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TO **DISNEY** IN
LOCKDOWN



Ronen Berka | New York, 2016

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Capital at risk



Let's hope ESG doesn't become a meaningless term

It is important to distinguish between those paying lip service to ethical investing and those making a tangible difference

In an age where ESG (environmental, social and governance) factors are becoming more important to investors, it can feel like funds and companies are clamouring to paint themselves in these colours for the cachet it involves.

The danger is that the term is diluted to the point of meaninglessness. For example, tobacco manufacturer **Imperial Brands (IMB)** is in the process of developing a new ESG Steering Committee and yet its main product has a major negative impact on global health.

You don't need to make a sweeping moral judgement on the sale of cigarettes to see that it is important to distinguish between businesses which are reaching for a label and those which are genuinely having a positive impact on society.

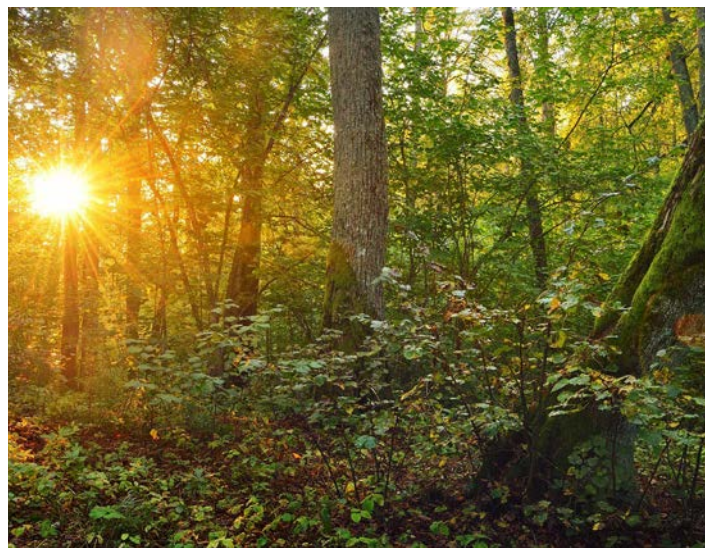
We should be able to make an informed choice about how to align our principles with our investing and treating ESG as a box to tick or trying to paint the activities of a business in an unrealistically favourable light does nothing to help.

A recently listed vehicle where it is much easier to see the good which is being done is **Home REIT (HOME)**.

Floated in October, the company recently confirmed it had attained real estate investment trust (REIT) status and announced the deployment of a further £42 million of the £250 million raised at IPO (initial public offering), taking the total allocated to date above £50 million.

Against the backdrop of a housing crisis in the UK, this money is being invested in properties across the country which will provide accommodation for a variety of vulnerable groups including women escaping domestic violence and people facing homelessness due to poverty.

This isn't a purely altruistic exercise – the trust is looking to generate a total return of 7.5% a year for investors as it claims inflation-linked rent payments from local authorities, themselves backed by the



Department of Work and Pensions.

However, there is an element of 'win-win' in this scenario as the accommodation it offers is cheaper than other temporary alternatives like hotels and bed and breakfasts.

Over time, the market and regulators are likely to get better at making distinctions between genuinely ethical investments and those which are merely paying lip service to the concept of social and environmental responsibility.

At the beginning of November 2020, the Competition & Markets Authority announced a crackdown on so-called green-washing or exaggerating the positive environmental impact of a product or service.

The focus is likely to fall on areas like the fashion industry, travel and transport, and consumer goods like food, beverages as well as beauty and hygiene products. There is the threat of enforcement action if it determines consumers are being misled.



By **Tom Sieber** Deputy Editor

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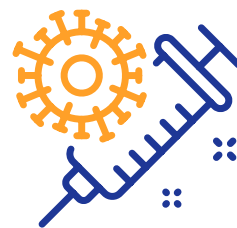
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Actual Investors

*Source: Morningstar, share price, total return in sterling as at 30.09.20. **Ongoing charges as at 31.03.20 calculated in accordance with AIC recommendations. Details of other costs can be found in the Key Information Document. Your call may be recorded for training or monitoring purposes. Issued and approved by Baillie Gifford & Co Limited, whose registered address is at Calton Square, 1 Greenside Row, Edinburgh, EH1 3AN, United Kingdom. Baillie Gifford & Co Limited is the authorised Alternative Investment Fund Manager and Company Secretary of the Trust. Baillie Gifford & Co Limited is authorised and regulated by the Financial Conduct Authority (FCA). The investment trusts managed by Baillie Gifford & Co Limited are listed UK companies and are not authorised and regulated by the Financial Conduct Authority.

The vaccine catalysts still in store



Stock gains more muted as investors welcome the news of another potential treatment

– WHERE WE STAND WITH OTHER VACCINES –

Vaccine candidate	Date started Phase 3 trials
Wuhan Institute of Biological Products/Sinopharm	July 2020
Beijing Institute of Biological Products/Sinopharm	July 2020
University of Oxford/AstraZeneca	August 2020
Sinovac	August 2020
CanSino Biological Inc./Beijing Institute of Biotechnology	September 2020
Gamaleya Research Institute	September 2020
Janssen Pharmaceutical Companies	September 2020
Novavax	September 2020

Source: Peel Hunt, Evaluate Pharma, WHO

The revelation from US pharmaceutical company Moderna that its vaccine was 94.5% effective in treating coronavirus, with no significant safety concerns, sent global stock markets up between 1% and 2% on 16 November.

This compares with a bump of around 5% in response to the positive update from Pfizer and BioNTech a week earlier and suggests there may be diminishing returns from further vaccine news – with the table showing some of the main other candidates, several of which are centred in China.

The most meaningful will probably come from **AstraZeneca (AZN)** which is due to report on its vaccine, being developed together with the University of Oxford, in the next month.

According to Adam Barker, analyst at Shore Capital, AstraZeneca's treatment 'doesn't have to hit a 90%+ efficacy bar to still be useful, and it remains the most stable of all the candidates at refrigerated temperatures'.

The market winners and losers were much the same on the Moderna news as the earlier vaccine catalyst, with hotels and airlines racking up large gains and previous lockdown 'winners' including online retailers suffering losses, albeit the moves were not as spectacular.

Moderna claimed preliminary analysis of its

late-stage trials involving more than 30,000 volunteers showed the vaccine prevented the most serious cases of infection, with no severe cases at all among those who received it. 'That for me is a game-changer', said Moderna chief executive Stephane Bancel. Moderna shares initially soared 12% on the news.

Like the Pfizer/BioNTech vaccine, which claims to be more than 90% effective, the Moderna treatment uses mRNA technology designed to turn the body's own cells into vaccine 'factories', creating copies of the virus's 'spike protein' which in turn stimulates the production of antibodies. Both firms have struck significant supply deals with the US government.

While the results are preliminary and the technology has yet to be approved, both firms are expected to ask the US Food and Drug Administration for emergency-use authorisation dependant on follow-up safety data later this month.

Crucially, while the Pfizer/BioNTech vaccine has to be stored at ultra-low temperatures of -60 to -80 degrees Celsius until a few days before use, the Moderna vaccine is stable at normal refrigerator temperatures of -2 to -8 Celsius and can be kept for up to 30 days or can be frozen if needed. This gives it a significant advantage in terms of ease of distribution.

The big rotation into value

The vaccine breakthrough has shone a light on the path towards recovery and exposed the market's preference for growth

Value investors often say there is no point trying to time the rotation back to their value style because it can happen in the blink of an eye and you often end-up chasing the move and paying higher prices. The market action on 9 November and follow-through in the intervening period certainly lends some credence to that view.

Commenting on the sharp moves over the last week, Jefferies noted that, 'if anybody was in any doubt that cyclical stocks would rally sharply on the re-opening trade, they got the evidence they needed with the parabolic moves on Monday'.



Leisure and hospitality shares have seen very big rallies with **Cineworld (CINE)**, **Hollywood Bowl (BOWL)**, **Hostelworld (HSW)** and **The Gym Group (GYM)** all rising between 40%-to-50%. Shares in **SSP (SSPG)** are up 76%. Banks and insurers are up around a quarter.

At the other end of the spectrum have been **Ocado (OCDO)**, **Games Workshop (GAW)** and **Keywords Studios (KWS:AIM)**, all off around 10% while companies focused on Covid-19 testing and therapeutics have seen the biggest falls. **Avacta (AVCT:AIM)**, **Synaigen (SNG:AIM)** and **Novacyt (NCYT:AIM)** have all fallen by around a third.

It has been the same story on the funds and trust side with value focused funds such as **Aurora**

(AVV) rallying 10% and **Fidelity Special Values (FSV)** up almost 15%. Funds with a heavy weighting in technology shares such as **Scottish Mortgage Trust (SMT)** have seen the price of their shares fall 5% over the last week.

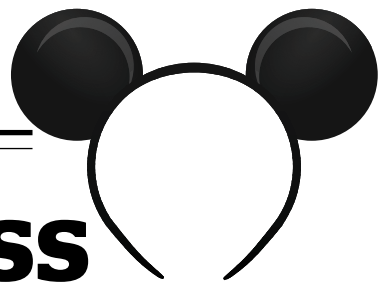
No doubt some of the moves in cyclical names were related to short-sellers being caught out on the positive vaccine news and rushing to buy back their positions. Cineworld is one of the most heavily shorted names with around 9% of its shares held by investors betting that its shares would fall.

However there are an increasing number of market observers taking the view that co-ordinated fiscal and monetary support is setting up the conditions for a global synchronized recovery sometime in 2021. Morgan Stanley is in the strong recovery camp saying 'our bull case assumes that the virus is contained quicker, allowing GDP to return to pre-Covid-19 levels by 3Q 21'.

They maintain that higher growth, rising inflation and higher bond yields suggest a 'reflation narrative' which favours financials, cyclicals and value over defensives, growth and quality.



Meanwhile even before the Pfizer and Moderna vaccine breakthrough news JP Morgan Cazenove said it believed markets were 'primed for a style rotation back into value' explaining the firm had taken profits on its long-standing bullish stance technology in favour of banks and insurers.



Streaming TV success boosts Walt Disney

Family entertainment giant reshaped during stay-at-home 2020

Family entertainment giant **Walt Disney** has seen its business massively reshaped as the coronavirus pandemic saw the gates slam shut at its global themes parks, cruises cancelled, cinemas closed and movie filming put on ice.

This saw the Dow Jones Industrial Average and S&P 500 member plunge to its first annual loss in 40 years.

Disney recorded a net loss of \$2.83 billion under generally accepted accounting principles (GAAP), on a \$4 billion revenue fall to \$65.4 billion. Disney estimates the impact of Covid-19 on its operating profit for fiscal 2020 at \$7.4 billion, with the Parks, Experiences and Products segment alone taking a \$6.9 billion hit.

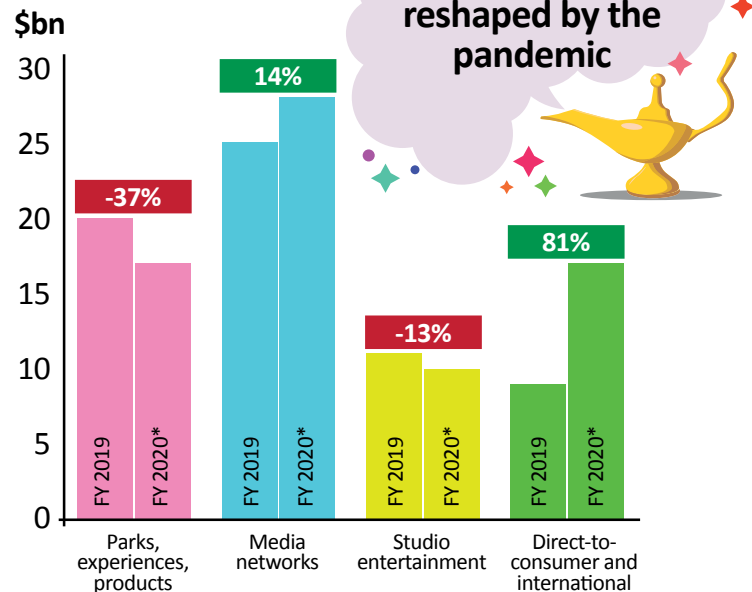
The entertainment giant was forced to shut its global theme parks early in 2020, with Disney World in Florida closing on 12 March. Disney World is the most popular tourist attraction on earth, with nearly 21 million visitors in 2019.

Investors rallied behind the stock despite this news, sending the share price jumping 13.5% to \$144.67, partly because losses were not as bad as feared and thanks to theme park re-openings. Only Disneyland in California and Disneyland Paris remain closed.

TV ON-DEMAND BOOST

But it was the incredibly popular streaming TV services, Disney+, ESPN+ and Hulu that have fuelled optimism among investors. Disney+, which includes the Disney animation films and the Marvel and Star Wars universes, saw paid subscribers surge to more than 73 million in its first year. That places its growth rate well ahead of Disney's goal of 60 million to 90 million customers by the end of fiscal 2024, which management set when the service launched in 2019.

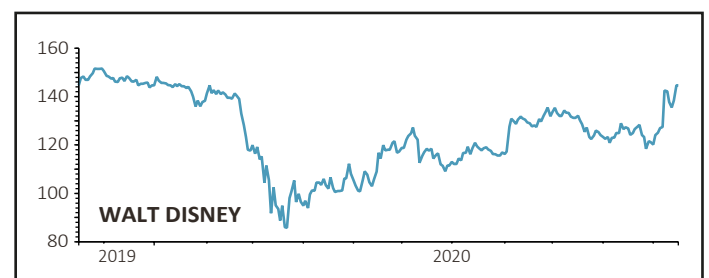
'The real bright spot has been our direct-to-consumer business, which is key to the future of our company', said chief executive Bob Chapek.



This saw streaming TV overtake its enormous theme parks operation in terms of revenue (see chart).

'Covid-19 and measures to prevent its spread impacted our segments in a number of ways, most significantly at Parks, Experiences and Products', the company wrote in its latest earnings report for the quarter and fiscal year ended 3 October 2020.

'Our theme parks were closed or operating at significantly reduced capacity for a significant portion of the year, cruise ship sailings and guided tours were suspended since late in the second quarter and retail stores were closed for a significant portion of the year. We also had an adverse impact on our merchandise licensing business,' the report said.



A new wave of renewable trusts set for London IPOs

Three vehicles plan to float and are keen to differentiate themselves from existing peers

As the stock market recovers and investors approach the new year in a more optimistic mood, a number of investment trusts are eyeing up an initial public offering (IPO) on the London market.

A lot of these trusts are in the renewable energy space, which has gained rising investor interest particularly this year as the cost of solar and wind farms has fallen dramatically, making them economically viable without any subsidies and in some cases making them more attractive, purely from a monetary point of view, to build and operate than fossil fuels like coal.

Three investment trusts in this space have over the past week announced their intention to float on the London Stock Exchange – **Victory Hill Global Sustainable Energy Opportunities**, **Downing Renewables & Infrastructure Trust**, and **Ecofin US Renewables**.

Trust	Expected listing/ size of fundraise
Downing Renewables & Infrastructure Trust	December 2020/ £200 million
Ecofin US Renewables	December 2020/ \$250 million
Victory Hill Global Sustainable Energy Opportunities	February 2021/ £400 million

Source: Company info

Anthony Catachanas, chief executive of Victory Hill, tells *Shares* that VH Global Sustainable Energy Opportunities aims to tap into growing investor interest in not just the transition to cleaner energy, but also funds that have a positive social impact and are aligned with the UN's Sustainable Development Goals.

He says: 'Over the last 10 years we've witnessed a change in mindset from institutional and indeed retail investors, who have recognised the environmental problems, social problems,



governance problems and a number of issues which have resulted from a lack of consciousness around human activity and the impact it has on society. Unsurprisingly, as financiers we want to provide a solution to that.'

The trust, which expects to publish a prospectus in early January and list by early February, is looking to invest in a range of renewable energies including wind and solar, but also projects in areas like hydro power, waste-to-energy and hydrogen.

There are 14 investment trusts focused on renewable energy currently on the London market, which all trade at a premium to net asset value (NAV) – in most cases a double-digit premium.

But one of the big concerns surrounding renewable trusts is the impact of a significant fall in future power prices, as the growth in carbon-free energy slashes the cost of electricity and reduces the amount of money they can generate. This has been highlighted by analysts and seen in the results of some trusts this year.

The trusts launching now are keen to stress their reduced exposure to power prices, and Tom Williams, head of energy and infrastructure at Downing, explains that 'one of the key aims' of Downing Renewable & Infrastructure Trust is to limit exposure to the merchant power price as much as possible.

He says: 'We use a range of tools to limit power price exposure. For our legacy assets we already have long-term subsidy agreements, but for our newer assets we have corporate power-purchase agreements (PPAs) and fixed-price contracts in place.'

What Tesla's inclusion in S&P 500 means

\$10 billion tracker funds trade on the cards for electric cars maker

Electric car maker Tesla is to join the S&P 500 next month, triggering a multi-billion mega-trade as index funds are forced to buy the Elon Musk-founded company's shares.

