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2021: Going Gold, Going Green

For Baker Steel, the key theme is **“Going Gold, Going Green”**. What does that mean?

“Going Gold” is about the macro-economic and geopolitical environment. We see unprecedented levels of government spending driving huge increases in money supply and borrowing. The inflationary forces and risks created by this are likely to be long-lasting and constructive for the gold price. Even when the world recovers and growth returns, we remind ourselves that wealth creation is ultimately a long-term driver for gold as well. At the same time, the valuations of gold miners are at near historic lows and do not reflect the potentially substantial increases in profits and dividends that we see ahead.

So, we are just in the middle of the **“Fear”** trade for gold and still have the **“Greed”** trade and **“Love”** trade to come!

“Going Green” means two things:

First, societal pressure and technological development, combined with targeted government action (regulations and targeted stimulus spending) means that the sustainable energy revolution is here to stay and is now accelerating. This will have a profound effect on demand growth for certain speciality and industrial minerals, and the mining companies that produce these.

Secondly, **“Going Green”** means that Environmental, Social and Governance (“ESG”) factors are now a front and centre concern for mining companies. The sector has reached that tipping point where most stakeholders, including investors, will not accept economic returns that come at the expense of mediocre ESG practices. This could create a virtuous circle for the good companies to achieve higher premium valuations (and a death spiral for the bad ones as access to capital and projects becomes limited).

These are themes that **Baker Steel Capital Managers LLP** has been positioning itself towards for years, by expanding the reach of our **market-leading, gold equities strategy**, which now includes a UK UCITS OEIC, **ES Baker Steel Gold & Precious Metals**, alongside the **BAKERSTEEL Electrum Fund**, which offers exposure to “future facing metals producers”. Furthermore, the continued development of our in-house ESG scoring system provides a complement to our set of unique valuation tools.

Click below to discover our funds or arrange a call with our team of experts today

Fund info

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Strap yourself in for a wild ride with airline stocks



Analysts could have underestimated the pent-up demand to fly once people are vaccinated against Covid

It's an odd and frustrating time to be invested in airlines but perseverance could yield rewards. The sector faces so many hurdles at present, yet we could be facing one of the biggest travel booms in a very long time once the pandemic is brought under control.

Currently we're all stuck at home, still dreaming of being able to hop on a plane to a warm climate and enjoy a relaxing break. Each day seems to bring more setbacks and some people are beginning to view 2021 as another write-off year for being able to do what they want.

The Covid vaccinations hold the key to reopening society and while there is progress on that front for 70-year-olds and above in the UK, it's looking more realistic that a much larger part of society won't get the jabs until much later this year.

Stock markets are forward looking and have already priced in the reopening trade for some airlines, rather than waiting for it to happen. Because of these high expectations, some investors are overreacting to the slightest bit of bad news which other investors might want to use to their advantage, if they believe it to be a short-term issue and not detrimental to the investment case.

For example, comments on 22 January that Spain won't welcome tourists until 70% of the country is vaccinated caused another sell-off in airline and holiday stocks including a 7% drop in **Jet2 (JET2:AIM)** on the day.

These large share price movements could be explained by investors worrying about short-term cash flows for airlines. Headlines such as the one about Spain could put people off booking at what is normally a busy time of the year for snapping up holidays. A lot is riding on foreign countries being efficient with the vaccine rollout but investing in a

stock is about taking a much longer-term view.

The direction of travel looks to be a mandatory requirement for proof of vaccination before travelling on a plane or cruise ship.

While initially a hassle, it makes perfect sense and isn't really that different to places like South Africa which already requires all travellers coming from yellow fever risk countries to show proof of yellow fever vaccination.

Having such rules in place could provide reassurance to other passengers that they are not travelling with unvaccinated individuals.

Looking at share price movements since last year's sell-off, the market is judging Jet2 as being one of the potential winners post-Covid, given how its shares have soared by 300% from the market low in March 2020.

International Consolidated Airlines (IAG) was lagging the pack but has seen strong share price gains in recent months. Financial liquidity has become less of a concern for investors than earlier in the pandemic after the British Airways owner raised a lot of cash and debt, but heavy exposure to business travel is a lingering issue as that market could take longer than leisure travel to recover.

The big question for investors is whether analysts have grossly underestimated the scale of demand for consumers to travel once vaccinated. I certainly think this is possible. If so, it means that even the airline stocks that have already done well since March 2020 have room to go much higher, though it could be a choppy ride.



By **Daniel Coatsworth** Editor

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Surge in amateur day traders suggests final stages of market bubble

There are growing concerns about inexperienced people in the US racing to buy stocks amid social media hype

Euphoria by US retail investors over certain stocks has raised concerns that we are in the final stages of a stock market bubble. This adds to a list of under-appreciated risks to markets which includes widespread optimism that stocks will continue to rise due to a combination of easy money, extreme valuations in bonds, and a rebound in growth thanks to the rollout of Covid vaccines.

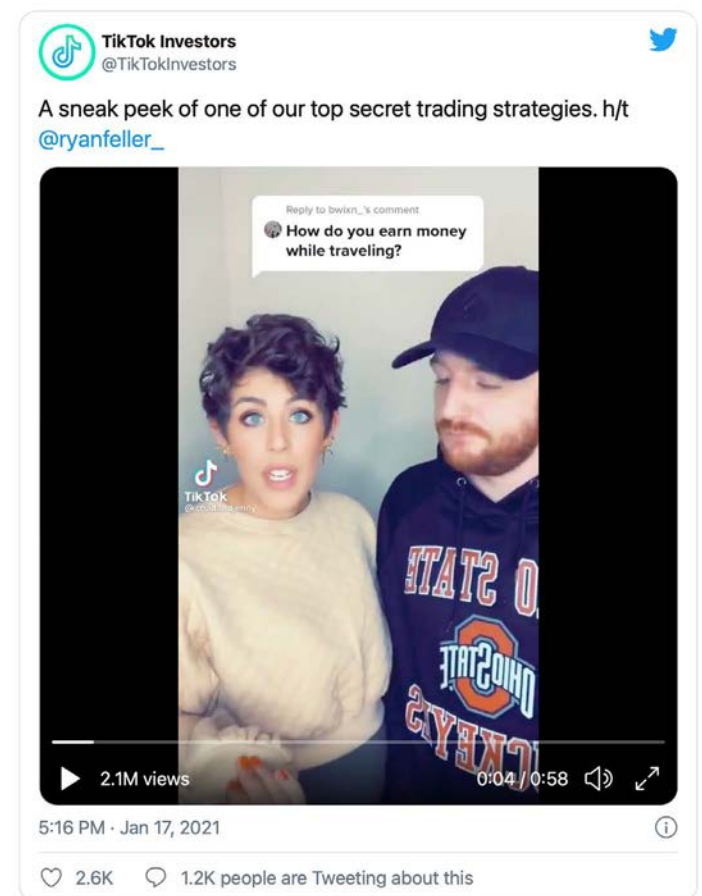
As it is, markets have started strongly this year, shrugging off new variants of the coronavirus as well as a Democratic sweep of the US Senate which many observers feared could trigger a collapse in tech stocks on concerns over tighter regulation and a spike in bond yields on worries over greater stimulus spending.

One of the biggest factors driving share prices higher in the US is a dramatic increase in speculative buying of stocks by new and inexperienced investors, encouraged by commission-free trading on platforms such as Robinhood together with an explosion in financial tips on social media platforms such as Twitter, TikTok and Reddit, often by individuals with very limited investing knowledge and no reference to the risks involved.

CHASING UNLOVED STOCKS

With many established technology stocks trading at sky-high valuations, day traders have turned their attention to low-priced stocks – or penny stocks as they used to be known – which tend to be highly illiquid.

By using message boards and posting videos on social media platforms, they build support for unloved stocks – frequently with poor balance sheets and many with a long history of losses – in order to buy in a concerted way and send the



shares higher.

Some of those caught up in the speculation are first-time investors in the US using their government stimulus cheque to buy single-stock call options, which allow them to put down a small amount in exchange for potentially large gains, rather than buy the shares outright.

The combination of a large volume of buy orders in stock and call options typically forces the broking firms on the other side of the trade to buy stock themselves, to hedge their positions in case the share price moves towards the strike price of

the option.

A typical example is Blue Sphere, a tiny profitless company whose shares rose 450% in a single day earlier this month on volume of more than 2 billion shares.

According to data from Bloomberg and Ally Financial, the volume of over-the-counter share trading in US penny stocks more than trebled between November and December and today is more than 10 times the level of a year ago.

At the same time, small buying of call options – often as little as one contract – now makes up nearly 10% of options volume on the New York Stock Exchange.

HISTORY REPEATING

Speculators are also being drawn to Special Purpose Acquisition Companies, or SPACs, of which more than 200 have listed in recent months. These are investment companies whose only assets are cash, with the intention of buying another company. Many have no revenues let alone profits, yet their shares have been turbocharged by a legion of buyers desperate for some new investment opportunity and speculating over what these cash shells might buy.

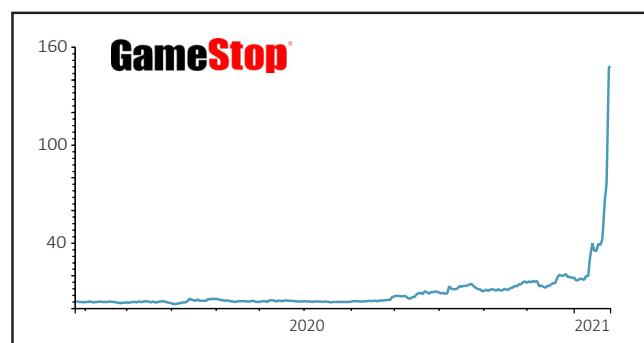
Echoes of the South Sea Bubble of the 1720s are hard to ignore. Put simply, speculation in assets such as penny stocks and SPACs has reached levels rarely seen in the past and *only* seen in the final stages of a stock market bubble, where higher prices are sustained not by fundamentals but by faith that a 'greater fool' will pay an even higher price.



