covers period of second Abe premiership, 26 Dec 2012 to 28 Aug 2020

BEAR CASE

Suga has work to do, especially as public satisfaction with the prior administration's handling of Covid-19 had slumped by the time Abe stepped down (even though the number of daily deaths had not exceeded 20 since May). Appeasing investors may be lower down his list of priorities and there are three reasons why investors may have doubts about building, or adding to, their exposure to Japanese equities.

• **The political situation is less clear.** Suga's early pronouncements have focused on mobile phone charges and boosting Japan's digital economy, while the ongoing global pandemic will also require attention. This may suggest that ongoing reform is not going to be top of Suga's list of things to do.

• **Abenomics may have boosted the stock and bond markets but it failed in its overall economic goals.** The main goal was to boost economic growth and drive inflation toward the Bank of Japan's 2% target but the programme's success rate is mixed, given that Japan is back in recession and headline inflation is 0.1%.

In addition, the BoJ's enormous QE scheme, which is running at ¥80 trillion (£588 billion) a year is seen as distorting the markets by some. The central bank's ¥683 trillion in assets represent around

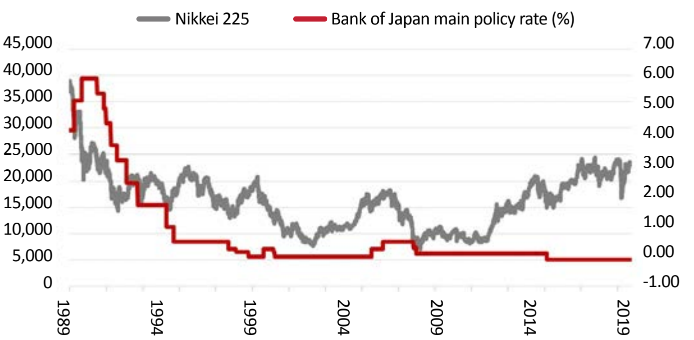
RUSS MOULD
AJ Bell Investment Director

125% of GDP and leave it holding some three-quarters of all Japanese exchange-traded funds (ETFs), more than half of the Japanese government bond market and some 10% of the stock market, according to some estimates.

• **Japan's economy is still bedevilled by poor demographics and huge public debts.** This is the long-term bear case – namely that Japan cannot break free from the legacy of the bursting of the debt-fuelled property and stock market bubble which peaked on 31 December 1989.

The economy has rarely gained sustained traction since and the Nikkei 225 still trades 40% below its all-time high, despite 25 years or more of QE and zero or negative interest rates.

Zero or negative rates have not helped the Nikkei return to past highs



Source: Refinitiv data, Bank of Japan. Since Nikkei 225's peak on 31 Dec 1989

BULL CASE

Bulls of Japanese equities will sweep aside such concerns.

• **Debt and demographic concerns are neither new nor unique to Japan.** As the US, UK and Europe all slip into the public debt mire, there may be less chance of the markets picking a fight with Japan's bond market or currency. Nor have these issues stopped the Nikkei rising 5% over the past year, despite Covid-19, or advancing from a modern day low of barely 7,600 in 2003 to more than 23,500 today.

Ultra-loose monetary policy from the Bank of Japan is helping, as investors look for returns better than those available from cash or Japanese government bonds, and the BoJ seems unlikely to throttle back any time soon, either.

• **Japan could offer value.** The fact that the bear cases are not especially new would suggest they are at least partly factored into valuations already. In addition, Abenomics actively promoted corporate governance reforms and even prompted the creation of a new stock index, the JPX Nikkei 400, where return on equity, dividend and buyback policies, and shareholder relations were key entry criteria.

Before the pandemic, Japan was trading on a lowly price to earnings ratio (PE) relative to its history, thanks to Abenomics' focus on profitability, and the latest spike in the PE simply reflects the hit to corporate earnings from the pandemic-related global recession.

Japanese stocks looked cheap before the pandemic

Source: Refinitiv data. Covers period since start of Abenomics, 26 Dec 2012

• **Japan provides exposure to global recovery.** The Japanese market is packed with high-quality manufacturers and exporters, giving it leverage into whatever form of global upturn follows the pandemic.

Business confidence is currently low, using the quarterly Tankan or the Business Short-Term Economic Sentiment Survey as a guide, but any upturn could quickly feed through to share prices.

The case for Japan as Abe departs

Shinzo Abe is stepping down as prime minister but the uncertainty this may create should not detract from an encouraging picture for Japanese equities.

By Masaki Taketsume, Fund manager, Japan Growth Fund Plc

Shinzo Abe has announced his resignation as prime minister of Japan, due to the resurgence of a long-standing health problem. His resignation comes just four days after he recorded the longest continuous term of any Japanese prime minister.

Despite Abe's departure, we think there is likely to be continuity in both fiscal and monetary policy. We would also highlight Japan's response to the Covid-19 crisis, which has been relatively more successful than other developed market economies.

Meanwhile, Japanese corporates have strong balance sheets that leave them well-placed to weather a global downturn.

Continuity of both fiscal and monetary policy even without Abe

The news that Abe would step down was already breaking during stock market trading hours on Friday 28 August. Japanese shares dipped initially but stabilised by the close, before the full details were available.