Tesla stock rallied more than 12% in after-hours trading on Nasdaq this week after S&P Dow Jones Indices announced that the company would join the S&P 500 index ready for trading on 21 December.

Barron's estimates nearly \$10 billion worth of Tesla stock will need to be purchased by index funds.

At \$459.90, the company's shares are less than 8% below their \$498.32 all-time high, struck on the final day of August this year.

Tesla will be 'one of the largest weight additions to the S&P 500 in the last decade, and consequently



will generate one of the largest funding trades in S&P 500 history', S&P Dow Jones Indices said, sparking rumours that the stock may be added in more than one tranche to help the market absorb the company in an orderly manner.

With a market capitalisation of more than \$435 billion, Tesla will become one of the most valuable companies on Wall Street and the eighth largest S&P 500 stock, ahead of Wal-Mart, the world's largest retailer at approximately \$432 billion.

The S&P 500 is one of the most closely watched barometers of the mood of investors across the pond, and its performance impacts stock markets globally.

Singles Day bonanza could salve Alibaba's Ant wounds

JD.com, Apple, L'Oreal join Chinese e-commerce giant in reaping huge sales

CHINA'S ONLINE shopping bonanza broke records this year with top brands like Apple iPhones, L'Oreal's Lancome skin toner and Nestle chocolates raced off the virtual shelves.

Chinese e-commerce giants Alibaba and JD.com racked up approximately \$116 billion in sales across their platforms during the Singles Day shopping event, both setting new records, according to Reuters data.

Singles Day, also known as

Double 11 because it happens on 11 November every year, is the world's biggest online sales event, eclipsing Black Friday and Cyber Monday in the US. However, because of disruption caused by the coronavirus pandemic, this year's event spanned 11 days rather than the typical one-off 24-hour bonanza.

New York and Hong Kong-listed Alibaba said its total gross merchandise value (GMV) over the 11-day period, a figure that shows the total value of orders across

Alibaba's shopping platforms, totalled approximately 498.2 billion yuan (\$74.1 billion) Alibaba said, as lockdown-weary consumers splashed out on as many as 16 million discounted goods, nearly double last year's 268.4 billion yuan. Rival Chinese online sales platforms such as Hong Kong-quoted JD.com and Nasdaq-listed Pinduoduo also ran Singles Day events. JD.com's transaction volume over the 11-day period totalled 271.5 billion yuan (\$41 billion), more than the 204.4 billion yuan it recorded in 2019.

JD.com stock jumped more than 22% to \$368 as investors absorbed the sales data, although Alibaba shares have been dragged lower in the wake of the pulled IPO of its former subsidiary and online finance business Ant.



Fundsmith

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% Total Return

12 months ending October	2020	2019	2018	2017	2016
Fundsmith Emerging Equities Trust	+1.2	+8.5	-4.3	-5.1	+25.3
AIC Global Emerging Markets Sector	-4.5	+5.8	-8.9	+10.3	+31.9

Source: Financial Express Analytics

Self-help makes Renewi a compelling recovery play

Strong cash flow generation and lower debt have transformed the investment case for waste firm

Unlike a lot of firms, international waste-to-product company **Renewi (RWI)** – which was formed from the merger between Shanks Group and Van Gansewinkel Group in 2017 – has emerged from the pandemic in better shape than it started.

First half turnover at its ongoing operations, which exclude the Canada municipal business sold in September last year and the Reym business sold in October 2019, was down just 3% despite the downturn in European economic activity.

After extensive lockdown measures in the first quarter, volumes at its Belgian commercial waste operations had recovered to 91% of last year's levels in the second quarter ended in September and 97% of last year's levels in the Netherlands, beating management expectations.

The Minerals and Waste division, which includes the ATM hazardous waste business, actually grew its volumes, revenues and profits, treating more contaminated soil and creating more new products for the construction industry.

At the same time, group cost savings of €10 million during the first half beat estimates, so full year efficiencies are now expected to be above the firm's

RENEWI
 **BUY**
 (RWI) 23.95p

Market cap: **£190 million**



earlier target of €15 million.

However it is the company's progress on cash flow generation and debt reduction which really catches the eye. Thanks to a big reduction in exceptional costs to just €8.1 million against €58 million last year, and the deferral of some taxes, free cash flow soared 89% in the first half to €97.8 million, allowing the firm to reduce what it calls its core net debt from €514 million to €381 million.

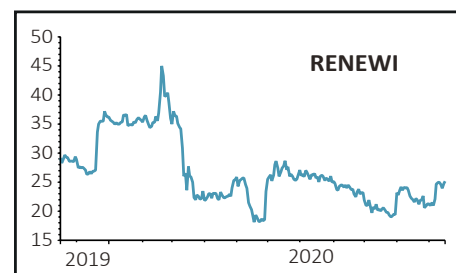
As chief financial officer Toby Woolrich explained, the underlying business was always attractive to investors, 'but our debt was too high, there were too many "exceptional costs" for integrating the businesses and for UK PFI contracts, and not enough free cash flow – that's all changed'.

After three years, the business is integrated and costs are being brought down sharply. At the same time, Renewi has a market-leading brand and a

three-pronged plan to increase underlying pre-tax profits by €60 million over the next three to five years.

The aim is to recover €20 million of 'lost' earnings at ATM, where progress is already under way: to improve efficiency through the tech-led Renewi 2.0 programme; and to develop new products such as bio-LNG where the firm is already working with global energy giant **Royal Dutch Shell (RDSB)**.

With management now forecasting full year earnings 'materially ahead' of its previous expectations, analysts at Investec and Peel Hunt have raised their price targets to 50p and 49p respectively.



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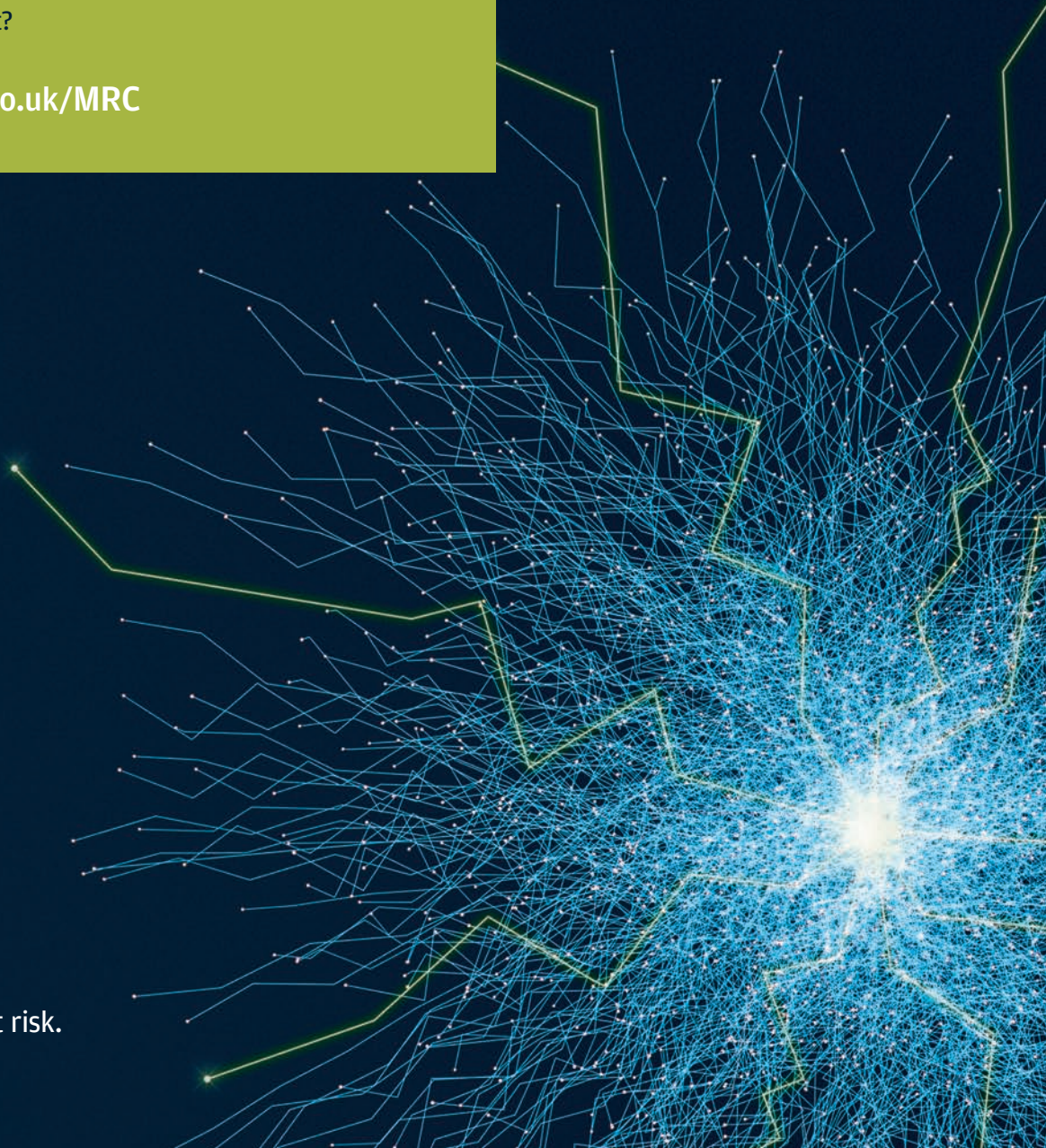
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Time to ride the bounce at Burberry

The trenchcoats-to-cashmere scarves seller is beginning to recover from the worst impacts of the pandemic

October's encouraging return to sales growth suggests luxury goods group **Burberry (BRBY)** is starting to recover from the worst effects of the pandemic.

And with Covid-19 vaccine breakthroughs pointing the way to a full reopening of the global economy and a rebound in intercontinental travel, *Shares* believes this is a compelling entry point into the stock.

Even after a post-results bounce, shares in the London-headquartered fashion house remain 26% below the £22.05 at which they started 2020. At current levels, they sell for a shade above twenty times forward earnings estimates for

BURBERRY
 **BUY**
 (BRBY) £16.34

Market cap: **£6.63 billion**

the years to March 2022 and 2023 according to Refinitiv data, a significant discount to luxury goods peers.

TIME TO BAG A RARE ASSET

Famed for its iconic Equestrian Knight Device and the Burberry Check, Burberry is blessed with a strong and enduring brand, which confers pricing power and underpins high margins and, in normal times, robust cash flow



generation upon the business.

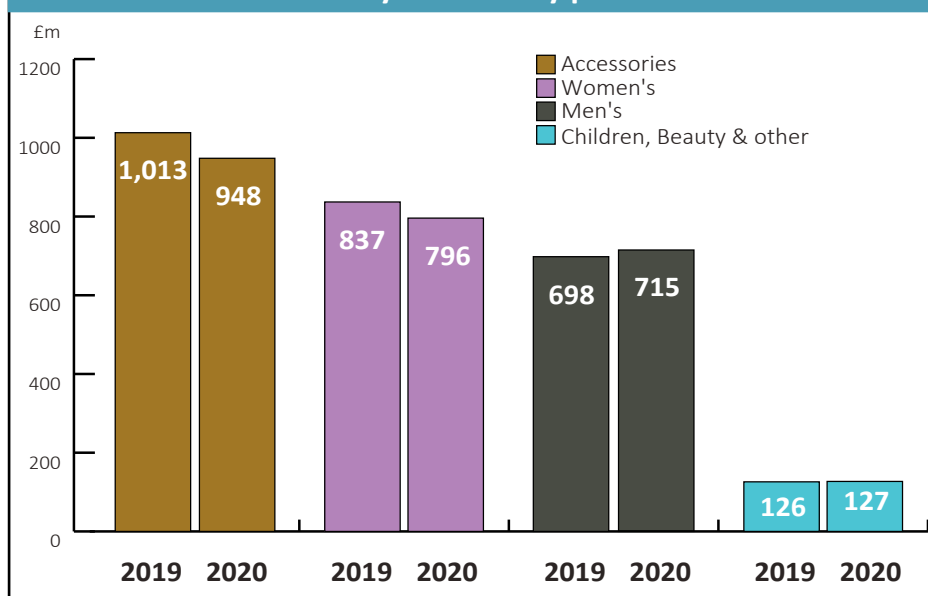
The FTSE 100-listed trenchcoats-to-cashmere scarves manufacturer and seller is a long-standing holding in the **Finsbury Growth & Income Trust (FGT)** managed by well-followed fund manager Nick Train.

In his latest factsheet commentary, Train explained his trust wants to own more UK companies with luxury, premium or aspirational brands and this is 'why we have thought it so important to maintain the size of our position in Burberry, through its recent share price weakness'.

CHINA DRIVES GROWTH RETURN

Much of Burberry's sales rely on globe-trotting, free-spending Asian customers, which explains why the shares sold-off heavily as the coronavirus began to spread out from China and why the momentum Burberry had built under chief executive Marco

Burberry revenue by product



Source: Burberry

Gobbetti was so badly disrupted by Covid-19.

Recent results, covering the six months to 26 September 2020, showed sales tumbled by 31% to £878 million, although this was better than analysts had predicted considering that Burberry began the half with 60% of its stores closed globally due to the pandemic.

Burberry did rather well to limit the first half decline in adjusted operating profit, down 75% to £51 million, while also delivering high double-digit online sales growth in the second quarter.

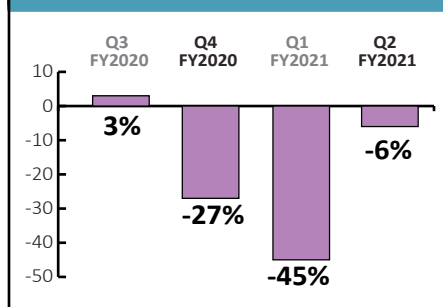
With the majority of Burberry's stores reopened by the end of June, like-for-like store sales were down 6% in the second quarter, representing a strong sequential improvement on the 45% slump suffered in the first quarter. Encouragingly, the recovery has further accelerated in the last two months; September's comparable store sales were down low single digits before turning positive in October.

During the second quarter, Burberry generated strong double-digit growth in mainland China, Korea and the US, though the virus continues to impact sales in EMEA (Europe, the Middle East, India, and Africa), Japan and South Asia Pacific.

The leather goods, dresses and knitwear maker is seeing a strong response to its brand among social media-savvy new and younger customers. In mainland China, where Burberry has seen significant digital adoption, the company has even opened its first social retail store in Shenzhen Bay in an exclusive partnership with Chinese



Burberry's recovering comparable store sales



Source: Burberry

internet giant Tencent, which should boost brand awareness over time.

RISKS TO CONSIDER

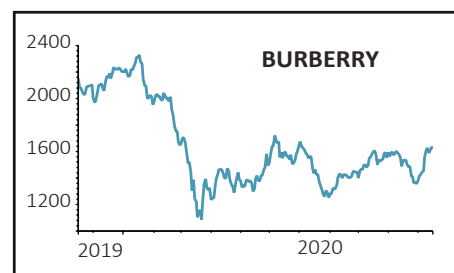
Burberry, which will review reinstating the dividend at the end of the current financial year, remains 'conscious of the uncertain macro-economic environment caused by Covid-19', mindful that more than 10% of its global stores are currently shuttered following the recent lockdowns in EMEA.

Thankfully, Burberry has the balance sheet strength to weather the remainder of the crisis. As at 26 September, Burberry's 12-month adjusted net debt-to-adjusted EBITDA ratio was 0.9 times and remained inside management's target range of 0.5 times-to-one times despite the impact of the pandemic.

Investors should also note that French luxury goods groups Hermes and Kering have both recently beaten third quarter sales forecasts amid strong demand in Asia and the US, suggesting a tentative recovery from the pandemic and its punishing lockdowns is now underway.

Furthermore, France's LVMH has finally ended its pandemic-induced dispute with Tiffany and agreed to buy the engagement rings purveyor for a lower-than-originally agreed \$15.8 billion.

Rather than walk away, Dior-to-Louis Vuitton owner LVMH salvaged the luxury sector's biggest-ever deal, which demonstrates just how highly prized luxury brands remain. This mega-deal might even spur further industry consolidation once the global economic picture improves, and a lunge for Burberry certainly shouldn't be ruled out.



Could this be the best value renewable energy fund on the market?

Renewable energy infrastructure funds are proving popular, with the vast majority now trading at share prices well above their net asset value (NAV).

In fact, according to the AIC and Morningstar, the average premium right now is more than 15%¹ above the NAV.

If you haven't yet got a little green in your portfolio, here is an opportunity to get into a new renewables trust at IPO without having to pay a big premium, making it potentially the best value offer on the market.

Why not take a look at what the **Downing Renewables & Infrastructure Trust (DORE)** has to offer.

- > DORE will invest in renewable energy & infrastructure assets in the UK, Ireland & Northern Europe.
- > It will be managed by an experienced investment team with a track record of delivering gross returns of 9%².
- > The target return in the medium to long term is 6.5%-7.5% p.a.³

To apply contact your stock broker or share dealing provider or visit [Youinvest](https://www.youinvest.co.uk).