An example of material being posted on social media hyping certain stocks

GAMING THE SYSTEM

The poster stock for speculators has been shopping mall-based video games retailer Gamestop. Having been the target of short sellers for many years due to its inability to turn a profit, Gamestop's shares were heavily hyped on Reddit's 'wallstreetbets' message board and soared over 100% in intraday trading last Friday (22 Jan).



That was followed by an intraday gain of 145% on Monday and a further intraday gain of 220% on Tuesday, taking its market value to \$10.3 billion.

While some people enjoyed large gains, the spike also generated billions of dollars of mark-to-market losses for short sellers, including Melvin Capital which was said to have lost 30% this month on short bets including Gamestop and required a \$2.75 billion capital injection from its backers.

Short selling involves taking a bet that a stock's share price will decline. The individual would effectively borrow shares from someone else for a small fee, sell them to raise capital and buy the same number of shares again at cheaper price in order to return the stock to the original lender, keeping the difference in price as profit.

If the shares go up in value then the short seller will either have to put more cash into their trading account to keep the bet going or be forced to buy stock at a higher price in order to close out their position.

The forced purchase is known as a short squeeze and some investors in the US are now targeting heavily shorted stocks in the hope that a cocktail of hype and short sellers being forced to buy will turbocharge the share price. This is a very risky strategy which could backfire with disastrous consequences.

Some of the names being targeted on 'wallstreetbets' include US mobile handset maker Blackberry and Finnish telecom equipment supplier Nokia. [IC]

Market excitement is building over electric vehicle growth

Shell joins BP by investing in charging infrastructure as vehicle sales surge

UK companies are accelerating their exposure to the rapid growth of electric vehicles (EVs), which showed a big jump in 2020 global sales. More than 3.2 million plug-in hybrid and battery-powered EVs were sold last year, according to data from EVvolumes.com, the Sweden-based consultancy and market researcher.

That was a 43% jump on 2019's 2.26 million despite difficulties for buyers and dealers between March and June, during the teeth of national lockdowns, and against a 14% fall in overall global car sales. EVvolumes.com's data shows EVs made up 4.2% of the global car market, up from 2.5% in 2019.

Tapping into this emerging opportunity earlier this week was FTSE 100 company **Royal Dutch Shell (RDSB)**, which agreed to buy one of Europe's largest on-street electric car-charging companies to

accelerate its move into low-carbon transport.

The oil company expects the deal to buy German car-charger Ubitricity to be finalised by the end of the year. No financial details of the acquisition, nor an official stock market announcement, were released. This implies that Ubitricity will not be material to group performance in the near term, yet the strategic importance is substantial given the mounting pressure from investors to cut its carbon emissions.

The Ubitricity car-charging network includes more than 2,700 charge points across the UK, or 13% of the existing market share, and more than 1,500 charge points across Germany and France.

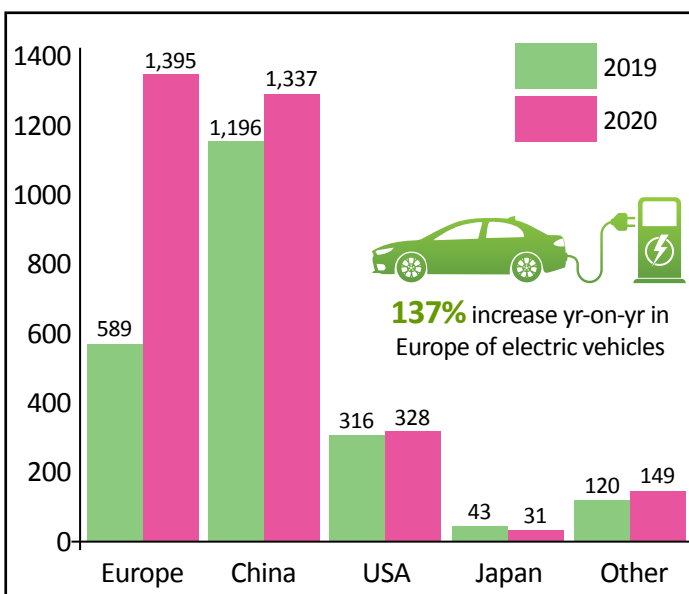
The deal has echoes of **BP's (BP)** own move into EV charging in the summer of 2018 when it acquired the UK's number one charging network operator Chargemaster.

This is an interesting time for the wider EV industry with investors clamouring to back businesses with clear means to tap into long-run growth in the wake of Tesla's stunning 700% stock run in 2020. Potentially exciting initial public offerings (IPOs) are coming thick and fast, albeit in the US.

ChargePoint, one the world's largest charging network operators with around 115,000 charging points, expects to float next month via a special-purpose acquisition company (SPAC), and will be backed by Baillie Gifford among others. EVgo, part of LS Power that owns and operates public fast chargers for electric vehicles, also unveiled IPO plans after agreeing its own SPAC deal. It will be valued at around \$2.6 billion.

Elsewhere UK-listed companies such as engineer **Ricardo (RCDO)** and fuel systems designer **TI Fluid (TIF)** continue to build out their own EV supply chain capacity despite the huge impact of the pandemic on the motor industry.

GLOBAL EV SALES 2020 ('000s)



Source: EVvolumes.com

Terry Smith denies overexposure to highly valued tech firms

Manager says 'highly rated does not equate to expensive any more than lowly rated equates to cheap'

Fundsmith Equity (B41YBW7) manager Terry Smith has taken aim at commentators who have attributed the fund's good performance to its heavy weighting in technology stocks which benefited from a tailwind last year. It returned 18.3% in 2020 versus 12.3% from the MSCI World Index.

While Smith acknowledged technology was the fund's highest sector weighting (28.9%), he also pointed out that consumer staples and consumer discretionary stocks together outweigh the fund's technology exposure (37.1%).

More fundamentally, Smith questioned the utility of such labels when Facebook, arguably a technology company, is included in communication services while Amadeus, Sage and Visa were labelled as technology firms.

These companies' activities span airline reservation systems, accounting and tax software and payment processing and their prospects are

not governed by a single factor such as technology, Smith argued.

What such companies have in common is their reliance on intangible assets (such as a patent or brand). This means their profitability is likely to be depressed compared with companies rich in tangible assets such as machinery.

That's because intangible investments are almost always 'expensed' and not capitalised as is the case for a tangible asset.

This 'makes a mockery' of using the PE ratio to compare companies' valuations he concluded.

In other words, reports of the fund's rich exposure to highly valued technology companies is misleading at best.



Rolls-Royce under pressure after new setback

Assumptions behind a cash flow warning could prove optimistic

SHARES IN aircraft engine maker **Rolls-Royce (RR.)** remain highly volatile with its latest trading update (26 Jan) revealing cash flow pressure as much of the aviation sector remains grounded.

A delay in a recovery among its customer base in the airline industry was always a material risk even with the breakthrough on vaccines. That risk has been heightened by the

emergence of new, apparently more infectious strains of Covid-19.

These factors, combined with the uneven pace of vaccine rollout globally, are putting pressure on governments to impose travel restrictions.

The resulting reduction in flying hours has a big impact on Rolls-Royce in the short and long term as the lucrative spares and repairs

contracts for its engines rely on planes being in the air.

A £2 billion cash outflow, up from the previously guided £900 million, is based on 2021 large engine flying hours at 55% of 2019 levels. This could still prove overly optimistic.

The business has made tangible progress in cutting costs and has £9 billion liquidity. It is also trying to sell £2 billion of assets.

Companies may tap investors again for cash to survive the crisis

Wetherspoon could kick-start another wave of companies issuing new stock in exchange for cash

The Government's refusal to provide a clear roadmap towards a permanent reopening is putting pressure on companies, particularly in the hospitality and leisure sectors, to consider asking investors once again for more cash to help them survive the pandemic.

Pubs group **JD Wetherspoon (JDW)** last week raised £93.7 million via a share placing, which follows a £138 million fundraise last April. We expect this to be the first in a new wave of companies tapping investors for cash.

Wetherspoon already had enough liquidity with around £139 million to tide it through to reopening sometime in the second quarter, but it was going to be a close call and hence the new fundraise.

The company is burning through around £17 million a month while its pubs are closed, and its banks insisted on a £70 million cash buffer.

Some fund managers worry that restrictions may remain in the pubs sector even after opening and that Wetherspoons may need to tap shareholders for a third time.

Investors have seemingly welcomed the latest fundraise as the shares at £11.67 are trading above the £11.20 placing price, implying that the benefits of increased financial strength outweigh the negative impact of dilution from issuing more stock.

'With operating and financial leverage, we expect pubs, restaurants and other leisure operators to be key beneficiaries of a vaccine rollout,' say analysts at investment bank Jefferies.

Asian stock markets have raced ahead so far in 2021

China, Hong Kong and Japan have all started the year strongly, outperforming their Western peers

ASIAN STOCK MARKETS have enjoyed a soaring start to 2021, having significantly outperformed major Western indices like the FTSE 100 and S&P 500.

The best performing major stock market in the world so far this year has been the Hang Seng in Hong Kong with a 10.8% return year-to-date according to SharePad, followed by the tech-heavy Nasdaq in the US with a 6.4% return and Japan's Nikkei 225 which has returned 5%.

Saxo Bank market strategist Eleanor Creagh says Asian outperformance has been driven by optimism regarding vaccine rollout and economic recovery, and it has been the region global investors have focused on since the back end of 2020.

