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SHARES

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BIG DRUG COMPANIES:

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PLUS

SMALLER COMPANY FUNDS ARE **STAGING A COMEBACK**

THEMATIC PRODUCTS TOP THE **ETF CHARTS** IN 2020

THE UNDERAPPRECIATED **BAILLIE GIFFORD FUND ACHIEVING STELLAR RETURNS**

Making sense of muted reaction to Games Workshop's stellar update

There are good reasons why its latest update failed to put a spark in the shares

It's rare to find a stock that has received three earnings upgrades in two months, but that's exactly what's happened with **Games Workshop (GAW)**. In fact, since July this year the consensus analyst forecast for its 2021 earnings per share has increased by more than 75%.

The scale of the upgrades goes to show that *Shares* was too pessimistic in its evaluation of the company in July when we effectively said: 'Great business, wrong price.' We underestimated its ability to keep growing earnings at a rapid pace and the company's tendency to under-promise and over-deliver.

Its shares took quite a knock in early November when investors rotated from growth to value style stocks, but they've started to make a slow comeback in recent weeks. On 7 December when the company published its latest trading update, Games Workshop's shares initially jumped more than 7% but strangely they had lost all the gains a few hours later.

It's an odd situation – a company delivering a string of good news should in theory enjoy an ongoing share price hike. However, there are perhaps two reasons why Games Workshop's shares aren't currently in a sustained upward trend.

Firstly, Sanford Deland, as the fourth largest shareholder in Games Workshop and the largest individual fund owner via its **SDL UK Buffettology Fund (BKJ9C67)**, is a forced seller. As discussed on *Shares*' Money & Markets podcast, Games Workshop became too big a stake in Buffettology thanks to earlier share price gains. Fund rules state individual holdings can be no more than 10% of the portfolio.

Secondly, the market is becoming more sceptical towards companies that have done well during the lockdown, for fears that 2020's success won't be repeated next year. For example, **Reckitt Benckiser (RB.)** has fallen 19% from its year-to-date peak as investors question its ability next year to match 2020's strong sales of health products.

Games Workshop clearly benefitted from people being stuck at home during lockdowns, looking for hobbies to keep them occupied. What happens when the Covid-19 vaccine starts to be rolled out and people want to venture outside?

For the year to May 2021, stockbroker Peel Hunt is forecasting 30% rise in sales to £350.1 million. It believes sales will progress even further to £375 million in the following year.

This implies there will not be a repeat of problems 15 years ago when the business suffered a very large hangover when consumer interest in fantasy worlds inspired by the *Lord of the Rings* films faded away.

In 2005 it reported a 31% slump in pre-tax profit and said: 'Following the phenomenal growth of the past few years, which has proven to be unsustainable, we do need to call "time out" while we re-establish our more normal pattern of growth in sales and profits.'

Shares believes it would be wrong to assume Games Workshop is going to experience another hangover. It was doing very before lockdown first began and its success has been driven by a growing number of people experiencing its products and getting more involved in its fantasy worlds. This doesn't seem like a fad driven by a few Hollywood movies.

Take advantage of the muted market reaction to the latest trading update and buy the shares.

By **Daniel Coatsworth** Editor

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INVESTING IN CLEAN ENERGY

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GRAVIS CLEAN ENERGY

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Supply chain issues could mean a bleak winter for UK consumers

Port delays could be compounded by lack of imports and foreign drivers

There is growing concern among hauliers, freight forwarders and their customers that even with a last-minute Brexit deal the UK's 'just in time' supply chain could face unprecedented disruption from January.

According to the Office for National Statistics (ONS), the UK imported £374 billion of goods from the EU last year, or more than half of total imports, making the bloc our biggest trading partner and generating a £97 billion deficit in traded goods.

However, construction firms are now warning about a lack of supplies of everything from screws to timber and power tools as delays at UK ports hold up deliveries from the continent.

John Newcomb, head of the Builders Merchants Federation, said some products were taking up to four weeks to unload instead of one week. Meanwhile, soaring shipping costs are leading to price rises for many goods.

Shortages are likely to spread to more sectors from 1 January. Leaked Government documents describe the potential for 'border delays, tariffs and new regulatory barriers/costs (which) may result in disruption to the supply of critical chemicals used in the UK, leading to the disruption of essential services such as food, energy, water and medicine'.

Government rules for EU firms operating in the UK from 1 January are still subject to negotiations but each movement of goods from the EU to the UK is 'both an export movement for EU authorities and an import movement for UK authorities', meaning more red tape.

According to the Government's 'reasonable worst-case scenario', the flow of medicines and medical products into the UK could fall between 20% and 40% with 'potential detrimental impacts' for human health, food safety, animal welfare and disease control.

Meanwhile, with nearly a third of Britain's food coming from the EU, supply is likely to see 'reduced availability, especially of certain fresh products', while 'supply of some critical dependencies for the food supply chain could be reduced'. The UK's Food & Drink Federation recently echoed those fears.

Aside from port congestion, concerns are now growing that EU suppliers may divert their exports to other countries, creating a lack of supply, and EU hauliers could cease to carry out 'cabotage' (delivering UK goods from one UK site to another and exporting UK goods to Europe as part of their return journey).

Without a steady supply of goods coming into the country, and without foreign trucks moving essential goods on UK roads, the supply chain from distributors to warehouses to retailers could come under immense strain, leading to shortages, spiraling costs, lower margins, and most likely higher prices to consumers in the long run. [IC]

Questions still linger over National Grid and SSE dividends

The regulator has relaxed some proposals but they still result in big cuts to energy company returns

Large utility companies will make lower returns under new plans by energy regulator Ofgem, yet the cuts aren't as bad as previously mooted. That triggered a relief rally in the shares of **SSE (SSE)** and **National Grid (NG.)** on 8 December, however the changes only provide slight relief to pressure on future dividend payments.

With the new five-year returns framework due to come into force from April 2021, the apparent 5.9% yield on offer from National Grid and 6% from SSE (based on consensus forecasts for their respective March 2022 financial years) could be tough to deliver.

In July 2020 Ofgem sparked some shock and anger in the sector with a cut in the baseline rate of return from the 7% to 8% which had been allowed under the regulatory regime in place from 2013 to just 3.95%.

The new rules lift the rate to 4.3% but that may not be enough to placate the power networks and they could still take an appeal to the Competition and Markets Authority (CMA).

They may take some encouragement from the success enjoyed by their counterparts in the water utilities space who submitted their own appeal to the CMA following the publication of new price controls covering the period from 2020 to 2025 from that sector's regulator Ofwat.

In provisional findings published in September 2020 the CMA argued for a more generous settlement for the water firms with 'an adjustment to the allowed rate of return to investors to reflect market evidence and best regulatory practice, with a view to ensuring continued investment in the sector'.

This sets an encouraging precedent for SSE and National Grid who have made the argument that they will be unable to deliver on the transition to greener forms of energy and reduce carbon emissions under Ofgem's new regime – basically the question being how will they attract the necessary investment if they can't offer attractive returns?

To partly address the point on delivering a cleaner future for energy, the spending package for investment over the five years has been increased by 20% to £30 billion, with an extra £10 billion under consideration for future green projects.

The post-Covid environment will create its own pressure to reduce the strain utility bills place on households and this could be a long-term issue for the wider space whatever the outcome of this current process.

These latest developments also demonstrate that while utilities are often considered to be lower risk investments and reliable sources of income, because their returns are regulated and therefore predictable, there are still risks associated with regulatory decisions and these returns are only predictable for fixed periods. [TS]

OFGEM PRICE CONTROLS JUL AND DEC 2020 DETERMINATIONS

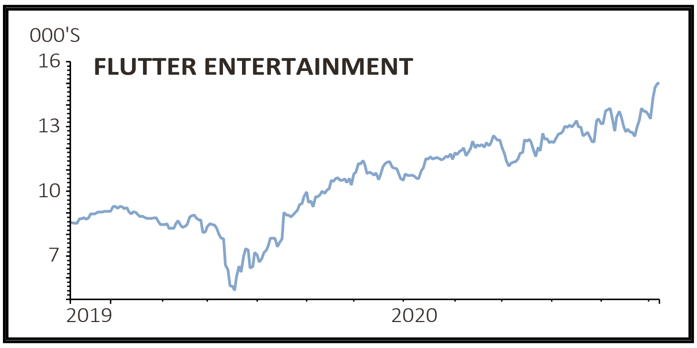
	July draft determination	December final determination
Notional gearing	60%	60%
Cost of equity	4.20%	4.55%
Expected outperformance	0.25%	0.25%
Allowed return on equity	3.95%	4.30%
Allowed return on debt	1.74%	1.82%
Weighted average cost of capital	2.63%	2.81%

Source: Ofgem

Flutter Entertainment secures prize US asset

The transaction simplifies the group's stakeholder position in the US, increasing control

Paddy Power Betfair owner **Flutter Entertainment (FLTR)** has taken a big strategic step by increasing its stake in US fantasy sports betting market leader FanDuel to 95% from 57.8%, in a £3.1 billion cash and shares deal. FanDuel's market access partner Boyd will hold the remaining 5% stake.



Flutter's US operations are still loss-making despite being expected to generate more than $1 billion of gross gaming revenues in 2020, up over 70% year-on-year, according to company estimates.

Owning a greater economic interest in FanDuel will increase the company's share of FanDuel's losses in the short-term.

Post the transaction Flutter expects net debt to EBITDA (earnings before interest, tax, depreciation and amortisation) to be below three times.

Gambling consultancy Regulus Partners believes the cash generative nature of Flutter's business means it won't have a problem supporting the debt, but it will increase the pressure on the core business to perform in a difficult economic and regulatory environment.

The US operations have been building strong momentum this year as seen from the 82% increase in third-quarter revenues to £161 million.

By the end of 2021 Flutter expects to be live in US states generating $9.1 billion of gross gaming revenues at maturity, equivalent to the size of the UK, Ireland and Australian markets combined. For

reference these regulated markets are expected to earn Flutter over $1 billion of EBITDA in 2020.

FanDuel is the market leader in fantasy sports with over 9.5 million customers and enjoys a structural cost advantage over most competitors when it comes to customer acquisition costs.

Despite a leading market position and growth potential, Flutter's transaction to increase its stake values FanDuel at $11.2 billion compared with Nasdaq listed DraftKings' $21 billion.

Management said the ability to buy the stake at below fair market value discount reflected several factors including the seller's minority position in FanDuel and the provision of price certainty and liquidity.

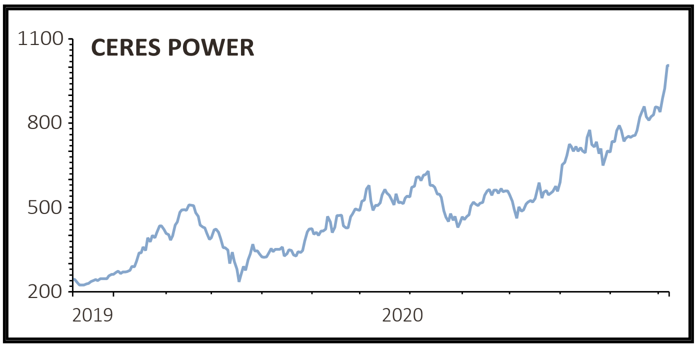
Jefferies' analysts noted that putting FanDuel on a similar valuation to DraftKings equated to a value of greater than £180 for Flutter. Its shares traded at £148 at the time of writing. [MG]

CORRECTION: There was an error in 3 December 2020 news article entitled *Consequences of the pound rally on certain UK stocks*. It incorrectly stated that after the Brexit vote in 2016, UK investors saw the value of their overseas holdings eroded due to sterling weakness. It should have said investors saw an increase in value. We apologise for any confusion.

Fast growing hydrogen stock Ceres gets closer to fulfilling its potential

Ceres Power has got analysts excited after its latest deal with German giant Bosch as it hits 'biggest milestone to date'

Fast growing hydrogen stock **Ceres Power (CWR:AIM)** has gone a long way to fulfilling its potential after inking a deal with German giant Bosch that analysts have called its 'biggest milestone to date'.



Ceres Power has seen its shares jump 295% this year as investors bet on hydrogen fuel cells playing a key role in decarbonising the global economy.

The company makes a solid oxide fuel cell known as 'SteelCell' which can run on hydrogen. Fuel cells work like batteries but don't run down or need recharging, and work by converting the chemical energy of a fuel (often hydrogen) and an oxidizing agent (often oxygen) into electricity.

Manufacturer Bosch plans to spend several hundred million euros to make fuel cells with technology from Ceres Power, and is preparing to start volume production of the Ceres-powered fuel cell systems in 2024, aiming to achieve initial annual production of around 200MW – equivalent to supplying around 400,000 people with electricity in their homes.

It comes after Ceres signed a deal with South Korean conglomerate Doosan in October worth £36 million to the company over three years, with an additional £7 million contingent on performance, ahead of longer-term royalties on the sale of fuel cell stacks.

The Bosch deal is worth around £23 million in licensing fees to Ceres between 2021 and 2023, of which £6 million is conditional on meeting targets. Ceres reported revenue of £19.9 million in the year to 30 June.

Analysts are very excited about the potential beyond 2023. Once the 200MW of capacity is operational in 2024 and Bosch is making and selling the systems, Ceres will begin generating royalty revenues.

Berenberg estimates these could be £30 to £100 per kilowatt, meaning at 100% capacity utilisation Ceres could generate between £6 million and £20 million in annual revenues from this 200MW of capacity. With royalty revenues around 80% gross margin, or possibly even higher, Berenberg also expects a material step-up in profitability, all else being equal.

From the point of view of Ceres' clients like Bosch, analysts at Liberum said one of the reasons their enthusiasm for fuel cells has increased over the last year is the demise in diesel car sales.

Bosch generates a significant proportion of its revenues from diesel technology, but Liberum says the diesel share of new car sales in Europe's four biggest car markets has plummeted to an average 24%, half the level of five years ago, and highlights that last month sales of electric vehicles in the UK were 13% higher than diesel sales at 18,000 units.

Shares in other hydrogen stocks **ITM Power (ITM:AIM)** and **AFC Energy (AFC:AIM)** have also been in demand in 2020, rising 495% and 126% respectively year to date. [YF]

Key catalysts for markets before the end of 2020

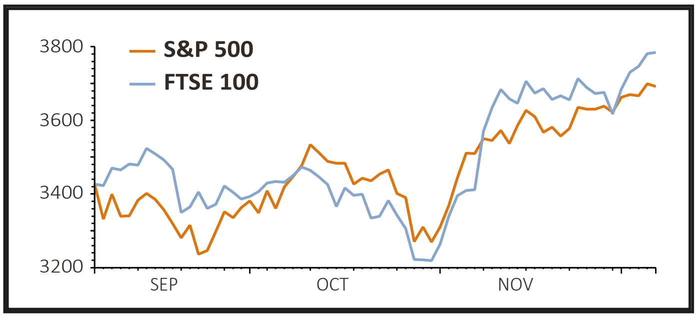
Brexit, US stimulus and the roll-out of vaccines are dominating investors' thoughts

There is plenty for investors to think about as we approach the end of a tumultuous year. For UK stocks the most significant remains Brexit and the prospects for a deal.