¹ Source: AIC list of renewable energy infrastructure investment companies, prepared by Morningstar as at 16.11.20.

² Based on the unlevered weighted-average gross Internal Rate of Return on exit for the 55 assets sold since 2010.

³ Target returns are not profit forecasts and there is no guarantee that they will be met.

Capital is at risk, past performance is not a reliable indicator of future performance and target returns are not forecasts and are not guaranteed.

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JPMORGAN JAPANESE INVESTMENT TRUST (JFJ)

(SKG) 688p

Gain to date: 25.6%

Original entry point:

Buy at 547.92p, 02 July 2020

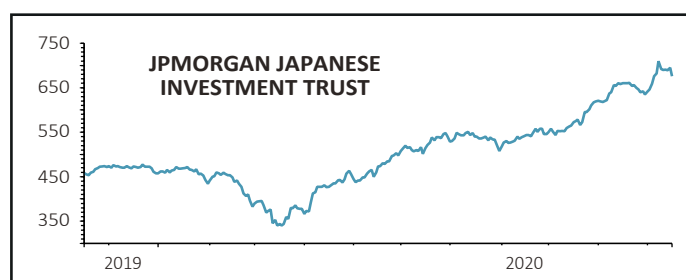


OUR BULLISH CALL on **JPMorgan Japanese Investment Trust (JFJ)** is now 25.6% in the money and we remain positive on the capital growth-focused fund, confident that managers Nicholas Weindling and Miyako Urabe will continue to find the most attractively valued Japanese investment themes and companies in an under-researched stock market.

Back in July, we highlighted the trust's then 10.2% discount to net asset value (NAV), which we believed belied a strong long-run record.

According to Quoteddata, this has been achieved 'by following a conviction-driven stock-picking approach that focuses on quality and growth, two aspects that have been in demand in a world tackling Covid-19'.

That discount has narrowed to 1.18% with investors increasingly recognising the trust's merits and sentiment towards Japan turning more positive, boosted by Japan's better than forecast third quarter GDP reading.



SHARES SAYS: ↗

Stick with JPMorgan Japanese Investment Trust.

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HOMESERVE

(HSV) £12.62

Gain to date: 9.3%

Original entry point:

Buy at £11.45, 16 April 2020

HIGHLIGHTED AS A resilient company which should weather the coronavirus pandemic and get through relatively unscathed, home repairs firm **Homeserve (HSV)** is performing as well as expected as it forecast annual profit ahead of expectations (17 Nov).

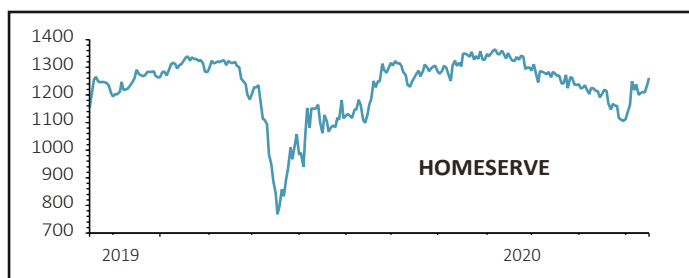


Homeserve shares had been drifting lower from their July peak over the past few months, though to some analysts and investors it has not been entirely clear why, with the firm having reported that activity has been 'business as usual' during the pandemic.

In its half year results to 30 September, Homeserve reported a 16% increase in adjusted pre-tax profit to £33.1 million, as revenue rose 17% to £536.7 million.

The company said that having performed better than expected in the first half and with marketing and full claims handling now resumed, it now expects to grow in the year and deliver adjusted pre-tax profit slightly ahead of current consensus earnings estimates.

'The latest wave of lockdowns has made no fundamental difference to our operations, and the good news for us and our customers is that engineers can continue to work in peoples' homes,' said CEO Richard Harpin.



SHARES SAYS: ↗

Unaffected by lockdowns and is able to continue growing. Still a buy.

FOCUSRITE

(TUNE:AIM) 924p

Gain to date: 34.5%

Original entry point:

Buy at 687p, 23 July 2020

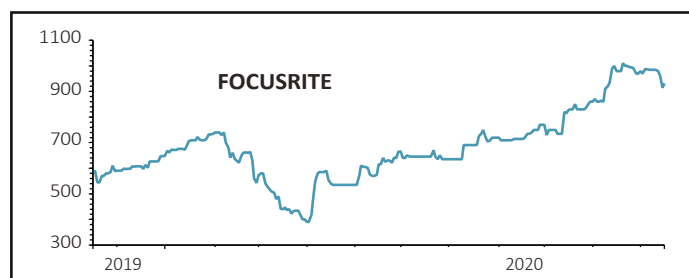
OUR FAITH IN the audio tech firm continues to be rewarded with the company's full-year results providing the latest catalyst.

It posted a 46% drop in profit for the 12 months to 31 August after it wrote down the value of its Martin Audio business, due to the pandemic hurting the live gig scene.

The company, however, raised its dividend by 10% to 4.2p per share while touting a stronger underlying operating performance.

In response to the numbers Peel Hunt upgraded its earnings forecasts by 3% for the August 2021 and 2022 financial years and commented: 'The demand for Focusrite's products has been unprecedented as Covid-19 saw musicians – professional and amateur – enjoying their passion at home.'

'However, its products have also expanded into podcasting, used with services such as Zoom, and for film/TV dubbing while actors are at home. Focusrite also launched 11 new products since the start of lockdown: the transition to work from home for the group "hardly missed a beat".'



SHARES SAYS: ↗

Expansion into new products and markets provide long-term growth drivers for Focusrite. Keep buying the shares.

OXFORD INSTRUMENTS

(OXIG) £19.64

Gain to date: 44.1%

Original entry point:

Buy at £13.60, 7 November 2019

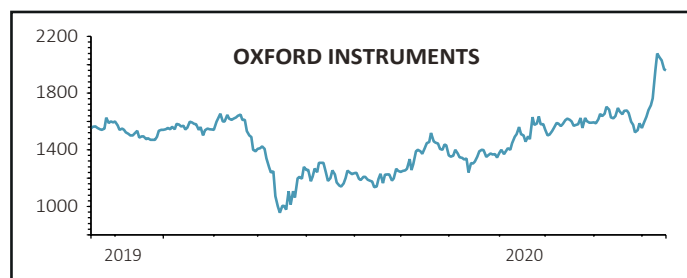
WHILE THE SURGE in other stocks have grabbed headlines **Oxford Instruments (OXIG)** has relatively quietly gone about its business, paying off brilliantly for investors.

The cutting edge science tools designer and maker has demonstrated beyond doubt its world class expertise and the enormous value it brings to the wider scientific community.

This comes as no surprise to *Shares*. Living in a world of climate change, ageing populations, pressure on food and water supplies and depleting raw materials, mankind is facing some of the stiffest challenges in its 200,000-odd year

history. Oxford Instruments remains among the leading lights in arming scientific boffins, health researchers and technology trailblazers with the tools to meet these tests.

Which makes us confident that even trading on a March 2022 price to earnings (PE) multiple of 28.5, the company's growth, margin expansion and free cash flows continue to make this a great stock to own for years to come.



SHARES SAYS: ↗

Forecast upgrade potential remains high, still a buy for the long-run.

GUINNESS

GLOBAL INNOVATORS FUND

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*Simulated past performance. Performance prior to the launch of the Guinness Global Innovators Fund (31.10.14) reflects the Guinness Atkinson Global Innovators Fund (IWIRX), a US mutual fund with the same investment process since May 2003.

For 17 years, we have invested in areas where advances in technology or innovative thinking have been creating pioneering, profitable business models.

Many of these emerged from the explosion of the internet in the 1990s. We invested in the companies that were building the technology to facilitate this explosion, such as Microsoft and Apple, then later in the companies that supplanted entrenched ways of doing business: Amazon, Netflix, Facebook, Google. We also identified innovation outside of technology – in industries including advanced healthcare, robotics, and consumer goods.

We recognised that not all innovators are made equal – that many new entrants would fall by the wayside. We believed then, as we do now, that our particular approach – buying and holding a concentrated, equal-weighted portfolio of quality companies with innovation in their DNA – would prove fruitful.

The results have been considerable, as is reflected in our fund's performance against the IA Global Sector over multiple periods.

Our approach has enabled the fund to navigate the market turbulence created by COVID-19 successfully. Almost every company in the portfolio is poised to emerge from the current economic environment with its prospects enhanced, not hindered.

We have a proven track record of success behind our thinking around innovation. If you favour our approach, this fund will make a sound addition to the growth allocation of your equity portfolio.

Risk: Past performance is not a guide to future returns. The value of your investments can fall as well as rise. You may not get back the amount you invested. Fund returns are for share classes with an Ongoing Charges Figure (OCF) of 0.99%; returns for share classes with a different OCF will vary accordingly.

GUINNESS

ASSET MANAGEMENT

Guinness Asset Management Ltd, authorised and regulated by the Financial Conduct Authority (223077). Calls will be recorded

Total return* from £10,000 invested from launch of strategy 01.05.2003



Source: Financial Express, 0.99% OCF

% Total return* vs IA Global Sector Average to 31.07.2020 in GBP

Period	Fund	Sector	Quartile
YTD	14.1	1.0	1st
1 Year	24.2	5.4	1st
3 Years	46.2	23.6	1st
5 Years	112.9	63.1	1st
10 Years*	378.2	157.7	1st
Launch of strategy	726.8	333.3	1st
12 month return	Fund	Sector	Quartile
June 20	24.2	5.4	1st
June 19	3.4	7.5	4th
June 18	13.9	9.1	1st
June 17	32.2	23.7	1st
June 16	10.2	6.7	3rd

THE LESSER-KNOWN US STOCKS WHICH HAVE BEATEN BIG TECH

We look at the unsung heroes of the rally in the S&P 500

The coronavirus pandemic has provided the world with its toughest stress test in more than 80 years. People across the globe have embraced the promise of a hitherto elusive vaccine, sending stocks around the world racing higher.

The victory of Joe Biden in the race to occupy the White House hot seat for the next four years has also fuelled market optimism, but not all recoveries have been equal.

While the UK benchmark FTSE 100's November rally has seen the index jump an impressive 12.9% (to 13 November), beating major US markets (S&P 500 +8.2%, Nasdaq Composite +7.3%), this relative outperformance over our across the pond cousins is a rarity in 2020.

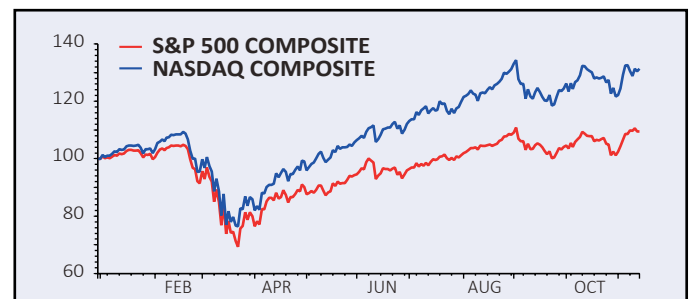
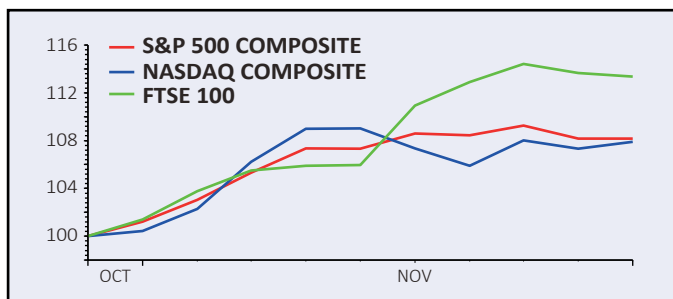
The FTSE 100 is still more than 15% below its

pre-Covid levels, using 20 February as the date when investors really began to price in a material impact from the pandemic. That compares poorly with US markets, which have stormed back from the pandemic sell-off to set new all-time highs this autumn.

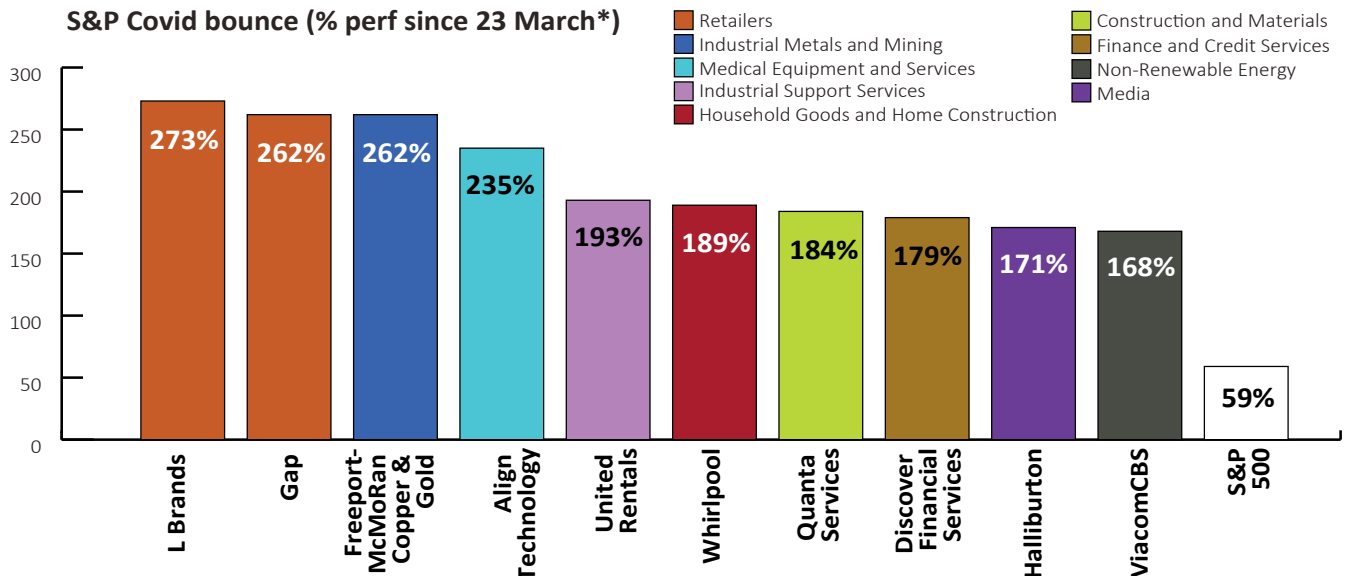
CLOSE TO ALL-TIME PEAKS

On 13 November the Nasdaq Composite was just 2.9% off its 12,056 high set in early September, despite the mild sell-off in top tech names as investors chase growth at cheaper prices in a more normal future. The S&P 500 stands barely 1.2% below its all-time 3,581 high.

This shouldn't really surprise anyone. The US remains home to many of the world's biggest



S&P Covid bounce (% perf since 23 March*)



Source: Sharepad (*data at 12 Nov)

and best technology companies that have been able to leverage their digital platforms and cloud delivery to keep millions productive in work, entertained at home and in touch with friends and family through the pandemic and its resultant lockdowns.

The likes of Amazon and Netflix, part of the FAANG stocks alongside Google parent Alphabet, Apple and Facebook, have made hay during the mayhem, driving the surge in the S&P 500 this year. And little wonder - throw in Microsoft and these six tech stocks have average a 44% gain in 2020, led by Amazon. Alphabet is the worst performer, yet is still up 28% this year.

Together these six stocks are now worth almost \$7.4 trillion, or 23.8% of the S&P's \$31 trillion market cap.

FAANGS' TOOTHLESS RELATIVE PERFORMANCE

Perhaps surprisingly, only Amazon and PayPal of these now familiar names are among the 10 best performing S&P 500 stocks of 2020, yet more than half of the top 10 are tech of one stripe or another (including healthcare or biotech), or beneficiaries from tech themes – the 77.1% rally in FedEx shares this year owes much to escalating home delivery of products bought online.

But the performance of the top 10 stocks since the market's coronavirus nadir on 23 March eclipses these numbers, with all more than doubling, while four names have trebled or more.

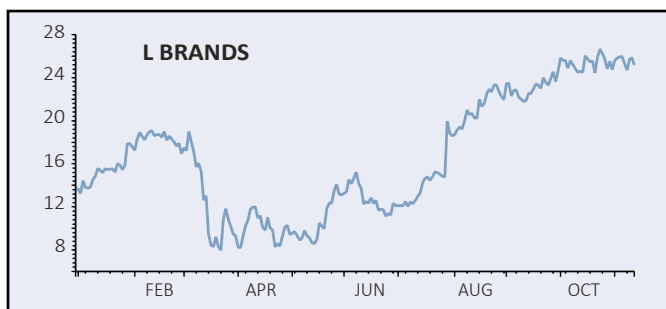
Some of these names will be well-known to UK investors, some will remain enigmatic, while recognition of others will emerge as familiar brands are revealed.