She adds that Asia is also 'benefiting from better virus handling, the engine of China's reflationary regime with broad scale infrastructure and construction

stimulus, and continued dollar weakness, supporting flows into emerging markets.'

While the broad Shanghai Composite index in China is up 3.9%, Chinese large cap stocks are significantly outperforming with the FTSE China 50 Index up 13.8% year to date while the CSI 300 Index, which takes the top 300 stocks in the Shanghai Composite, has gained 6.7%.

In comparison, the FTSE 100 and S&P 500 have both returned around 2.6%, while European stocks have fared worse with France's CAC 40 and Germany's DAX both in negative territory.

There is so much to like about ASOS as an investment

The web-based fashion wonder stands out in a crowded fast fashion market

Investors seeking exposure to a global growth stock with a powerful structural tailwind at its heels should bag shares in high-flying online fashion retailer **ASOS (ASC:AIM)**.

Though the stock has already powered ahead during the pandemic, ASOS is in an upgrades cycle driven by the accelerated spending shift to the web.

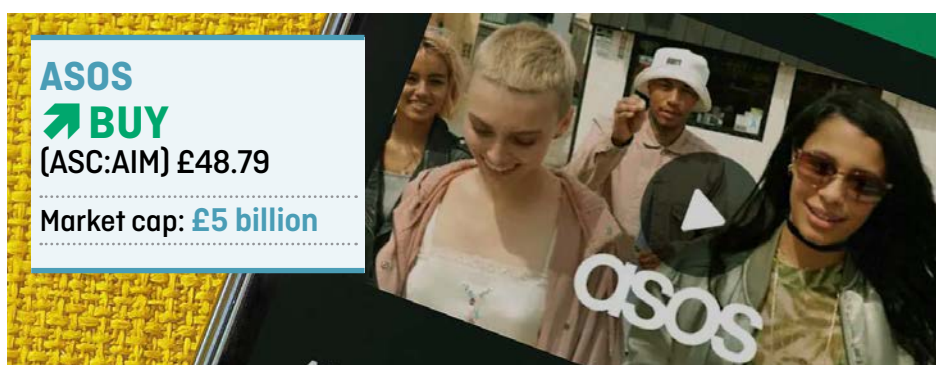
It trades on roughly 35 times forward earnings estimates for the next two years, a punchy yet palatable rating considering the international growth opportunity ahead.

Covid-19 has dramatically accelerated the shift towards online shopping and a vaccine-induced return to socialising around the world should turbo-charge growth rates at ASOS, which is also benefiting from investments in warehouse efficiency.

TOP (ONLINE) SHOP

While the pandemic has put socialising on hold, reducing demand for occasion and formal wear, agile operator ASOS has pivoted towards categories including activewear and lockdown relevant products.

The retail giant has clearly benefited from the closure of rivals' non-essential brick and



ASOS - Forecasts

Year to August	Pre-tax profit (£m)	Earnings per share (p)	PE
2019 (A)	33.1	29.4	166
2020 (A)	142.1	113	43
2021 (E)	170	138	35
2022 (E)	180	144	34

Source: Numis Securities/Shares. August year end.

mortar stores during lockdowns and virus-related restrictions, which have enabled it to grab market share and generate good growth in active customer numbers.

Boohoo (BOO:AIM), ASOS' online fast fashion rival, may have bagged the online business and brand assets of collapsed department store Debenhams, but ASOS is also seeking to cherry-pick prized assets from another fallen retailer, Arcadia.

As *Shares* went to press, the online retailer for fashion-loving 20-somethings was in exclusive talks with the administrators over the acquisition of Arcadia's

Topshop, Topman, Miss Selfridge and athleisure brands.

ASOS believes this potential deal would represent 'a compelling opportunity to acquire strong brands that resonate well' with its customer base and would be funded from the group's considerable cash reserves.

Shares believes these brands would be exciting additions to ASOS' online platform, through which it sells unique in-house labels as well as an array of winning third party brands.

Chief executive Nick Beighton clearly believes that the Topshop, Topman, Miss Selfridge and

athleisure brands still resonate sufficiently with value and fashion conscious shoppers, even if their heyday may have passed.

ASOS would by far be the most complementary new owner for Topshop, Topman and Miss Selfridge, brands which are already popular sellers through its third-party platform, while its global reach and digital prowess should help these brands to attract new shoppers.

STILL STRUTTING ITS STUFF

Even if the deal fails to materialise, ASOS is still a very strong business delivering double digit revenue growth across major geographies and with years of profitable expansion opportunity ahead of it.

At a time when many shopkeepers are laying off staff or even going under, ASOS is in rude health, having just announced it will invest £90 million in a new warehouse in Staffordshire to support growth, with a plan to employ 2,000 people at the site over the next three years.

The international business is growing like topsy as ASOS leverages its global infrastructure including warehouses in the UK, US and Germany. ASOS grew revenues in the EU and Rest of World regions in the four months to December 2020 while seeing increasing momentum in the important US market.

And the ASOS brand continues to resonate on home turf too. UK sales shot up by 36% to £554 million in its first quarter, triggering another earnings upgrade from ASOS, whose performance also reflected the resumption of lower product

Geographic sales split - 4 months to 31 Dec

Region	Sales (£m) 2020	Sales (£m) 2019	Reported increase (%)
UK	554.1	408.9	36
EU	390.7	332.5	18
US	156.8	139.3	13
ROW	224.2	194.2	15

Source: ASOS



return rates driven by tighter social restrictions.

Following the trading update, Numis upgraded its pre-tax profit forecast for the year to August 2021 from £135 million to £170 million and its 2022 estimate from £175 million to £180 million.

RISKS TO CONSIDER

Poor environmental, social and governance practices have dogged its rival, Boohoo. However, ASOS's reputation remains intact and investors aren't treating it with the same scepticism even though it operates in the same fast fashion space.

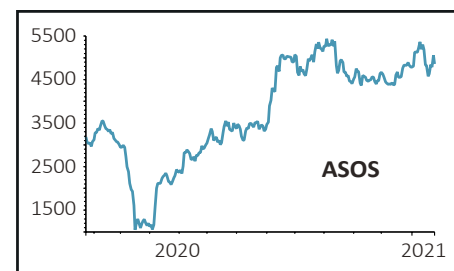
Boohoo is known for selling cheap dresses that are worn

once and chucked, which isn't environmentally friendly. ASOS's core proposition is much broader, with customers using it for coats, trainers, jeans, jumpers as well as dresses and tops.

In the short term, the financial hardships and lifestyle disruptions that Covid is inflicting on ASOS's core shopper demographic is a key risk to consider.

Yet on the flipside, young fashionistas with robust finances and job security are kicking their heels during lockdown and looking for things to spend their money on, which should support sales growth rates near term. Put bluntly, a good chunk of its target market is bored at home and ordering clothes and shoes gives them something to look forward to.

This tailwind is likely to ease as society starts to reopen, however at that point you'll see people wanting to refresh their wardrobes again as they rediscover their social life. There is plenty to like about ASOS on both a short and long-term basis. [JC]



Act fast with Brunner to secure very cheap access to good stocks

Heavy selling by a major shareholder has caused Brunner to trade significantly below the true value of its portfolio

There is a lot to like about **Brunner Investment Trust**, not least the discount to net asset value (NAV) which has blown out to 16.3% from 9.4% in October 2020, according to Winterflood data.

Part of the reason is down to the actions of one of its largest shareholders, Aviva Global Investors. Data from Refinitiv shows that Aviva has been busy selling, nearly halving its position since November 2020. It still owns 9.9% but the discount has the potential to narrow once the overhang has run its course.

While Aviva's selling has put pressure on Brunner's share price, it does offer investors the chance to get heavily discounted exposure to some of the best quality companies in the world and a 2.4% dividend yield compared with 1.8% average for the peer group.

Managed by Matthew Tillett and Marcus Morris-Eyton, Brunner takes a more balanced view when searching for global opportunities rather than sticking to a pure value or growth style. Tillett focuses on finding reliable income while Morris-Eyton focuses on faster growth opportunities.

The portfolio isn't skewed to either investment style, and it

BRUNNER INVESTMENT TRUST

BUY
(BUT) 862p

Market cap: **£363 million**

has faster growing companies trading on higher PE multiples as well as lower growth firms on cheaper multiples.

The common theme running through stock selection is quality with both managers looking to hold high quality companies with strong balance sheets and good cash generation.

The trust seeks out the best global opportunities for capital growth and reliable dividends, and gauges performance against a weighted benchmark composed of 70% of the FTSE World ex-UK index and 30% of the FTSE All-Share.

Over the last five years the net asset value and share price have gained 83% compared with 73% for the benchmark according to Refinitiv.

The trust is 46% exposed to the US, with Continental Europe comprising 28% and the UK at 18%. Asian companies comprise the rest of the portfolio.

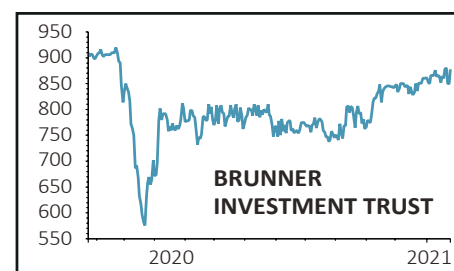
The healthcare and industrial



sectors account for around 20% each, with financials at 17% and technology at 13%, giving the portfolio decent exposure to 'reflation' prospects.

The largest holding is US software group Microsoft worth around 4.3% of the fund, followed by healthcare company UnitedHealth (3.8%), semiconductor company Taiwan Semiconductor (3.3%) and Swiss pharma group Roche (3%).