As we write talks were going to the wire. However, an important point to remember is that even if a deal is secured it will be quite a limited one and it will still mean extra checks and regulation on goods flowing from the EU to the UK and vice-versa. This raises the prospect of disruption when the transition period ends in January.

Whether this might have an impact on the roll-out of vaccines – key to a reopening of the economy – could become a more pressing story with 90-year-old Margaret Keenan in Coventry becoming the first person in the world to receive the Pfizer vaccine.

The other big politics meets economics story is the bi-partisan stimulus package in the US with suggestions an agreement could come soon. This would likely provide stocks with a further catalyst although some kind of support has arguably already been priced in by the market as US equities soared to new record highs as a weak jobs report (4 Dec) was seen as increasing the pressure to get a stimulus deal signed off. [TS]



Big Goco shareholder Peter Wood throws weight behind Future tie-up

The publishing firm's deal for the price comparison site had a frosty reception from the market

AT LEAST ONE person appears to be a very big fan of **Future's (FUTR)** recommended £535 million cash and shares deal for **Goco (GOCO)**.

Goco's largest shareholder and chairman Peter Wood has snapped up £2 million worth of Future shares after they slumped in the wake of the deal being unveiled to the market (25 Nov).

Future's shares were trading close to £20 and within sight of record highs before the takeover was announced, and now sit at £17.46.

The negative market reaction implies concern over a large transaction which sits outside Future's traditional approach of buying cheap magazine assets and incorporating them into a central platform to generate revenue from their content and brands through a mix of digital advertising, e-commerce and click-throughs to partnered retailers and events.

However, Liberum analyst Harry Read notes: 'Alongside buying another quality platform asset, Future has identified synergies associated with the deal including cross-selling, lower customer acquisition costs (presumably by advertising GoCo on Future websites) and benefiting from future tech stack.'

Wood's share purchase means he can support the transaction from both sides – he owns almost 30% of Goco. He was quoted as saying he bought Future shares because they are undervalued and he thinks the company has good prospects and is run by an outstanding chief executive in Zillah Byng-Thorne. [TS]

The underappreciated Baillie Gifford fund achieving stellar returns

It's time for Monks to stop living in the shadow of sister investment trust Scottish Mortgage

MONKS INVESTMENT TRUST
BUY
(MNKS) £13.14
Market cap: **£2.97 billion**

While Baillie Gifford's flagship investment trust **Scottish Mortgage (SMT)** tends to hog the headlines, there are other top-performing funds that bring exposure to the highly rated investment management group's best growth ideas. One high-flying trust that looks particularly compelling is **Monks (MNKS)**, which has a differentiated approach to global growth.

Typically holding over 100 stocks offering a range of different growth profiles, Monks offers investors a diversity of growth drivers which has translated into an outstanding track record. As such, the 3.1% premium to net asset value (NAV) isn't prohibitive, while a low ongoing charges figure of 0.48% only adds to Monks' myriad attractions.

STELLAR TRACK RECORD

Rigorous, bottom-up analysis is at the heart of Monks' investment process, with managers Charles Plowden, Spencer Adair and Malcolm MacColl looking to identify companies with above-average earnings growth.

The team take a long-term view on their holdings as this ensures that the fundamental attributes of a company are given ample time to drive returns and since this trio took over the portfolio in March 2015, Monks' performance has been outstanding.

Over the past five years it has achieved 25.8% annualised returns versus 14.8% from the FTSE World total return index, according to Morningstar.

Investec Securities says the trust has 'a clear and distinct philosophy and a proven investment process'. It adds: 'Since the adoption of the current approach, the company is ranked seventh out of 263 global open and closed end funds in terms of shareholder total returns. This has enabled the company to establish itself as a core strategic investment for investors.'

Monks significantly outperformed its benchmark in the most recent half-year to 31 October 2020, with net asset value (NAV) growth of 26.8% helping to power the share price 25.7% higher. This represented another knock-out performance versus the FTSE World benchmark, which rose 10.2%.

Unlike Scottish Mortgage, the Monks team take a broader and more diversified approach with

Monks Investment Trust performance

Annual returns	2015	2016	2017	2018	2019	2020*
Price	8.9	33.8	35.0	-4.8	32.4	32.3
NAV	7.0	26.5	26.0	-4.8	28.4	35.3
Benchmark	4.3	29.6	13.3	-3.1	22.8	10.3

Source: Morningstar. *Data to 30 November 2020. Benchmark is FTSE World TR GBP over 100 stocks and the largest 10 holdings only account for roughly 21% of the portfolio, providing for a more balanced, global approach.

DIFFERENT FROM THE BENCHMARK

Macroeconomic forecasts or the structure of the benchmark equity index are of relatively little interest to the managers, as the portfolio's high 86% active share demonstrates.

Active share is a measure of how different a fund's holdings are from its benchmark – being the index against which performance is measured.

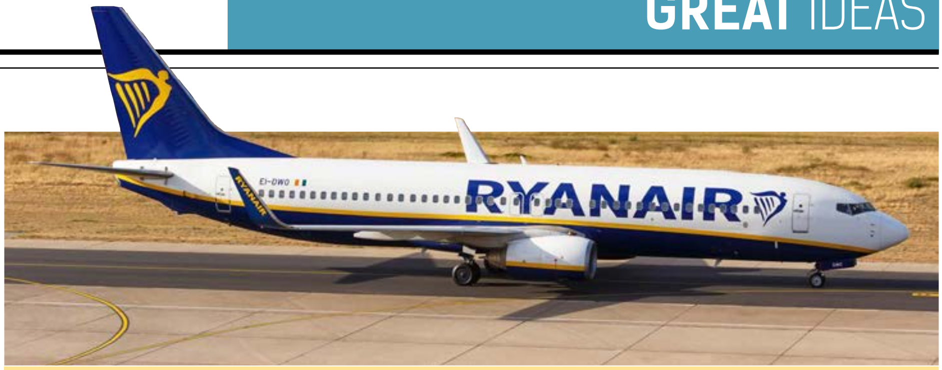
If a fund had no holdings at all in common with its benchmark, it would have an active share of 100%, and if all its holdings were the same as the benchmark, its active share would be 0%.

DIVERSIFIED GROWTH DRIVERS

Monks' portfolio contains four distinct categories of growth stock: 'Stalwart', 'Rapid', 'Cyclical' and 'Latent'. At around 25% of the portfolio, growth stalwarts are names considered to have a durable franchise generating earnings growth of around 10% per year, such as Microsoft and Mastercard.

Over half of Monks' portfolio is invested in rapid growth stocks. These are companies in the early stage of their business cycle with a vast growth opportunity ahead, typically delivering 15% to 25% earnings growth per year.

Cyclical growth names are delivering 10% to 15% growth over the economic cycle, with common characteristics including a significant structural growth opportunity and a strong



Examples of holdings by growth category

Growth stalwarts	Rapid growth	Latent growth
Moody's	Naspers	Softbank
Microsoft	Amazon	Ryanair
Mastercard	Alibaba	
Thermo Fisher Scientific	Alphabet	
Anthem	Meituan Dianping	
AIA	Shopify	
Olympus	SEA	

Source: Monks IT, as of 31/10/20

management teams with proven capital allocation pedigree.

The latent growth bucket currently includes SoftBank and **Ryanair (RYA)**. Here, you'll find out-of-favour companies with a specific catalyst that could drive above-average earnings in the future.

Investec points out that in recent years there has been a distinct rotation away from cyclical to the rapid growth category, although Monks' managers have good valuation discipline too. They will sell if future growth is fully reflected in the price of a holding, as happened with the recent sales of fast-food chain Chipotle and payments group Visa.

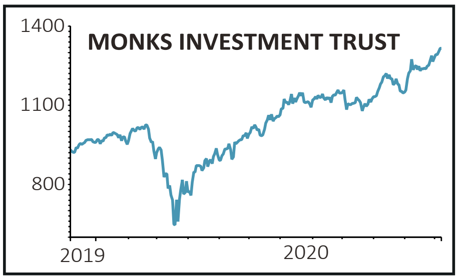
NEW ADDITIONS

Recent investments include the likes of online furniture seller Wayfair and music streaming platform Tencent Music Entertainment, a joint venture between Chinese social media platform Tencent and Spotify.

Plowden has also ploughed cash into cloud service businesses, among them Snowflake, Cloudflare, Datadog and Twilio, as well as online travel agency Booking and car sharing company Lyft.

Sports apparel company Adidas and cosmetics firm Estee Lauder have also been added to the portfolio in the belief both brands will emerge in a stronger position post-pandemic.

Monks has also put money to work with mining giants **BHP (BHP)** and **Rio Tinto (RIO)** to add diversity of growth drivers to the existing portfolio, while also upping its stake in low-cost airline Ryanair. [JC]



We see potential in the overlooked and underloved

FIDELITY SPECIAL VALUES PLC

This investment trust seeks out good-quality but unpopular companies, whose long-term growth potential has been overlooked by the market.

Portfolio manager Alex Wright's contrarian approach to the trust thrives on volatile and uncertain markets, when there's more chance of stocks being misjudged and undervalued. Investing mainly in the UK, and supported by Fidelity's extensive research team, Alex looks to invest in out-of-favour companies, having spotted a potential trigger for positive change that he believes has been missed by others.

It's a consistent and disciplined approach that has worked well; the trust has outperformed the FTSE All Share Index over the long term both since Alex took over in September 2012 and from launch 25 years ago.

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. The trust invests more heavily than others in smaller companies, which can carry a higher risk because their share prices may be more volatile than those of larger companies and the securities are often less liquid.

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	9.9%	19.1%	8.7%	-4.9%	-18.5%
Share Price	1.1%	28.2%	14.0%	-6.9%	-25.4%
FTSE All Share Total Return Index	11.7%	14.3%	4.7%	0.4%	-12.7%

Past performance is not a reliable indicator of future returns.
Source: Morningstar as at 31.08.2020, bid-bid, net income reinvested.
 The FTSE All Share Total Return Index is a comparative index of the investment trust.

To find out more, go to fidelity.co.uk/specialvalues or speak to your adviser.

moneywise Investment Trust awards 2019 WINNER
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Higher margins should drive big share price gains for DiscoverIE

The electronics engineer is delivering on its strategy to go up the value chain

Electronics engineer **DiscoverIE (DSCV)** has been on quite a journey in recent years, pulling itself up the supplier value chain by executing a clear strategy.

This ambitious adventure is far from over. We believe the company's success will soon lead to its share price trading beyond 750p for the first time in 20 years.

We have followed the DiscoverIE growth story for quite some time and flagged its appeal many years ago when it was called Acal.

DISCOVERIE
BUY
(DSCV) 600p

Market cap: **£540 million**

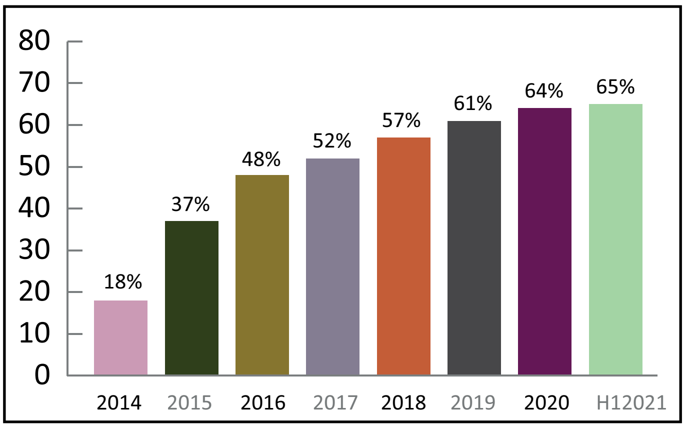
SHARPER FOCUS

The company used to be a simple distributor of parts and components to the electronics manufacturing industry. It still makes about a third of its revenue from supplying bits of kit on long-run contracts (£76.6 million of the first half to 30 September's £217.9 million group sales) through its Custom Supply (CS) arm.

During the past few years, it has made a deliberate attempt to design and make bespoke pieces of equipment to highly regulated industries, now called the Design & Manufacturing (D&M) operations.

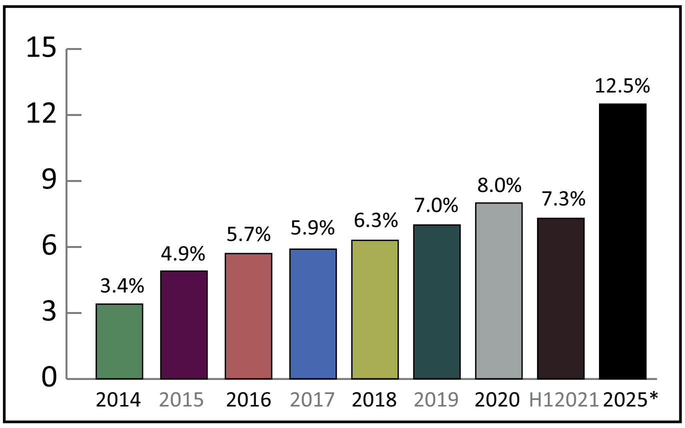
It focuses on sectors where unique custom designs are often required and where corners simply cannot be cut, such as

More higher margin business*



Source: DiscoverIE *D&M share of overall revenue

Scope for margin growth



Source: DiscoverIE *Forecast

medical, aerospace, transport and renewables. These are sectors where equipment needs to be high-performance, reliable, efficient and regulations-compliant, and that should mean fatter profit margins.

There are also high barriers to entry, providing reasonable defence against lower grade, me-too products from low-cost places like China and elsewhere.

For example, it makes components such as blade controls for wind turbines, artificial intelligence-based telematics and connectivity components, and sensing and power systems.

The customised nature of many designs helps raise the value of these products and often creates a virtuous cycle of replacements over years.

This strikes us as a very sensible strategy and one that, presuming all goes to plan, could prove very profitable for the company and its shareholders.

IMPROVING MARGINS

Because a large part of income still comes from distribution it means that operating profit margins are coming from a comparatively low starting point.

Operating profit margins were just below 6% a couple of years ago, but they had improved to 7.3% across the company in the latest half year period to September.

Some analysts see the opportunity to improve low single-digit supply margins, but the real profit boost will come as DiscoverIE continues to expand its higher, double-digit margin D&M side. This combined transition should see overall

operating margins move to 8% in the next year or two, with 12.5% targeted by 2025.

To put that into context, an 8% operating margin in the first half this year would have added £1.6 million on top of the £15.8 million operating profit reported.

ACQUISITION PROSPECTS

Progress was slowed by the Covid-19 pandemic this year, which suggests that with the widening deployment of vaccines through 2021, recovery could come quickly.

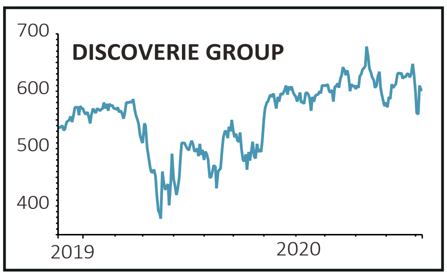
This will be bolstered further through buying in new growth opportunities and expertise. Mergers and acquisitions have always been a part of the story – DiscoverIE has done around 15 deals over the past decade, but the company is now increasingly looking to expand beyond its UK/Europe traditional stomping ground.