Abe's departure is down to an existing health condition. Nevertheless, it is also the case that his popularity had declined, albeit his rating remained above the critical 30% level.

This low popularity came despite Japan's relatively good virus data. Japan has taken a very different path through the Covid-19 crisis compared to other developed market countries. It has seen far fewer infections and deaths without the implementation of a strict lockdown.

The reasons for Japan's relative success in containing the virus remain unclear, and the population isn't giving much credit to the government for it. Much seems to rest on the population's existing high levels of risk aversion, including the habitual wearing of masks.

The public have been critical of perceived inconsistencies in the response to the virus and the recent uptick in cases of new infections – albeit from a very low base.

Even prior to Mr Abe's announcement, expectations on the political timetable were already complicated by the pandemic and the postponement of the Tokyo Olympics to July/August 2021. A general election is due in October 2021 but, in the last few weeks, we had been looking at an increased chance of a snap election in autumn 2020.

The change in political leadership may cause some nervousness in financial markets, especially among foreign investors. Mr Abe is very closely identified with his government's economic plans, under the banner of "Abenomics". This has involved aggressive monetary easing, boosting government spending, and enacting reforms to make the Japanese economy more competitive.

In reality, since the LDP will remain the dominant party, we would expect little to change. In fact, this may be a good opportunity for a new leader to refresh the cabinet and refocus the pandemic response. The next prime minister may bring some differences in the emphasis on various structural reforms but overall we would expect continuity of fiscal policy. Monetary policy under the Bank of Japan Governor Haruhiko Kuroda will also be unchanged.

One feature of Mr Abe's tenure has been a relatively stable relationship with leaders of both the US and China. We will watch closely whether his successor adopts a similar approach

Overall, we feel that the departure of Mr Abe should not distract investors from other positive factors, such as Japan's containment of the virus and improvements in areas such as corporate governance.

And while Japan has outperformed many other countries in dealing with the virus so far, in our view this is not yet reflected in share prices.

Authorities' policy response should smooth the downturn

In April, the Japanese government announced an economic stimulus package with a headline figure of ¥117 trillion ($1.1 trillion), equivalent to 22% of GDP. An additional package was announced in May. Although much of this headline number will never materialise as real money, the effective size of the stimulus easily exceeds past fiscal measures and, as a percentage of GDP, could also outstrip the stimulus seen in other major economies.

One concern is the speed with which these measures will be able to impact on the real economy, and the additional uncertainty created by any longer-lasting changes in consumer behaviour. A specific move directed at consumers was to replace the initial plan for support payments to affected individuals with a much simpler one-off payment of ¥100,000 to all residents, regardless of income.

All these plans are funded by new issuance of Japanese government bonds, but we do not expect this to generate any particular stress in fixed income markets.

Meanwhile, the Bank of Japan increased the pace of its purchases of exchange-traded funds temporarily from March and has since announced additional monetary initiatives. In our view, the overall alignment of fiscal and monetary policy has improved.

As a result of all these factors, we think Japan is likely to see a smoother progression through the downturn and recovery without the huge dislocations seen elsewhere. This contrast is particularly stark in the labour market where the jump in unemployment has still left Japan's jobless rate below 3%. Companies' experience of serious labour shortages in recent years may be making them particularly reluctant to lay off workers in response to short-term pressures.

Strong balance sheets limit damage to corporates

In terms of the scale of the economic decline and earnings impact of Covid-19, many comparisons are being made with the aftermath of the 2008-09 global financial crisis. However, we think investors should also appreciate that Japanese companies are generally in a much stronger financial position now than they were in 2008. As a result, we are not seeing any significant new equity issuance for company refinancing.

We feel that the strength of balance sheets across listed companies in Japan is emerging as a distinct competitive advantage. While we are already seeing significant impact to corporate earnings in Japan from the sudden onslaught of a global recession, we believe companies are in a strong enough financial position to withstand this.

As visibility emerges on the medium-term outlook, we are therefore reasonably confident about buying into distressed earnings and low valuations in Japan. We have also been expecting to see smaller aggregate dividend cuts in Japan, as we did after the global financial crisis. It is early days but the initial evidence on this from the recent results season is quite encouraging.

Indeed, while corporate profits are clearly under pressure, the recent quarterly earnings season brought more positive surprises than we might have expected. The pandemic has made it very hard to form a clear consensus for earnings, with many companies unwilling to provide guidance due to the extreme uncertainty. However, on our estimates, around 40% of companies beat market expectations, with 40% in line and 20% underperforming. This compares to a more typical split of roughly one third in each category.

From a corporate governance point of view, virus concerns clearly have had an impact globally in terms of shareholders being physically present at AGMS. Even so, the recent July AGM season in Japan has brought signs of better shareholder communication from companies and evidence of more shareholder participation.

Our own internal fundamental research remains particularly focused on the long-term sustainability of Japanese businesses. We continue to engage actively with companies where we believe we can have a positive impact.

For more information on Schroder Japan Growth Fund and the full range of investment trusts at Schroders, subscribe to our newsletter here.

The FTSE 100 firms which have delivered a decade of negative returns

The list is dominated by supermarkets and banks but can they turn things around?

Thirteen companies in the FTSE 100 have lost money for investors who have held the shares over the past decade, based on share price performance and dividends reinvested for the 10 years to 24 September 2020.