The trust has a very competitive 0.45% annual management charge and ongoing 0.66% charge which includes operational expenses. [MG]



SHARES

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Destiny Pharma

DESTINY PHARMA
Neil Clark, CEO

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

Strix
INNOVATIVE TECHNOLOGY

STRIX GROUP
Mark Bartlett, CEO
Strix Group is a designer, manufacturer and supplier of kettle safety controls and other complementary water temperature management components involving water heating and temperature control, steam management and water filtration.



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Contact

Lisa Frankel
media.events@ajbell.co.uk

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FORD MOTOR

(F:NYSE) \$11.29

Gain to date: 61.5%

Original entry point:

Buy at \$6.99, 13 August 2020

OUR DECISION TO flag the value in car manufacturer **Ford** looks increasingly like a smart move as the shares continue to motor higher.

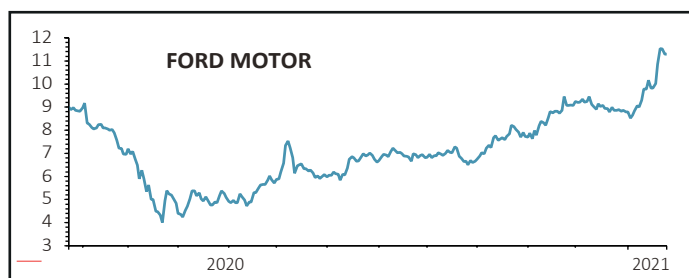
The company is finally getting some credit for its investments in areas like electric and autonomous vehicles.

One of these investments, electric pickup truck maker Rivian, in which Ford has an undisclosed stake thought to be between 10% and 15%, recently took in a reported additional \$2.7 billion in funding. This valued Rivian at \$28 billion, roughly the valuation of Ford as a whole when we highlighted its appeal back in August 2020.

Ford is an obvious beneficiary of the vaccine breakthrough in the final quarter of last year as it allowed the market to look through to a reopening of the economy, and with that greater opportunities to sell vehicles.

The Detroit-based firm could also see a tailwind from shifting habits in the wake of the pandemic as people want to use their own vehicles rather than take the perceived greater risks associated with public transport.

A key thing to watch for investors is sales of the Mustang Mach E all-electric SUV which has just started shipping. This will be among the items in focus when the company reports its fourth quarter earnings on 4 February.



SHARES SAYS: ↗

Keep buying with upcoming Q4 earnings being the next big catalyst. [TS]

TREATT

(TET) 917.52p

Gain to date: 51%

Original entry point:

Buy at 607p, 29 October 2020

Shares in extracts-to-ingredients supplier **Treatt (TET)** have risen by 51% since we said to buy last October. The company says annual profits are expected to 'materially' exceed the £15.1 million market consensus and prompted analysts to raise their earnings expectations.

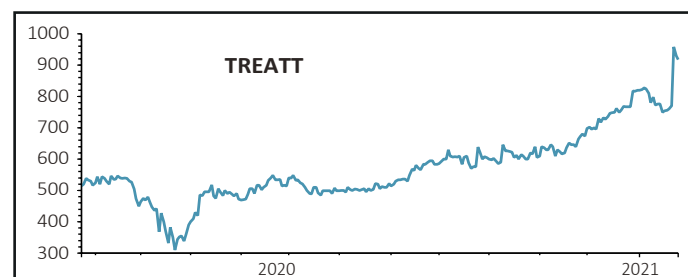
While some investors will be put off by the shares now trading on 37.3 times upgraded earnings forecasts, there is good reason to keep them in your portfolio.

A new UK plant is scheduled to become operational this summer, which will deliver 'a step change in terms of capacity, capabilities and potential margins,' says broker Peel Hunt.

'We see Treatt as on a virtuous circle, where stronger growth is both delivering higher profits and funds to invest in additional capability and capacity.'

Treatt is performing particularly well in its citrus, health and wellness, fruit and vegetables and tea categories and has seen some material new business wins, including in the rapidly growing global alcoholic seltzer category.

As a supplier of natural extracts including its sugar reduction solutions, Treatt is well positioned to profit from the war on obesity post-Covid.



SHARES SAYS: ↗

We sense there will be some profit taking by investors in the coming days following the recent spike in the share price, but we see merit in sticking with Treatt longer term as it becomes a stronger business. [JC]

PZ CUSSONS

(PZC) 240.5p

Gain to date: 3.2%

Original entry point:

Buy at 233p, 23 December 2020

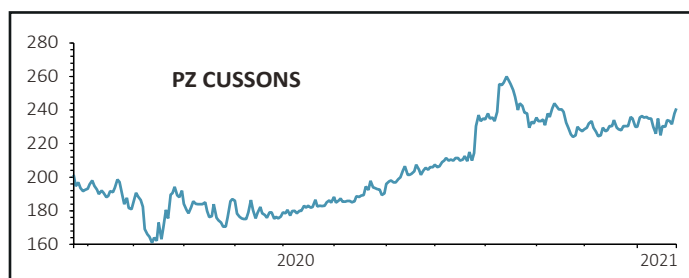
ONE OF [SHARES' key stock selections](#) for 2021, branded consumer goods group **PZ Cussons'** shares have edged up 3.2% since we highlighted the company's turnaround attractions in December.

Encouraging half year results from the Carex hand wash-to-Imperial Leather soap maker suggest recently appointed chief executive Jonathan Myers' strategy is already starting to bear fruit, with PZ Cussons generating sales and profit growth in all regions during the period.

Total sales grew 10.2% to £312.9 million and adjusted pre-tax profit rose 16.3% to £34.9 million, boosted by pandemic-driven growth in hand wash and hand sanitiser sales in Europe and America as well as an improved performance in Africa, where revenue rose 5.9% and Myers has begun to simplify the key Nigerian business.

PZ Cussons also reported a reduction in net debt, down £120 million to a mere £18 million, giving Myers greater balance sheet flexibility to effect his turnaround, though extra coronavirus-related costs and the uncertain environment meant the dividend was left unchanged at 2.67p.

Myers will share more details of his ongoing strategic review at a capital markets day on 25 March, which could prove to be the next share price catalyst.



SHARES SAYS: ↗

PZ Cussons has strong momentum under its new management team. Keep buying. [JC]

YAMANA GOLD

(AUY) 374.9p

Loss to date: 18.5%

Original entry point:

Buy at 460p, 22 October 2020

GOLD MINER **YAMANA Gold (AUY)** has fallen 19% since we said to buy in October but we think it's worth sticking with a company described by analysts as a 'stable operator with plenty of upside'.

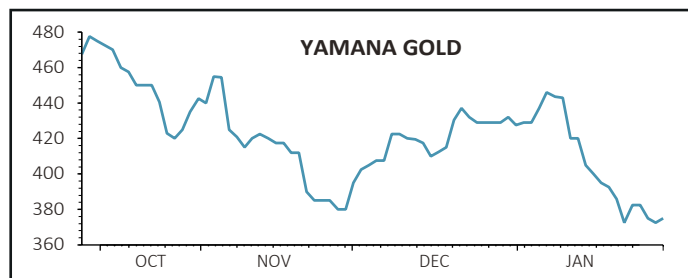
Gold miners can be leveraged plays on the gold price, and the firm's falling share price reflects the 5% drop in the value of gold over the past few months as investor nervousness makes way for vaccine-induced optimism.

The company has proven itself to be a reliable operator and investor sentiment should change as it continues to demonstrate its strength. We also believe investor interest will return to gold miners as inflation expectations are rising. Gold is a natural hedge against inflation.

It produced 779,810 ounces of gold in 2020 and generated strong cash flows which has helped to significantly reduce net debt.

Yamana also has the long-term in mind, illustrated by its plan to increase output to 1 million ounces of gold a year through to 2030, underpinned by 'continued operational success' at its existing mines, which have consistently replaced mineral reserves above depletion.

The Canadian mining giant said it is 'well-positioned to fund all exploration, expansions, projects and opportunities' identified in its guidance and decade-long outlook using available cash and cash flow from operations.



SHARES SAYS: ↗

Yamana is a reliable operator with a strong plan for growth. Use the dip as a buying opportunity. [YF]

China's structural shifts gather speed

THE SWIFT revival in China's economic activity creates a fertile backdrop for its corporate sector. Dale Nicholls, portfolio manager of Fidelity China Special Situations PLC, examines the investment opportunities ahead and explains how he is focusing on the structural trends accelerated by Covid-19.

Chinese markets rose on news that the world's second-biggest economy grew 6.5% in the fourth quarter, beating expectations and well ahead of other Asian and Western peers¹. The return to "normality" in China should mean lower risks relative to those countries still struggling to get the virus under control. We still see many companies left behind by markets offering significant value.

Our focus remains firmly on 'new' China sectors which benefit from the country's long-term growth story, particularly among the consumer-related, technology and healthcare sectors. In many of these areas, Covid-19 has super-charged structural trends already underway in China.

E-commerce is a particularly compelling theme. Many consumer goods in China have real capacity for growth and we see a trend towards upgrading and buying premium brands.

Within financials, we are particularly interested in insurance. 'Protection' type life insurance is only lightly used, and we believe demand will naturally rise with higher incomes.



In terms of risks, we are monitoring geopolitics and capital market reform. Tensions between the US and China are entrenched, but a more measured approach from the US side is likely under the new administration.

Looking ahead, we believe further expansion of these capital market reforms to the broader A-share markets would be positive for Chinese markets.

We are also following regulatory developments closely. Recently we have seen draft regulation in the fintech space that delayed the hotly-anticipated Ant IPO, plus there are some anti-trust rules brewing in the technology area. We don't sense that these will change the outlook significantly for the large technology companies, but developments certainly need to be monitored.

Lastly, sustainable investing remains a core part of our investment process and we believe that high standards of corporate responsibility makes good business sense.