The €14.5 million purchase of thermal components and sensors business Limitor earlier this month is a good example. While it will mainly bolster sales in Europe, about 15% of its €8.5 million income in 2019 was spread over the US, Asia and European nations outside the EU.

The Limitor deal pushed net debt to about 1.5-times earnings before interest, tax, depreciation and amortisation (EBITDA), comfortably within the company's preference not to exceed two-times, and way below the three-times level when lenders typically start to get nervous.

DiscoverIE is also fantastically cash generative, throwing off 159% of operating profit as cash flow in the first half (2019: 106%). This means that borrowings can be paid down quickly if needs be, or additional debt can be managed if the right acquisition crops up.

Analysts are forecasting diluted earnings per share (EPS) of about 22.5p for the current Covid-impacted full year to 31 March 2021, about 25% to 30% down on last year. But EPS recovery is expected to be sharp, with 26.5p and 28.5p pencilled in for the following two years. We wouldn't rule out a takeover from a larger peer in the future. [SF]



BAILLIE GIFFORD POSITIVE CHANGE
(BYVGKV5) 338.2p

Gain to date: 59.2%
Original entry point:
Buy at 212.5p, 7 May 2020

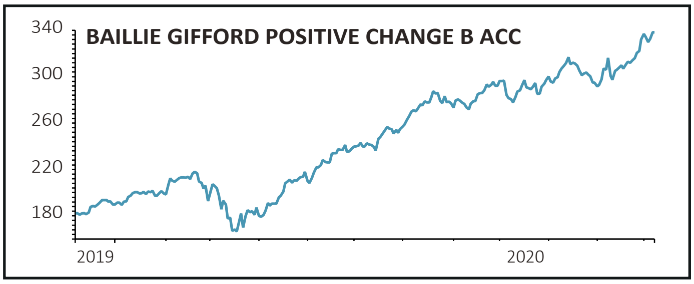
MANY INVESTORS SHUN funds in the belief they will get a better return from picking individual stocks. **Baillie Gifford Positive Change (BYVGKV5)** is proof that funds can deliver superior returns, with a near-60% gain since we said to buy in May.

Launched in January 2017, the fund has ranked in the top quartile for performance on a six-month, one year and three-year basis, according to FE Fundinfo.

The managers believe that every company within the portfolio has the potential to deliver positive impact as well as strong financial returns. It invests in high-quality companies whose products or behaviour can aid education, social inclusion, healthcare and the environment. That seems like a great space for investors.

Tesla's 300%-odd rally since early May has helped the fund's performance this year, but there have been other strong performers among the stocks in its portfolio, such as healthcare names like Teladoc and Illumina, and Covid-19 vaccine hopeful Moderna.

No fund will enjoy success all the time with every holding. Like other funds in the Baillie Gifford stable, the fund managers are very patient and are happy to sit through any bad periods for portfolio companies providing the fundamental investment and impact case remains intact.



SHARES SAYS:
There's a strong team sitting behind this fund. Still a buy for the long-term. [SF]

BEGBIES TRAYNOR
(BEG:AIM) 89p

Gain to date: 1.1%
Original entry point:
Buy at 88p, 19 December 2019

WHILE A 1% gain is normally little cause for celebration, given the events of the past year and the fact the FTSE All-Share is nursing losses of more than 8%, we'll take a small gain as a win.

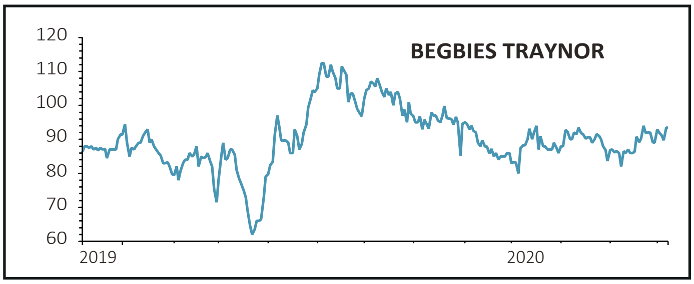
Begbies' chief executive Ric Traynor described the firm's performance in the first half to October as 'moving forward in very difficult circumstances', which underplays the 11% rise in turnover, a 25% rise in profits and an increase in the dividend.

Considering the extent to which state support has limited the number of insolvencies, the business recovery and financial advisory division delivered good top-line growth thanks to prior-year acquisitions and an element of underlying improvement.

The property advisory business suffered from the complete closure of the commercial property market during the first lockdown, and while activity has recovered swiftly the market has not yet recovered to pre-Covid levels.

However, the firm reports that there has been no significant impact on its businesses during the second period of lockdown.

Crucially, the company is well-capitalised ahead of what is likely to be a 'tidal wave' of insolvency work next year once support is reduced, and it has been hiring fee earners to bolster its market-leading franchise.



SHARES SAYS:
Stick with Begbies as a savvy counter-cyclical bet. [IC]

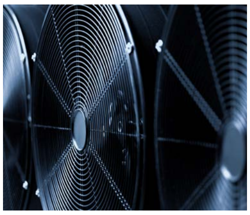
VOLUTION

(FAN) 244p

Gain to date: 35.2%

Original entry point:

Buy at 180.5p, 9 July 2020



NEWS OF POSITIVE trading and a new sustainability-linked debt facility have given a lift to **Volution's (FAN)** share price.

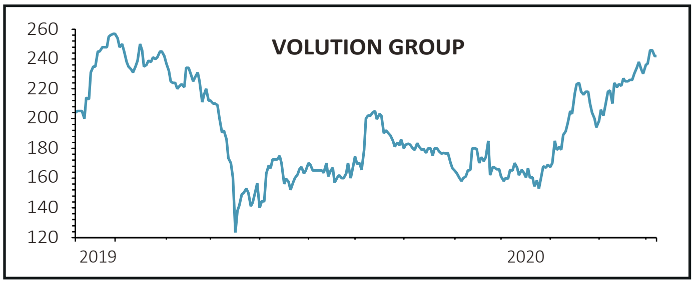
The company says favourable revenue and margin trends seen in late summer have continued into October and November. Further information will be published on 11 December when it updates the market in more detail on trading.

It has replaced a £120 million revolving credit facility with a new one for £150 million with the option to increase it by a further £30 million. Liberum analyst Charlie Campbell says the increased size of the facility is 'a clear signal' of continuing appetite for acquisitions.

The sustainability targets linked to the debt facility are to increase the percentage of sales from low-carbon products from 59% in 2020 to 70% by 2025, and increase the percentage of plastic processed in its factories from recycled sources from 56% in 2020 to 90% by 2025.

Hitting these targets results in interest savings which would then be used by Volution to invest in its sustainability initiatives and programmes.

'Volution is keeping pace with the leaders in the building products and materials universe: **Kingspan (KGP)** issued a Green private placement in September and LafargeHolcim a sustainability bond in November,' says Campbell.



SHARES SAYS:

We're encouraged by the progress so far. [DC]

Smaller company funds are staging a comeback

How to get exposure to this part of the market via funds, investment trusts and ETFs

In recent years small caps globally have suffered from investor risk aversion and concerns over everything from Covid-19 perceptions to trade war and Brexit-related worries. Until the recent rotation into value, investors had continued to show a preference for larger companies, driving down the weighting to small caps held by both passive and active funds.

As 2020 draws to its conclusion, investors should ask themselves how much of an allocation should they continue to have with larger companies, and whether now is the time to focus more on global small caps in order to find the big success stories of the future?

We can already see the performance of many small cap funds having improved in recent months, so get on board if your portfolio is missing this part of the market.

'ATTRACTIVE ENTRY POINT'

Robin Geffen, manager of **Liontrust Global Smaller Companies Fund (B29MXF6)**, is convinced there's 'a really attractive entry point for buying global small caps' at present.

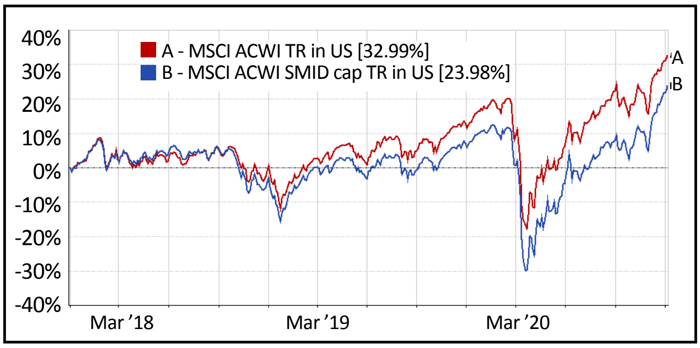
He says that despite strong long-term returns, the past three years have been the worst for global small caps on a relative basis since the 1990s, creating an opportunity for long-term investors who buy now.

'One of the best kept investment secrets is that smaller companies outperform larger companies consistently over the medium and long term,' enthuses Geffen. 'Since 1994, the start date of the World Small Cap index, small caps have consistently outperformed large caps and the longer you hold them for, the greater the probability of outperformance.

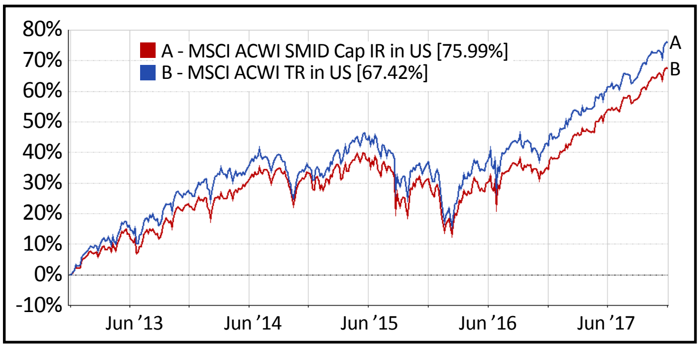
'There's a treasure trove of exciting smaller companies out there,' continues Geffen. 'This current level of underperformance by global smaller companies makes me very excited, as global smaller companies have a history of outperforming during periods of recovery in the market,' he adds.

Interestingly, the most pronounced underperformance has been in the US, which Geffen regards as a fertile hunting ground for quality companies capable of exponential growth and where over 70% of the

The MSCI ACWI small and mid cap index has underperformed in the past three years...



...but it outperformed in the previous five years



Source: FE fundinfo, 7 Dec 2020

Liontrust Global Smaller Companies Fund is invested.

ROARING AHEAD

Liontrust Global Smaller Companies has trounced both the IA Global and MSCI World SMID Cap Index since its inception. Geffen's investment philosophy is to buy tomorrow's winners when they are no less than £2 billion. They are sold on reaching £10 billion, unless he thinks they can reach £50 billion or £100 billion or beyond, in which case he'll bank some profit, but hold onto a smaller proportion of the shares.

Once a company surpasses £10 billion in value, its prospects are evaluated, and the best opportunities migrate to a sister fund run by the asset manager called **Liontrust Global Alpha Fund (3119055)**. Recent examples of stocks that have made the jump include cloud communications platform Twilio, US-based voice-over-internet supplier RingCentral and software developer HubSpot.

Despite global small caps enduring one of their longest and most pronounced periods of underperformance relative to large caps since the 1990s, Liontrust Global Smaller Companies has performed strongly during this period against both the small cap index, the large cap index and in absolute terms, stresses Geffen.

His portfolio includes names such as security solutions company Rapid7, identity software management play SailPoint and eco-friendly decking products group Trex.

AROUND THE WORLD

Investors seeking exposure to smaller companies around the world have a wide choice of funds, both actively and passively managed.

For example, **ASI Global Smaller Companies (B7KVX24)** generated a 28.3% return in first 11 months of 2020 versus 8% from benchmark MSCI ACWI SMID index, according to Morningstar. Over the past five years it has achieved 17.7% annualised returns versus 12.6% from the benchmark.

There are also plenty of options for investors happy holding a series of funds in different geographies for small cap exposure rather than just having a global fund.

Shares has run the numbers to find the best five-year performers in the IA Japanese Smaller Companies, IA European Smaller Companies and IA North American Smaller Companies sectors.

According to Trustnet, they are **Baillie Gifford Japanese Smaller Companies (0601492)**, **Janus Henderson European Smaller Companies (0747642)** and **Artemis US Smaller Companies (BMMV576)** respectively, the latter managed by Cormac Weldon and ranked first quartile over five years, during which it has materially outperformed its IA sector.

IA North American Smaller Companies sector: fund performance

Fund	1yr (%)	5yr (%)	10yr (%)
T. Rowe Price US Smaller Companies Equity Fund Q GBP in GB	23.2	140.3	373.1
GS US Small Cap CORE Equity Portfolio R Snap GBP TR in GB	2.2	73.5	218.4
Legg Mason Royce US Small Cap Opportunity X Acc USD in US	27.3	84.1	163.7
Barclays GlobalAccess US Small & Mid Equity M Hedged Acc GBP in GB	7.3	51.7	n/a
NB US Small Cap B Acc USD in US	19.5	66.8	n/a
Premier Miton US Smaller Companies B Acc in GB	57.6	n/a	n/a
Allianz US Micro Cap Equity C Acc GBP in GB	38.9	n/a	n/a

Source: FE Fundinfo, data as of 4 Dec 2020

EXAMPLES OF ETFS

Investors who prefer low-cost passive funds have several options when it comes to global small caps. **SPDR MSCI World Small Cap UCITS ETF GBP (WOSC)** and **iShares MSCI World Small Cap UCITS ETF GBP (WLDS)** both track the same index, and the iShares product is cheaper with a 0.35% ongoing charge (versus 0.45% for the SPDR product).

The MSCI World Small Cap index tracks approximately 4,200 smaller companies from across 23 developed market countries. As of 30 October 2020, the average market cap size

AIC Global Smaller Companies sector performance			
Company	**Share price total return (%) 1 year**	**Share price total return (%) 5 years**	**Share price total return (%) 10 years**
Edinburgh Worldwide	70.3	263.9	478.3
Herald Investment Trust	46.2	178.9	359.0
North Atlantic Smaller Companies	10.6	56.1	231.4
BMO Global Smaller Companies	4.3	50.8	213.3
Smithson Investment Trust	27.2	n/a	n/a

Source: The AIC, data as of 3 Dec 2020

for companies in the index was $1.38 billion, with the largest being $14.4 billion and the smallest $32.7 million.

The index has generated 7.2% annualised returns, on a US dollar basis, over the past five years, or 8.8% annualised over 10 years.

Alternative ways of getting exposure to overseas small caps include ETFs that track relevant indices in key regions such as Europe, emerging markets and the US, such as **Xtrackers MSCI Europe Small Cap UCITS ETF GBP (XXSC)**, **WisdomTree Emerging Markets Small Cap Dividend UCITS ETF GBP (DGSE)** and **iShares MSCI USA Small Cap ETF USD Acc GBP (CUS1)** respectively.

INVESTMENT TRUST EXAMPLES

The closed-ended structure of investment trusts is an advantage for fund managers investing in small, often illiquid stocks, where investment theses can take time to play out, as it means they aren't forced sellers of stocks when investors want their money back, as can happen to open-ended fund managers.

Investment trust options within the Association of Investment Companies' (AIC) Global Smaller Companies sector include **Smithson (SSON)**, the quality small-to-mid cap seeker which invests in firms that are too small for inclusion in Terry Smith's flagship **Fundsmith Equity (B41YBW7)**.