Investors will know the names listed earlier, while the likes of fashion chain Gap, white goods manufacturer Whirlpool, and US stalwarts like General Electric and General Motors will be very familiar.

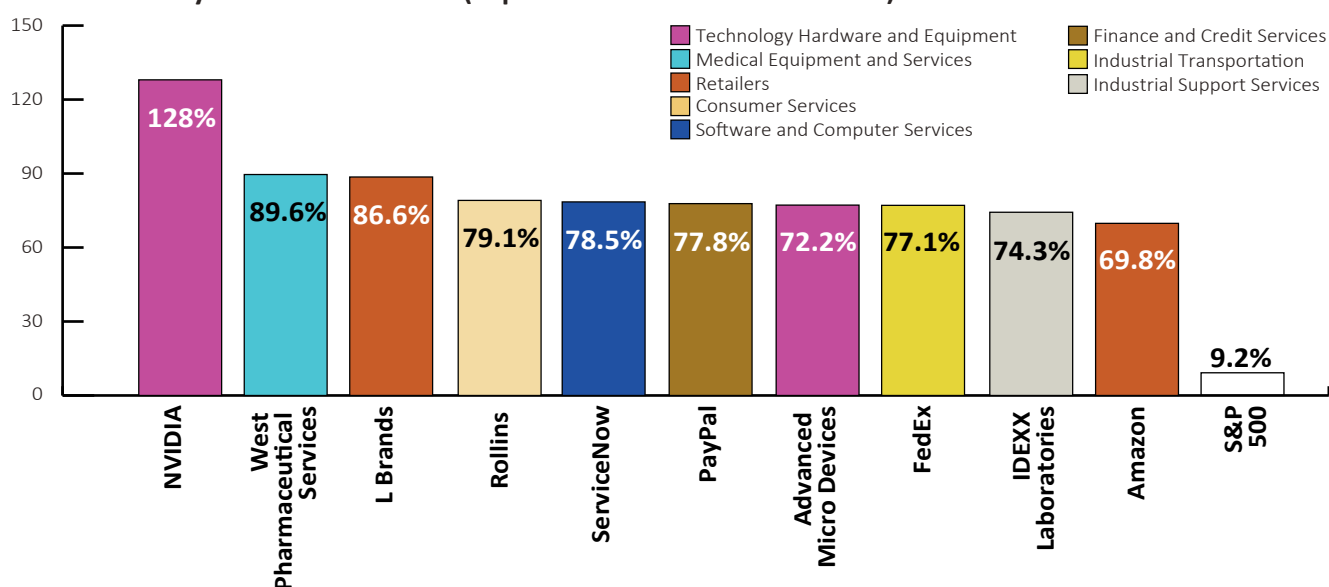
Some individuals may also recognise microchips firms NVIDIA and Advanced Micro Devices, oil services giants Halliburton and Baker Hughes, and probably media and entertainment colossus ViacomCBS, which owns the CBS TV network in the US, film studio Paramount Pictures and cable channels MTV, Nickelodeon and Comedy Central.

FAMILIAR MYSTERY STOCKS

Retailer L Brands is an interesting stock that many investors don't know they know. It operates hundreds of largely shopping mall-based outlets around the world and a busy internet operation selling fancy women's nightwear and underwear,



S&P 2020 year to date winners (% perf since 31 December 2019*)



Source: Sharepad (*data at 12 Nov)

other clothing lines, plus personal care, beauty and home fragrance products.

The company's shares have soared this year, rallying 88.6% in 2020 and 273% since the market bottom, the top S&P performer over that time frame. After its run the stock trades on a 12-month rolling price to earnings (PE) multiple of 16, according to Refinitiv data.

Why it has performed so well may be partly revealed by the identity of its store chains which include Victoria's Secret, La Senza, PINK and Bath & Body Works, the sort of product lines that largely transfer well to online sales.

Align Technology operates in dental technology, a field that has recovered from the dental practice closures earlier in the year.



It specialises in computer-aided design/computer-aided manufacturing (CAD/CAM) digital scanners for dentistry (making dentures, for example), intra-oral scanners, orthodontics and cosmetic teeth alignment tools.

The business saw the inevitable drop-off in Q2 revenues in the teeth of the lockdown, leading to a \$27.6 million quarterly net loss,

but it has rapidly recovered. Net income hit \$177.9 million in Q3, building on its first quarter level of \$57.9 million.

With optimism of a return to some sort of normality sparking a string run for global stock markets this month, other previously bombed out stocks like Align have staged a bounce, such as Coty. It is the perfumes and cosmetics business behind Calvin Klein, Marc Jacobs, Davidoff, Rimmel, Beyonce and, since July's decision to buy a 20% stake, Kim Kardashian's cosmetics brand.

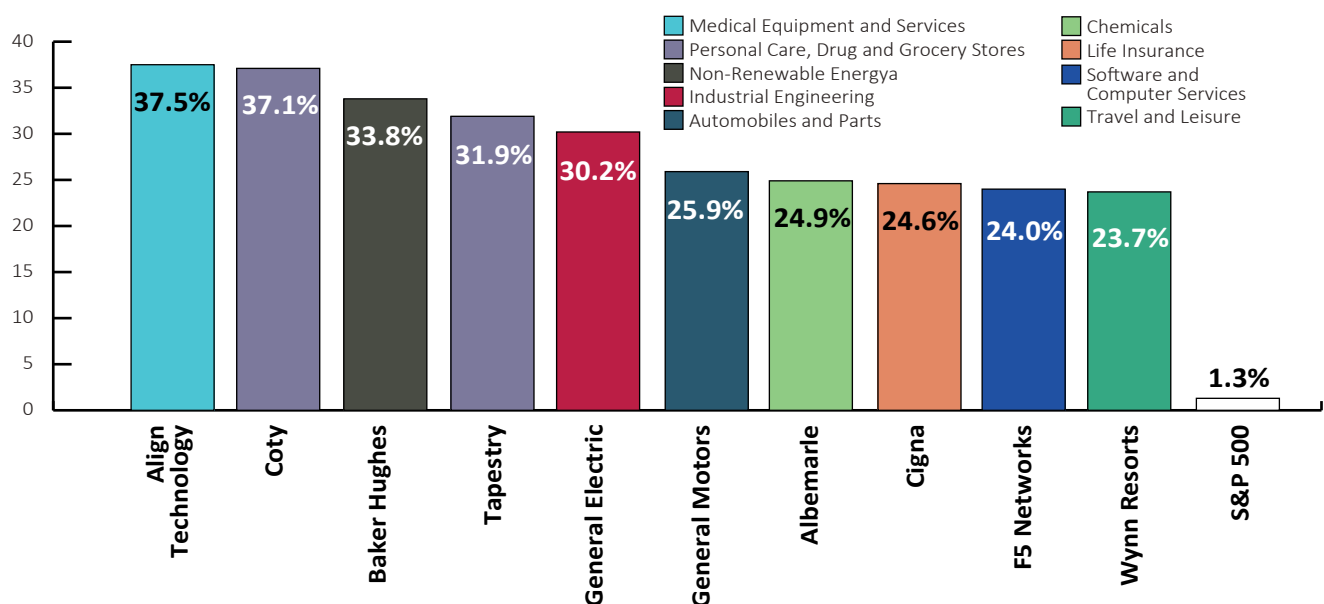


A massive loser since the start of 2020, plunging 60%-odd, the stock has rallied strongly in recent weeks – up 55% since 4 November, suggesting a retail re-opening bounce. For some businesses that rely on the personal touch, online is a poor substitute for in-store pampering.



By Steven Frazer News Editor

S&P stars in past month (% perf since 12 November 2020*)



Source: Sharepad (*data at 12 Nov)

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PAST PERFORMANCE

	Aug 15 – Aug 16	Aug 16 – Aug 17	Aug 17 – Aug 18	Aug 18 – Aug 19	Aug 19 – Aug 20
Net Asset Value	16.4%	23.4%	8.2%	6.7%	6.8%
Share Price	5.2%	29.7%	7.0%	8.6%	10.3%
FTSE World Europe ex-UK Total Return Index	15.4%	26.0%	1.4%	4.8%	0.7%

Past performance is not a reliable indicator of future returns.

Source: Morningstar as at 31.08.2020, bid-bid, net income reinvested.

©2020 Morningstar Inc. All rights reserved. The FTSE World Europe ex-UK Total Return Index is a comparative index of the investment trust.

Using Fidelity's extensive research team, portfolio manager Sam Morse aims to select well-established European companies with proven business models, attractive valuations and the ability to grow dividends both now and in the future. It's these classic giants with market-beating potential that have helped the investment trust outperform the index over the long term.

Past performance is not a reliable indicator of future returns. The value of investments can go down as well as up and you may not get back the amount you invested. Overseas investments are subject to currency fluctuations. The shares in the investment trust are listed on the London Stock Exchange and their price is affected by supply and demand. The investment trust can gain additional exposure to the market, known as gearing, potentially increasing volatility.

To find out more, go to [fidelity.co.uk/europe](https://www.fidelity.co.uk/europe) or speak to your adviser.





THE STOCKS TO BUY AHEAD OF A VACCINE

The news on 9 November of successful early trials of a coronavirus vaccine sent global markets soaring with the most beaten-down sectors like travel, leisure and hospitality, energy and banks enjoying their best daily or weekly performance in years. This has been followed by further positive news on other vaccines in development.

It remains the case, however, that many of the top-performing stocks in recent times are still structurally challenged, vaccine or no vaccine.

Airlines still face huge over-capacity, as do hotels and restaurants, oil firms face a low-carbon future dominated by renewables and banks still face large bad loan provisions and historically low interest rates.

There are other sectors, however, which have been equally hard-hit in stock market terms but which are much better poised to rebound once the global economy reopens. In this article we look at areas of likely strength as well as sectors where the risks still look elevated. The table



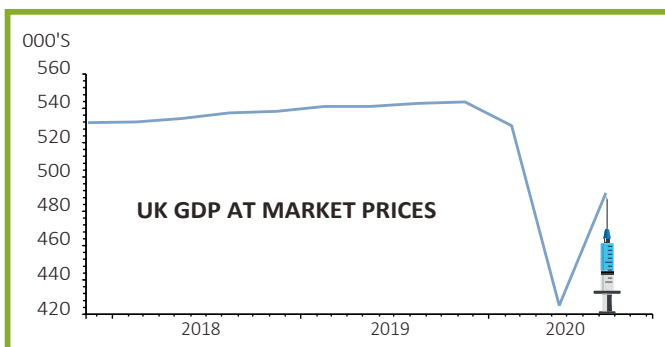
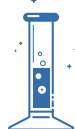
By **Ian Conway** Senior Reporter

overleaf shows some of the UK market's laggards over the last 12 months and could highlight some names worthy of further investigation.

TOTAL SHUTDOWN

Covid-19 brought economic activity around the world to a sudden and dramatic halt. Companies everywhere slammed the brakes on, stopping all non-discretionary investment including advertising and hiring, as they hunkered down.

There was no road-map for a global pandemic, and the fear amongst the public and the business world was almost palpable. People locked themselves indoors, while only firms providing absolutely essential services were allowed to remain open, most in a much reduced capacity.



Investors fled to safety, bidding up bonds and equities with 'bond-like' characteristics. Technology stocks became 'havens', especially those which provided alternative ways of living and working during lockdown.

In the retail sector, pure online operators were amongst the biggest beneficiaries of Covid, with consumers flocking to the internet to buy everything from appliances to homewares and musical instruments.

ROAD TO RECOVERY

Now, the hope of a vaccine means there is a possibility of life getting back to something resembling 'normal' in the foreseeable future. Yet, just as none of us had ever experienced a pandemic, the world has never experienced a recovery from a pandemic either.

The likelihood is that whereas the onset of the pandemic was like a light being switched off, the recovery will be 'more like a dimmer switch turned up slowly' to quote Julie Palmer, partner at insolvency and business services firm **Begbies Traynor (BEG:AIM)**.

The good news is that the global economy is running so far below its potential growth rate that central banks are unlikely to step back from their easy money policies. To the contrary, they

CATCH-UP CANDIDATES - COMPANIES WHICH HAVE LAGGED THE MARKET

Company	One-year relative strength (%)
Rank	-30.0
Redde Northgate	-29.4
WH Smith	-29.1
Headlam	-28.7
Young & Co's Brewery	-27.5
Marks And Spencer	-25.5
Aggreko	-25.2
Scapa	-24.8
Fuller Smith & Turner	-24.5
ITV	-24.2
Johnson Service	-23.9
Serco	-21.5
Informa	-18.0
On The Beach	-15.1
Midwich	-13.5
WPP	-12.4
Moneysupermarket.com	-11.9
Restore	-10.0

Source: Stockopedia. Data as at 11 November 2020.

will want to keep interest rates low to encourage banks to lend so that as many companies come through the crisis as possible.

For investors, betting on the recovery isn't a simple question of dumping 'growth' stocks in favour of 'value'. In fact the idea of dividing stocks into silos isn't helpful or useful. What we are looking for are companies with long-term structural growth prospects which can cash in on the cyclical recovery but which have been overlooked at this early stage.

EARLY WINNERS

AS NOTED EARLIER, two of the areas of corporate spending which were hammered at the onset of the crisis were advertising and recruitment. Both areas are essentially investments in growth, so it makes sense that companies pulled the plug early. It also makes sense that with business opening up again they should be amongst the first beneficiaries.

Advertising is a particularly good bellwethers for the economy because companies will increase spending on advertisements when they are feeling positive and scale back during tougher times.

The question is where any potential increased spend will go. The acceleration in the shift to a more digital economy means businesses may look online and go direct to the likes of Facebook and Google.

However, the need to manage reputational risks from being associated with controversial or extreme content on the internet means there is probably still a place for agencies.

This could benefit **WPP (WPP)** which is currently in the process of executing a turnaround strategy following the acrimonious departure in 2018 of founder Martin Sorrell.

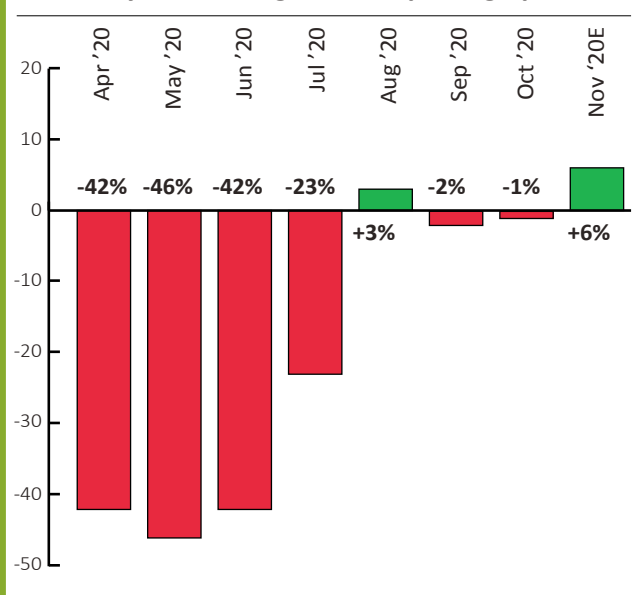
Having announced improving advertising trends in a third quarter update (29 Oct), chief executive Mark Read and well-regarded finance chief John Rogers are continuing the process of simplifying the business.

Shore Capital analyst Roddy Davidson is bullish on the difference simplification can make to the business. He says: 'Specifically, we are positive on the long-term upside potential created by a proactive approach towards: simplifying operations/merging brands; fostering internal cooperation; driving competitive advantage through concerted investment in technology; unlocking efficiencies; reducing debt; realising value from non-core operations; and pursuing a more disciplined capital allocation policy.'

Sorrell's new venture **S4 Capital (SFOR)** has enjoyed strong gains this year thanks to its exclusive focus on digital advertising.

The relevance of television as a medium has been bolstered by the pandemic as lockdown measures saw people turn to the box to keep them occupied, whether they were streaming

Monthly advertising revenue picking up at ITV



Source: ITV

content or watching live TV.

The problem for broadcasters such as **ITV (ITV)** is that while they had plenty of eyes on their product, few advertisers were in the mood to spend earlier this year.

However, like WPP, ITV's third quarter update revealed an improved advertising trend. It also revealed a recovery in its ITV Studios production business which had been hit by an enforced hiatus during the first lockdown.

ITV is a running *Shares Great Ideas* but investors looking for an alternative way to play the impact of a reopening of the economy on advertising spend should look at its effective sister operation in Scotland: **STV (STVG)**.

STV has a very dominant position in the Scottish commercial television market and is growing its digital footprint while also increasing its investment in production.

It benefits both from the improvement in national advertising revenue but also its own regional ads.

In Q3 regional advertising was up 8% and video-on-demand advertising grew by 10%. TV viewing was up 13% and online viewing increased by 82%. Based on Shore Capital forecasts, at 268p the stock trades on a 2021 price to earnings ratio of 7.3 and yields 7.8%.