In comparison over the same timeframe, the 10-year total return for the index stands at 52% and the top performer is tool hire firm **Ashtead (AHT)** which has delivered a total return of 2,750%.

Stocks on the 'losers list' like **Lloyds (LLOY)** and **Tesco (TSCO)** are widely held by retail investors. A hypothetical investment of £10,000 a decade ago in the worst offender **NatWest (NWG)** would be worth less than £3,000 today and that's without even accounting for the impact of inflation.

A DECADE OF LOST RETURNS FROM FTSE 100 FIRMS

Company	What £10,000 invested 10 years ago would be worth today	10-year total return (%)
NatWest	£2,550	-74.5
Standard Chartered	£4,420	-56.8
Barclays	£4,940	-50.6
Lloyds Banking	£4,980	-50.2
Rolls-Royce	£5,020	-49.8
Tesco	£6,860	-31.4
Marks & Spencer	£7,020	-29.8
Sainsbury's	£8,340	-16.6
HSBC	£8,890	-11.1
Pearson	£8,920	-10.8
Anglo American	£9,210	-7.9
Morrisons	£9,290	-7.1
Man Group	£9,530	-4.7

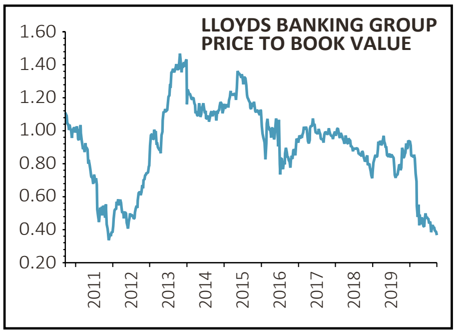
Source: Shares, Sharepad, data as at 24 September 2020. All dividends reinvested.

WHY HAVE SOME SHAREHOLDERS BEEN PATIENT?

Such poor returns raise the question of why people are putting up with such lousy performance for so long and whether they will continue to demonstrate such high levels of patience.

While several of these stocks will have paid dividends at a fairly generous yield over the period, perhaps in part explaining their appeal to investors, if held for the full 10 years this income would have been swallowed up by capital losses – to a significant extent in some cases.

Looking at the list, it is clearly dominated by banks



and supermarkets. It is a little over 13 years since the run on Northern Rock which demonstrated for Britons the seriousness of the credit crunch. There would have been hopes that the banks could have repaired the damage from that crash by now but despite considerable effort and resources they have been unable to enjoy a sustained recovery.

This is linked to several factors: the persistence of ultra-low interest rates as central banks have looked to prop up the economy, scandals of their own making like the PPI debacle, an uneven political and economic backdrop, and most recently the impact of Covid-19.

The latter saw the regulator step in to prevent the banks from doing one of the things that probably helped them hang on to any long-suffering fans – pay dividends.

The financial crisis revealed just how central the banks were to the entire underpinning of the economy and society so this almost guarantees they will face particularly tough regulation.

BANKS ARE CHEAP

Given all of this, why would you even consider investing in a bank? The main answer is that they are cheap.

Berenberg analyst Peter Richardson says: 'Low levels of default and delinquency, due to government support schemes and forbearance, mean that uncertainty about how the current economic stress will translate into realised losses remains high.'

If the banks' performance is easy to understand then the not-quite-so terrible but still fairly awful returns on offer from the groceries sector are more of a puzzle.

It tells a story of individual failings, notably **Tesco's (TSCO)** damaging accounting scandal and arguable move away from the basics in the early 2010s, and strategic setbacks for **Sainsbury's (SBRY)** including the collapse of a merger with Asda thanks to the intervention of the competition authorities.

The established supermarkets have also faced disruption in several key areas – the rise of the German discounters Aldi and Lidl, a shift away from big superstores towards convenience outlets and the shift of the weekly shop online, which has brought with it opportunities but also considerable costs.

IMPROVED PROSPECTS FOR SUPERMARKETS

Shore Capital analyst Clive Black is optimistic on the prospects for the sector. He says: 'There is greater scope for positive operational gearing, to help fund pricing activity, other drags on earnings are easing, such as the online channel turning positive from a profit perspective...

'More structurally, the annual rate of industry space growth is easing whilst the annual value of industry sales grows, so building sales and cash flow densities per square foot.

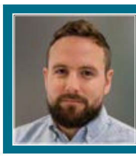
'Therefore, after a sustained period to 2016 of declining sales densities, capital returns and asset impairments, we see an industry with rising densities, building returns and greater investor interest in supermarket assets.'

WHAT ABOUT THE OTHERS?

The remaining four names on our list which fall into neither the bank or supermarket category have endured a mix of internal issues and external factors.

While some people, including fund manager Nick Train, think publishing group **Pearson (PSON)** can be an eventual beneficiary of a shift to digital learning, to date this has been bad news for the business as it has seen high margin sales of expensive academic textbooks collapse.

Miner **Anglo American (AAL)** has been a victim of commodity price volatility and its own operational mistakes, while aircraft engine maker **Rolls-Royce (RR.)** has endured problems with its kit, poor cash flow performance and more recently the devastating hit to its key customer base in the aviation sector from Covid-19. Asset manager **Man Group (EMG)** hasn't been helped by patchy performance for its funds.