On a share price total return basis, the best performer of the past decade is **Edinburgh Worldwide (EWI)** with a 478.3% gain. The Baillie Gifford-managed trust's strong showing is reflected in the shares trading at a 3.5% premium to net asset value.

Some would argue this isn't strictly a small cap fund. Baillie Gifford starts off by investing in 'initially immature entrepreneurial companies' but manager Douglas Brodie runs his winners which means the best performing stocks are retained rather than sold when they get too big, explaining why $567 billion electric vehicle company Tesla and £16.5 billion supermarket technology group **Ocado (OCDO)** still feature in the portfolio.

Hot on Edinburgh Worldwide's heels with 359% share price total return over the past 10 years is the Katie Potts-managed **Herald Investment Trust (HIT)**, an investor in small caps in the tech space.

Trading on a 5.3% discount to net asset value and offering exposure to a diversified portfolio of international small caps is **BMO Global Smaller Companies (BGSC)**. The trust invests in stocks as well as other collectives and has increased its dividend in each of the last 50 years.

'Under the management of Peter Ewins, the strategy invests in a manner that has not only helped the trust outperform its benchmark over the long term, but has done so in a risk-conscious way,' explain the analysts at Kepler Trust Intelligence.

'Peter also makes use of externally managed collective investments for Japan and the emerging markets, such as open and closed-ended funds, leveraging members of BMO's multi-asset and multi-manager teams to aid in identifying external managers.'

James Crux,
Funds & Investment Trusts Editor

Disclaimer: Editor Daniel Coatsworth owns shares in Smithson and units in Fundsmith Equity referenced in this article.

Lacklustre UK performance makes international diversification vital

Investing across the world can help investors manage their stock market risk

We are all being urged to shop local as part of a rescue package to save British high streets. The UK Government has pressed shoppers to visit their high street to support businesses stripped of footfall during pandemic lockdowns.

We'll leave readers to draw their own conclusions about where and how they do their own Christmas shopping, but from an investment prospective, *Shares* believes that applying similar 'local' thinking to their investment strategy is a huge risk.

Recent headlines like 'FTSE stages November rally', or 'FTSE hits nine-month highs' might give the impression that UK equity markets have done OK this year, but the reality is a much less positive for UK stocks.

For example, in the year to date (to 7 December, at time of writing), the UK's benchmark FTSE 100 has declined 13.8% even after posting its biggest monthly gain in three decades in November 2020. That means that £10,000 invested in Britain's largest companies would have been whittled down to £8,620 this year.

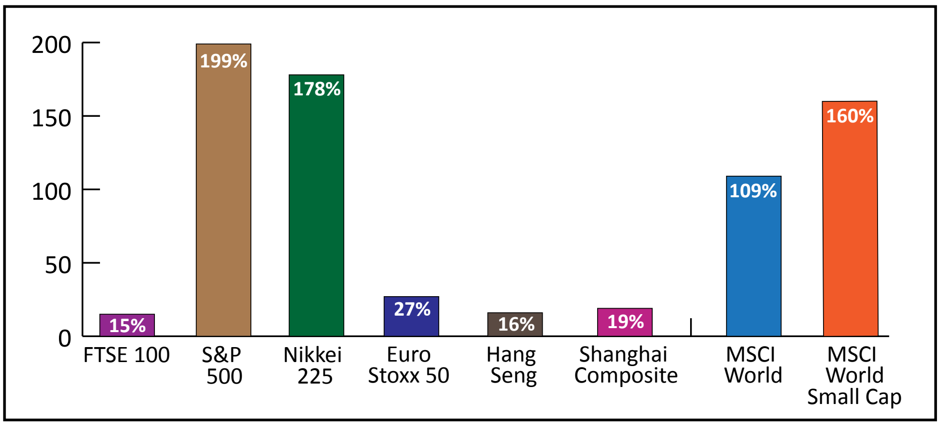
Yet this horrid pandemic has

Selected top performing global equity funds

Fund	Five-year annualised performance (%)
GAM Star Disruptive Growth	27.6
Baillie Gifford Global Discovery	25.9
T Rowe Price Funds - Global Focused Growth Equity	24.2
Baillie Gifford International	20.7
T Rowe Price Funds - Global Growth Equity	20.6
Baillie Gifford Global Alpha Growth	20.0
Fundsmith Equity	19.5
Liontrust Sustainable Future Global Growth	18.9
Guinness Global Innovators	18.3
Janus Henderson Global Sustainable Equity	18.3

Source: Morningstar

UK VS THE WORLD, 10-YEAR PERFORMANCE



Source: Refinitiv

not pulled the wheels off other markets. The S&P 500 has rallied 13.5% this year, Japan's Nikkei 225 is up 12.2% and China's Shanghai Composite is 11.6% ahead.

The MSCI World index, which measures the performance of approximately 1,600 companies from 23 developed nations, has risen 11.9%.

BLACK SHEEP OF GLOBAL STOCK MARKETS

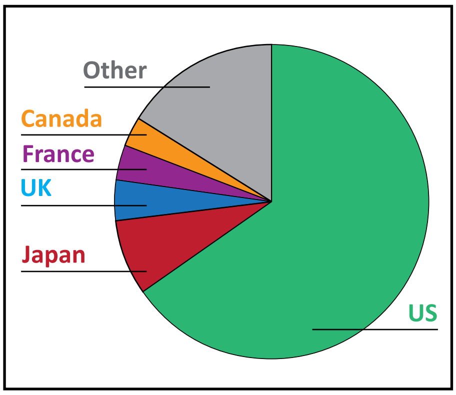
The UK's underperformance versus global stocks goes deeper than just 2020, it can be charted back to the Brexit referendum in June 2016, as the clouds began to gather over Britain's economy and the potential fallout with Europe.

This can be demonstrated by looking at the stats for global equities after stripping out UK stocks. Since the end of June 2016 the MSCI World index has rallied 59%, versus the MSCI World-ex UK's 62%. That three percentage point difference is down to the UK stock market and its poor performance.

It is true that the FTSE 100 may be dominated by companies that make much of their earnings overseas. Something like 65% to 70% of FTSE 100 profits are earned abroad, which should mean that the index is somewhat insulated from a downturn in the UK economy and provides a level of in-built investment portfolio diversification. Even so, that has not been enough to counter broader negative sentiment towards UK assets among international investors.

This makes diversification across international markets

MSCI WORLD COUNTRY WEIGHTING



Source: MSCI

an important part of managing your risk. If the UK economy and stock market struggles, its declines should be cushioned by stronger performance elsewhere.

AVOIDING TOO MUCH HOME BIAS

Investors may need to overcome home market bias first. Research shows that most investors favour their own stock market, picking from a pool of companies with which they are most familiar.

But the standard financial-theory approach is quite different. This calls for investors to invest proportionally according to market capitalisation. 'This method assumes that markets are reasonably efficient and that stock prices reflect all the available information, investment positions, and expectations of the investing community,' says Brian J Scott, one of the authors of a research paper on diversification for Vanguard updated in 2017.

'Investors in countries such as Japan, the UK, Canada and Australia would allocate less than 10% of their equity portfolio to their domestic stock market,' the paper says.

This can be actioned easily by buying UK-based funds or investment trusts that put your money to work globally. There is also flexibility within this universe, so if you think US stocks look expensive right now, you can put more of your money in vehicles that invest elsewhere, such as China, Europe or global small caps, for example.

The table shows some of the best performing funds in the Global category over the last five years. We have focused on products with annual charges of 1% or less.

The list confirms the reality that ESG (environmental, social and governance) linked investments are a coming force, with two of the funds having an explicit focus on sustainability.

The lowest five-year annualised return on the list of 18.3% is more than three-and-half times the annualised return from FTSE 100 tracking product **iShares Core FTSE 100 (ISF)** at 5%.

By **Steven Frazer**
News Editor

Picking winners in a pandemic

Guy Anderson, portfolio manager of The Mercantile Investment Trust, discusses the strong performers navigating structural change during the pandemic.

Navigating structural change during the pandemic

Guy Anderson, lead portfolio manager of The Mercantile Investment Trust discusses some strong performers from the trust's portfolio which are successfully navigating the structural change that has been a key theme for many sectors in a year of unprecedented challenges.

One of the key themes in the market this year has been structural change. This is a trend that has been catalysed or, in some cases, accelerated by the ongoing Covid-19 pandemic. During the initial UK lockdown from March to July, we witnessed forced changes in the behaviour of consumers and in the operations of businesses. The most obvious examples are the accelerated adoption of online shopping and increased demand for home-working solutions, balanced by a collapse in demand for travel and some forms of leisure. These shifts have inevitably created winners and losers. While many of Mercantile's holdings have been direct beneficiaries, the challenge remains to maintain balance in the portfolio by identifying those companies in sectors which have been challenged, but could emerge in a relatively strong competitive position.

> *We witnessed forced changes in the behaviour of consumers and in the operations of businesses*

Direct beneficiaries

Technology companies have generally benefitted from the structural changes caused by the pandemic. The en-masse move from office to home-working has elevated demand for products such as cybersecurity software and technology sourcing. This has helped our holdings in Avast, the antivirus provider, and IT sourcing and services business, Computacenter. Moreover, changes in corporate behaviour have lowered cost bases – a case in point is Computacenter, which is also profiting from material cost savings.

As well as corporates, consumers have been forced to adapt to the new restrictions. We have changed the way we spend our leisure time and money – from going out or going on holiday, to stay-at-home pursuits such as gaming. Video game developer and publisher Team17, in which Mercantile holds a stake, has been one of the beneficiaries of this behavioural change. The company has experienced very strong demand since the onset of the pandemic, particularly for its back catalogue of games.

Relative winners

The sector that is arguably experiencing the largest bifurcation in outcomes as a result of Covid-19 is retail. While the Mercantile portfolio only holds a handful of retailers in the mid and small-cap space, in aggregate retail constitutes one of the Trust's largest sectoral overweights, reflecting the pockets of opportunity where companies are not merely surviving, but thriving.

One of our largest positions is in homewares retailer Dunelm. Heightened demand for home improvement products and an excellent omnichannel proposition has contributed to the company's robust position. Furthermore, it has demonstrated very strong trading momentum since the re-opening of its stores in May. Another implication of consumers spending greater amounts of time at home has been an increased desire for pets and pet products. Pets at Home, another retailer with strong multichannel capabilities, has been a clear beneficiary of this trend.

Both of these businesses have been placing increasing focus on harnessing customer data in order to drive improved retention and loyalty, and they are both now reaping the reward of investment in these measures. This highlights another important theme – that companies which can more effectively utilise the data they generate will enjoy a significant advantage in a world of accelerated channel shift.

While retail has produced both winners and losers, one sector that has undoubtedly been negatively impacted is travel. While travel and leisure as a whole is one of the largest sectoral underweights in the portfolio, our largest holding in the space, National Express, reflects our view that the bus company is likely to be the winner in its category over the longer term. The business is highly diversified but has no exposure to UK rail, where many of its peers have previously shed value. It has a track record of strong operational performance, with industry-leading margins and cash generation. In fact, even this year the business has been cashflow-positive, with a large proportion of revenue underpinned by contractual agreements. This is in stark contrast to other names in the sector that are burning through their cash reserves while pandemic restrictions remain in place.

> *Pockets of opportunity where companies are not merely surviving, but thriving.*

A balanced approach

While the portfolio's relative performance has been elevated by its holdings in companies that have successfully navigated – and benefitted from – accelerated structural change, there remain a number of positions in stocks that we believe are likely to outperform their peers in a recovery scenario. This balanced approach is an important component of our strategy in navigating these volatile markets.

BIG DRUG COMPANIES:

The ones to make the world and your portfolio healthy

By **Martin Gamble** Senior Reporter

This year has reminded the world about the importance of the pharmaceutical industry and investors have understandably become very interested in the sector's big players.

With a vaccine for Covid-19 now being rolled out, the market's attention is moving on to earnings prospects for companies involved in this treatment as well as those tackling other illnesses.

It's plausible that governments globally will be more committed to combating health issues following the pandemic, and the rapid speed at which the Covid-19 vaccine has been developed raises the question of whether other drug developments could be accelerated.

All these factors make the pharmaceutical industry very interesting and so investors naturally want to know which stocks to own. We've got three top picks in this article and one to avoid.

GIVING THE INDUSTRY A BOOST

The Pfizer-BioNTech vaccine, which received emergency approval from the UK regulators last week, marks the fastest ever development of a vaccine.

This could provide a much-needed boost for an industry that prior to 2020 was struggling with its public image in the face of increasing criticism over alleged 'predatory' drug pricing and shareholders losing faith in the growth story.

Finding a vaccine in record time has the potential to radically improve the image of the industry and permanently change the way new drugs are developed.

The global effort and collaboration between public bodies, academic institutions and pharmaceutical companies has also been a game-changer.

SPEEDING UP DRUG DEVELOPMENT

A lot of the processes that would be normally have been done sequentially were done in parallel, saving valuable development time.

In addition, key manufacturing capacity has been built ahead of approvals from regulators so that distribution can begin as soon as safety data

Pipeline as percentage of total value and growth

Company	As % value of whole company	Contribution of pipeline to future earnings growth
Glaxo	11%	27.0%
AbbVie	11%	18.7%
Novartis	13%	15.7%
Roche	13%	15.4%
Merck	13%	15.0%
Astra	14%	14.0%
Eli-Lilly	20%	10.0%
Novo Nordisk	12%	8.4%
Bristol-Myers Squibb	16%	6.4%
Sanofi	19%	5.3%
Pfizer	16%	0.0%

Source: Berenberg, Shares

has been validated.

Government financial support lowered the financial risk and encouraged some drug companies to take more risk on cutting edge technologies and innovative solutions.

Good examples are the Pfizer and Moderna Covid-19 vaccines which came about by experimenting with mRNA technologies which until now have never been commercialised.

Traditional vaccines infect people with a modified harmless version of the virus so that the bodies' immune system can recognise the threat.

With an mRNA injection the body's immune cells are told how to recognise the virus so that the body can make antibodies. This means the virus doesn't need to be grown in the lab, saving valuable time. It also means there is zero chance of accidentally infecting people with the virus.

TOO GOOD TO BE TRUE?

While it's generally thought the required safety protocols have been followed, there is a risk that the public might view the speed of approval as a sign that corners were cut or that longer-term effects of taking a vaccine haven't been given enough consideration.

The confusion surrounding the **AstraZeneca (AZN)**/Oxford University Covid-19 vaccine trial results is a good example of the fine line that big pharma and governments need to tread to keep the public trust. Making vaccination mandatory is unlikely to be a successful long-term strategy.

The announcement from AstraZeneca focused on an average effectiveness of 76% depending on the level of dosage. But it turned out that the higher 90% rate was effective only on patients under the age of 55 and involved a half dose followed by a full dose which wasn't the originally intended dosage.

The efficacy rate is still way more effective than the average flu jab, but this got lost in the debate, leaving some observers questioning the credibility of two of the most respected institutions in the world.

In any event AstraZeneca's chief executive Pascal Soriot has said the company will conduct another trial to confirm the true relationship between dosing pattern and efficacy.