Source: Financial Times as at 28.01.21

Important information

The value of investments and the income from them can go down as well as up, so you may get back less than you invest. Past performance is not a reliable indicator of future returns. Investors should note that the views expressed may no longer be current and may have already been acted upon. Reference to specific securities should not be construed as a recommendation to buy or sell these securities and is included for the purposes of illustration only. This information is not a personal recommendation for any particular investment. If you are unsure about the suitability of an investment you should speak to an authorised financial adviser.

Overseas investments will be affected by movements in currency exchange rates. The Fidelity China Special Situations Investment Trust invests in emerging markets which can be more volatile than other more developed markets. This 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. This trust uses financial derivative instruments for investment purposes, which may expose it to a higher degree of risk and can cause investments to experience larger than average price 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 latest annual reports, key information documents (KID) and factsheets can be obtained from our website at www.fidelity.co.uk/its or by calling 0800 41 41 10. The full prospectus may also be obtained from Fidelity. Fidelity Investment Trusts are managed by FIL Investments International. Issued by Financial Administration Services Limited, authorised and regulated by the Financial Conduct Authority. Fidelity, Fidelity International, the Fidelity International logo and F symbol are trademarks of FIL Limited. **UKM0121/33007/SSO/0621.**

SUPERIOR FUNDS

The ones consistently at the top of their game



By James Crux
Funds and Investment
Trusts Editor



As the oft-quoted disclaimer forewarns, ‘past performance is no guide to future returns’, yet those funds and managers that routinely outperform over economic and stock market cycles must be pursuing a winning process that should pique the interest of investors.

To find theses super-consistent unit trusts and open-ended investment companies (OEICs), *Shares* analysed data from FE Fundinfo to identify retail funds which have consistently appeared at the top of the performance tables. We narrowed our focus to nine key sectors out

of the 35-plus sectors compiled by industry trade body The Investment Association (IA).

To qualify for inclusion in our screen, funds must have delivered top quartile performance over the one, three, five and 10-year periods to 14 January 2021.

Outperforming year in, year out is no easy feat, so the super-consistent funds that populate the tables in this article can be considered the best of the best within their respective sectors. In the following sections, we’ll look at a selection of these products split by fund sector.

IA UK ALL COMPANIES



IA UK All Companies: total return

Fund	3yr	5yr	10yr
Royal London Sustainable Leaders Trust	31.3%	71.4%	198.7%
Baillie Gifford UK Equity Alpha	30.1%	96.6%	162.2%
TB Saracen UK Alpha	15.7%	56.7%	142.7%

Source: FE Fundinfo. Data taken 14 Jan 2021

In the UK All Companies sector, a trio of funds met our criteria. In the top spot based on 10-year returns is **Royal London Sustainable Leaders Trust (B7V23Z9)**, which has returned the best part of 200% over the past decade.

Boasting a five-star Morningstar rating and a high sustainability rating (the clue is in the name) and managed by long-serving Mike Fox, the fund's stated aim is to achieve capital growth from a diverse portfolio of mainly UK companies likely to deliver a net benefit to society in terms of their products or services they provide or that show ESG (environmental, social and governance) leadership.

Reasonably concentrated, and thus representing Fox's best ideas, the fund's top portfolio positions at last count included utility **SSE (SSE)**, which has reduced its reliance on fossil fuels and become a developer, operator and owner of low-carbon, renewable energy assets; Covid vaccine maker **AstraZeneca (AZN)**; and sustainability-obsessed consumer goods colossus **Unilever (ULVR)**, which has committed to making all suppliers pay the living wage by 2030.

Other names Fox holds include **Rentokil (RTO)**, the hygiene-to-pest control giant, as well as consumer credit checker **Experian (EXPN)**.

Hot on its heels in terms of 10-year performance are the £809 million **Baillie Gifford UK Equity Alpha (0585819)**, managed with a long term, low turnover approach by quality growth seeker Gerard Callahan, and **TB Saracen UK Alpha (0571119)**.

The latter's co-manager Scott McKenzie

says he remains 'generally positive' on the UK market given 'the potential for positive earnings revisions from current low levels and improving outlook'. TB Saracen UK Alpha's managers say they expect 'a strong pick-up in M&A activity in 2021 as a result of low valuations in the UK, low interest rates and the wall of money in the private equity world looking for a home.'

They are also beginning to see evidence of a post-Covid-19 recovery in earnings expectations from UK companies. These improved revisions have emerged as corporates report strong recoveries following the initial lockdown, led by pent-up demand in many cases. 'This combination of low valuation and improved earnings momentum may prove a potent one in the year ahead,' say the managers.

IA UK SMALLER COMPANIES



IA UK Smaller Companies: total return

Fund	3yr	5yr	10yr
FP Octopus UK Micro Cap Growth	58.8%	141.8%	269.2%

Source: FE Fundinfo. Data taken 14 Jan 2021

Only one fund in the IA UK Smaller Companies sector has scored a top quartile performance for all the one, three, five and 10-year periods under analysis, and that's **FP Octopus UK Micro Cap Growth (BYQ7HP6)**. Managed by Richard Power, Dominic Weller and Chris McVey, the fund has returned 270% over the last 10 years.

Also sporting a five-star rating from Morningstar and adorned with five FE crowns, this still-nimble fund is managed with a winning 'core-satellite approach'; the core of the portfolio is populated by 'proven winners', established, cash generative companies with strong management teams and track records. The satellites are the 'emerging stars', which are special situations such as IPOs, enabling the fund to take advantage of shorter-term market mispricing or extraordinary growth opportunities.

IA NORTH AMERICA

IA North America: total return

Fund	3yr	5yr	10yr
Baillie Gifford American	224.4%	463.6%	864.3%
Morgan Stanley US Growth	175.6%	341.0%	655.9%
Morgan Stanley US Advantage	119.3%	230.1%	505.2%
T. Rowe Price US Large Cap Growth Equity	76.1%	192.5%	467.3%
T. Rowe Price US Blue Chip Equity	69.0%	170.2%	446.9%
UBS US Growth	77.9%	167.9%	403.0%
Legg Mason ClearBridge US Large Cap Growth	61.6%	159.8%	387.7%
Wells Fargo Worldwide US Large Cap Growth	91.7%	196.3%	352.8%
GS US Focused Growth Equity Portfolio	81.2%	158.7%	338.3%
Wells Fargo Worldwide US Large Cap Growth	77.6%	170.8%	305.1%
Janus Henderson US Forty A2	73.3%	154.2%	288.9%

Source: FE Fundinfo. Data taken 14 Jan 2021

Our FE fundinfo screen reveals that the undisputed star turn of the IA North America sector on a 10-year time frame is the growth-focused **Baillie Gifford American (0606196)**, having returned 864% over 10 years and 464% over five years according to the data. Holdings include Tesla, Amazon and Shopify which have all done well on the stock market recently, as well as positions in pandemic winners Zoom, Wayfair and Netflix.

The next best 10-year performer to meet our stringent consistency criteria is the \$7 billion **Morgan Stanley US Growth (4590842)** fund. It has returned a spectacular 656% thanks to the investment team's focus on quality established and emerging firms with sustainable competitive advantages, strong free cash flow yields and favourable returns on invested capital.

According to the end-November factsheet, leading portfolio positions include Jack Dorsey-driven payments processor Square and the aforementioned e-commerce platform Shopify. Morgan Stanley US Growth also has positions in music streamer Spotify and ride-sharing app-to-food delivery disruptor Uber.

IA GLOBAL

Within the IA Global sector, **Baillie Gifford Global Discovery (0605933)** has proved a super-

consistent performer, putting up returns of 618%, 276% and 136% over the last 10, five and three-year periods, comfortably ahead of the 371%, 216% and 90% generated by the next best performer, **T. Rowe Price Global Focused Growth Equity (BD44677)**.



IA Global: total return

Fund	3yr	5yr	10yr
Baillie Gifford Global Discovery	136.4%	276.1%	617.7%
T. Rowe Price Global Focused Growth Equity	89.6%	216.4%	370.9%
Baillie Gifford International	64.6%	177.4%	311.6%
Baillie Gifford Global Alpha Growth	60.3%	170.1%	305.3%
Aubrey Global Conviction	80.4%	205.1%	296.6%
T. Rowe Price Global Growth Equity	70.2%	176.1%	289.0%
Fidelity Global Focus	62.4%	150.3%	259.5%
JOHCM Global Select	51.0%	123.3%	220.7%

Source: FE Fundinfo. Data taken 14 Jan 2021

Douglas Brodie-managed Baillie Gifford Global Discovery is invested in well-known growth names including Tesla, **Ocado (OCDO)** and property platform Zillow. The fund also has positions in companies that may be less familiar to UK investors such as telehealth platform Teladoc, implantable lenses play Staar Surgical and electronic fixed-income trading platform MarketAxess.

IA GLOBAL EQUITY INCOME

Only two funds in the IA Global Equity Income sector cut the mustard under our stringent long-term consistency criteria, being **Baillie Gifford Global Income Growth (0577247)** and **TB Guinness Global Equity Income (BVYPNY2)**.

The Guinness fund is up 184% on a 10-year view thanks to the delivery of capital growth combined with a growing dividend. These performance figures are on a total return basis which assumes dividends are reinvested.

Launched in late 2010, this stellar performer is managed by Ian Mortimer and Matthew Page

and invests in global equities with sustainable income growth. More specifically, the managers seek out companies with at least 10 years of persistent high cash flow return on capital every year, strong balance sheets and the robustness to stand up to economic shocks while delivering a sustainable, growing dividend.



IA Global Equity Income: total return

Fund	3yr	5yr	10yr
TB Guinness Global Equity Income	33.8%	98.3%	183.7%
Baillie Gifford Global Income Growth	36.0%	107.7%	181.7%

Source: FE Fundinfo. Data taken 14 Jan 2021

This strategy certainly helped the fund during the height of the Covid-19 crisis, which forced many companies to slash dividends. Only one company in the portfolio cut its dividend in 2020, namely **Imperial Brands (IMB)**, and zero portfolio companies cancelled their dividend completely.