By **Tom Sieber**
Deputy Editor

Kepler Trust Intelligence

ATST: More than meets the eye

ALLIANCE TRUST (ATST) is one of the largest trusts in the investment companies universe, sitting in the FTSE 250 with gross assets of around £3bn.

The management of the fund was changed in April 2017 from an in-house investment team to an externally managed multi-manager approach. Willis Towers Watson (WTW) were appointed to oversee it, with the investment committee, led by Craig Baker, selecting the external managers for different parts of the underlying portfolio. WTW gives the managers mandates, with few restrictions, and each has the aim of creating a 'best ideas' portfolio of between 10 and 20 stocks from anywhere in the world. Through this approach, the team hope that can generate the levels of alpha associated with concentrated portfolios, without the risk profile of a single portfolio. WTW actively manages the allocations between managers to ensure that performance is primarily driven by stock selection, rather than by sector, style or country weightings.

Due to the high alpha approach of the team at WTW, capital appreciation, rather than income, often gains the most attention. However, there is more to ATST in terms of income than initially meets the eye.

Dependable income, with a record to prove it...

Throughout 2020 we have seen a 'dividend drought', with income seekers coming under a great deal of pressure due to the impact of COVID-19. According to the most recent Janus Henderson Global Dividend Index, which measures the income of 1,200 global firms, Q2 this year saw a 22% drop in dividends. Within Europe 54% companies reduced their pay-outs, of which two thirds cancelled them. Banks, which were asked to favour emergency loans over paying dividends, accounted for 50% of the decline.

In this environment, a safe haven for income investors has become an obvious priority. The investment trust structure has particular advantages in this regard – the ability to pay income from the capital account, and the ability to build income 'reserves' to shore up their dividends on a 'rainy day' among them. Alliance Trust is a good example of these advantages in practice. The trust has one of the most impressive dividend track records in the entire investment trust universe, increasing it progressively for the last 53 years. Over the past five years, this has come at a rate of more than 7% *(source: JPMorgan Cazenove)*. The most recent full-year dividend (2019) equated to 13.96p per share, an increase of 3% over the 2018 dividend. Although ATST's shares yield only 1.7%, this compares favorably to the rest of the AIC Global sector, where the weighted average yield is 1.1% *(JPM Cazenove)*.

When Kepler spoke to the team, they said that a 54th year of dividend increases is highly probable and a key reason for this is the support offered by the revenue reserves. Unlike open ended funds, investment trusts can retain up to 15% of the revenue they receive from their underlying investments in a reserve. Over time, this can be built up and, should there be a cut in the income of the underlying companies, the board can utilise their reserves to maintain dividends the trust pays. The most recent full year dividend from ATST was covered 2.35x by revenue reserves and, to further strengthen this, the board have also announced their intention to convert their merger reserve to a distributable reserve. Assuming the board's plan is approved by shareholders and the courts, this means that there would be an additional £645.3m available to support increased dividend levels in the future.

Alongside this, the board have also introduced a 'Dividend Reinvestment Plan' for investors themselves. This has been available since the June 2020 dividend and brings with it a number of benefits. It is a considerably more cost-effective way of investing, due to the lack of brokerage costs. Alongside this, there are significant compounding benefits. If one compares the total return of the MSCI ACWI (a comparative global index) to the price return, investors have seen returns 17.98% greater due to the reinvestment of dividends.

As this is a multi-manager strategy, the job of choosing where to invest is taken away from the investor, and given to professional fund selectors with access to the skills, resources and knowledge of some of the best investment houses in the world – giving the trust particular appeal to those who prefer not to get involved in the mechanics of portfolio construction themselves.

This, combined with the factors we have discussed in this article, means ATST is an interesting option for investors searching for an 'all-in-one' solution offering exposure to the stock market which can deliver not just capital appreciation, but a reliable income too.

Click here to read more on the expertise leading this high conviction stock-picking approach.

Strong demand expected for new Buffettology trust

The asset manager behind CFP SDL UK Buffettology Fund and Free Spirit Fund has its eye on the smaller company space

The brains behind two of the best performing UK equity funds in recent years is to launch its first investment trust, targeting smaller companies that look cheap and which have the right characteristics to grow for many years to come.

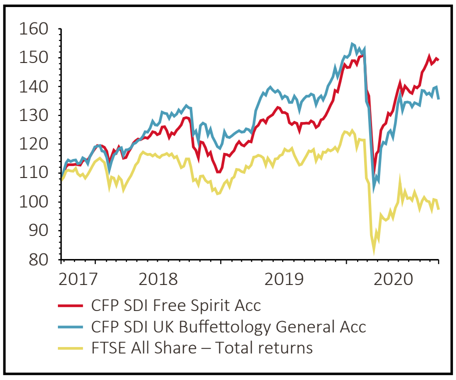
Sanford DeLand-run **Buffettology Smaller Companies Investment Trust** is seeking to raise at least £100 million with its IPO offer open to both retail and institutional investors, ahead of joining the stock market at the end of October. The annual management charge will be 0.65%.

Keith Ashworth-Lord, Sanford DeLand chief investment officer and one of the managers of the new product, says he has never had so many messages from institutional and private investors and other contacts as when the trust launch was announced on 25 September, implying considerable interest in the forthcoming IPO.