One important point to bear in mind is that all the vaccine makers have said they will submit clinical data for peer review, so when all the dust settles, only the most effective vaccines with the best safety data will be on the market.

PHARMA TO THE RESCUE

In addition to Pfizer and AstraZeneca, other large pharma companies such as **GlaxoSmithKline (GSK)** and French group Sanofi are also collaborating on a Covid-19 vaccine. Eli Lilly recently signed an agreement with the US government to supply 300,000

"The big pharma groups involved in developing vaccines for Covid-19 have said they don't intend to make a profit from the pandemic, at least initially"

of its investigational neutralising antibodies called Bamlanivimab. It is seeking emergency approval use.

The big pharma groups involved in developing vaccines for Covid-19 have said they don't intend to make a profit from the pandemic, at least initially.

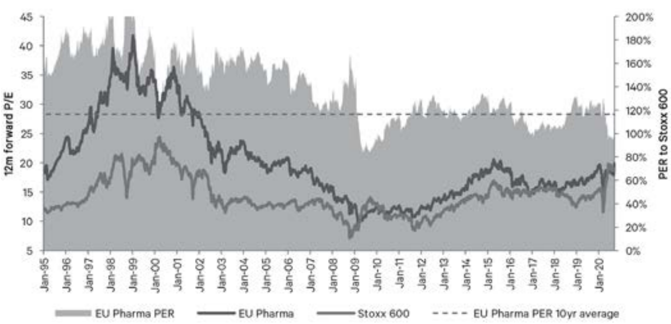
That doesn't rule out doing so in the future if, for example, annual vaccinations are required like the flu jab. But most analysts' forecasts don't include any financial benefits from successfully developing a vaccine at this stage.

That said, there may be longer-term benefits to flow through to the pharma industry if it has the appetite and the will to apply what has been learnt from fighting Covid-19.

For example, it is intriguing to think what might be achieved if similar co-ordinated efforts and faster drug development were used to fight cancer and rare diseases.

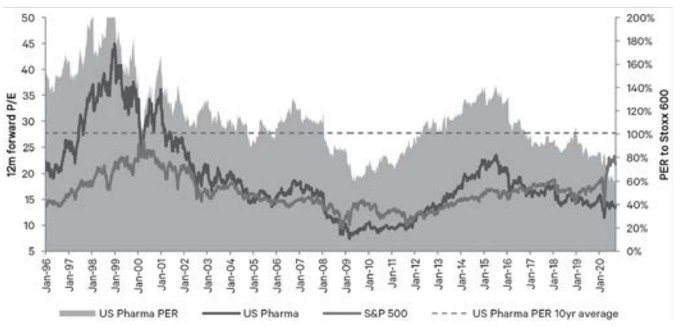
At the least it may result in faster drug development which would have big implications for returns on investment. That's because the faster and cheaper a drug is developed, the greater the return on the research and development spending. And greater interest in the sector and increased funding may be a welcome by-product.

EU large pharma PE - relative to EU market



Source: FactSet, Berenberg, Sep 2020

US large pharma PE - relative to US market



Source: FactSet, Berenberg, Sep 2020

What the companies are known for

Company	Area of Speciality/ Leading Drugs
AbbVie	Psoriasis, Arthritis
Astra	Cancer
Bristol-Myers Squibb	Blood Clots
Eli-Lilly	Diabetes, Insulin
GlaxoSmithKline	Vaccines, Cancer
Merck	Immune System, Cancer
Novartis	Cancer, Multiple Sclerosis
Novo Nordisk	Diabetes, Insulin
Pfizer	Vaccines, Cancer
Roche	Biotech, Cancer
Sanofi	Diabetes, Insulin

NO GROWTH PRICED IN

It might seem surprising that European and US pharma are trading at depressed valuations relative to the long-term averages.

During the late 1990's pharma used to command a price to earnings (PE) ratio almost double that of the market. As the charts show the sector has since fallen out of favour with investors.

According to research published by Berenberg on 28 September this year, the sector just over two months ago was not only trading at a discount to its historical average but also to the general stock market in the case of the US, namely a 37% PE discount at the time of the study. European pharma traded at a small 6% premium to the European stock market.

This means from an investment perspective, there isn't much of a growth premium priced into the sector. This looks anomalous given significant long-term growth potential stemming from increased demand for new drugs as a result of an ageing global population.

HAVING A TIGHTER FOCUS

Many of the big companies have in recent times shed non-core assets to become pure-play specialist pharma groups focused on specific areas of science.

For example, GlaxoSmithKline plans to divest its consumer healthcare business into a joint venture with Pfizer's in 2022, to focus on its vaccine and cancer franchises.

Lastly there is the prospect of the industry becoming more efficient which will boost profitability and cash generation.

MANAGING PATENT EXPIRIES

The key to delivering growth and shareholder value is creating the right balance between revenue growth today and future growth from a strong pipeline of new drugs.

That's because patented drugs generally expire after 20 years, which means drug companies need to replace lost revenues from expiring patents.

Once drugs lose their patent exclusivity and protection, they are quickly challenged by generic drug makers who undercut on price and rapidly take market share.

Not having a balanced portfolio can lead to a so-called patent cliff, which refers to a sudden loss of revenues which aren't immediately replaced.

Company valuations

Company	Market Cap (£bn)	FY1 PE
Bristol-Myers Squibb	105	8.35
GlaxoSmithKline	70	11.9
AbbVie	139	12.4
Merck	155	12.9
Sanofi	96	13.4
Pfizer	170	14.2
Novartis	156	14.5
Roche	216	15.7
Eli-Lilly	104	18.3
Novo Nordisk	118	21.2
AstraZeneca	104	21.5

Sourec: Stockopedia, Refinitiv

US firm Pfizer is a good example of a company which faces a deep cliff from 2026 according to Berenberg analysts who reckon it will lose $18 billion of sales between 2025 and 2030.

It is forecast to make incremental sales of $1.7 billion a year from growing assets but an average $4.4 billion of lost sales to eroding assets in the second half of the decade.

In contrast AstraZeneca has relatively few eroding assets and a strong pipeline of new drugs. Its cancer franchise growth is expected to result in an estimated $6 billion of incremental sales over the next two years.

Pfizer faces a big problem in the coming years as patents expire. Over the 2025-30 period, Berenberg forecasts $18 billion of lost sales

INVESTING IN PHARMA VIA FUNDS

Investors who prefer funds to individual stocks can get exposure to the pharma sector through various means including **Polar Capital Global Healthcare (PCGH)**, an investment trust which seeks to generate capital growth by investing in a global portfolio of healthcare stocks.

Its top holdings include Roche, Medtronic, UnitedHealth, Sanofi, Amgen and Eli Lilly. The trust trades on a 10.6% discount to net asset value and has generated a 7.7% annualised share price return over the past five years to 3 December, according to Morningstar.

Another way to get exposure is via exchange-traded fund **Amundi ETF MSCI Europe Healthcare UCITS ETF GBP (CH5)**. This track the MSCI Europe Healthcare index which contains mid and large healthcare stocks from 15 developed market countries in Europe. The top holdings are Roche, Novartis, AstraZeneca, Novo Nordisk, Sanofi, GlaxoSmithKline and Bayer.

The index has delivered a 5.8% annualised return over the past five years to 30 November, says MSCI. The Amundi ETF has a 0.25% annual ongoing charge.

Later stage growth from the pipeline is expected to come from its cancer, lupus and respiratory products currently in development as well as expansions to its successful Imfinzi/Lynparza cancer treatments.

The potential value of Eli-Lilly's pipeline stands out and represents a relatively high 20% of its total portfolio value according to Berenberg estimates. This is encouraging given the benign erosion of sales over the coming decade at just 4% a year.

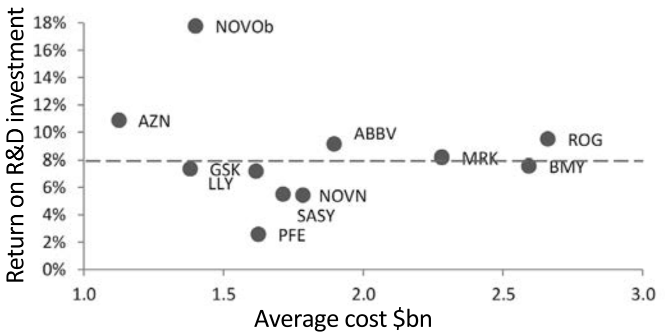
The company has also successfully streamlined its activities to become a pure-play pharma business after it exited animal health in 2018.

Eli Lilly is focused on the diabetes market and has a strong market position. Trulicity, one its drugs used in the treatment of type II diabetes, is expected to be one of the top selling diabetes drugs in the market by 2024 according to management.

GETTING A GOOD RETURN ON RESEARCH AND DEVELOPMENT

Another key component of delivering good shareholder returns is to ensure that the investments into the pipeline of new drugs achieve an adequate economic return.

Cost to develop a drug versus RORI



Source: Company reports, Berenberg estimates

The key levers are development costs and the level and duration of commercial success of those drugs that make it to market.

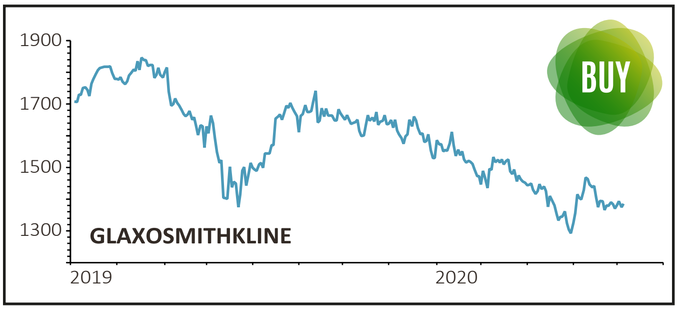
AstraZeneca is a standout performer, being the most efficient developer of new drugs, spending an average of around $1.2 billion and achieving a return on investment of around 11%.

At the other end of the spectrum are Bristol-Myers Squibb and Swiss-based Roche which spend more than double in development costs, some $2.6bn but do manage to achieve decent returns on investment of between 8% and 9%.

THE PHARMA STOCKS TO BUY

GlaxoSmithKline

Price: £13.96. Market Cap: £69.3 billion



We believe **GlaxoSmithKline** offers investors underappreciated growth with margin uplift potential as it prepares to spin off its consumer healthcare division into a joint venture with Pfizer's consumer healthcare business, unlocking value.

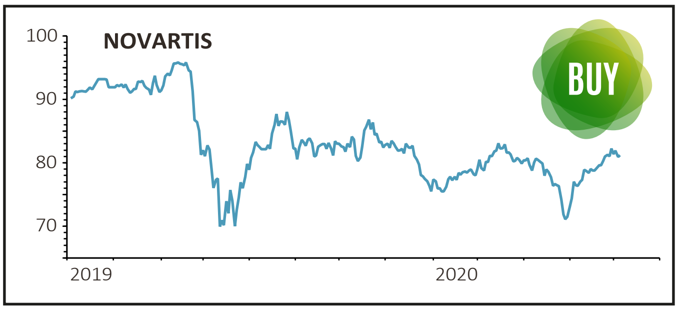
The short-term drag on the sales momentum of its vaccines business due to access disruption in the early part of the year will lift at some point in 2021. The fast-growing shingles product Shingrix will benefit from increased capacity in 2023, allowing entry to key markets such as China.

The cancer franchise has a strong pipeline with Liberum forecasting revenues to reach $4 billion by the end of the decade.

The performance of ovarian cancer drug Zejula and Blenrep for treating multiple myeloma, a type of bone marrow cancer, is key to delivering future growth above the industry average.

Novartis

Price: CHF 82.2. Market Cap: £153.3 billion



With its shares trading on the Swiss Stock Exchange and the New York Stock Exchange, Novartis consists of two divisions: Sandoz which manufactures generic medicines and a branded pharmaceutical division called Innovative Medicines.

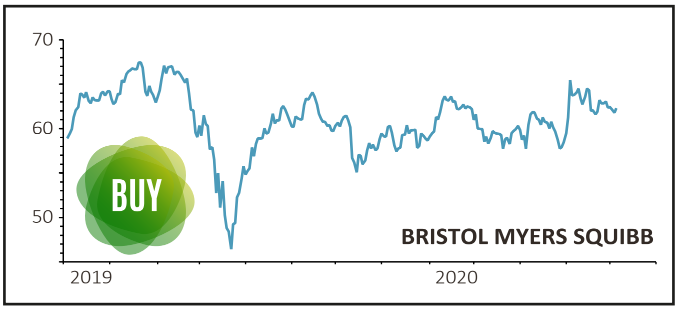
Chief executive Vas Narasimhan has simplified the structure of the business with the separation of ophthalmology company Alcon while business costs have been streamlined, giving a boost to margins.

While the scope for incremental margin expansion has narrowed profit growth from established drugs like Cosentyx (treatment of psoriasis and psoriatic arthritis), heart failure drug Entresto should drive near-term growth.

The shares trade on a PE of 14.5, an unwarranted discount to the sector average compared with the growth potential.

Bristol-Myers Squibb

Price: $62.37. Market Cap: $105.1 billion



The $80 billion acquisition of Celgene in 2018 made Bristol-Myers Squibb a leading biopharmaceutical company with a more diversified revenue steam.

The company has dominant positions in cancer, immunology (using the body's immune system to fight infection) and cardiovascular disease.

The deal was seen by analysts as a unique opportunity to combine complementary portfolios and thereby reduce reliance on a single cancer drug.

The combined pipelines have numerous opportunities to launch new drugs in an area of dominance and expertise.

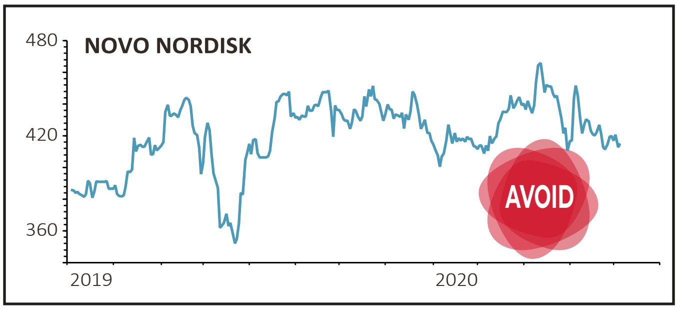
Berenberg sees several possible catalysts over the next 12 to 18 months which secures the long-term outlook.

None of this potential is reflected in the valuation of the shares which trade on 8.4 times next year's earnings, which is too cheap given the potential growth.