In fact, 28 of Guinness Global Equity Income's companies grew their dividend in 2020, and six maintained a flat dividend. While the dividend distribution for 2020 remains flat on 2019, the managers anticipate the payout will grow in 2021.

This concentrated, equally weighted portfolio of 35 stocks will appeal to investors seeking to protect against inflation over the long term, with holdings ranging from Medtronic and Taiwan Semiconductor to Abbvie, Raytheon and **British American Tobacco (BATS)**.

HONOURABLE MENTIONS

In the IA Europe ex-UK sector, our research unearthed two super-consistent performers, namely **Baillie Gifford European (0605825)** and **Allianz Continental European (B3Q8YX9)**.

The former scours the continent for companies with strong competitive positions run by management teams with the owner's eye, with top 10 holdings including German duo Zalando (online fashion retailer) and Adidas (sportswear brand), as well as music streamer Spotify and food marketplace Delivery Hero. The large cap-focused Allianz fund is invested in the likes of luxury goods leviathan LVMH and ASML, the Dutch supplier of crucial equipment to semiconductor giants like Samsung and Nvidia.

Within the IA Asia Pacific ex-Japan and IA China/Greater China sectors, portfolios managed by Baillie Gifford pop up as impressive performers again. In the former camp, **Baillie Gifford Pacific (0606323)** heads up a quartet of ultra-consistent funds in performance terms, having risen 316% over the past decade.

Consistently first quartile ranked Baillie Gifford Pacific is a long-term Asian (ex-Japan) growth fund seeking quality companies that will outperform over a five year or longer time horizon. Managers Roderick Snell and Ewan Markson-Brown's portfolio has an active share of 78% versus the MSCI AC Asia ex Japan Index benchmark as at 30 November, with top 10 positions ranging from JD.com and Alibaba to Tencent, Samsung and Ping An Insurance.

Active share looks at how different a fund is from its benchmark – a low percentage figure means it is very similar and a high figure means the portfolio is very different from the benchmark.

For the Japan category, **T. Rowe Price Japanese Equity** was the only fund to meet our stringent performance hurdle and has risen 209% over the past decade.

Fund	3yr	5yr	10yr
IA Europe ex-UK: total return			
Baillie Gifford European B	62.5%	168.3%	299.0%
Allianz Continental European C	41.2%	103.9%	224.8%
IA Asia Pacific ex-Japan: total return			
Baillie Gifford Pacific B	79.8%	232.9%	315.8%
Allianz Total Return Asian Equity	57.2%	164.2%	172.6%
GAM Multistock Asia Focus Equity	43.7%	166.7%	135.3%
GS Asia Equity Portfolio	41.8%	137.3%	129.4%
IA Japan: total return			
T. Rowe Price Japanese Equity	43.9%	100.6%	208.6%

Source: FE Fundinfo. Data taken 14 Jan 2021



9 WINNING FUNDS TO BUY

IA GLOBAL



T. Rowe Price Global Focused Growth Equity offers exposure to quality international names including Facebook, Mastercard and JPMorgan Chase.

IA GLOBAL EQUITY INCOME

TB Guinness Global Equity Income would suit investors seeking strong total returns and inflation protection from a portfolio of quality companies with strong balance sheets and high cash flow return on capital. It has a 2.3% historic yield.

IA NORTH AMERICA

Morgan Stanley US Growth has generated stellar returns over the years. We like the fund's focus on growth companies with sustainable competitive advantages and robust free cash flow.

IA UK ALL COMPANIES

We like **Royal London Sustainable Leaders** for its focus on quality and ESG factors as well as the lengthy tenure of manager Mike Fox.

IA UK SMALLER COMPANIES

Overseen by seasoned growth company expert investor Richard Power, **FP Octopus UK Micro Cap Growth** offers a compelling mix of proven winners and emerging stars.

IA EUROPE EX UK

Ultra-consistent Baillie Gifford European offers exposure to companies with strong competitive positions run by management teams with the owner's eye.

IA JAPAN



T. Rowe Price Japanese Equity is a diversified all-cap portfolio offering exposure to typically 60 to 80 of its best growth ideas in Japan.

IA ASIA PACIFIC EX JAPAN

Having dramatically outperformed the three other ultra-consistent funds in this category, our top pick is consistent first quartile performer **Baillie Gifford Pacific**, which dares to be different from the index and backs quality companies that should outperform over a five year or longer time horizon.

IA CHINA/GREATER CHINA



Baillie Gifford China offers investors an easy way to get exposure to big themes in the Asian superpower with the portfolio having the largest weightings in tech, retail and pharma/biotech.

Annoyed with stop-start bank dividends? Here are other places for income

There are plenty of alternative sources of income among stocks and funds

Next month the banking sector will be able to start paying dividends to its shareholders again. However, before investors get too excited about renewed payouts from these erstwhile income favourites there is a potential sting in the tail.

The Prudential Regulation Authority will allow the banks to pay a dividend covering their 2020 financial year but dividends for 2021 can only be accrued and not doled out until the regulator has had time to reassess the situation in the summer.

That spells further disruption to the flow of dividends from this sector, which is very annoying to anyone dependent on income from their investments.

To help investors with alternative income options, *Shares* has run a screen of the UK market and identified some interesting high-yielding companies delivering strong returns and with robust balance sheets. Later in the article we suggest two of these stocks to buy. You can also read *sine* insights from fund managers on a global perspective for dividends.

DEEP SCARS FROM FINANCIAL CRISIS

The disruption to dividend

payments from banks is a reminder that the deep scars left by the global financial crisis in 2007/2008 will lead authorities to keep the banks on a tight

leash to protect their ability to absorb a deterioration in the credit markets and lend to consumers and businesses.

Manager of **BMO UK High**

TWO STOCKS TO BUY FOR INCOME

Berkeley (BKG) £44.59

Dividend yield: 4.5%

Housebuilder **Berkeley (BKG)** is arguably the highest quality operator in its sector. It has a strong balance sheet, with net cash of nearly £1 billion at the last count. It has also provided unrivalled clarity on the level of dividends shareholders can expect over the medium term.

It has committed to £280 million a year in shareholder returns up to 30 September 2025, with the next £140 million on track for payment by 31 March 2021.

Investors should look through any short-term bumps in the property market and focus on the longer-term need for more housing in the UK and a nation still intent on owning rather renting property.

Moneysupermarket.com (MONY) 266.8p

Dividend yield: 4.1%

The £594 million takeover of rival Goco by publishing group **Future (FUTR)** (14 Jan) leaves **Moneysupermarket (MONY)** as the only pure UK-listed price comparison business.

In the words of Shore Capital analyst Roddy Davidson, 'this status should increase both its strategic and scarcity value in a sector that we expect to benefit from further structural growth'.

Crucially, from an income perspective the business generates lots of cash and has a strong balance sheet. It should benefit from a reopening of the economy as demand for its services in areas like credit cards and home services increases.

Income (BHI) Phil Webster, who deliberately avoids the banking space, sums it up: ‘There is an awful lot of focus on banks for income, but they operate in a commoditised industry, offer poor customer service and have “me too” business models. Yet again in this crisis their dividends have been cut.’

If investors can no longer rely on the banks for a smooth stream of dividends, they will have to start looking elsewhere.

Making this job more difficult is the fact that other previously reliable sectors for dividends, such as oil and gas, have also disappointed on the income front *and* seen pressure on their share prices both through the Covid-19 pandemic and in the years leading up to it.

‘You need to think about your total return,’ says Andrew Lister, manager of investment trust **Aberdeen Emerging Markets (AEMC)**. ‘If you have an investment yielding 5% and it drops 5% in value, your total return is 0% and there’s really no point (in owning it).’

ALTERNATIVE INCOME PLAYS

The accompanying table shows UK-listed stocks with a net debt to EBITDA (earnings before interest, tax, depreciation and amortisation) ratios of less than two times, a forecast return on equity in double digits and dividend yields of 4% or above (based on estimated dividends and the latest share price).

Essentially these are companies that do not have excessive amounts of debt relative to earnings, they are expected to make a decent return on the money they spend on their

High yield UK stocks making good returns on investment and without excessive debts

Company	Yield (%)	Company	Yield (%)
Belvoir	6.3	Record	4.9
Evraz	6.2	Ninety One	4.8
Centamin	6.1	IG	4.8
Trans-Siberian Gold	6.0	BAE Systems	4.8
BHP	5.9	Keller	4.7
Polymetal	5.7	Property Franchise	4.6
Rio Tinto	5.7	Empresaria	4.6
CMC Markets	5.6	Quartix	4.5
Devro	5.6	Tate & Lyle	4.5
DWF	5.6	Berkeley	4.5
Jupiter	5.6	Man	4.5
Integrated Diagnostic	5.6	Central Asia Metals	4.3
XPS Pensions	5.5	Telecom Plus	4.2
Polar Capital	5.3	Moneysupermarket.com	4.1
Alumasc	5.3	Somero Enterprises	4.1
PayPoint	5.2	M Winkworth	4.1
Vp	5.2	Severfield	4.1
TP ICAP	5.1	Persimmon	4.0
Brewin Dolphin	5.0	River & Mercantile	4.0

UK-listed stocks with net debt/EBITDA of two or less and forecast return on equity of 10% or more.
Source: SharePad, data as at 21 January 2021. Yields based on payments for next financial year to be reported.

business, and they are forecast to pay out decent dividends.

Data-screening exercises are useful, but you also need to treat them with caution. The numbers in isolation won’t tell you everything about a business.