GOOD TRACK RECORD

It's easy to see why people are excited. Sanford DeLand's **CFP SDL UK Buffettology Fund (BF0LDZ3)** has achieved 26% total return over the past three years and its **Free Spirit Fund (BYYQC27)** has achieved a 38.8% total return over the same period, both top quartile performances according to FE Fundinfo.


Avon Rubber features in Free Spirit Fund's portfolio



Buffettology Small Companies will follow the same investment process as these funds, a strategy heavily influenced by legendary investor Warren Buffett.

Sanford DeLand likes to invest in companies whose share can be bought at a fair price versus the estimated intrinsic value of the business. Its process involves identifying companies which tick the following boxes:

- Easily understood business model
- Transparent financial statements
- Consistent operational performance with relatively predictable earnings
- High returns on capital employed
- Convert a high proportion of earnings into free cash
- Strong balance sheet and low financial leverage
- Management focused on delivering shareholder value and is candid with the owners of the business
- Preference for organic growth over 'frenetic' acquisitions

30-BAGGER

'We find great businesses and get in early doors,' says Ashworth-Lord, revealing a preference to hold on to winning stocks for as long as possible.

'We've had tremendous success with some holdings. **Bioventix (BVXP:AIM)** has been an eight-bagger for us,' he says, meaning he's made eight times the original investment. '**AB Dynamics (ABDP:AIM)** has been a 10-bagger and **Games Workshop (GAW)** is now a 30-bagger for us.'

CFP SDL UK Buffettology Fund and Free Spirit Fund can invest in large, medium and smaller-sized companies with Free Spirit having a slight bias towards technology firms.

REASON FOR LAUNCHING NEW TRUST

Ashworth-Lord says the £1.3 billion CFP SDL UK Buffettology Fund has become too big to invest in micro-cap stocks, hence the launch of the investment trust to mop up opportunities in that space.

The asset manager runs concentrated portfolios so CFP SDL UK Buffettology Fund would run the risk of having to own a large chunk of a company if it were to invest in the micro-cap space, which has happened in the past and something Ashworth-Lord wants to avoid again.

'Eighteen months ago, we held three micro-caps in the open-ended Buffettology fund, being **Air Partner (AIR)**, **Revolution Bars (RBG:AIM)** and **Driver (DRV:AIM)**. We ended up owning 15% to 20% of each business which was too much, so we took the decision to divest of all micro-cap holdings.'

Keith Ashworth-Lord is a fan of Focusrite

PORTFOLIO POSSIBILITIES

The new investment trust will focus exclusively on the £20 million to £500 market cap space at the time of the original stake purchase, and purely on UK-listed stocks.

Ashworth-Lord declined to reveal any names under consideration for the investment trust's portfolio. He would only say that it would be at least 70% different to CFP SDL UK Buffettology Fund and Free Spirit Fund.

'I have 11 companies on a notepad where we will do some work now, deciding if the investment is "go or no go". (Analysts) Eric Burns has a similar number and David Beggs has three ideas, but one is already too big,' explains Ashworth-Lord.

'Seven companies feature in both the CFP SDL UK Buffettology Fund and Free Spirit Fund portfolios which is a 15% overlap, down from 30% before Andrew Vaughan started running the latter fund (in 2019).'

He says all three portfolios will be relatively uncorrelated so people could use both open-ended funds and the investment trust if they wanted and not really double up on positions.

UK GOING CHEAP

Sanford DeLand's new product will be the third trust trying to float in the coming weeks aimed at exploiting opportunities in the UK market, alongside **Tellworth British Recovery & Growth Trust** and **Schroders British Opportunities Trust**.

All three see an opportunity to pick up good businesses at discounted prices. 'Small companies are really out of favour and stock market valuations in the UK are lower than the US and Europe because of Covid and Brexit.

'In reality there are still good companies doing well, such as **Focusrite (TUNE:AIM)** which has sailed through the pandemic. Those types of business will find their way into our investment trust,' says Ashworth-Lord.

AJBell SHARES MONEY & MARKETS

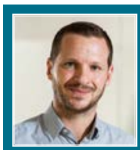
Shares recently interviewed Andrew Vaughan, manager of Free Spirit Fund, in the *Money & Markets* podcast. Listen to that interview to find out the secret of his success.

By **Daniel Coatsworth**
Editor

Should I lower portfolio risk five years before retiring?

AJ Bell's Tom Selby on the key considerations for someone approaching the end of their working life

What are the risks to personal contribution pension pots of share prices falling and should anyone within five years of retirement do anything to reduce risk of the portfolio being insufficient?
John



Tom Selby
AJ Bell
Senior Analyst says:

Because personal pensions – often referred to as 'defined contribution' retirement pots – are invested in bonds, stocks and shares, their performance can be volatile, particularly over a short time.

We witnessed a classic example of this activity during March and April, when Covid-19 and the subsequent lockdown sparked a stock market sell-off, with the FTSE 100 down over 20%.

In investments a period of negative performance such as this is sometimes called a bear market (while you might hear strong performance labelled a bull market).

The extent of the impact of a bear market on your defined contribution pension will depend in part on the amount of risk that you take and the mix of assets you hold.

Someone who invested their entire pension in a fund which tracks the performance of the FTSE 100, for example, would have total exposure to the performance of that index and so would have experienced double-digit falls at the start of lockdown.