THE PHARMA STOCK TO AVOID

Novo Nordisk

Price: DKK 413.7. Market Cap: £118 billion



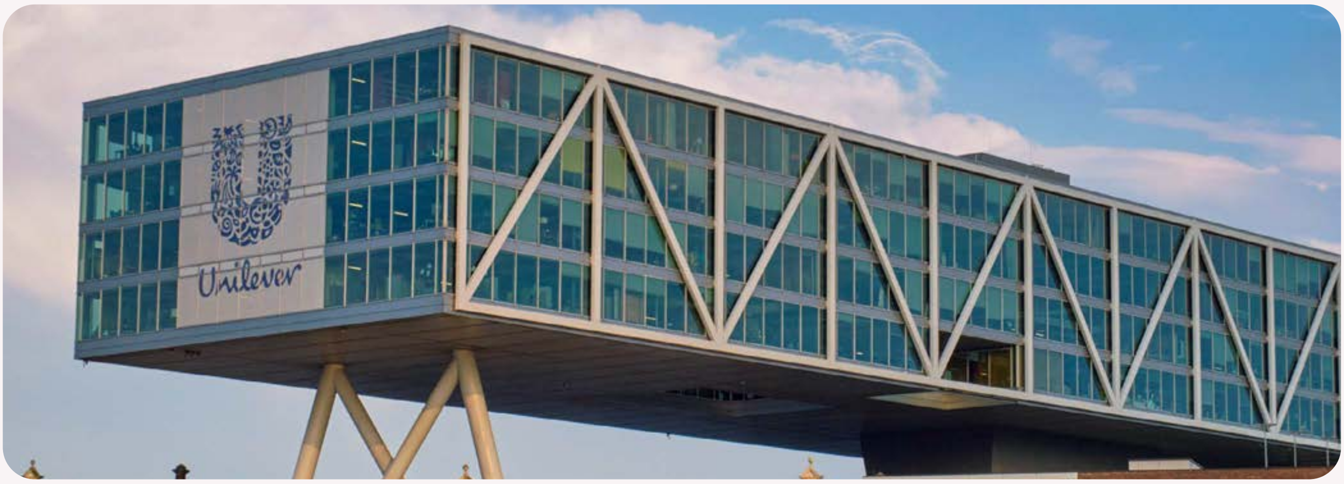
Novo Nordisk is a pure-play biopharmaceutical company focused on diabetes, obesity and haemophilia (impaired ability to make blood clots, to stop bleeding).

While the company's returns on R&D spending has been best in class at around 22%, the shares trade at a PE premium to the sector which fully reflects past success as well as growth expectations for anti-diabetic drug Ozempic.

Berenberg notes the relatively 'light' pipeline which is expected to grow around 8.4% compared with the sector average of 12.4%.

In addition, the company has said it faces some headwinds in the US market from the impact of higher unemployment which moves more people into the lower price rebated government funded Medicaid system.

Getting defensive – where to now?



With the concept of a 'blue chip' stock fading over recent years, we examine what constitutes a defensive investment strategy in the current climate, and how The City Of London Investment Trust is positioning itself strongly to confront the uncertainties which lie ahead.

IT IS SAID that Chairman Mao claimed communism to represent a state of "permanent revolution". Seen through the zealous eyes of an idealogue, that may have held some semblance of truth but, in reality, a state of permanent revolution is much more soundly represented by its antithesis – capitalism – the powerful and ever-present effects of competition, albeit within a stable political and economic framework, making it the greatest force for increasing productivity, and therefore profitability, known to man. Such is its power that no company – however large or financially stable – can insulate itself wholly or indefinitely from the ravages of competition or other adversity.

For evidence, look no further than the waning use of the term 'blue chip' when describing certain types of corporate stock. The term emerged in the early 20th century and is derived from the game of poker where the blue-coloured chips held the highest value. The Cambridge Dictionary defines the term thus: *"A blue chip company or investment is one that can be trusted and is not likely to fail."* One might be tempted to infer from this somewhat unequivocal definition that 'blue chip' equates infallibly with safety; in the financial field, however, few things are certain. In common with most investment vehicles, The City of London Investment Trust has spent the majority of 2020 confronting the uncertainties of the current economic climate whilst positioning itself appropriately for those that lie ahead.

For decades, markets favoured corporations which were already substantial, for the simple reason that access to capital was limited: money attracted more money. Now, however, capitalism has evolved whilst technological advancements threaten all businesses, irrespective of size, and the rise of venture capital and private equity means that entrepreneurs possessing nothing more than talent and ideas can raise billions in days. Indeed, it's arguably the very essence of a highly efficient market that it allows heroes to become zeros. Historically, blue chip companies were also national champions: the Germans took pride in Volkswagen, and the Americans in General Motors, for example. The former saw its share price plummet over 30% in just three days as a result of its 2015 emissions scandal; the latter, once the bellwether of the US economy, suffered falling market share and margins for decades until, in 2009, it detailed plans to issue up to 60 billion new shares in a bid to pay off debt to the US government, bondholders and the United Auto Workers union, leaving its stock investors with just

1% of the equity in a restructured automaker. Pan American Airways, once the largest airline in the world, is now a distant memory; Xerox Corporation, which invented photocopying, has gone the same way; Eastman Kodak filed for Chapter 11 bankruptcy in 2012.

Of the 30 shares that constituted the original Dow Jones index, only one, General Electric, is still in existence. Moving closer to home, the travails that have beset a number of UK corporate leviathans – the likes of BP, RBS, Marks & Spencer and Thomas Cook – are well-documented. Whilst the concept of a blue chip stock may be fading rather than wholly extinct therefore, these experiences, coupled with the impact of the Covid-19 pandemic, do beg the question as to what now constitutes an effective defensive investment strategy in the current climate. What one is seeking is an approach to portfolio allocation designed to minimise the risk of losing principal, essentially by identifying companies whose revenues and earnings have the potential to hold up reasonably well during a recession.

Typically, the approach has been to focus on sectors which displayed defensive characteristics on the basis that, even in recessionary times, they are less vulnerable to the vagaries of consumer demand:

- consumer staples – e.g. food, beverages, and non-durable household products
- utilities – e.g. water, gas and electricity (and, increasingly, internet-related services)
- health and personal care – e.g. pharmaceuticals, medical services, and medical equipment manufacture.

More recently, however, there has been a discernible shift in investors' views as to what constitutes a genuinely defensive strategy. Take the food sector – long considered a classic defensive play – and one of its giants, Kraft Heinz, the fifth largest food and beverage business in the world. Created in 2015 when Heinz merged with Kraft, it has been challenged by web-based disruptors like Amazon, by evolving consumer tastes for healthier and more organic food, by market consolidation, and by accelerating competition from online delivery start-ups. In the face of these challenges, it cut costs too far, failing to invest sufficiently in marketing and innovation, and took on too much debt. It's been

largely downhill since: between February 2017 and February 2019, its shares plunged more than 60%[1], it took a $15.4 billion write-down on the value of some of its struggling brands[2], and it cut its year-on-year dividend by 36%.[3]

The pandemic-affected world is changing therefore and it's by no means certain that companies which have displayed strong defensive characteristics historically will all continue to do so. In a sustained downturn, those with strong earnings growth, a powerful market position and the ability to disrupt established industries through the power of innovation may also be considered sufficiently defensive – Google owner Alphabet and Microsoft, universally considered growth stocks, might be good examples therefore, given that information technology can now be considered to be a consumer staple. As ever, shrewd stockpicking will prove an important component of success.

A second and frequently adopted defensive strategy is to target stocks with healthy earnings, and thus a relatively attractive dividend yield and payout ratio, especially when set against the yield available from UK government gilts and US treasury bonds – the so-called 'risk-free rate'. Defensive stocks display the ability to provide reliable dividend income, irrespective of the performance of the economy. In turbulent times, with share prices under pressure, the dividend yield becomes sufficiently high that investors with excess liquidity enter the market en masse, buying up those shares and driving the price upwards – hence higher dividend-paying stocks typically suffer less damage in a market downturn. In strained economic times, the stability of profits, and the dividends they

[1]Source: NASDAQ, 17.02.17 to 22.02.19
[2]Source: Reuters, 21.02.19
[3]Source: The Kraft Heinz Company, 2019 vs. 2018, http://ir.kraftheinzcompany.com/stock-information/dividend-history

Janus Henderson INVESTORS

support, is vitally important.

Within the Janus Henderson investment trust stable, The City of London Investment Trust has demonstrated its resilience over many years of solid outperformance. It focuses predominantly on large cap companies with cash generative businesses able to grow their dividends with attractive yields, and so shareholder returns continue to be derived from a mixture of capital growth and income. With regard to its defensive stance, consumer staples currently represent almost a quarter of the trust's holdings by value; the top three holdings – British American Tobacco, Unilever and Diageo – are all consumer staples.[4]

The summer of 1966 was significant for English football fans as it was the first (and most recent) time England won the World Cup. It was also the start of City of London's dividend growth track record which has now continued uninterrupted for 54 years – the longest record of any investment trust and, importantly, a period in which the UK experienced no fewer than 11 bear markets.

Over that time, an initial investment of £1,000 has yielded investors £41,000 in gross income, assuming that they had not reinvested that income, compared to just £29,000 paid out by the UK equity market, as measured by the FTSE All-Share Index over the same period.[5]

In addition to providing investors with a growing source of income, if investors had reinvested their dividends back into shares in the trust over the same period, an initial £1,000 investment would be worth almost £600,000 today. For comparison, an investment of £1,000 in the UK market, as measured by the DataStream UK Market Index (data for the FTSE All-Share Index total return only goes back to 1986) would be worth just £368,000.[5]

Needless to say, there are major uncertainties in the months which lie ahead – Covid-19 and a second wave, the long-term effect of the massive build-up of government debt, and Brexit being the most obvious – and so it's likely that City of London will have ample opportunity to display its defensive credentials yet again.

[4]As at 30.09.20
[5]Janus Henderson/Refinitiv Datastream, 01.01.66 to 30.06.20

RUSS MOULD
AJ Bell Investment Director

Insightful commentary on market issues

What is the yield curve telling investors?

The fact the curve in the UK is at its steepest since August 2019 is very important

No investment indicator is infallible – if it were, none of us would be working and all of us would be playing the markets (only to find, ultimately, that there would be nothing in which for us to invest except each other's investments).

However, one which is generally held to stand the test of time is the yield curve. Investors may be intrigued to learn that the curve in the UK stands at its steepest since August 2019, while in the US the yield premium offered by 10-year US Treasuries relative to two-year paper is at its highest since October 2017.

In theory, this is bond markets' way of saying that an economic upturn and possibly inflation are coming. This is a view which has considerable implications for financial markets and asset allocation strategies overall, as well as fund and specific stock selection strategies.

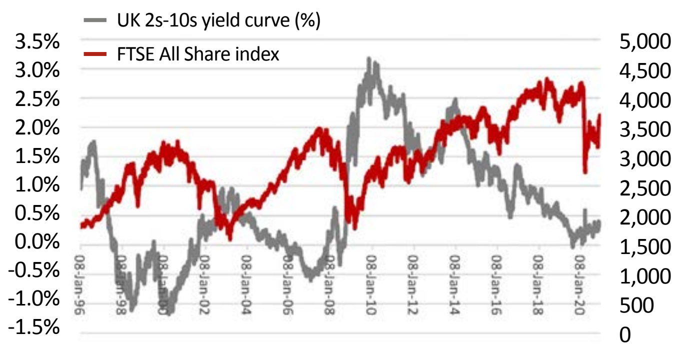
UNDERSTANDING YIELD CURVES

In general terms, there are four types of yield curve, using the difference in yield between two and 10-year government bonds as a benchmark.

• **Normal**. Here yield on the 10-year paper is higher than that of the two-year. Investors demand compensation for the additional eight years to maturity, as this means there is more time for things to go wrong. Inflation, interest rate increases and default are the main three dangers.

• **Steep**. In this case, long-term yields rise more quickly than near-term ones as investors look to price in an acceleration in economic growth and interest rate increases. Investors fear being locked into low rates and demand greater compensation for owning longer-dated paper.

The UK yield curve is steepening



Source: Refinitiv data

• **Flat**. This is where the bond market is unsure how to proceed. Yields on two and 10-year paper are the same as the economy transitions from downturn to upturn, or upturn to downturn.

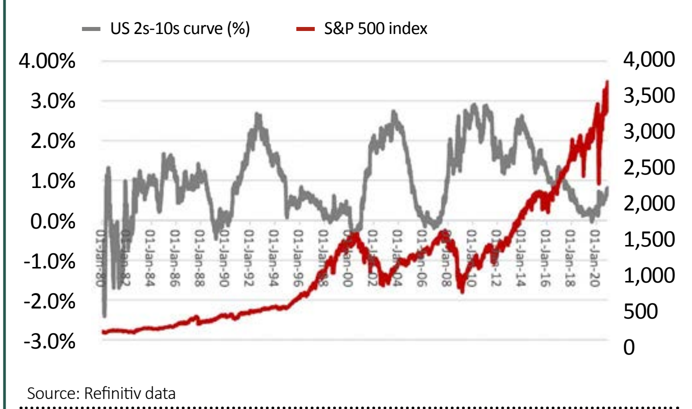
• **Inverted**. Here, bond markets fear an economic slowdown or recession and the yield on longer-dated bonds drops below that of shorter-term paper. This happens because investors price in future interest rate cuts in response to the slowdown and a drop in coupons on bonds issued by governments in the future.

Twelve to 18 months ago the talk was of how yield curves were inverting and how that could have been warning of trouble ahead (though no-one would pretend that fixed-income markets saw the pandemic or subsequent recession coming).

The picture is quite different now. Buoyed by further momentum the race for a Covid-19 vaccine and further fiscal stimulus from Congress, combined with further monetary largesse from

RUSS MOULD
AJ Bell Investment Director

The US yield curve is also steepening



Source: Refinitiv data

the US Federal Reserve, the yield curve is now steepening in the US, a trend which characterised the early stages of the bull equity markets that began in 1982, 1990, 2002 and 2009.

Admittedly, Japan's experiences since 1990 suggest the yield curve can be a poor predictor of economic activity but the yield curve has had its uses in the UK.

Inverted yield curves in 2000 and 2007 helped to call the top for the FTSE All-Share index but a marked steepening represented the beginning of bull runs in 1998, 2003 and in the early stages of the last decade.

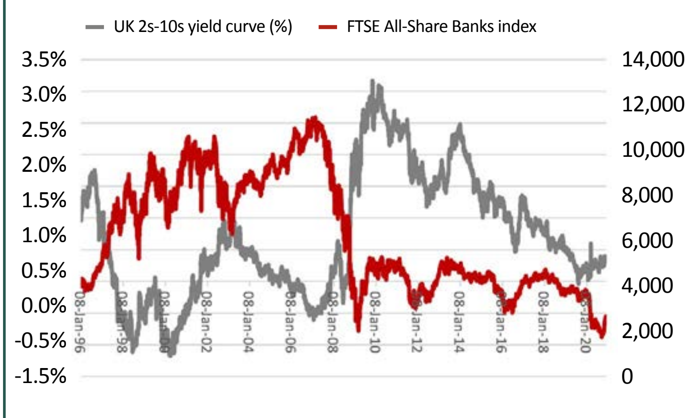
STYLE COUNCIL

There may be further implications below the level of headline indices. Banking stocks, for example, have been crushed by central banks' efforts to keep yields low (and by implication yield curves flat) as they try to help governments fund their burgeoning debts.

A steeper curve could boost banks' net interest margins, earnings power, share prices and ability to pay dividends. This could be influential in the UK market, for example, where the FTSE 100's Big Five banks are so integral to earnings and dividend growth forecasts.