Events firms should also benefit if a vaccine helps unlock the global economy, with the scaled-

**BUY
STV at
268p**

down digital events many firms have been forced to run in the interim not generating the kind of returns seen with physical exhibitions and events.

This explains the positive response of **Informa (INF)** to news of a vaccine and other media firms which often dovetail events alongside professional information services and publishing could also be beneficiaries such as **RELX (REL)** and **Euromoney (ERM)**.

RECRUITMENT BOOST

In the recruitment sector, the major quoted companies were quick to respond to the sudden downturn in demand by cutting their own outgoings and trimming their headcounts.

In its full year results to the end of June, **Hays (HAS)** – the UK's largest staffing firm by market value and revenues – posted an 11% drop in group net fee income with an exit rate of a punishing 34% fall in income.

While acknowledging market conditions were 'far harsher than I have known', chief executive Alistair Cox was able to point to 'modest signs of improvement' in the permanent job market and 'relative resilience' in its specialist

BUY
HAYS at
132.6p

temporary markets of IT and Life Sciences.

Encouragingly, the Office for National Statistics said last week that the number of job vacancies in the UK jumped by nearly 40% or 146,000 to 525,000 in the three months to October.

Similarly, the UK's Recruitment and Employment Confederation (REC) reported an upsurge in job advertisements in the first week of November to 1.36 million, the highest level since early March.

The REC noted a strong recovery in demand for construction, logistics and food processing roles, although it noted there was a 'stark difference in demand across the regions' with the number of job adverts down 19% in London compared with March and up 37% in the north west of England.

Having protected its business during the shutdown and shored up its balance sheet

with a £200 million capital raise early on, we think Hays is well placed to capitalise on a reopening not just of the UK but the global economy.

While its shares jumped 20p on the vaccine news, they are still nearly 30% below their pre-pandemic highs and close to 40% below their 2018 highs meaning they still have plenty of upside.

THE TRAVEL AND LEISURE SECTOR STILL FACES BIG RISKS

TRAVEL AND LEISURE stocks have shone as the lockdown losers are now considered to be vaccine winners with potential for a big rebound in earnings.

The market is looking towards next summer and pricing in the chance that demand, and therefore earnings, will move significantly higher than this year and start returning towards normality again.

Summer is the crucial trading period for travel and leisure stocks as they look to make big profits that more than offset losses made during the quieter winter months.

Any signs of progress being made with a vaccine will boost investor sentiment towards the sector as it raises the chance of people being able and willing to go on holiday or spend more on leisure activities.

But this strong recovery in demand that's being priced in for summer 2021 is by no means assured.

Even if a vaccine is successfully developed, approved and manufactured by the end of this year, the logistical challenges of producing something at an unprecedented scale that has never been commercialised before means it could take time for a full roll-out globally and for people to be able to move freely between countries again without any restrictions, something which is fundamentally important for confidence in the sector.

Selective exposure makes sense – with some areas more likely to see a rapid rebound in demand than others.

BUY **HOLLYWOOD BOWL (BOWL) 181P**

The UK's largest 10-pin bowling operator **Hollywood Bowl (BOWL)** is well positioned for the opening up of the economy and benefiting from pent-up demand. The company saw strong customer appetite after reopening the estate

from mid-August, and a similar result should be expected once the current lockdown measures are removed.

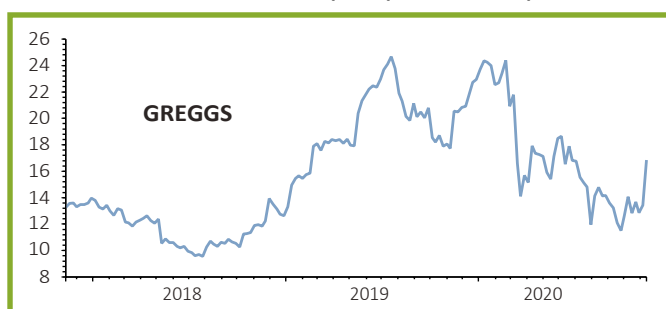
Performance reflects the actions of management to equip venues with Covid-19 safety measures enabling social distancing and ensuring the safety of customers and staff. The quality and attractions of Hollywood Bowl's out-of-town sites was demonstrated by the fact

that the majority of them operated at maximum capacity with trading levels similar to last year at weekends and holiday periods.

Despite closing venues for five months and seeing a 38.7% drop in year-on-year revenues the company managed to report a marginal profit for the year to 30 September 2020. This underscores the huge potential in store once the economy reopens.

FOOTFALL MAY NOT INCREASE QUICKLY ENOUGH FOR FOOD-ON-THE-GO

A REOPENING OF the economy facilitated by an effective Covid-19 vaccine would do wonders for the fortunes of the footfall-dependent food-to-go companies, names such as bakery retailer **Greggs (GRG)**, sandwiches-to-salads maker **Greencore (GNC)** and food-to-go rival **Bakkavor (BAKK)**, not to mention travel food outlet operator **SSP (SSPG)**. Shares in this lately-unloved quartet turned up on vaccine optimism, yet they remain well below their pre-pandemic peaks.



But first a dose of reality; it will take time to deliver a vaccine on a vast scale in the UK and there is no immediate prospect of social restrictions being lifted. Then there's structural change to consider. Working from home has become more ingrained, so a return to commuting into city centres by millions of

Britons is uncertain.

Any pick-up in supermarket shopping visit frequency driven by a reopening would deliver a much-needed boost to sandwiches firm Greencore, a casualty of the coronavirus lockdowns which have kept commuters at home and caused city centre footfall to slump.

Shore Capital continues to see 'disrupted trade for Greggs and other food-to-go players well into full year 2021, which means that despite very favourable comparatives, the two-year sales stack is likely to be challenging'.

Greggs was a market darling before the Covid disaster struck, but its world was turned upside down by the economic shut down and the requirement for social distancing. The vegan sausage rolls, coffees and doughnuts seller received a negative response to a relatively robust third quarter trading update in late September. Greggs said activity had picked up in September following a slower August, though it reiterated the outlook remained uncertain with 'rising Covid-19 infection rates leading to increasing risks of supply chain interruption and further restrictions on customer activities out of the home'.

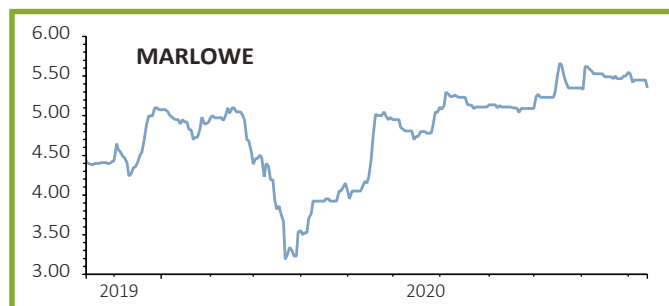
Like-for-like sales in company-managed shops averaged 71.2% of the 2019 level in the 12 weeks to 26 September, before the second lockdown. Shore Capital believes it will most probably be in the 2023 financial year rather than full year 2022 before Greggs returns to its pre-pandemic trading and profit levels, with the brokerage noting 'a disrupted new store development programme too that takes energy out of the hopper whilst a vertically integrated players faces the double whammy of negative operational gearing'.

SERVICES FIRMS POISED FOR PICK-UP

MORE BUSINESSES ARE open during the current lockdown than before with many designated as essential to the economy.

One example is specialist services group **Marlowe (MRL:AIM)** which provides water treatment, fire safety, air quality and compliance services. All its services are non-discretionary and therefore generally insulated from trends in the wider economy.

The strategy is to grow through acquisition and integration and build enduring long-term customer relationships and annuity-type recurring revenues. Revenues has grown 10-fold from £20 million in 2015 to around £200 million, 78% of which is recurring.



In a similar vein multi-brand Franchise company **Franchise Brands (FRAN:AIM)** is focussed on building market-leading businesses in selected customer segments by organic growth and a buy and build strategy.

It operates a 'capital light' model which means that each franchisee is expected to provide the capital investment and the company earns fees through start-up charges, license fees and product sales.

The bulk of revenue comes from providing commercial drain clearance and repair and maintenance services on a 24/7/365 basis through the Metro Rod and Metro Plum brands. The company's purchase of leading pump supply and installation business Willow Pumps is expected to expand the range of services in this segment.

BUY FRANCHISE BRANDS (FRAN) 102.7P

Shares in multi-brand franchising company **Franchise Brands (FRAN:AIM)** languish within 20% of the March lows and 50% below pre-Covid-19 levels which doesn't reflect the steady recovery in trading since June 2020. Buy for



recovery potential.

Founded by Stephen Helmsley and Nigel Wray, the company's business to business division is deemed an 'essential business' and is composed of Metro Rod, Metro Pumps and recently acquired Willow Pumps. From the start of June the Metro businesses have grown by an average of 8% per month with September actually 9% higher than the prior year.

At the third-quarter update on 28 October the company said it was confident of meeting market expectations for generating full-year revenues of £48.6 million and adjusted earnings before interest, taxes, depreciation and amortisation (EBITDA) of £6.1 million.

BUY RESTORE (RST:AIM) 353.1P

A reopening of society thanks to a vaccine would benefit the office removals part of **Restore (RST:AIM)**.

Companies are likely to think hard about their office requirements and we could see many move to smaller premises or have a hybrid model for working.

The latter could involve staff working from home permanently for a few days a week, so companies would have less requirement for floorspace as everyone could hot-desk when they do come to the office. In essence, Restore could see a bumper period where it helps businesses right-size their office requirements.

Restore could also benefit via its IT recycling operations if companies decide they don't need as many desktop PCs. It could also see an uptick in shredding services.

Its document storage operations provide a resilient backbone with money coming in during good and bad economic conditions.

Analysts forecasts 12% revenue growth and 39% pre-tax profit growth in 2021, according to Refinitiv.

OPPORTUNITIES AMID MARKET CONFUSION

BLACKROCK SMALLER COMPANIES TRUST PLC

Markets may have moved higher, but many businesses are still operating below their peak. For investors with a long-term perspective, this presents real opportunities, says Roland Arnold, Portfolio Manager of the BlackRock Smaller Companies Trust plc.



Roland Arnold
Portfolio Manager, BlackRock
Smaller Companies Trust plc

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

The outbreak of coronavirus and subsequent global lockdowns will certainly be described as one of the most bizarre events of modern times, and for many investors have been one of the most challenging. The panic driven sell-off witnessed in the first quarter of 2020 was substantial and indiscriminate, with share prices completely detaching from fundamentals. While the market may have rebounded, many businesses remain a long way off share price highs as disruption to many industries remains elevated. However, we believe for those willing to take a long-term view, this environment presents a fantastic investment opportunity.

“Unprecedented” is one of the most commonly used words of 2020, but far from a cliché, “unprecedented” is an appropriate one-word summary of the year. No one would have expected that around 40% of our portfolio would have a period of generating zero, or close to zero revenues, but this became the reality for many businesses during lockdown. It certainly isn’t a situation anyone would have factored into company analysis. When looking for potential investments, financial strength and the ability to convert earnings to cash are key attributes we look for. While this provided a buffer to many of our holdings, several businesses we would have regarded as financially strong have raised equity capital, although in many cases these companies also have one eye on future opportunities. As active investors we have been spending a lot of our time in recent months providing fresh capital to existing holdings and opening new positions in businesses that have raised funds.

A NEW NORMAL

But what has been the core focus of our analysis? We have said many times in recent months, that we can’t pretend to have the answers to many of the questions that have arisen as a result of COVID-19; the scale and duration of the virus, the likelihood of a second wave; the scale of the impact on the global economy. One thing that we are sure of though, is that things will eventually get better, and return to normal, or at least settle at the “new” normal. And when thinking about what the new normal looks like, we could begin to question how “unprecedented” things really are... From what we are seeing in company trading updates and hearing from the management, the direction of travel remains the same.

In our mind the result of COVID-19 is simply accelerating many of the structural trends that have been happening in various industries over a number of years. Whether it’s the shift to more agile/remote working or falling footfall for physical retail as people transition online, these changes were happening already, it’s just now they have accelerated. This environment is perfect for well-managed smaller companies with more agile structures to quickly adapt and take advantage of these trends.

Take Games Workshop for example, the creator of the Warhammer universe. Traditionally selling through physical stores it should have been one of the first victims of social distancing and lockdowns. But this has not been the case. Despite having to cease operations for a short period when its stores were mandated to close, the business successfully accelerated the transition of its unique product to online, and the demand from stuck at home hobbyists more than offset the lost sales in its physical stores. It is this ability to adapt quickly to changing market trends that has always been a key attraction for investing in smaller companies, as often larger more complex companies lack the flexibility to respond quickly to shifting market dynamics.

It is important for organisations to understand the structural changes caused by the pandemic. This is where YouGov comes in. When time is of the essence, YouGov’s vast amount of data and market leading analytical tools make them a key partner for their clients as they look to understand changing industry dynamics in order to focus their future investment.

VALUATION OPPORTUNITIES

Despite all this structural change, traditional industries still provide opportunity. To maintain social distancing, pubs and restaurants must now operate at lower levels of capacity. Unfortunately, many will go out of business, but as people return to pubs, those that survive will gain market share as

the weaker competitors exit the market. The indiscriminate market reaction means some pub companies now trade beneath the value of their freehold properties, meaning we effectively acquire the 'pub business' for free!

While the outlook remains unclear, we believe many businesses can use change to their advantage and look to the future with optimism. Vladimir Lenin once said, "There are decades when nothing happens and then weeks when decades happen." This is what is happening right now, the pace of change has accelerated, and dynamic nimble smaller companies will adapt to the new normal, see their competitive positions enhanced, and emerge from this pandemic in stronger positions. Our investment process has always sought out these types of business, and we believe this environment will prove to be a fantastic opportunity for our strategy.

Risk: Reference to the names of each company mentioned in this communication is merely for explaining the investment strategy and should not be construed as investment advice or investment recommendation of those companies.

The opinions expressed are as of October 2020 from BlackRock and are subject to change at any time due to changes in market or economic conditions.

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

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CLICK HERE**



Risk Warnings

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

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Trust Specific Risks

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

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

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

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How does the UK escape from its debt trap?

What happens when a country's rate of borrowing increases so rapidly

This week's column comes in response to a number of questions from a reader about the national debt, how the Government funds it and what the implications are for investors' portfolios.

The last numbers with which we can work are those presented in the Budget of March 2020, although the world already looks like a very different place.



The Budget forecast annual central Government expenditure of £928 billion, with £285 billion going on what chancellor Rishi Sunak termed 'social protection' (Covid-19 costs), £178 billion on the NHS and £116 billion on education.

Income was forecast to be £873 billion, with the bulk of that coming from income tax (£208 billion), VAT (£161 billion) and national insurance (£150 billion), followed by corporation tax (£58 billion) and excise duty (£48 billion).

The pandemic has wrecked Sunak's best-laid plans, since outgoings have exceeded receipts by £200 billion in the first six months of the year alone.

The Government fills any revenue shortfall with borrowing and each annual deficit adds to the aggregate public debt, which now exceeds £2 trillion for the first time. The UK then funds this by selling gilts to institutional investors such as life insurance companies or overseas buyers, as

well as banks and building societies, who use the interest on those debt instruments to match or fund their own future liabilities, such as interest or pension payments or insurance claims. The UK also sells National Savings & Insurance products to private individuals.

How the Government funds its borrowing

Issue	Total (£ billion)	Interest rate (%)	Interest paid (£ billion)
Conventional gilts	683.4	2.3%	15.8
Gilts in APF*	371.4	0.9%	3.3
Index-linked gilts	437.6	3.1%	13.4
NS&I	172.0	1.5%	2.5
Other	151.9	2.2%	3.3
Total	1,816.3	2.1%	38.3

Source: Office for Budget Responsibility.

*Asset Purchase Facility, run by the Bank of England.

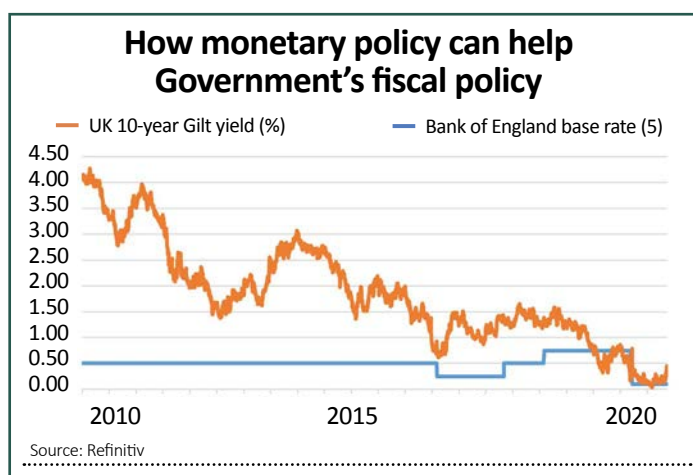
A new wrinkle from the past decade is that the Government issues gilts (debt) and the Bank of England then buys them, under its quantitative easing (QE) programme, to both mop up supply and keep the coupon – or interest rate – on the gilts as low as it can, to help the Government fund its spending.