This is one of the reasons diversification is important for retirement investors – by investing in different assets around the globe which are not correlated – this just means they don't rise and fall in tandem with each other – you should be able to reduce volatility without lowering your ability to generate investment returns.

If you don't feel confident in picking your own investments, you can pay a fund manager to do it for you. Some managers even offer multi-asset funds where the portfolio is diversified by asset class.

Because investments can be volatile, particularly in the short-term, it is important you understand and are comfortable with the risks you are taking.

You should also bear in mind that if you have a long investment time horizon, you can be less worried about short-term ups and downs in the value of your pot. Historically short-term volatility has been the price for long-term investment growth.

Your approach to investing as you close in on retirement will depend in part on what you plan to do with your money. If you are going to withdraw all of it at once or buy an annuity, you should consider reducing the level of risk in your fund to protect against market falls just before you retire.

If you are planning to keep your fund invested and take a steady stream of income through drawdown, you might want to review your investments as you approach retirement but, provided you are happy with the risks you are taking, you might not need to make any big changes.

When making this decision, remember that a healthy 65-year-old might still have an investment time horizon of 30 years or more, so should still have capacity to take some investment risk.

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.

The financial advantages of being married

Why tying the knot can lead to big savings on tax

'It's just a piece of paper'. 'We've got a mortgage and kids, we're already committed.' 'We can't afford a fancy wedding.' Whatever your objections to marriage, don't be so quick to rule it out. The financial benefits can be huge, and not everyone realises quite how much security they're missing out on when they don't tie the knot.

Marriages and civil partnership give equal financial protection, and now both options are open to both same-sex and mixed-sex couples, so if you're one of the UK's 3.5 million cohabiting couples, you could still have a legally recognised union even if marriage doesn't feel right for you.

Lisa Orme, a mortgage adviser at Keys Mortgages, had been with her partner for 15 years with no intention of getting married, until they sat down with their accountant one day. 'We had built a very large portfolio of properties in this time and a chat with our accountant changed everything when he said, "if one of you dies, you're looking at a massive tax bill".

'We were married within six months of that meeting. At the wedding we had so many people ask us why we'd decided to get married after all this time. No-one believed us when we said "tax reasons".'

IHT AND CGT RELIEF

Orme would potentially have been caught by inheritance tax (IHT) rules had she stayed unmarried. The transfer of assets between spouses is exempt from inheritance tax, so if one of you dies, you can pass any unused nil rate band to your partner.

The nil rate band is a tax allowance which means you don't have to pay IHT on assets worth £325,000 or less per person. There's also something called the residence nil rate band, worth £175,000 per person.

Crucially, you can inherit both of these reliefs, so together they add up to £1 million per couple. That means you could avoid paying 40% inheritance tax on up to £1 million of assets. But only if you're married or civil partnered.

'The tax treatment of

unmarried cohabiting couples is arguably a scandal,' says Rowley Turton Private Wealth Management director Scott Gallacher, noting that the Government denies non-working partners benefits because the other partner is working, effectively treating them as a unit, but doesn't apply the same principles when deciding who gets tax advantages.

As well as reducing your inheritance tax bill if one partner dies, getting married can also give you capital gains tax relief, because you can transfer assets to your spouse tax-free. Useful too is the marriage allowance, which lets you transfer up to 10% of your personal allowance to your spouse to reduce their income tax bill.

INHERITING PENSIONS

Married partners can inherit each other's ISA allowance, and there are implications for pensions too. If you are married and one partner dies, you may be able to use their state pension record along with your own if you don't have enough qualifying years to get the full state pension.

Bear in mind also that couples who are not legally recognised as spouses won't automatically inherit each other's pension benefits. Financial adviser Leanne Lindsay of Edinburgh Wealth Management said two of her clients who had been together for 20 years decided to get married following a financial review meeting.

One of the reasons was that one partner had a final salary pension scheme which both would rely on for their

HOW MARRIAGE CAN SAVE YOU THOUSANDS IN IHT

Rowley Turton Private Wealth Management director Scott Gallacher explains how being married helps with IHT with a hypothetical example:

'Imagine John owns a house worth £1m. When he dies, he leaves it to his partner Jane, but this creates a £270,000 IHT liability in the estate*. Jane is forced to downsize to a £730,000 home to pay the bill.

Jane then dies leaving the £730,000 house to their son James, but this time there's £92,000 due in IHT so James inherits just £638,000**. "Had his parents been married, there would have been no IHT to pay at all in this example,' says Gallacher.

'It's arguably even worse if assets are in one partner's name and there's no will, as the cohabiting partner won't then inherit those assets, albeit the IHT might be less. In my example, with no will then on John's death the house passes to James and is subject to a £200,000 IHT bill.'

***How this is calculated:**

Estate – **£1,000,000**
Nil Rate Band – **(£325,000)**
Taxable Estate – **£675,000**
Inheritance Tax rate **40%**
Inheritance Tax payable **£270,000**

****How this is calculated:**

Estate – **£730,000**
Nil Rate Band – **(£325,000)**
Residential Nil Rate Bans – **(£175,000)**
Taxable Estate – **£230,000**
Inheritance Tax rate **40%**
Inheritance Tax payable **£92,000**

retirement income, but the other partner would not be automatically entitled to it if the first partner died. 'It would be at the discretion of the trustees of the scheme whether they would pay out to the surviving partner.