Even more intriguingly, a steeper yield curve, hinting as it does of a stronger economy and inflation, seems to favour cyclical earnings growth over secular earnings growth – or, to put it more crudely, 'value' as a style over 'growth' – at least if

Banking stocks could benefit from a steeper yield curve



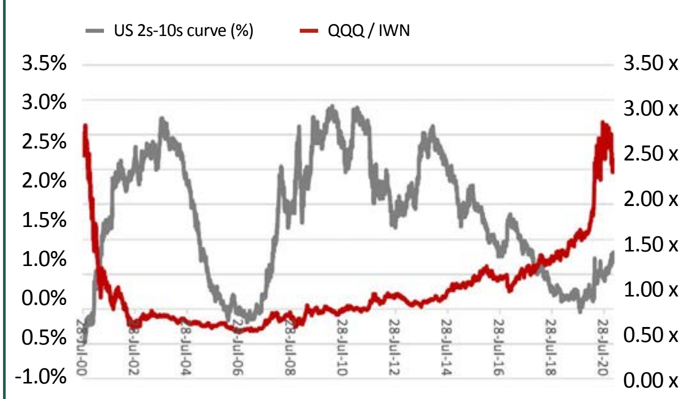
Source: Refinitiv data

history is any guide.

As this column has noted (*Shares*, 29 Oct 2020), value has tried to forge a recovery relative to growth, using the ratio of the price of the Invesco QQQ Trust, an exchange-traded fund (ETF) designed to track and deliver the performance of the heavyweight NASDAQ 100 index (minus its running costs), relative to the iShares Russell 2000 Value ETF, as a benchmark.

Some are wondering if this trade is already exhausted. Yet based on what happened in 2000, you could argue that it has hardly begun, such was the violence of the switch from growth to value as the former began to falter under the twin weights of lofty valuations and earnings disappointment.

Expensive growth stocks are losing favour with investors



Source: Refinitiv data

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Thematic products top the ETF charts in 2020

The acceleration of certain trends by the pandemic is reflected in the showing of select ETFs

It's been argued that the coronavirus pandemic has, rather than changing the world entirely, acted more like a time machine in accelerating trends so that shifts which might have taken years or decades have come through in a matter of months.

That argument is supported by the list of the best performing exchange-traded funds (ETFs) in 2020.

The shift to cloud computing, more spending on healthcare, increased use of artificial intelligence, the ongoing rise of China and greater online penetration in emerging markets were all trends experts predicted we would see in 2020. The pandemic appears to have turbo-charged them significantly.

It has also turbo-charged the performance of many ETFs tracking these themes, with a lot of them recording gains above 50% year-to-date.

A lot of trackers following broad market indices, the UK aside, have also done relatively well.

TOP PERFORMING ETF

Stripping out very niche products like cryptocurrency trackers and three-times leveraged ETFs – which are extremely volatile and come with a very high risk of loss – the best performing ETF has been **iShares Global Clean**

TOP PERFORMING ETFs IN 2020

SELECTED BEST PERFORMING ETFS IN 2020	Gain
iShares Global Clean Energy	94.2%
WisdomTree Cloud Computing	89.7%
Market Access NYSE Arca Gold BUGS	79.1%
Invesco Elwood Global Blockchain	70.6%
VanEck Vectors Video Gaming and Esports	70.5%
EMQQ Emerging Markets Internet and Ecommerce	68.5%
L&G Battery Value-Chain	64.6%
WisdomTree Artificial Intelligence	59.7%
KraneShares CSI China Internet	55.0%
L&G Healthcare Breakthrough	50.5%

WORTHY MENTIONS	Gain
First Trust Dow Jones Internet	47.1%
Xtrackers MSCI USA Consumer Discretionary	42.8%
iShares Nasdaq 100	40.8%
L&G Ecommerce Logistics	38.0%
HSBC MSCI China A-Shares	34.5%

SELECTED WORST PERFORMING ETFS IN 2020	Loss
iShares Oil & Gas Exploration and Production	-35.1%
Lyxor MSCI Brazil	-24.1%
HSBC MSCI Turkey	-22.6%
WisdomTree UK Equity Income	-21.8%
Amundi MSCI Europe Banks	-20.4%

Source: Morningstar, 3 December 2020

Energy (INRG) with a return of 94% year-to-date.

This ETF tracks the S&P Global Clean Energy index, which is comprised of 30 large cap stocks and includes solar PV maker SolarEdge Technology, whose share price has almost trebled so far this year; and wind turbine manufacturer Vestas, which has more than doubled since hitting a low in the March sell-off.

Part of the reason these companies have done so well is the fact that solar and wind farms across the world are now becoming economically viable without government subsidies, a big tailwind for demand for solar panels and wind turbines as the world transitions to renewable energy.

But another big factor in their share price surge has been investor optimism over Joe Biden's victory in the US election and the $400 billion clean energy spending plan he has pledged to push through Congress.

IN SECOND PLACE

The second best performing ETF this year has been **WisdomTree Cloud Computing (KLWD)**, which has returned 86% year-to-date.

Cloud computing is the delivery of computing services – including servers, storage, databases, networking, software, analytics and intelligence – over the internet to offer faster innovation, flexible resources and economies of scale.

A lot of the big tech players like Amazon, Google and Microsoft all have big cloud computing businesses, but the WisdomTree ETF tracks the BVP Nasdaq Emerging Cloud index, which tracks more of the lesser known names in the space which due to their smaller size have potentially more significant growth potential ahead of them.

Its top three holdings are Cloudflare, Blackline and Zendesk, three young tech firms set up post-2000 which have seen their share prices soar this year. Cloudflare's shares have risen over four-fold in 2020.

One of the benefits of ETFs is that they can be a lower cost way to access markets and investment themes than open-ended active funds.

Thematic or sector-based ETFs are often more expensive than products tracking major indices like the FTSE 100 but even for this ETF's 86% return this year you would have had to pay a total annual fee of just 0.4% of your investment.

WHAT'S UNDER THE BONNET?

It's important to research an ETF before investing and check what index it is following, and not just go by its name, as evidenced by both the WisdomTree Cloud Computing ETF and the other one available to UK investors, **First Trust Cloud Computing (FSKY)**.

While the WisdomTree ETF has delivered an 86% return this year, the First Trust ETF – which has a 0.6% a year charge – has returned 47.1%. Still impressive, but significantly below the WisdomTree one despite both seemingly being a passive way to track the same industry.

The First Trust ETF follows the ISE CTA Cloud Computing index, which contains more of the bigger names like Oracle and Google owner Alphabet, companies which have seen decent share price growth this year but not anywhere near to the same extent as their smaller counterparts.

Unsurprisingly given 2020 has seen a once in a century global pandemic and the economic carnage that has ensued, gold has had a standout year, even if the rally is starting to fizzle out a little as vaccines provide hope.

IN THIRD PLACE

That means the third-best performing ETF this year has been **Market Access NYSE Arca Gold BUGS ETF (GOLB)**, returning 79.1% year-to-date. It tracks the NYSE Arca Gold BUGS index, which is comprised of US-listed gold miners and includes Barrick and Newmont.

In fourth place is **Invesco Elwood Global Blockchain (BCHS)** with a 70.5% return year-to-date. It tracks the Elwood Blockchain Global Equity index and provides exposure to listed companies that participate or have the potential to participate in the blockchain or cryptocurrency ecosystem.

Blockchain was dismissed a couple of years ago as just hype and a short-term fad and, despite grandiose expert predictions, that appeared to be the same for much of this year.

But during November, the share prices of many blockchain stocks exploded in line with the rally in Bitcoin. Blockchain is the technology that enables among other things the existence of cryptocurrencies, Bitcoin included.

GAMING GAINS GROUND

Other top performing ETFs include **VanEck Vectors Video Gaming and Esports**

(ESGB), which is also up 70.5% year-to-date.

A lot of its holdings aren't necessarily pure play video game firms but instead have a chunk of their revenues from gaming, like top holding Tencent which is involved in many areas but among them is being the world's largest video game seller; and Nvidia, whose stock has more than doubled year-to-date as its earning per share skyrocketed 130% year-on-year.

This was mostly down to its AI-driven data centre platform, but its gaming arm had also reported strong growth. Lindsell Train-backed Nintendo, a lockdown winner whose stock has risen 25% this year on higher sales growth, is also one of the top holdings in the ETF.

The rise of online penetration and the middle-class consumer in emerging markets has been reflected in the strong performance of **EMQQ Emerging Markets Internet and Ecommerce ETF (EMQP)** and **KraneShares CSI China Internet (KWEB)**, both of which have benefitted greatly from exposure to China's ecommerce giants Alibaba, Tencent, JD.com and Meituan Dianping.

TWO ETFS TO BUY

EMQQ EMERGING MARKETS INTERNET AND ECOMMERCE (EMQP)
£13.03

The rise of the middle class consumer in emerging markets – from China to India to Latin America – is one of, if not potentially the biggest investment opportunity in the world today.

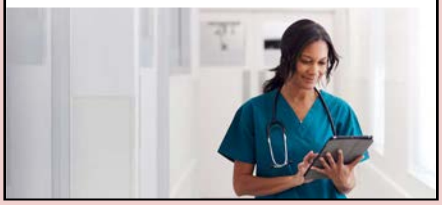
Respected consultant McKinsey says that by 2025 annual consumption in emerging markets will reach $30 trillion, something it calls 'the biggest growth opportunity in the history of capitalism.'

One of the best ways to play this theme could be through **EMQQ Emerging Markets Internet and Ecommerce ETF (EMQP)**.

It doesn't come cheap with an ongoing charge of 0.86% a year, but this ETF has returned 67.6% year-to-date, following on from its 26% return last year, and is packed with some of the biggest growth names in the world.

The ETF's holdings mean it is perfectly placed to capture the rise of the emerging market consumer, and its top five holdings include Chinese online shopping and ecommerce giants Alibaba, Tencent, Meituan Dianping, and Latin American equivalent MercadoLibre.

L&G HEALTHCARE BREAKTHROUGH (DOCG)
£12.27



Innovation in healthcare has long been considered a crucial part of shaping the world of tomorrow. But having seen the havoc caused by the pandemic, you can bet dollars to donuts that improving and fundamentally reshaping healthcare for the better will shoot up the list of government priorities once it is largely over.

This has already been evidenced by the share price growth of many healthcare stocks this year, with those in the healthcare technology space seeing the best growth.

A great way to access this theme both for the here and now and longer term is through **L&G Healthcare Breakthrough ETF (DOCG)**, which has returned 50.3% year-to-date for a total expense ratio of 0.49% a year.

Its tracks the ROBO Global Healthcare Technology and Innovation Index, which is comprised of companies across diagnostics, robotics, genomics, precision and regenerative medicine, lab automation, instruments, data analytics, and tele-health.

Disclaimer: Editor Daniel Coatsworth owns shares in iShares Global Clean Energy ETF.

By **Yoosof Farah**
Reporter

BlackRock

LOTS OF UNCERTAINTY, **BUT AN ABUNDANCE OF INVESTMENT OPPORTUNITIES**

BLACKROCK THROGMORTON TRUST PLC

The COVID-19 pandemic has created unprecedented dispersion of financial performance between individual companies. From here, differentiated companies with financial strength and a compelling product offering will continue to get stronger, whilst industry disruption continues to accelerate.

Daniel Whitestone
Portfolio Manager, BlackRock Throgmorton 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.

What has been remarkable about this crisis is the level of dispersion in financial performance across industries and companies. Some companies have been hit hard while others have been able to take market share at an accelerated rate. This in turn has reinvigorated the ongoing debate about "growth versus value", and whilst there have been many attempts to call the top for growth and the bottom for value, these calls have generally been incorrect as in our view they fail to appreciate the profound structural changes affecting cash flows on a medium-term basis.

Understandably, the economic outlook remains uncertain, but that is an opportunity rather than a problem for this strategy. There remain sizeable opportunities for companies that can differentiate themselves and/or are exposed to long-term secular trends, while the pressure on balance sheets and cash flows for struggling companies is intensifying. This dispersion of returns between sectors and within sectors is likely to persist.

History has shown that crises accelerate industrial trends, market share shifts, and changes in consumer behaviour. We thought this would be the case with COVID-19, but, even so, we have been surprised by the sheer speed and scale of the level of dispersion of financial performance created across industries and companies.

THE IMPORTANCE OF A COMPANY'S FINANCIAL STRENGTH

For us, the financial strength of a company has long been one of our key considerations when evaluating shares. Companies with strong balance sheets and a high conversion of profits to cash have generally been able to respond far better to this crisis, investing in their offering and products, or indeed evolving their business model where necessary to compete more effectively. When financial strength is combined with attractive industry dynamics, a compelling product offering and a proven management team, good things tend to happen! These are the companies we think will emerge in an even stronger position as this pandemic accelerates "Corporate Darwinism" on an unprecedented scale.

FINDING THE DIFFERENTIATED

We are strongly of the view that there remain sizeable opportunities for well financed companies that can differentiate themselves with a compelling product offering. Take Games Workshop as an example, (a top 10 holding), who have been able to grow their sales and profits through this crisis. They have been very successful in investing behind their product offering, growing their online presence, and attracting increasing levels of new customers, which should lead to higher levels of repeat ordering. Other companies we think are well placed to benefit are those driving and/or exposed to long-term secular growth trends like digital marketing and data analytics (e.g. YouGov), or cloud enabled communications (e.g. Gamma Communications). Conversely, the pressure on balance sheets and cash flows for struggling companies in structurally challenged industries is intensifying. We expect these trends to persist.

DIGITAL TRANSFORMATION

Digital transformation is one secular area of spend where growth rates have meaningfully accelerated during COVID-19 as corporates continue to invest in their digital capabilities in order to drive demand and win share, adapt to changes in consumer behaviour, and remove costs and complexity from their operations. It remains a key focus for every board globally. We have deliberately sought exposure to these trends in recent years and have increased our exposure recently as we think the growth outlook has improved, notably in digital payments, software-as-a-service, online learning, and cloud enabled audio and visual communications. Video Gaming is another industry where we think the outlook for growth has improved, where we see the value for content appreciating, a growing installed

BlackRock

base of players and a long-term increase in player time and in-play monetisation.

HIGH RATES OF UNCERTAINTY YET COMPELLING OPPORTUNITIES ABOUND

The level of dispersion in financial performance across many industries and companies that this crisis has created is incredibly exciting for fundamental active investors, and we will do everything we can to continue to ensure the BlackRock Throgmorton Trust capitalises on these opportunities both from a long and short perspective.

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

This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or financial product or to adopt any investment strategy. The opinions expressed are as of October 2020 and may change as subsequent conditions vary.

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

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.

Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.

Trust Specific Risks

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

Complex derivative strategies: Derivatives may be used substantially for complex investment strategies. These include the creation of short positions where the Investment Manager artificially sells an investment it does not physically own. Derivatives can also be used to generate exposure to investments greater than the net asset value of the fund/ investment trust. Investment Managers refer to this practice as obtaining market leverage or gearing. As a result, a small positive or negative movement in stock markets will have a larger impact on the value of these derivatives than owning the physical investments. The use of derivatives in this manner may have the effect of increasing the overall risk profile of the Funds.

Financial Markets, Counterparties and Service Providers: The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss.