Usually, higher borrowing would lead to higher interest costs as lenders (gilt buyers) seek greater compensation to reflect the increased risk reflected by the growing debt pile – even if the UK has not failed to pay interest on its debt since 1672 and the Stop of Exchequer under King Charles II.

In November, the Bank of England added £150 billion to QE, to take the total to £875 billion, getting on for half of the gilts in issue. That is



helping to anchor the benchmark 10-year gilt yield at 0.35%, as is the headline base interest rate, which is set at an all-time low of 0.1%.



MIND THE GAP

That helps the Government service the debt but not necessarily to repay or reduce total borrowing, where there are three potential solutions:

- Rapid GDP growth, which generates extra tax income and reduces the need for social support and welfare spending.
- Tax increases.
- Or 'financial repression', a term coined by the American economists Ronald McKinnon and Edward Shaw in the 1970s to explain how several emerging economies had tried to dig their way out of a series of debt crises.

Harvard professor Carmen Reinhart further developed this concept in a National Bureau of Economic Research paper back in 2010, when she outlined the four mechanisms governments could use to reduce their debts by sequestering cash that would flee elsewhere if it had the chance:

- Exercise control over the cost of borrowing and government bonds yields.
- Take ownership or control of domestic banks.
- Create a captive market for government debt by using regulations to force banks to hold such assets as part of their reserve requirements.
- Impose capital controls to stop cash leaving the country.

Step one is already being taken and step two is arguably on its way, as the Government gets banks to issue state-backed loans to companies to help them through the pandemic. Step three would be next if financial firms are leaned upon to buy gilts (with central banks possibly also issuing their own digital currencies backed by assets purchased through QE, or even with those assets being made legal tender). The Bank of England could also just directly fund major infrastructure projects to try and get the economy going via 'The People's QE.'

PORTFOLIO PUZZLE

There seems to be little political or public appetite for tax increases and it does not yet feel as if GDP growth is about to rip higher and help the Government inflate away its debts – although if it does, then 'real' assets such as commodities and property may come back into vogue over 'paper' ones, such as gilts and the Government's promises to pay its interest, which will offer little more than return-free risk, given the nugatory yields on offer.

Nor is there any sign of financial market revolt, but history suggests there is always a tipping point somewhere, when lenders (bond buyers) refuse to fund Government debt. That is where financial repression would come in, to stem the tide of bond selling and *oblige* banks or financial intermediaries to own gilts whether they are offering positive returns or not.

It might offer gilts and bonds some support, but it would do nothing for banking or insurance stocks, for example and the degree to which equities are affected would depend on the degree of repression, the state of the economy and whether capital controls come too – if so, investing overseas and finding money trapped there would hardly be an attractive option.

Rapid growth is therefore the best of the three scenarios for equities, so investors may need to start crossing their fingers. But then hope is not a strategy, which may be why assets such as gold and Bitcoin are performing relatively well as investors seek a bolt-hole from the threat of 'financial repression'.

CAN PRIVATE EQUITY THRIVE IN THE ‘NEW NORMAL’

By Alan Gauld, Investment Manager, Standard Life Private Equity Trust plc



- **Private equity has thrived since the Global Financial Crisis**
- **After declines in March, private equity valuations have recovered**
- **Private equity companies have proved resilient**

This has been a golden decade for private equity. The financial conditions following 2008's Global Financial Crisis were ideal for the asset class to flourish, with interest rates low and plenty of capital looking for higher growth assets. The question today is whether private equity can continue to thrive in the 'new normal' that emerges from the Covid-19 crisis?

Over the past decade, private equity has seen a virtuous circle. Returns have been strong, encouraging new capital into

the sector, which has allowed good companies to stay private for longer. While companies might have previously listed at an enterprise value of around \$500m (e.g. Amazon), today, they have been able to raise the money to grow while remaining in private equity hands (e.g. Airbnb).

However, today, investors are questioning whether returns can be sustained at the levels we've seen for the last 10 years. Investors have assumed that this crisis will see private equity valuations weaken, as they did during the financial crisis. There have been media reports of some problems at private equity-owned companies, particularly in 'at risk' sectors such as leisure and travel.

Certainly, we saw a large decrease in valuations in March. Private equity companies will

use public market valuations as a benchmark, so it was inevitable that the weakness in the major stock markets around the globe had an impact in the private equity sector. However, as valuation figures have come through over the summer, we have seen a significant uptick that almost fully offsets the drop in March.

Resilience in challenging conditions

Undoubtedly, there are still companies in there that are struggling, but the number of companies that have proved extremely resilient in challenging conditions is perhaps the greater surprise.

Part of this resilience was that private equity managers had recognised in advance that the market environment was likely to



change. They knew this was the longest bull market they had seen and, in many cases, had prepared their portfolios. They were increasingly investing in resilient sectors such as technology, healthcare and consumer staples. For the Standard Life Private Equity Trust, these sectors now represent around half of its net asset value (NAV).

Where private equity managers are invested in more cyclical sectors such as industrials, or consumer discretionary, they are focused on specialist areas. Typically, digitalisation and the shift to online is a big part of the investment thesis. The Trust is an investor in Photobox, for example. While this is ostensibly a consumer discretionary company and should be vulnerable to weaker economic conditions, it has proved resilient in this crisis. People took the opportunity of lockdown to organise the photos on their phone, creating new albums and the company has posted record numbers. Similarly, Dr Martens, the footwear brand, initially appeared to be vulnerable because of the closure of its physical stores during lockdown, but its online channel has almost completely offset lost physical sales. Allegro, the Polish online marketplace, has also traded at record levels during 2020 and

recently successfully listed on the Warsaw Stock Exchange during the second half of year.

Weathering the storm

Merger, acquisition and Initial Public Offering (IPO) activity hasn't dried up as would be expected. Firms still have a lot of 'dry powder' - capital available to deploy - and a limited time frame to use it. As such, we have seen private equity firms continuing to sell to other private equity firms. Undoubtedly, there have been difficulties where it has been impossible to meet face to face, but it is not as bad as might have been anticipated in March.

To our mind, companies seem to be generally weathering the storm. Where businesses have experienced disruption to their business model, many have managed to cut costs, furlough staff, and raise additional capital. We estimate that only 9 of the Trust's top 100 underlying companies by value have seen a severe negative impact from the pandemic and are likely to experience debt covenant and liquidity issues. The remaining 91 companies have only seen a temporary negative impact at worst, with several actually benefitting from current situation.

Looking at the Trust's performance, we saw the NAV

drop in March, but at less than half the fall of wider equity markets. By June it had recovered almost all that loss (on a constant currency basis). It has undoubtedly been volatile, but the swing in public markets was far greater. Historical analysis shows that private equity has a lower-than-expected correlation with comparable listed markets and so we believe that it has diversification benefits in an overall portfolio.

New firepower

While we have made some small adjustments to the portfolio, we are happy with the way it looks today. We recently extended the size of the Trust's debt facility by £100 million, which gives us more firepower to deploy into new investments. We believe there may be some distressed sellers, particularly in the secondary market, so this cash can be used to pick up positions more cheaply.

In spite of some gloomy predictions at the outset of the pandemic, private equity has shown its resilience in the face of a challenging environment. To our mind, this reflects the changes seen in the sector over the past decade - including a focus on more resilient sectors and a greater operational involvement in underlying companies, including an increased focus on

digitalisation and environmental, social and governance factors. We believe that private equity will continue to build from here as we

move into the 'new normal'.
Companies selected for illustrative purposes only to demonstrate the investment

management style described and not as an investment recommendation or indication of future performance.

DISCRETE PERFORMANCE (%)

Year ending	30/09/20	30/09/19	30/09/18	30/09/17	30/09/16
Share price	-4.6	5.7	5.8	31.9	28.0
NAV	4.0	10.6	14.0	15.5	25.2
FTSE All-Share Index	-16.6	2.7	5.9	11.9	16.8

Past performance is not a guide to future results.

Important information

- The value of investments and the income from them can fall and investors may get back less than the amount invested.
- Past performance is not a guide to future results.
- Investment in the Company may not be appropriate for investors who plan to withdraw their money within 5 years.
- The Company may borrow to finance further investment (gearing). The use of gearing is likely to lead to volatility in the Net Asset Value (NAV) meaning that any movement in the value of the company's assets will result in a magnified movement in the NAV.
- The Company may accumulate investment positions which represent more than normal trading volumes which may make it difficult to realise investments and may lead to volatility in the market price of the Company's shares.
- The Company may charge expenses to capital which may erode the capital value of the investment.
- There is no guarantee that the market price of the Company's shares will fully reflect their underlying Net Asset Value.
- As with all stock exchange investments the value of the Company's shares purchased will immediately fall by the difference between the buying and selling prices, the bid-offer spread. If trading volumes fall, the bid-offer spread can widen.
- Yields are estimated figures and may fluctuate, there are no guarantees that future dividends will match or exceed historic dividends and certain investors may be subject to further tax on dividends.
- Certain trusts treat the generation of income as

a higher priority than capital growth; such trusts may deduct part or all of their management charge from capital. This will increase the amount of income available but at the expense of capital growth.

- Investing globally can bring additional returns and diversify risk. However, currency exchange rate fluctuations may have a positive or negative impact on the value of your investment.
- Specialist trusts which invest in small markets or sectors of industry are likely to be more volatile than more diversified trusts.
- The Company's investments may include unquoted and/or private equity investments which are not publicly traded or freely marketable and may therefore prove difficult to redeem. In addition, the potential volatility of investments in unquoted securities may increase the risk to the value of the investment.

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How Fundsmith Emerging Equities Trust plans to fix performance

FEET hasn't enjoyed the magic touch of Fundsmith Equity and Smithson but that could change

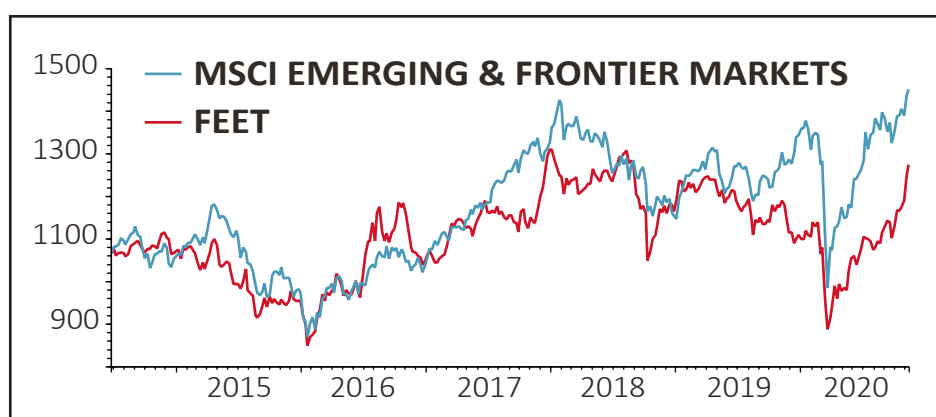
Launched to much fanfare in 2014, it's fair to say the performance of emerging markets investment trust **Fundsmith Emerging Equities Trust (FEET)** hasn't quite gone according to plan over the past six years.

Since inception the trust has significantly lagged its benchmark, delivering a total return of 35.5% in net asset value (NAV) terms and just 19.1% in share price terms compared to 60% for the MSCI Emerging & Frontier Markets index.

Compare this to the other products in the Fundsmith stable open-ended fund **Fundsmith Equity (B4Q5X52)**, which has returned well over 100% in the past five years, or small and mid-cap investment trust **Smithson (SSON)** which has returned over 50% in share price terms since IPO in October 2018.

Star manager Terry Smith stepped back from running FEET in 2019, with portfolio manager Michael O'Brien taking over, assisted by equity analyst and assistant portfolio manager Sandip Patodia. Smith still provides advice to the two managers in his role as chief investment officer.

The managers previously



admitted that 2019 was 'not a vintage year for the fund' with NAV falling 0.5% compared to a 13.9% gain from the index.

However, 2020 has been a better year so far for the trust, up 11.1% in NAV terms and 8.1% in share price terms compared to just a 3.2% rise in the index.

We think the current management team can address the historic issues and that the trust is a good option for someone looking to gain access to emerging markets. The annual management charge of 1% looks reasonable.

INDEX 'LARGELY IRRELEVANT'

Speaking to *Shares*, O'Brien and Patodia are quick to make clear that the 'index to us is largely irrelevant' and highlight the fund's 97% active share, but concede 'mistakes' were made

in the past and admit to having been caught out by some stocks, particularly in frontier markets.

O'Brien explains: 'We have in the past had investments in countries where there been deteriorating macroeconomic conditions, which has typically fed through to currency weakness and currency devaluations – Nigeria and Egypt are the best two examples of this.'

'And there's been a few select cases where we've overestimated the company's growth, or more importantly, underestimated regulatory issues to that company.'

On this point, O'Brien says that when the fund was launched, they took the view that macroeconomic factors were largely irrelevant, instead choosing to focus on company

fundamentals in the belief that ‘a good company would thrive regardless of the market or country in which it operates’.

But he adds: ‘Looking back at the experience of the last six years, it has taught us that even a great company in frontier markets is affected to some degree by macro factors.’

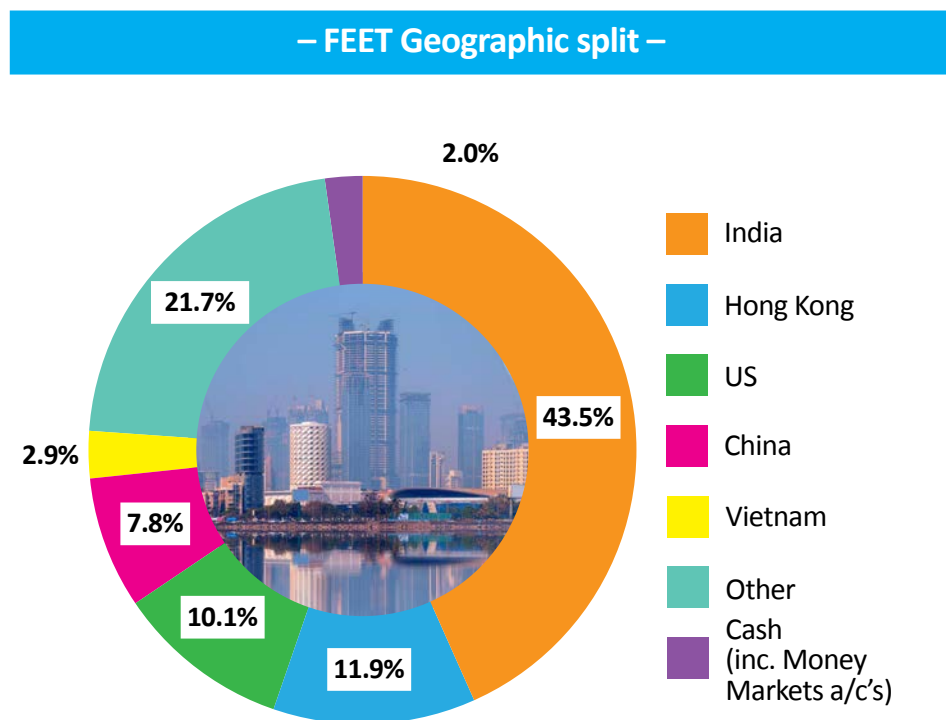
As a result, O’Brien explains the proportion of the fund in frontier markets could ‘continue to decline’ after reducing exposure to owning only a ‘very limited, select number of high conviction names’ in a handful of frontier countries, having cut holdings in Nigeria from three to one, in Sri Lanka and Bangladesh from two to one, and with no more holdings in Ghana or Pakistan.

CAN FUNDSMITH FORMULA WORK IN EMERGING MARKETS?

There is also the wider point of whether the Fundsmith investment process works with emerging and frontier markets. Finding companies that generate free cash flow is a key part of that process, but on the face of it this may not always seem compatible with companies that are investing for growth, such as those you might find in emerging markets.

O’Brien and Patodia believe the stocks they own are compatible, pointing to their high levels of cash generation and return on capital, another key Fundsmith metric.

O’Brien notes: ‘The free cash flows after capex of emerging market companies may be significantly lower than companies in developed



Source: Fundsmith as at 30 Oct 2020. By listing.

markets, largely because faster growth requires reinvestment at high returns of capital.

‘We think that largely the business models of those businesses we invest in are relatively conducive to having a compatible outcome in terms of looking at businesses which typically have high returns on capital, generating sufficient cash to fund growth. And typically these businesses would have highly attractive working capital cycles and sound balance sheets to support that growth.’