'Some schemes accept a declaration of partner form which means you can nominate your partner although not married, but others schemes may not allow this if their rules have not been updated,' she explains. 'In this scenario, when they die, their pension dies with them.'

WHY YOU NEED A WILL

If you really don't want to get married, at least make a will and have a Power of Attorney (POA) in place, advises Lindsay. 'This

appoints an attorney to make decisions for you for welfare and or financial decisions, depending on the scope of your POA. Some people may also consider a cohabitation agreement,' she says. Having a will is important because, without one, your partner isn't automatically entitled to inherit your estate, even if they live in a house you own.

They may have to move out so the house can be sold. If unmarried, you may find a relative is classed as your partner's next of kin, so if something happens to them, you may not be able to make medical decisions on their behalf, for example. Should they die, you also wouldn't be eligible for the government's bereavement support payment, worth up to £9,800.

So, yes, that certificate which proves you're married or civil partnered is just a piece of paper, but it's an important one. In fact, not having it could prove much more costly than a wedding.

By **Hannah Smith**

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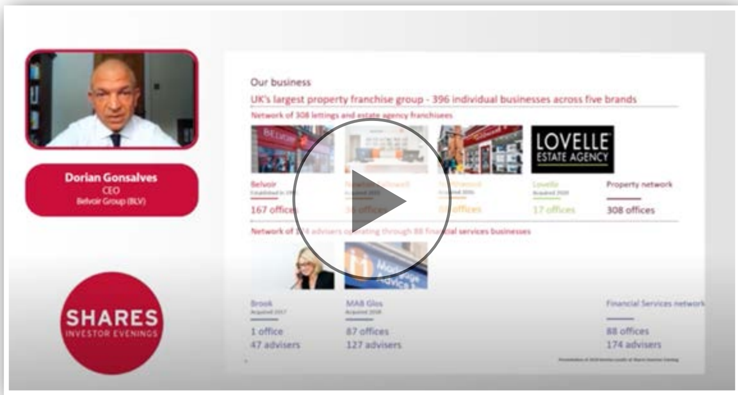
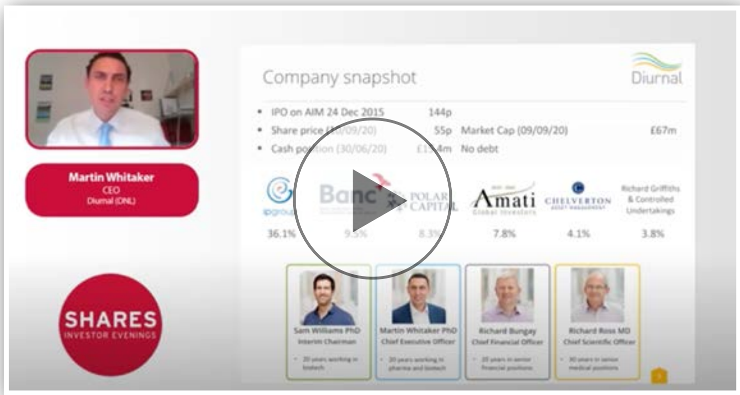


Belvoir Group (BLV) – Dorian Gonsalves, CEO & Louise George, CFO

Belvoir Group was founded in 1995 and listed on AIM in 2012, is the UK's largest property franchise operating nationwide from 396 offices across five brands specialising in residential lettings, property management, residential sales and property-related financial services.

The Group manages 69,000 properties and reported record revenues of £19.3m in 2019.



Diurnal (DNL) – Martin Whitaker, CEO

Diurnal Group is a specialty pharmaceutical company developing hormone therapeutics to aid lifelong treatment for rare and chronic endocrine conditions, including Congenital Adrenal Hyperplasia, Adrenal Insufficiency, Hypogonadism and Hypothyroidism.

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What the price-to-earnings ratio means

The price to earnings (PE) ratio is the most commonly used way to value a company's shares

When fund managers, analysts, the financial press and so on talk about 'cheap' and 'expensive' stocks, it's important for anybody thinking about investing to know what that actually means.

It does not mean that because a company's share price is £100 it is expensive, or that because it's share price is £2 it is cheap.

In fact, the stock with the £2 share price might possibly be more expensive than the one with the £100 share price. It all comes down to measuring the value a share price puts on the business.

There are a number of ways to measure value and we'll touch on all the main ones over the next few articles of this series.

For now we'll start with the most commonly used and most talked about metric – the price-to-earnings (PE) ratio.

The PE ratio is probably the simplest way to measure the value of a stock and can be one of the most effective. It is simply the company's share price divided by its earnings per share (EPS) figure.

PE = SHARE PRICE ÷ EARNINGS PER SHARE

A company's share price can easily be found with a Google search or on the London Stock Exchange website, while its earnings per share figure – and indeed numbers like the PE ratio and other valuation metrics – can be found via financial information providers including Bloomberg or Refinitiv, or via free-to-use websites such as *Shares'* own website or Sharecast.com.

HOW MANY YEARS TO PAY YOU BACK

A good way to think about the PE ratio is that it tells you how many years the company would take, with profits at current levels, to make enough money to cover the cost of all its shares in issue. A company's PE, and other valuation metrics including the ones we'll look at in the next few articles, is often referred to as its 'multiple' or 'rating'.