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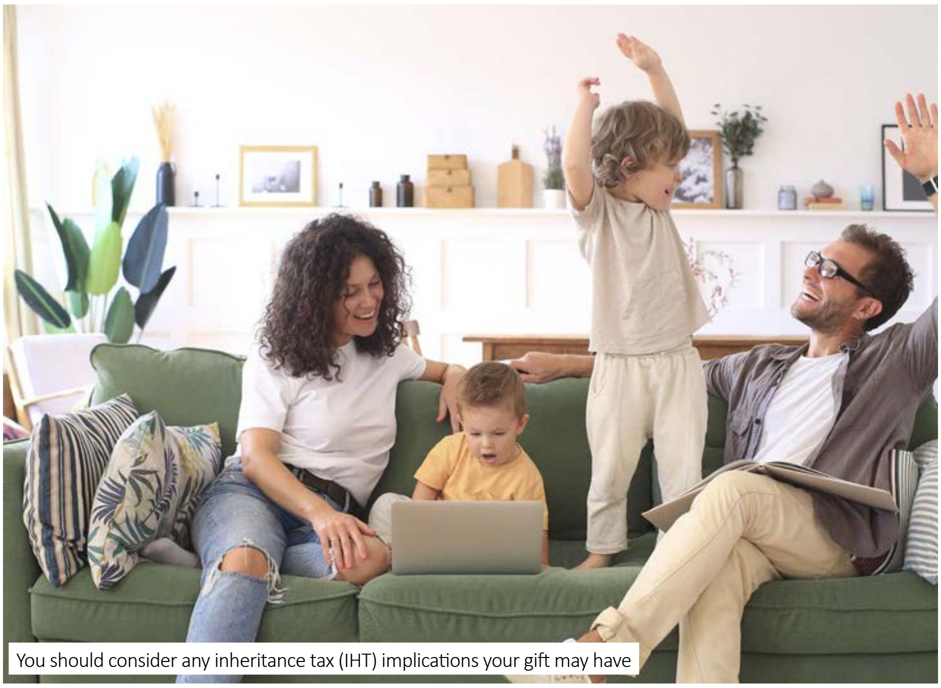
This material is for information purposes only and does not constitute an offer or invitation to anyone to invest in any BlackRock funds and has not been prepared in connection with any such offer.

How to give investments without losing to the taxman

Follow these simple steps and you could make someone (and yourself) very happy

As we approach the festive period, and Santa's movements may be affected by coronavirus restrictions, the more financially minded of you might be considering gifting shares to children or grandchildren, as well as, or instead of the latest must-have console game.

This is a good way to give kids a financial head start in life and is likely to still be reaping rewards from compound returns when the aforementioned game is gathering dust in an attic. But there are a few things you need to know before you take the plunge.


You should consider any inheritance tax (IHT) implications your gift may have

CAPITAL GAINS TAX IMPLICATIONS

If you're gifting an investment that you already hold, capital gains tax is potentially payable when you pass it across to the child, even if you don't sell the asset.

This would only be the case if your total gains for the tax year exceed the annual exempt amount of £12,300. If this is the case then capital gains tax would be payable at 10% or 20% of the chargeable gain, depending on whether you are a basic rate or a higher rate taxpayer.

If you find yourself in this situation, you may consider transferring assets to a spouse or civil partner if they haven't used their annual exempt allowance of £12,300.

The transfer between spouses or civil partners doesn't attract capital gains tax, and they can then gift the shares to a child or grandchild. Your spouse will inherit your base cost for the investment when it comes to working out how much the gain is.

INHERITANCE TAX IMPLICATIONS

Whether you're gifting shares or cash to invest, you should also consider any inheritance tax (IHT) implications your gift may have. You have an annual gift allowance of £3,000 which you can use without worrying about inheritance tax being levied on the gift should you die.

That limit is not per person you gift to, but rather is a total for all gifts you make, excluding those to a spouse or civil partner.

There are some other IHT exemptions for gifts. These may account for some of the other gifts you make in any given year, for instance gifts made to a child or grandchild who is getting married, or gifts which are made out of 'normal' income and don't affect your standard of living like typical birthday and Christmas presents.

However, if you exceed your

annual gifting allowance then IHT may be due on the gift if you die within seven years, assuming your estate is worth more than the nil rate band for IHT.

The tax works on a sliding scale, so if you die less than three years after gifting then 40% IHT would be due, but if you die between six and seven years after the gift then the tax rate falls to just 8%. After seven years, no inheritance tax would be due.

Children can only earn up to £100 in income each year on money or investments gifted to them by a parent

WATCH OUT FOR THIS RULE

You also need to be aware of a rule which means that children can only earn up to £100 in income each year on money or investments gifted to them by a parent.

If they earn more, then all that income is attributed to the parent, and so potentially taxable. This doesn't apply to money gifted by a grandparent or other relative, and parents can get round this problem by using a Junior ISA, which allows tax-free income and gains to be accumulated.

Indeed, even grandparents and other relatives should consider this route because when the child grows up, they can roll over into an adult ISA and continue to enjoy tax-free benefits.

Contributions to Junior ISAs must be made in cash, so if you're looking to gift existing shareholdings they would need to be sold and then repurchased within the ISA.

WHAT ABOUT PREMIUM BONDS?

For years NS&I premium bonds have been a popular present to give to children. It's easy to see why – they add a fun element to saving through the monthly prize draw, and there's always the very small chance you could be one of the lucky winners of a £1 million jackpot.

However, children have such a long investment horizon that they are ideally suited to a stocks and shares investment, because they can ride out the ups and downs of the market over time.

What's more NS&I has cut the interest rate used to calculate the prize pool from 1.4% to 1% per year – that the rate of return you will get if you have average luck. Given such a measly return, the stock market looks much more attractive for long term savings than relying on NS&I's random number generator, ERNIE.

- In the UK, everyone gets a £3,000 annual gifting allowance.
- Think about any capital gains tax or inheritance tax implications from gifting.
- Children can only earn up to £100 in income each year on money or investments gifted to them by a parent (beyond which the parent may be taxed) – but a Junior ISA helps to get around this situation.

By **Laith Khalaf**
Financial Analyst

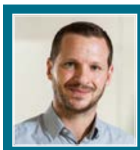
What's the difference between a Lifetime ISA and a SIPP?

Our resident expert looks at how two products with a retirement focus stack up

What's the difference between a Lifetime ISA and SIPP for younger people when looking at retirement?

I am maxing out my company pension up to the level they match and would like to save some extra for my retirement. I would be comfortable making the investment decisions myself and have six months' savings for day-to-day backup.

If deciding between a Lifetime ISA/SIPP, do the different income tax bands have an effect? What are the differences when looking to drawdown later in life? Are there other considerations that should be made? ***Dan***



Tom Selby
AJ Bell
Senior Analyst says:

Usually up to £40,000 can be paid into a SIPP and benefit from tax relief. Within this annual allowance is a limit on your personal contributions of 100% of 'relevant earnings' – broadly your earned and investment income.

Contributions are boosted by upfront basic-rate tax relief. This means if you pay £80 into a SIPP, it will automatically be increased to £100 through tax relief.

In addition, higher and additional-rate taxpayers can claim back an extra 20% or 25% tax relief via their tax return.

This means that for a higher-rate taxpayer a £100 SIPP contribution can come at a net cost of £60, while for an additional-rate taxpayer the net cost is just £55.

A quarter (25%) of your fund is then available tax free from age 55 (rising to age 57 from 2028), with the remaining 75% taxed in the same way as income. If you choose drawdown you can time how you take your money out of your pension fund so it's in the most tax-efficient manner.

Lifetime ISAs, on the other hand, allow you to pay in up to £4,000 a year, with each 'subscription' benefitting from a 25% Government bonus (up to a maximum of £1,000). In other words, on subscriptions up to £4,000 the upfront bonus is exactly the same as basic-rate pension tax relief.

You must be aged 18-39 to open a Lifetime ISA, and once opened you can keep paying in up to £4,000 annually and receiving the 25% bonus until the day before your 50th birthday, regardless of your income tax band. You can then withdraw the money tax free if it's being put towards a first home worth £450,000 or less, from your 60th birthday, or if you become terminally ill.

In all other circumstances the Government will levy a 20% early withdrawal charge (rising to 25% from April 2021).

Investment growth is tax-free in both SIPPs and Lifetime ISAs.

From a tax angle Lifetime ISAs represent a viable alternative to SIPPs for basic-rate taxpayers, benefitting from the same upfront bonus on the first £4,000 paid in but being able to take the whole fund tax free (albeit a few years later than a SIPP).

Lifetime ISAs also offer extra flexibility as you can access the money at any age (subject to an early withdrawal charge). For higher and additional-rate taxpayers, SIPPs mean higher tax relief. As ever, it will all depend on your personal circumstances.

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.

At The Scottish, we take a contrarian approach to global stockmarkets.

That's because golden opportunities – ugly ducklings, as we think of them – can be found in unlikely places. By ignoring the latest investment trends and scrutinising unloved stocks, we can spot the potential for reappraisal that others miss.

Our philosophy is simple. We recognise that popular stocks become overvalued while unfashionable stocks are often too cheap. And we aim to exploit this inefficiency to deliver long-term gains for our investors.

Exploiting irrational markets

By the time everyone realises that a great company is great, it may no longer be the best investment. It becomes difficult to see the storm on the horizon when everyone is toasting past success. Similarly, when a company has hit rock bottom, it can be hard to see that there will ever be good times again.

Market inefficiency is driven by human nature – people feel comfortable sticking with the crowd. But the herding instinct that ensured human survival in the past may not serve our best interests in financial markets. We believe it pays to ignore these instincts when it comes to making investment decisions.

By looking for positive signs of change in the out-of-favour areas of the market, and avoiding the unsustainable bubbles, we see a better balance of risk and reward.

Stand apart from the crowd

Our investment approach is differentiated in a world awash with index trackers. We don't want to own the overpriced areas of the market, so we construct the investment portfolio without the constraints of a benchmark. This means we expect our performance to be differentiated too.

Built for uncertain times

When the market mood turns, we believe it is important to have a keen eye on risk and reward. That's particularly pertinent when markets have soared through new highs lately.

The fortitude of our convictions

When we see that positive change is afoot, we have the conviction to back our ideas. But we know it can take time for the changes we see to be recognised by investment markets. That's why we take a long-term view. By being patient, we can wait for our investment cases to come to fruition – for ugly ducklings to turn into beautiful swans.

> “ a return while we wait for our thesis to unfold ”

Being paid for our patience

Although the ugly ducklings we choose are unloved, we believe that they have the strength and flexibility to adapt and thrive over the longer term. While we never consider a high yield an attraction in its own right, a substantial dividend from such companies is appealing to us as it offers a return while we wait for our thesis to unfold.■

8 December 2020

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Engaging with companies via AGMs, investor events and more

There are numerous events that enable shareholders to hold firms to account or learn more about the business

In previous parts of this *First-Time Investor* series we have talked about how shareholders should consider themselves as a part owner of a business.

By owning shares in a company, you have a voice and there are various ways you can engage with a business you are invested in.

It is easier for big institutional investors to engage with firms than it is for retail investors, however that doesn't mean you shouldn't try too.

It is important to take advantage of the opportunities available to you. Go to annual general meetings (AGMs) if you can (or watch online) and if you are invested in smaller companies you may even find management will respond if you get in touch directly on an issue which exercises you.

In addition, smaller companies often give presentations at private investor conferences and internet webinars, many of which you can sign up for free. For example, you can find details of upcoming events run by *Shares* here.

These events can be extremely useful as you hear directly from the businesses themselves and can get the inside track on how

Examples of key resolutions at an AGM

- To receive the report and accounts
- To declare a dividend
- Election/re-election of directors
- Authority to allot shares
- To approve the remuneration policy and report

Above are some of the main resolutions which are typically put to a vote at an AGM – though AIM firms do not, for example, have to put remuneration to a vote. This is important as shareholder opposition is often concentrated on pay, particularly when it is perceived that the awards for directors are excessive.

In September 2020, 34.2% of shareholders voted against the pay policies at **Ryanair (RYA)** at its AGM after CEO Michael O'Leary received a €458,000 bonus despite a major crisis in the aviation sector.

Cases where a majority of shareholders vote to reject a pay package are rare.

What are EGMs?

An EGM or extraordinary general meeting refers to a shareholder meeting called outside of an AGM to deal with important matters that cannot wait until the next annual event.

Typically, they relate to items like mergers and acquisition activity or changes to a company's structure or stock market listing. They can also be requisitioned by major shareholders, often if they want to remove incumbent directors and/or appoint other directors to the board.

a company is performing and executing on its strategy. You may even have an opportunity to quiz key directors yourself.

A 'SLIGHT WRINKLE'

There is a slight wrinkle with AGMs and EGMs. Only people listed on the share register are ensured of the right to attend general meetings and vote on resolutions and only those who hold their shares in paper certificate form or through Crest personal membership will be listed on the register; Crest being the depository for the UK's electronic share holdings.

If you instead hold shares in the nominee account of an investment platform then you are not on the share register (the platform is instead) and nor are you a member, you are simply a beneficial owner of the shares.

As such your presence at general meetings is not assured and you will not necessarily be able to vote, although most platforms will facilitate both and you should be able to vote by proxy if you cannot attend in person.

If you do want to attend in person you will need a letter of representation which you can request from your platform. It's also worth remembering that you may need to allow some time for such a request to be processed.

MOVING IN A DIGITAL DIRECTION

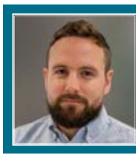
Going to an AGM can be tricky when a company's registered office is outside the UK, however one side effect of the 2020 coronavirus pandemic was that businesses were forced to conduct virtual meetings and hopefully a digital element will be maintained in the future to give all shareholders the option of participating.

Not everyone will have the time and inclination to attend AGMs or investor events but if you can catch up and vote in proxy online then there is a strong argument for taking your interests as a shareholder into your own hands.

Another way that companies look to engage with shareholders, particularly when they are planning to revamp or update their strategy, is to conduct what are typically called capital markets days.

Quite often these will be restricted to institutional investors but some companies, particularly larger ones, may allow you to stream or catch up on presentations through their website.

Also, market-sensitive information discussed at these events will have to be disclosed separately in advance through a regulatory announcement.



By **Tom Sieber**
Deputy Editor

KEY

- Main Market
- AIM
- Fund
- Investment Trust
- Overseas Share
- ETF

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

11 December: Nexus Infrastructure.
15 December: Chemring, Driver, Shaftesbury.
16 December: Real Good Food.

Half year results

11 December: Polar Capital Technology Trust.
15 December: Purplebricks. **16 December:** Dixons Carphone, FRP Advisory. **17 December:** Watches of Switzerland.

Trading statements

11 December: Bellway, Rolls-Royce.
14 December: Sthree.

WHO WE ARE

EDITOR: Daniel Coatsworth @Dan_Coatsworth

DEPUTY EDITOR: Tom Sieber @SharesMagTom

NEWS EDITOR: Steven Frazer @SharesMagSteve

FUNDS AND INVESTMENT TRUSTS EDITOR: James Crux @SharesMagJames

SENIOR REPORTERS: Martin Gamble @Chilligg; Ian Conway @SharesMagIan

REPORTER: Yoosof Farah @YoosofShares

CONTRIBUTORS Laith Khalaf, Russ Mould, Tom Selby

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

PRODUCTION
Head of Design: Darren Rapley
Designer: Rebecca Bodi

CONTACT US:
support@sharesmagazine.co.uk

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