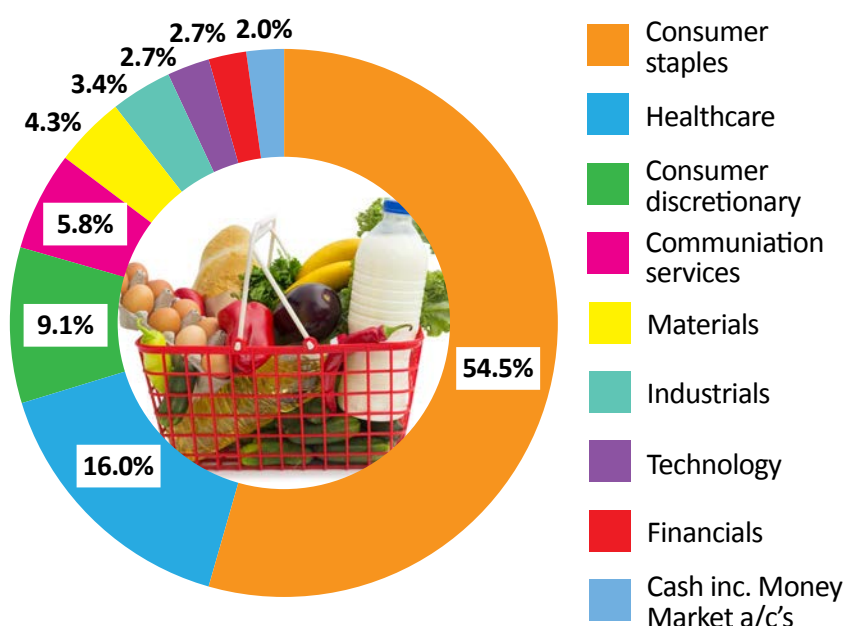
He also points out the vast majority of companies in the portfolio have no net debt, and says there is less of a dividend culture in emerging markets, so the cash that would’ve used as a shareholder payout is instead reinvested to fund growth, ‘we quite like that as investors because if a company can invest their cash flows rather than give

it back to us, it solves a problem of what we do with it’.

Portfolio turnover increased markedly last year, reaching 28% as O’Brien and Patodia made their mark on the fund, and is set to remain elevated in 2020 as the fund lowers its exposure to consumer stocks and increases its allocation to technology and healthcare, two sectors which have experienced supercharged growth in 2020 and are expected to be big beneficiaries as a result of the coronavirus pandemic.

This is however something of a departure from the Fundsmith focus on consumer stocks, with the Fundsmith Owner’s Manual describing how a consumer company which ‘sells many small items each day is better able to earn more consistent returns over the years than a company whose business is cyclical, like a steel manufacturer, or “lumpy”, like a property developer.’

– FEET Sector split –



Source: Fundsmith as at 30 Oct 2020 by NAV - GICS® Categories.

SHIFT FROM CONSUMER STAPLES

Patodia says the focus on staples gave the portfolio downside protection, but concedes that it 'also somewhat limits the upside' as it 'makes the portfolio very defensive and as long term investors your returns are best achieved in companies where you have multi-generational growth opportunities'.

He continues: 'We wanted to shift the focus from being largely defensive to a more defensive growth allocation. That's why our allocation to technology and healthcare sectors has increased because it helps the portfolio perform better in both down and up cycles.'

'During a down cycle in the economy, staples would do well because people don't stop consuming essential items, but in an up cycle there is higher discretionary consumption and

more focus on growth. If you have a more balanced portfolio in terms of sectors, we believe performance may be better.'

While technology and healthcare have been the stars of 2020 from an investment perspective, another area exciting investors with its growth potential – but somewhere Fundsmith has been curiously absent when comparing its allocation to other fund groups – is China, which makes up just 7.8% of the fund compared to 42.5% for its benchmark index.

REASONS FOR LOWER CHINESE ALLOCATION

O'Brien insists Chinese companies 'do provide interesting investment opportunities' and insists 'we've looked at dozens since we launched the fund', but says they often have issues related to corporate governance and transparency, and also says

Chinese firms generally are 'poor allocators of capital'.

He says: 'You've got to remember China does not have an independent judiciary. The success rate for prosecutions in Chinese courts is 99.9%. So therefore, if you're a foreign investor, you typically have a legal system which is stacked against you.'

The managers also took a look at Chinese giant Ant Group as it was readying what would've been the world's biggest ever IPO, and O'Brien reveals the more they looked at Ant, the more issues they found.

Ant had to abort IPO plans after the Shanghai regulator raised questions over its ability to meet disclosure and listing conditions.

O'Brien explains: 'The more we looked at Ant, the more it looked like a bank, felt like a bank, smelled like a bank and therefore probably could be deemed to be a bank, and we felt that was probably where it would run into regulatory issues.'

'There was clearly a risk impact, both in terms of its credit expansion amongst consumers, but also what we felt was probably the biggest risk was through its platform. It has helped a number of secondary and tertiary lending institutions grow their balance sheet very, very quickly, and we felt potentially there would be some form of regulatory backlash against that.'

BIAS TOWARDS INDIA

The fund's biggest allocation by country is India, making up 43.5% of the fund, a market which underperformed

significantly in 2019 and has seemingly underwhelmed compared to other emerging markets in the past five years, with the MSCI India index recording a five-year annualised return of 7.87%.

But Patodia says any notion India has been an underperformer for the fund is simply not true, highlighting that Indian stocks have been the largest contributor to fund performance since inception, while 13 of the 15 Indian companies in the portfolio are up year-to-date despite the pandemic.

He says India is a 'large repository of high quality businesses among emerging markets', especially in the fast-moving consumer good (FMCG) sector, and says the country's stock market also contains a lot of founder-led or family-owned businesses that are 'very well run' and with 'strong market positions'.

Patodia adds that accounting standards in India are comparable to South Africa, which has the best accounting standards among global emerging markets, and highlights that minority shareholder protection rights in the country are also very high.

Two stocks in the trust which appear to have had a mixed year are the Indian subsidiaries of consumer goods giants Nestle and Unilever, which have recorded modest share price gains over the past year but not the kind of spectacular growth associated with large cap EM stocks. However, both have either tripled or close to it in the past five years.

MULTINATIONAL WINNERS AND LOSERS

Patodia puts multinational subsidiaries generally into two camps – those who understand the local market well, and those that don't. It's pretty clear which ones thrive and which ones don't.

He explains, 'It's increasingly apparent to us not all multinational subsidiaries are created equal, and not all excel.'

'Some multinational subsidiaries parachute unincentivised management in from overseas with no real understanding of the market they are operating in, and we found they lose market share to local players, which has a subsequent impact on financial performance.'

But unsurprisingly he points out this is not the case for the Unilever and Nestle Indian businesses, and says both 'have a very high level of quality.'

He adds, 'We have found that they've lived up to expectation or even exceeded it from both an operational performance point of view and ultimately an investment point of view. In these cases management have a deep understanding of local culture, consumer behaviour and market trends.'

Given the trust's varied performance so far, investors have understandably been questioning what sort of returns they could expect from FEET going forward.

The managers emphasise they can't predict returns, but what they will do is stick with the Fundsmith principles of investing in good companies, not overpaying and doing nothing.



– FEET Top 10 holdings –

MercadoLibre

Foshan Haitian

Vitasoy

Asian Paints

Info Edge

Nestlé India

Metropolis Healthcare

Havells

Hindustan Unilever

Marico

Source: Fundsmith

O'Brien adds: 'What I can say is that we are confident in the growth prospects of our companies over the long term.'

'The rise of the consumer class in emerging markets is a trend that still has a long way to go, and at the moment we're probably only scratching the surface.'



By Yoosof Farah
Reporter

AIMING FOR ZERO: EUROPE RAISES ITS CLEAN ENERGY GAME

ADVERTORIAL



PICTET
Asset Management

Europe's ambitious new climate goal will help it become carbon neutral and spur investments into the clean energy industry.

Shifting into a higher gear. This is precisely what the European Union has just done as it steers towards a more sustainable economy. Its new climate blueprint proposes cutting greenhouse gas emissions by 55 per cent compared with 1990 levels by the end of the decade. Europe's ambitious green spending commitments and stricter regulations not only give an environmental template for other countries to follow, they also offer the prospect of stronger economic growth and open up new investment opportunities.

"The only way to meet the world's growing demand for energy while decreasing its carbon emissions is to adopt more energy-efficient technologies and switch to low or zero carbon energy alternatives. Combined with accelerating advances in enabling technologies, this energy transition will create investment opportunities for decades to come."

Christian Roessing, Senior Investment Manager, Pictet Clean-Energy fund

The Biden victory at the US election will accelerate further the energy transition. Environmental and clean energy technology is a key pillar of Biden's USD2 trillion infrastructure investment programme. Biden aims to achieve a net zero carbon economy by 2050, committing USD2 trillion in new investment over four years. The energy transition in the world's largest economy seems unstoppable. This should strengthen the potential for attractive future growth in companies offering goods and services that would drive a transition to a zero carbon economy.

Pictet-Clean Energy fund: investing in the energy transition

Europe's 2050 climate target is set to disrupt and transform a number of industries, each representing rich and diverse investment opportunities:

- **E-mobility:** Some 80 per cent of today's transport energy needs to be converted to electricity to meet the emissions target. BNEF expects 57 per cent of all passenger vehicle sales will be electric globally by 2040, compared with only 3 per cent in 2019. This will likely boost investments into not only EV manufacturers but, more significantly, supporting technologies such as batteries and power semiconductors, as well as smarter grid networks and charging infrastructure.
- **Renewables:** Under the European plan, the share of renewables in power generation must rise to 85 per cent by 2050 from today's 20 per cent, with the bulk of that covered by wind and solar. The way we generate power is transforming as an increasing number of European power utilities ramp up their production of renewable energy with aggressive expansion plans.
- **Green buildings:** All new European buildings must be "nearly net zero energy" starting 2021. We also expect a significant increase in demand for "retrofitting" existing buildings.

Pictet-Clean Energy is a compartment of the Luxembourg SICAV Pictet. The latest version of the fund's prospectus, KIID (Key Investor Information Document), regulations, annual and semi-annual reports are available free of charge on assetmanagement.pictet or at the fund's management company, Pictet Asset Management (Europe) S.A., 15, avenue J. F. Kennedy, L-1855 Luxembourg. Before making any investment decision, these documents must be read and potential investors are recommended to ascertain if this investment is suitable for them in light of their financial knowledge and experience, investment goals and financial situation, or to obtain specific advice from an industry professional. Any investment incurs risks, including the risk of capital loss. All risk factors are detailed in the prospectus.

The secret formulas employed by the experts

We talk to managers about the metrics they use as a first step in identifying potential investments

The main reason investors care about valuation is because of the risk of suffering underperformance if they overpay for a stock.

There are many different approaches used to value companies ranging from discounted cash flow based measures, relative valuation and multiple based methods.

In this article we take a closer look at specific valuation metrics used by four fund managers and discuss how they are incorporated into the investment process.

We have selected screening criteria to identify stocks which could qualify under each valuation approach although these are just a starting point for further research. All the managers we spoke with emphasised that screening was just one part of the overall investment process.

THE PEG RATIO

The PEG (price-to-earnings growth) ratio is the PE (price-to-earnings) ratio divided by growth and was effectively first referenced by Peter Lynch in his book *One Up on Wall Street* where he said: 'The PE ratio of any company that's fairly priced will equal its growth rate.'

Lynch managed Fidelity's Magellan Fund from 1977 to 1990



with assets under management growing from \$14 million to \$14 billion under his tenure.

In the early 1990's Jim Slater popularised the PEG for UK investors and it is still used to manage money at Slater Investments under the tutelage of his son Mark Slater. For Slater the PEG ratio adds another dimension to the PE by incorporating growth into the equation.

After all, growth is what



investors pay for and the PEG has the added advantage that it allows investors to compare companies with different growth rates and PE's.

Mark Slater told *Shares* that stipulating at least double-digit expected earnings growth eliminates 95% of the universe of available investments leaving the team a more manageable list of investments to scrutinise and to conduct qualitative assessments.

What the **Slater Growth Fund (B7T0G90)** is looking for is companies which can grow sustainably over the medium term, so the team removes cyclical companies and those with no history of consistent growth. At the same time Slater doesn't want to overpay for growth, so he insists on a PEG ratio below one, that is to say, the PE should be below the expected growth rate.

Slater says the firm had never



— Slater Screen —

Company	Two-year forecast EPS growth	Two-year forecast PE
Breedon	22.1	17.4
Clinigen	19.3	8.3
Brooks Macdonald	14.6	10.9
Tatton Asset Management	13.2	17.9
Sthree	12.7	13.6

Source: Stockopedia, Refinitiv. Data as at 13 November 2020.

paid more than a PE of 20 for a share over its 26 year history. Another important consideration is that companies are generating cash in line with profits. Once the team have identified potentially good growth businesses trading at attractive prices, they conduct further qualitative work. The goal is to ascertain the reliability of the growth.

One very important part of the qualitative work is to make a distinction between a 'very good growth' business and 'an excellent' one. The team would be minded to take profits if the PE of the former gets 'ahead' of its sustainable growth rate, essentially sticking to the PEG valuation discipline.

However the fund would look to hold an excellent growth business forever, irrespective of value as long as the growth credentials remained intact. Slater emphasised that running winners was key to delivering top-notch returns for growth

oriented managers.

A good example and the largest holding in the Slater Growth Fund is media company **Future (FUTR)** which was initially purchased for 200p for a PE of 12 compared with the current £19.90 and forward PE of 24 according to data provided by Stockopedia and Refinitiv.



— Guinness Asset Management Screen —

Company	Trailing 12-months earnings yield	Five-year average ROCE*
Plus500	34.8	116.7
Ferrexpo	27.2	35.6
Paypoint	16.7	88.5
Somero Enterprises	16.4	47.4
Jupiter Fund Management	13.5	26.9

Source: Stockopedia, Refinitiv. Data as at 13 November 2020. *return on capital employed.

CASH FLOW RETURN ON INVESTMENT (CFROI)

The CFROI measures a company's cash flow in relation to its cost of capital, adjusted for inflation. The model 'looks through' reported earnings numbers to the underlying cash flows and attempts to calculate a 'true economic return'.

Guinness Asset Management differentiates its investment approach by filtering the global equity universe through Credit Suisse's proprietary Holt CFROI model. To qualify as an investment candidate for its funds, companies must first demonstrate a CFROI of at least 10% a year for every year of the past decade.

This reduces the global universe to around 500 companies. It also ensures the screen only captures companies which have maintained high returns through thick and thin.

Companies passing the initial screening are thought to have an 80% chance of continuing to

earn higher than 10% CFROI over the subsequent three-years.

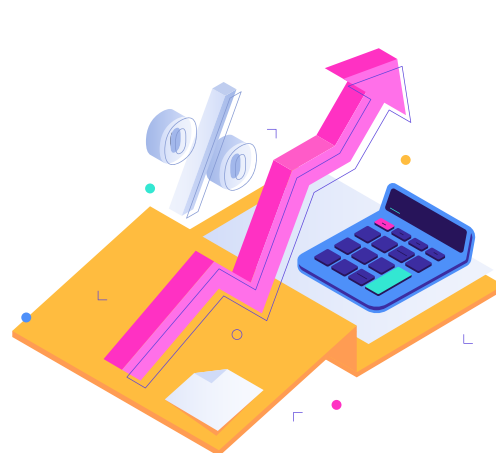
One of the advantages of CFROI is it provides a consistent approach to compare operating performance across a portfolio, or markets with different accounting rules.

The **Guinness Global Income fund (BVYPNY2)** then applies a valuation tilt to find those companies which are cheap versus the market, peers and the company's own history, using more traditional metrics such as price to cash flow.

It is also on the lookout for situations where the market has wrongly assumed a company's returns will fall back to average.

The value tilt differentiates the income fund from other quality focused managers that tend to be exposed to growth rather than value.

We don't have access to the Holt product, and have used return on capital employed as a proxy measure combined with earnings yield to isolate



qualifying stocks. Earnings yield is operating earnings divided by enterprise value, or the total value of a company including net debt.

GROWTH IN INTRINSIC VALUE

Freddie Lait, manager of the **Latitude Horizon Fund (BDC7CZ8)** believes the most important factor in delivering investment success is to focus on the growth in intrinsic value as well as capital returned to investors via dividends.



The team is very patient with Lait telling Shares they 'buy only when prices are demonstrably cheap. Although by no means a fixed rule, stocks trading on roughly 12 times forward PE, 8% FCF (free cash flow) yield or around one times tangible book value, are highly attractive provided the business is of high quality.'

The firm believes the best metrics for capturing intrinsic value are EPS, free cash flow and in the case of capital intensive industries book value per share. High returns on capital are also considered an attractive characteristic.

Essentially the team are looking for businesses with strong market positions and competitive advantages which can grow their intrinsic value sustainably at between 8% and 12% a year. The premise is that over the long term share prices follow earnings.

Focusing on intrinsic value is considered more predictable and preferable than relying on the 'quick fix' of multiple expansions. This refers to the PE ratio going up or down irrespective of earnings or cash flow.



— Latitude Horizon Screen —

Company	Two-year forecast EPS growth	Two-year forecast PE
Hummingbird Resources	29.3	2.8
Babcock International	23.3	4.9
N Brown	19.1	4.9
STV	19.9	6.4
Norcros	18.7	6.7

Source: Stockopedia, Refinitiv. Data as at 13 November 2020.