Remember, a company's share price isn't driven by the here and now – it's about the future outlook, with investors always looking at what they believe is likely to happen to the business in the next 12 months to two years. So that's why it's more useful to look at a company's forecast earnings figure and its forward PE than to rely on historic figures.

For example online fashion retailer **ASOS (ASC:AIM)**, a beneficiary of the shift to online shopping during the coronavirus pandemic, in September 2020 was trading on a 12-month forward PE of 47.9 according to Stockopedia, meaning it would take 47.9 years for the company to make enough money to buy back all its shares at today's price.

This is considered an expensive stock with a 'high rating'. Companies with high ratings are usually given such a price tag because the stock market believes their income stream is high quality and/or that they have good growth prospects going forward, with investors in effect paying up for that future growth today.

In comparison, a 'fair value' stock may be considered one with a PE of under 20 times forecast earnings, while a cheap stock would be one with a PE of under 12 times. There are variations across stocks and different types of business. A PE in single figures would often suggest there was a serious problem with the business.

CHEAP FOR A REASON

For this reason it is not as simple as saying if one stock is really expensive and one is cheap, you should just go for the cheap one. Not so fast. Often there is a reason the cheap stock is cheap.

In his book *Making the Right Investment Decisions*, author Michael Cahill gives the example of banks and housebuilders.

Back in 2007 they were trading on very low PEs but trading was still very good, he says, leading to some fund managers to think the shares were cheap.

However the key here, Cahill explains, was that the shares were anticipating a sharp slowdown in the economy, especially in the housing market, and reflecting the high risks in that sector especially for those with a lot of debt. While the stock market doesn't always get it right, on this occasion the shares accurately predicted the looming problems.

In reality they were anything but the bargain they appeared to be.

It's also important to note certain sectors where PE is a less useful measure, like the finance and property sectors, where firms are often better measured by asset values rather than earnings.

For a property company the focus is often on the value of its assets divided by the number of shares in issue. This is called net asset value (NAV).

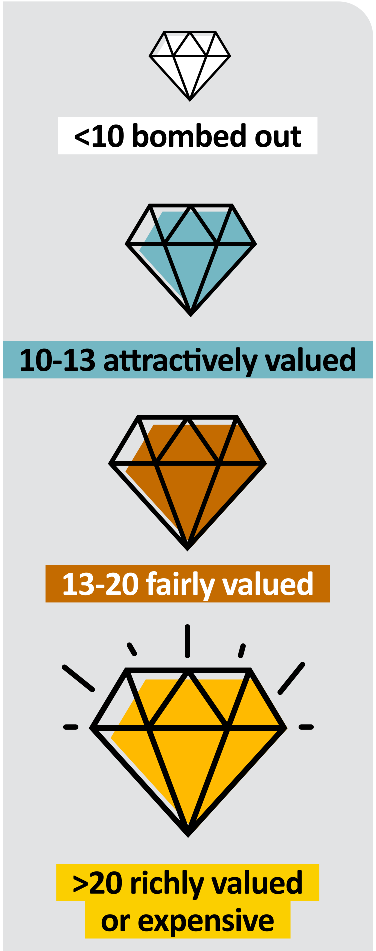
In addition, it's pointless to use the PE ratio to value companies where there are currently no earnings, such as start-ups. Also cyclical companies which have fallen into losses, or very low level of earnings which distort the PE, would also be inappropriate. As would companies with large amounts of debt, something not factored in by a PE.

In these instances, enterprise value/sales or EV/earnings before interest, tax, depreciation and amortisation (EBITDA) could be more useful measures. We'll discuss these in later articles in this series.

You mind find a company has done really well and released a bumper set of results with high levels of profit, but it has a low PE.

This will likely be because the market sees little prospect of further growth, with the company dominating its market and/or reporting good profit margins, but with no defined strategy for generating further growth.

PE - WHAT IS CHEAP AND EXPENSIVE?



Source: Shares

USING THE PE ALONGSIDE OTHER MEASURES

The PE undoubtedly has some limitations but there is value in its simplicity. There is nothing to stop you using the PE as a starting point and then using other metrics to get a more in-depth idea of how a business is being valued by the market.

By **Yoosof Farah**
Reporter

KEY

- Main Market
- AIM
- Fund
- Investment Trust
- ETF
- Overseas Share
- IPO Coming Soon

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

5 October: Quadrise Fuels. **6 October:** Smartspace Software, YouGov.

Half year results

6 October: Harworth, Inspiration Healthcare.
7 October: Tesco. **8 October:** Phoenix Global Resources.

Trading statements

8 October: CMC Markets, Electrocomponents, Motorpoint.

WHO WE ARE

EDITOR:
Daniel Coatsworth
@Dan_Coatsworth

DEPUTY EDITOR:
Tom Sieber
@SharesMagTom

NEWS EDITOR:
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James Crux
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SENIOR REPORTERS:
Martin Gamble
@Chilligg

Ian Conway
@SharesMagIan

REPORTER:
Yoosof Farah
@YoosofShares

CONTRIBUTORS
Russ Mould
Tom Selby
Hannah Smith

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

PRODUCTION
Head of Design
Darren Rapley
Designer
Rebecca Bodi

CONTACT US:
support@sharesmagazine.co.uk

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