Looking at the list, mining companies and property-related stocks are well represented. While still reliant on volatile commodity prices, the mining firms do look better placed than their close counterparts in the oil and gas sector.

This is because they are likely to see demand increase rather than fall as a result of the transition away from fossil fuels given the

importance of metals in areas like electric vehicle production.

While there are no banks on the list there are several other financial stocks which are not dogged by the same regulatory obstacles.

TECH AS A FUTURE SOURCE OF INCOME

We continue to see more fund managers looking at the technology sector for income. While dividend yields may be relatively low, many tech firms are expected to grow dividends by a large amount every year which makes them appealing over the long term for investors

seeking income.

BMO's Webster is one such income fund manager with significant exposure to the technology sector. He even invests in tech stocks that do not currently offer any yield, but justifies their inclusion in his portfolio as having the potential to generate capital growth in the short term and offer income potential longer term as they generate a lot of cash.

Both Apple and Microsoft pay dividends quarterly. Apple may only yield 0.6% based on forecasts for it to pay 85 cents worth of dividends in its current financial year. However, analysts believe it will pay just over \$1 worth of dividends in 2023, which is twice as much as it paid in 2015 and illustrative of how fast dividends are growing.

Microsoft yields 1% but dividends are growing by about 7% or 8% a year, so significantly ahead of the rate of inflation.

Aberdeen Asian Income (AAIF) manager Yoojeong Oh notes that some technology enablers like Samsung and Taiwan Semiconductors pay dividends while even in more immature parts of the technology space like electric vehicles there are stocks offering income.

'LG Chem is one of the top three companies for electric vehicle batteries and it recently increased its dividend,' she says.

GOING GLOBAL FOR DIVIDENDS

The Link Asset Services UK Dividend Monitor report for the fourth quarter of 2020 made the stark prediction that UK dividends will not regain their pre-Covid levels until 2025 at the earliest.

Investors do not have to

Global equity income investment trusts		
Investment Trust	Historic dividend yield (%)	Total return over five years (%)
JPMorgan Global Growth & Income	3.3	146.0
Scottish American Investment	2.5	124.0
Securities Trust of Scotland	2.8	89.6
Murray International Trust	4.7	86.9
Henderson International Income Trust	3.7	66.3
Invesco Perpetual Select Global Equity Income	3.3	65.4
Majedie Investments	5.0	16.7

Source: SharePad, AIC. Data as at 21 January 2021

restrict themselves to UK shares in their hunt for income. Lots of global companies pay dividends too, and many fared better through the coronavirus crisis.

Martin Connaghan, deputy manager of global income investment trust **Murray International (MYI)**, observes: 'In China, third quarter (2020) dividends were up 3% on the previous year and in the US they fell just 3%.

'There are different reasons why that's the case. Because US firms had been buying back stocks at record levels all they really needed to do to maintain payouts was to stop buybacks. In Asia companies have lower gearing (borrowing).'

For many investors the best way to access these markets, given complications around currency and withholding taxes in certain territories, will be through funds and investment trusts. The table shows how global income investment trusts have performed on a total return basis over the last five years.

Connaghan adds: 'We are not

constrained by lines on a map. Regardless of where it happens to be domiciled, we are looking for a company to maintain and grow dividends.'

At the higher end of the risk spectrum is the approach taken by Aberdeen Emerging Markets' Andrew Lister who says: 'Income can be found in unusual places – often the most attractive income is found in areas that have not been scoured over by the masses. For example, frontier market bonds are very undervalued. In some cases, they have yields to maturity of over 9%.'

In a more general sense Lister thinks 2021 should be good for income as a theme, as many of the businesses which maintained dividends demonstrated their resilience through the pandemic and capital is set to move out of low-yielding fixed income investments and into dividend-paying equities.



By **Tom Sieber**
Deputy Editor

Will Europe's smaller companies deliver **big returns**?

EUROPEAN EQUITIES HAVE been largely unloved by investors for some time, having lagged their global peers over the past decade: the MSCI Europe ex UK Index has grown by circa 6% pa whilst the MSCI World Index is up circa 11% pa. European smaller companies have fared markedly better than their large cap counterparts however, outperforming the world in 2017 and growing at an annualised rate of over 10% during the last 10 years, as measured by the MSCI Europe ex UK Small Cap Index.¹

Indeed, over the long term, European Smaller Companies has been one of the strongest performing sectors across the globe, as can be seen from the chart below²:

Whilst the closing months of 2019 were marked by increasing volatility driven by a slowdown in global growth, Sino-American trade wars and Brexit, all this paled into insignificance in the first quarter of 2020 when cases of COVID-19 infections were confirmed outside of China, shutting down the global economy as the virus swept from China, through Europe and on to the US.

In early March 2020, global stocks saw a downturn of at least 25%, and 30% in most G20 nations, as the pandemic inflicted rising human costs worldwide and the necessary monetary and fiscal protection measures severely impacted economic activity. Global and Euro-area growth are projected at -4.4% and -8.3% respectively in 2020³, signalling the worst recession since



the Great Depression. The initially savage drops in stock markets were promptly followed by a dramatic bounce from mid-March onwards, Europe included, and by the end of October 2020, a sterling investor had seen a 12-month gain on an investment in European smaller companies of circa 10%, aided by a weak pound.⁴

EURO SMALL CAP – THE DRIVERS OF POSITIVITY

The region's smaller companies continue to be one of the more attractive investment sectors within world markets, for a host of reasons:

- it represents a unique blend of industries and companies which are less prominent in other regions



- European smaller companies have traded at a discount to their peers elsewhere over recent years, and so companies which would potentially command premium ratings in, say, the US are considerably more attractively priced in Europe
- it is an imperfect market which is ideally suited to active management, especially given the relative paucity of research available on its constituent companies: there are circa 2,500 quoted European stocks with a market capitalisation of between £100m and £5bn, compared to circa 400 with a market cap of over £5bn
- it offers exposure to high growth niches such as fintech, computer gaming, e-commerce and green energy (the EU is leading the world with its green agenda)
- the policy environment is as constructive for equities as it has been for some time – the considerable support injected into European economies by governments and central bankers – furlough schemes, guaranteed loans, interest rate suppression and the like – have had a positive overall effect and appear to have staved off the worst (although, for companies without a viable long-term business model, this support merely delays the inevitable)
- historically, European smaller company outperformance has been highly correlated to positive Purchasing Managers' Index (PMI) data – given this correlation, there is an expectation that the European small cap sector, and indeed value, will outperform as the economy strengthens and PMI data improves further
- Europe as a region is highly geared to global trade and so should be amongst the first regions to benefit from a post-COVID recovery
- at circa 1.5x, the price to book ratio (a key indicator of value) of European small cap stocks is currently some 15% below its historic average of circa 1.8x

- 2021 forecast earnings per share growth for European small cap stocks is amongst the highest of any region (see table below).⁵

	Share Price
UK large cap	33.8
UK small cap	35.3
US large cap	28.1
US small cap	40.1
Continental Europe large cap	37.1
Continental Europe small cap	46.8

TR EUROPEAN GROWTH IN 2020

Despite the unprecedented market turbulence, TR European Growth Trust (TRG) – managed by Ollie Beckett since 2011 – has performed impressively, achieving total return outperformance of 9% in its net asset value (NAV) relative to the benchmark over the last 12 months.⁶ Ollie attributes this achievement to a number of factors:

- an undiluted focus on the fundamental worth of a business, at a time when favouring short-term momentum would have proved very costly
- the diversity in portfolio holdings, with a mix of early-stage growth businesses, sensibly priced structural growth stocks, mis-priced value names and self-help turnaround stories: the trust currently holds circa 130 stocks
- good stock selection, primarily managing to buy online business models that have benefitted from a COVID-19 tailwind at a reasonable price
- a willingness to go down the market cap scale – early entry into these growth stocks has enabled acquisitions at low valuations
- it is not a value portfolio, valuation having been out of vogue as a stock market discipline for the last decade; despite that, the trust remains acutely valuation aware – maintaining valuation discipline throughout the market dislocation, it has taken the opportunity to buy some great businesses at good prices and some good businesses at great prices.

Annual performance (cumulative income) (%)

Discrete year performance % change (updated quarterly)	Share Price	NAV
30/09/2019 to 30/09/2020	13.4	16.8
28/09/2018 to 30/09/2019	-11.4	-8.4
29/09/2017 to 28/09/2018	-10.9	-5.5
30/09/2016 to 29/09/2017	56.1	37.4
30/09/2015 to 30/09/2016	33.6	40.7

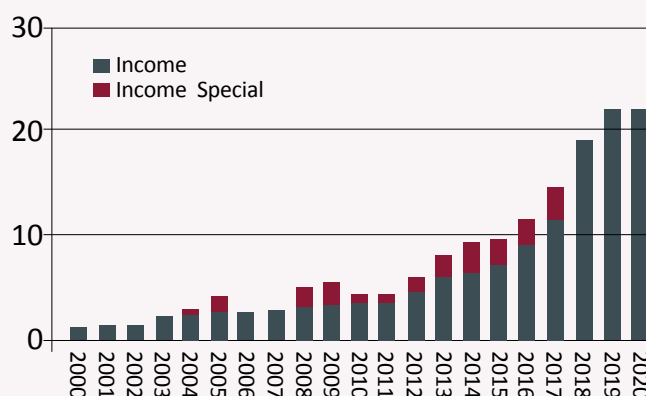
All performance, cumulative growth and annual growth data is sourced from Morningstar, as at 31st October 2020.
 Past performance is not a guide to future performance.

At a geographical level, the trust remains overweight in Germany (21.6%) and the Netherlands (8.0%), and has built a reasonably large overweight position in France (13.6%). It remains underweight in Spain and Austria, where it has proved difficult to find attractively valued opportunities for a few years. At a sector level, the trust remains overweight in technology, consumer discretionary and industrials.