Lait expects the bulk of the fund's returns to come from growth in intrinsic value with an additional 1% or 2% coming from the PE moving 'back to trend' or mean-reverting as it also referred to sometimes. In other words, the team's patience and value discipline is also expected to pay off.

It is worth noting that around half of the portfolio is held in low risk bonds and inflation protected bonds. This part of the portfolio offers protection in volatile market conditions and provides a very safe positive return of around 3% a year.

FREE CASH FLOW YIELD

While investor favourite **Fundsmith Equity (B41YBW7)** is focused on finding the world's best quality companies and holding them for a long time, it is also keen not to overpay for

those businesses.

In the owners manual, Terry Smith outlines a valuation approach based on the forecast annual free cash flow yield. This metric compares the annual free cash flow per share with the share price.

The manager is looking for yields which are high relative to long-term interest rates and when compared with the free cash flow yields of other investment candidates.

Free cash flow here is calculated after deducting taxes and interest expenses but adding back discretionary capital expenditures, sometime shortened to capex, so as not to penalise the company for investing in growth.

It's worth pointing out that calculating what part of capex is discretionary or growth related and what is necessary for maintaining operations isn't



as straightforward as it sounds because companies don't readily split it out this way.

One way to estimate it according to famed investor Warren Buffett is to add-up capex over the last five-years and then deduct depreciation charges. What's left over is a good guide to the amount of growth capex spent.

In more recent market commentaries the Fundsmith team has said it is comfortable paying a premium for quality businesses, because it argues that valuation is not as important as sustainable growth, especially over the long-run.

High quality businesses with sustainable growth prospects are a key focus for the team when conducting fundamental research. These companies are characterised by higher than average returns on capital employed and consistent rather than explosive growth.



— Fundsmith Screen —

Company	Price to free cash flow trailing 12 months	Five-year average ROCE*
Plus500	4.4	116.7
Sthree	5.6	50.9
Moneysupermarket.com	15.8	48.8
Pagegroup	7.8	39.0
Hays	6.7	29.2

Source: Stockopedia, Refinitiv. Data as at 13 November 2020. *return on capital employed.



By **Martin Gamble**
Senior Reporter

MONEY & MARKET\$

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Preparing for a potential capital gains tax raid

As the Treasury looks for ways to rebuild the public finances investors should get ready for changes

Everyone knows the UK Government is going to have to raise taxes to try and get the public finances in order once the pandemic is in the rear-view mirror. Capital gains tax looks like a prime candidate for a Treasury raid, after chancellor Rishi Sunak ordered a review of CGT in the summer.

That review has now been concluded by the Office for Tax Simplification (OTS), who have set out a number of recommendations.

Among them they propose raising capital gains tax rates to income tax rates, cutting back the annual exempt amount of gains from £12,300 to somewhere in the region of £2,000 to £4,000. They also recommend getting rid of the rule that allows assets to be passed on with no accrued CGT on death.

These are conditional proposals, and the Government might not ultimately take them forward. The Conservative Party positions itself as the party of low taxation, but you can see how raising capital gains might look like the least worst option when it comes to repairing the hole coronavirus has torn in the budget.

It hits those with the broadest shoulders, and doesn't put the

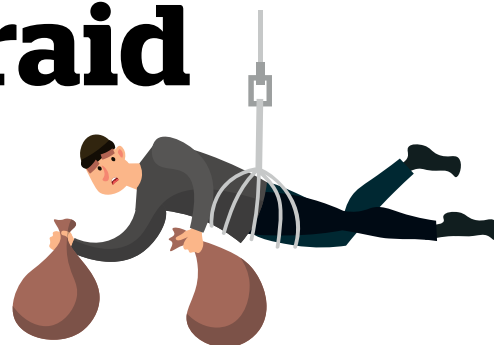
brakes on economic activity to the same extent as raising income tax or VAT.

WHO WOULD BE OUT OF POCKET?

A rise in CGT rates would potentially hit share investors, landlords, holiday homeowners and entrepreneurs. For basic rate share investors, it would mean increasing the tax on chargeable gains from 10% to 20%, and raising it for higher rate taxpayers from 20% to 40%, or 45% for additional rate taxpayers.

Property disposals already attract a further 8% capital gains surcharge on top of the current rates for shares and other assets.

The stakes are pretty high for both taxpayers and the Treasury. The OTS reckons the reduction in the annual exemption to £2,500 would mean around 360,000 more individuals having to report capital gains to HMRC, on top of



the 265,000 who do so currently. This measure alone would haul in an extra £835 million of tax each year for the Exchequer.

REDUCING CGT FOR INVESTORS

Landlords and entrepreneurs face some tricky choices if the Government enacts these proposals, because properties and businesses are difficult to shield from CGT.

For share investors on the other hand, there are perfectly legal, mainstream steps that they can take to reduce their exposure to capital gains tax, and anyone who thinks they might be caught out should now be giving serious thought to how to prepare in case there are changes, which could come as soon as next spring.

The first port of call is using your £20,000 ISA allowance, because all gains within an ISA are free from CGT. A couple can save £40,000 between them each tax year. The tax year resets on 6 April 2021 with fresh allowances, so that's potentially £80,000 a couple can shelter in ISAs over the next six months.

If you don't have fresh funds to commit, consider doing a Bed and ISA, in which you sell existing shareholdings and buy them



back within the ISA, essentially protecting them from tax on future gains.

The sale does crystallise gains to that point however, which are potentially chargeable, but at the moment you have the £12,300 annual CGT exempt amount to soak up these gains. ISAs also come with the added benefit of protection from income tax too.

CONSIDER RETIREMENT SAVINGS

Pensions and Lifetime ISAs (LISAs) are less flexible in that there are minimum ages for withdrawal, currently 55 (rising to 57 in 2028) for pensions and 60 for LISAs. In the case of the LISA, a maximum age for contributions also applies, which is 39 for new accounts and 49 for top ups to existing accounts - ages are inclusive.

If you're willing to lock your money away for a bit longer, both vehicles are worth considering as they shelter investments from capital gains tax and income tax.

A pension also offers tax relief on contributions at your marginal rate, and 25% tax-free

cash when you come to draw on it. They are also free from inheritance tax (IHT) and can be passed on tax-free to your nominated beneficiaries if you die before your 75th birthday. The pensions annual allowance is usually £40,000 or 100% of your UK earnings, whichever is lower.

LISAs are similar to ordinary ISAs but with a 25% upfront bonus on a maximum £4,000 annual contribution. Withdrawals are tax-free for a first home purchase (provided it is worth £450,000 or less), if you reach age 60, or if you become terminally ill. In all other circumstances the LISA comes with a 20% early withdrawal charge (due to rise to 25% from April 2021). Putting money into a LISA does take up some of your overall £20,000 ISA allowance so consider whether you prefer flexibility, or a boost from tax relief.

DOUBLE UP WITH YOUR SPOUSE

If you're married or in a civil partnership, you can also spread gains between you to make use of both partners' annual

CGT free allowance. Transfers between spouses and civil partners are free from Capital Gains Tax, so if you have a big gain pending, you can transfer half of it and thereby spread it between two annual CGT free allowances, giving you £24,600 of tax-free gains you can make in the current tax year.

There's also a transaction bizarrely called 'Bed and Spouse', which effectively means selling investments up to the annual exemption for gains, and then your spouse rebuying them in their name. Then the asset will be in your spouse's name for future tax liabilities, which is helpful if your wealth is unevenly split right now. You can also do 'Bed and Spouse and ISA' which means that your spouse then puts the investments into an ISA, where they won't be charged income or capital gains tax in the future

BE PREPARED FOR TAX RISES

Capital gains tax may not be the only tax rise the Government is forced to impose to pay for the costs of the pandemic. We don't know exactly where the hammer will fall, but we can be pretty sure that it will be bearing down on us once the coronavirus is more under control. News of a potential vaccine clearly makes that a more real and present prospect. When tax rises do come, those who have prepared, and made best use of their tax shelters and allowances, will consider that time well spent.



By **Laith Khalaf**
Financial Analyst

SIPPs | ISAs | Funds | Shares



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Can I open a SIPP alongside my workplace pension?

Our resident expert looks at your options when it comes to retirement savings

My partner is 54 and has a small defined benefit (DB) pension from a previous employer that will provide about £3,000 a year from age 60. She also has a defined contribution (DC) scheme with her current employer where she earns about £15,500 a year.

She pays about £100 a month into her existing scheme and will inherit a significant amount of money in the next six months.

Can she open a SIPP as well as her existing scheme? How much can she pay into her pension (or pensions) each year? Is it possible to backdate contributions and if so, is this easy to do?

John



Tom Selby

AJ Bell

Senior Analyst says:

There is no limit on the number of pensions someone can pay into at any one time, so your partner is able to open a SIPP alongside her existing workplace scheme.

The annual allowance for most people is £40,000. This is the total amount that can be paid into a pension by an individual and their employer in a tax year before any tax charges might apply.

Within this allowance, there is a limit on the level of personal contributions you can make and benefit from tax relief. This is 100%

of 'relevant UK earnings'. Broadly, this includes earned income such as salary and bonuses, but not investment income such as property and investment income.

If your partner's total UK relevant earnings for the 2020/21 tax year are £15,500, this is how much she could contribute personally across her pensions and benefit from tax relief.

This figure is inclusive of pension tax relief. For example, someone with earnings of £15,500 could make £12,400 in contributions to a SIPP from their bank account, with HMRC automatically adding £3,100 to the SIPP via basic-rate tax relief.

CARRY FORWARD

A 'carry forward' facility which can allow you to use unused allowances from the three previous tax years in the current tax year. In order to qualify for carry forward, you need to have:

- Been a member of a pension scheme during each tax year you want to carry forward from, even if you didn't make any contributions;
- Used up your full annual allowance in the current tax year;
- Contributed less than your annual allowance in one or more of the last three tax years (including personal and

employer contributions);

- Earnings of at least the amount you're contributing in that tax year, if you are making personal contributions.

It is the last bullet point that is probably most relevant in your partner's case. Up to £120,000 of extra annual allowances can in theory be carried forward (£40,000 from each of the previous tax years), the amount anyone can pay in personally is still restricted by the person's UK relevant earnings in the current tax year.

So if your partner inherited a large sum and wanted to pay this into a pension, her annual allowance would still be restricted by her earnings.

To use carry forward, there is no need to fill out any forms. If the annual allowance is exceeded under any single scheme you are a member of, the provider will update you on annual allowance usage for that, and the previous three, tax years. This will allow you to confirm that you used carry forward when completing your self-assessment tax return.

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.



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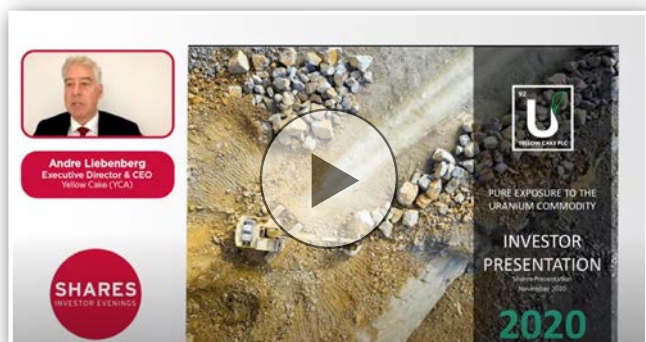
Shanta Gold (SHG) – Eric Zurrin, CEO

Shanta Gold is a producing gold company generating approximately US\$100 million EBITDA pa (US\$1900/oz). Shanta has three assets in two countries (Tanzania and Kenya) totalling 3.2 million ounces of gold grading 3.6 g/t contained.



Wentworth Resources (WEN) – Katherine Roe, CEO

Wentworth Resources is an East Africa-focused upstream oil and natural gas company. It is actively involved oil and gas exploration, development, and production operations.



Yellow Cake (YCA) – Andre Liebenberg, Executive Director & CEO

Yellow Cake is a specialist company operating in the uranium sector. The principal activity of the company is to invest in uranium projects.

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How much debt should a business have?

When comparing companies it's important to understand how they are financed

When it comes to our own finances we typically see debt as a negative but the reality is more nuanced.

Most of us would not have been able to purchase a home without a mortgage and yet running up unpaid bills on credit cards could leave you swamped in interest payments.

For businesses too, the use of debt is a balancing act and in this article we will look at the role borrowings play on a corporate level and the factors investors should keep tabs on.

WHY BORROW MONEY IN THE FIRST PLACE?

Fictional company Face Easy manufactures and sells face coverings and operates from a small warehouse. To meet strong demand the owners decide to purchase a new machine.

Face Easy shareholders have so far provided all of the money to set up the firm and run operations and are contemplating either bringing in outside shareholders to provide the funds or go to the bank. Most of the owners have spent all of their available cash on the business.

The first option means that new shares would be created and the current owners would see their collective percentage



ownership fall, also known as dilution, unless they could somehow find the cash to contribute to the equity raise.

The second option involves obtaining a bank loan and the bank decides to loan Face Easy the cash they need on the proviso that the company puts up the warehouse as collateral. This means that in the event of the loan not being paid back on time, the bank would take ownership of the warehouse and potentially the business.

The cost of losing a piece of the company after all the hard work seemed like an unattractive option to the owners. After all they estimated that the loan could be paid back in under five years given current demand and profitability.

THE ADVANTAGES OF USING DEBT

After speaking with their accountant they discovered

there are some financial benefits to taking on some debts.

For starters, bank interest is deducted from operating profit which means paying lower taxes.

This in turn increases the return on equity (ROE). Think of ROE as the interest rate that shareholders receive on their investment. It is calculated by dividing net income into the book value of equity.

The owners estimated that once the new machine was operating at full capacity it would add around 20% to potential sales, most of which would fall to the profit line because there were very few extra costs involved with selling more product as it was all done online. This is known as operating leverage.

The trade off here is between keeping all the extra future profits generated by the investment minus the interest costs versus not paying interest costs at all and only keeping say

95% of future profits because of the dilution effect.

Another advantage of debt is the current low cost of finance which reflects the fact that UK interest rates are almost zero. In Face Easy's case the bank wanted to charge the company 5% annual interest.

DISADVANTAGES OF USING DEBT

Debt becomes a problem if a business experiences a downturn and it has so much debt that cash flows aren't high enough to keep making the interest payments to the bank.

Even where a company makes an operating profit, subtracting interest costs can sometimes push the overall business into a loss making situation, which makes banks nervous.

Measuring the level of gearing in a company is one way to assess the situation. Gearing is usually calculated by comparing debt to equity.



Using Face Easy as an example, let's assume the debt is £5 million and the equity is £30 million, dividing one into the other gives a gearing ratio of 16.6%, which is considered very low gearing.



Any ratio below 50% is considered moderate but once it moves above 50% it gets progressively more risky. Higher gearing means higher debt costs as banks demand increased rates of interest to compensate for the extra financial risk.

Large publicly traded companies that regularly issue debt have credit rating analysts providing credit research designed to assess the creditworthiness of the company for the benefit of debt and bondholders. Bonds are debt instruments that represent a loan made by an investor.

The safest credit rating is known as an investment grade rating and means that the borrower is very likely to pay back its loans.

Investment grade is usually defined as having a net debt to EBITDA (earnings before interest, taxes, depreciation and amortisation) ratio below 2.5 times, but this can vary depending on the industry and visibility of cash flows.

FIND THE RIGHT BALANCE

In practice having some debt is a good thing for shareholders for all the reasons touched



upon but like a lot of things in life, using debt in moderation is always better than going overboard and prudence should always take precedence.

Generally speaking debt finance costs less than equity finance, although calculating the cost of equity isn't as straightforward.

Think of the cost of equity as the expected return that prospective investors require compensating them for the risk of owning the shares. For most large quoted companies this is between 6% to 9%. In comparison the highest quality corporate debt yields are around 2.3%.



By **Martin Gamble**
Senior Reporter

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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

20 November: Sage. **23 November:** Carrs, Cerillion, Daily Mail & General Trust. **24 November:** Compass, Greencore, Ten Lifestyle, Treatt, UDG Healthcare. **25 November:** Brewin Dolphin, Cambria Automobiles, Marstons. **26 November:** Tracsis.

Half year results

20 November: Argentex, Fusion Antibodies, The Panoply Holdings. **23 November:** Cake Box, Codemasters, D4T4 Solutions, LXI REIT, MindGym, NextEnergy Solar Fund, Northern Bear, Sirius Real Estate, Sys Group, Thruvision. **24 November:** AO World, CML Microsystems, Eckoh, IG Design, Pennon, Pets At Home, Record, Severfield, Trifast. **25 November:** Alpha Financial Markets, De La Rue, Helical, HICL Infrastructure, Liontrust, Shearwater, United Utilities. **26 November:** First Property, JLEN Environmental Assets, Motorpoint, NewRiver REIT, QTAQ, Severn Trent, Ted Baker, XPS Pensions.

Trading statements

24 November: Intertek.

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