The key driver of outperformance, however, has been the trust's unalloyed commitment to bottom-up stock-picking: whilst risky concentrations are always avoided, index weightings play little to no part in asset allocation and Ollie is comfortable running the portfolio with substantial divergence from the benchmark. TRG has consistently generated its own investment ideas rather than relying on external analysts, which is fortunate given the declining availability and quality of external analysis exacerbated by MiFID II. To that end, the TRG portfolio management team – Ollie, Rory Stokes and Julia Scheufler – spends hundreds of hours meeting and analysing medium and small-sized companies across western Europe – circa 600 meetings in the course of a typical year. It's their belief that only through this level of immersive interaction and investigative rigour can the potential for significant outperformance be realised.

DEPENDING ON DIVIDENDS

Despite not targeting income, one of the attractive aspects of the trust relative to its peers is its dividend payment solidity: over the last five years, average annual dividend growth of 25.7% is the highest in its sector.⁷ A final dividend of 14.20p to shareholders was agreed at the 2020 annual general meeting and, together with the interim dividend of 7.80p, brings the total dividend for the year to 22.00p, in line with last year – no small feat given Q2's widespread

Dividend history (pence/share)⁸


Please note this chart could include dividends that have been declared but not yet paid.

corporate dividend-cutting and suspensions.

Since the end of October, the trust's outperformance has accelerated post the positive news regarding the Pfizer vaccine, coupled with renewed investor attention on value. Looking beyond COVID-19, some voices are contending that we will see new lows in the market; Ollie doesn't agree, being of the view that, whilst the market may again show some volatility later in the year as we emerge from the virus lockdown, confidence in an economic recovery is tested, and – as we've said – sentiment will undoubtedly be bolstered by the rollout of the Pfizer and AstraZeneca vaccines.

European smaller companies continue to be an attractive area. As already stated, it's an imperfect market and the TRG team is confident that the hard work it puts into understanding the companies in its universe will enable it to continue to take advantage of further opportunities and mispricing, thereby identifying ongoing sound prospects for the deployment of shareholder capital.

GLOSSARY

Volatility – The rate and extent at which the price of a portfolio, security or index, moves up and down. If the price swings up and down with large movements, it has high volatility. If the price moves more slowly and to a lesser extent, it has lower volatility. It is used as a measure of the riskiness of an investment.

Market capitalisation – The total market value of a company's issued shares. It is calculated by multiplying the number of shares in issue by the current price of the shares. The figure is used to determine a company's size, and is often abbreviated to 'market cap'.

Price-to-book (P/B) ratio – A financial ratio that is calculated by dividing a company's market value (share price) by the book value of its equity (value of the company's assets on its balance sheet). A P/B value <1 can indicate a potentially undervalued company or a declining business. The higher the P/B ratio, the higher the premium the market is willing to pay for the company above the book (balance sheet) value of its assets.

Gearing – A measure of a company's leverage that shows how far its operations are funded by lenders versus shareholders. It is a measure of the debt level of a company. Within investment trusts it refers to how much money the trust borrows for investment purposes.

Monetary (protection) policy – The policies of a central bank, aimed at influencing the level of inflation and growth in an economy. It includes controlling interest rates and the supply of money. Monetary stimulus refers to a central bank increasing the supply of money and lowering borrowing costs. Monetary tightening refers to central bank activity aimed at curbing inflation and slowing down growth in the economy by raising interest rates and reducing the supply of money. See also fiscal policy.

Fiscal (protection) policy – Government policy relating to setting tax rates and spending levels. It is separate from monetary policy, which is typically set by a central bank. Fiscal austerity refers to raising taxes and/or cutting spending in an attempt to reduce government debt. Fiscal expansion (or 'stimulus') refers to an increase in government spending and/or a reduction in taxes.

¹EUR, 10 years to 30.11.20

²Source: Janus Henderson, DataStream, in GBP, as at 31.10.20. Indices used: Euromoney Smaller European Companies ex UK, FTSE 100, FTSE 250, S&P 500, MSCI Emerging Markets, Datastream UK 10-Year Gilt, MSCI Europe ex UK

³Source: International Monetary Fund, World Economic Outlook, October 2020

⁴Source: MSCI Europe ex UK Small Cap Index, year to 31.10.20

⁵Source: TR European Growth Trust PLC, Annual Report 2020

⁶Source: Morningstar, relative to EMIX Smaller European Companies ex UK Index, as at 31.10.20

⁷Source: Association of Investment Companies/Morningstar, as at 18.11.20

⁸Source: Morningstar, as at 31.10.20.

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US stocks as expensive as before the 1929 and dot-com crashes

The S&P 500 has only been at such a high valuation on the key CAPE metric twice before

We all know that financial markets are discounting mechanisms that look to 'price in' future events (and therefore trade off their perception of events rather than necessarily the reality of them).

However, it did look more than a little odd that the US stock market hit new all-time highs just as protestors were storming Capitol Hill to challenge the presidential election result, data highlighted how America was still piling up twin fiscal and trade deficits and the number of Covid cases continued to tick up inexorably.

This leaves investors to decide whether US equities are now overbought, overvalued and primed for a fall (or least some underperformance relative to other options) or capable of adding to a glittering run that dates back to end of the financial crisis in 2009.

BULL CASE

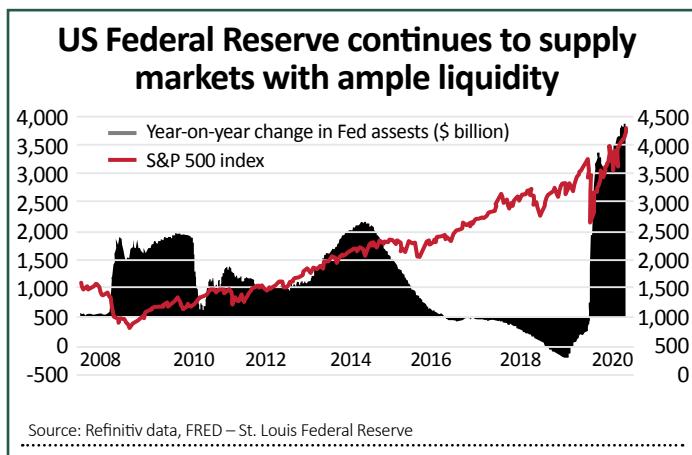
The bull case for US equities has three main planks. The roll-out of the vaccination programme will accelerate and further boost an official recovery rate of 97% among those Americans unlucky enough to catch Covid-19.

That will help in turn to unleash pent-up demand from consumers and corporations, stoking a strong economic upturn, especially as Government and the US Federal Reserve continue to offer strong fiscal and monetary stimulus.

The Fed is in no rush to raise rates until 2023 or even 2024, if you apply its requirement for a return to full employment and 2% trend inflation. The US central bank is still adding nearly \$1.5 trillion a year

to its quantitative easing (QE) scheme, too, and the financial asset prices do seem to be benefiting from this tidal wave of liquidity.

This is a good environment for equities, as corporate earnings, dividends and buyback activity will recover, and potentially a bad one for cash and bonds, especially as the Fed seems willing to let inflation run over and above its 2% target, at least for a while.



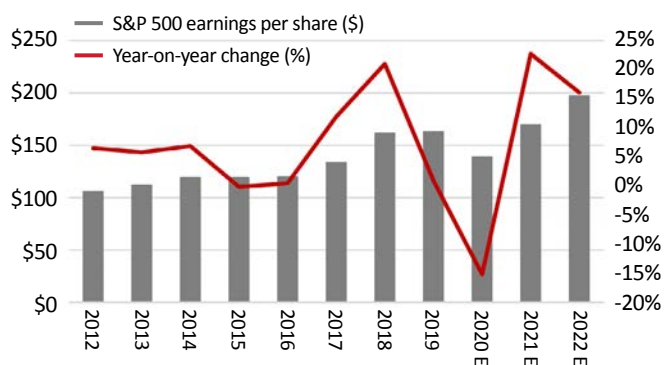
BEAR CASE

The counter arguments go as follows. There remains a risk that new strains challenge the vaccination programme and delay the recovery in both the US economy and corporate profits, which could also be affected by ongoing global trade tensions and tariffs.

Even if the economy and company earnings bounce back as hoped or expected, current analysts' estimates factor a lot of that in already, especially as consensus forecasts already assume the earnings per share (EPS) for the S&P 500 index



Analysts are already forecasting a rip-roaring US earnings recovery



will exceed 2019's pre-pandemic peak in 2021.

Even if analysts are right with EPS forecasts for the S&P 500 of \$169.6 and \$196.7 for 2021 and 2022 respectively, that still leaves US equities on 22.6 times and 19.5 times those forecasts, multiples which are lofty by historic standards.

The valuation implications of professor Robert Shiller's cyclically adjusted cape earnings (CAPE) ratio are even more challenging.

Shiller's work, which irons out the vagaries (and habitual optimism) of near-term analysts' forecasts, puts US equities on a CAPE multiple of 33.7 times. The S&P 500 has only twice before traded at such elevated levels and they were 1929 and 2000, episodes which did not end well for investors.

THE RIDDLE(R)

Bulls of US equities will rebut the Shiller methodology on the grounds that the past is no guarantee for the future and that the CAPE ratio has been a poor timer of markets. Both arguments are valid.

But even if CAPE does not mean a crash is certain, the compound average returns over the following decade from past peaks have been undeniably poor.

The truth is that no-one knows what will derail US equities or when it will do so. All you can say is that it will happen eventually, whether the cause is an unexpected recession and earnings disappointment, inflation that forces interest rates higher and blocks the monetary spigot currently

provides asset prices with a rising tide or (more likely) something that no-one is yet considering.

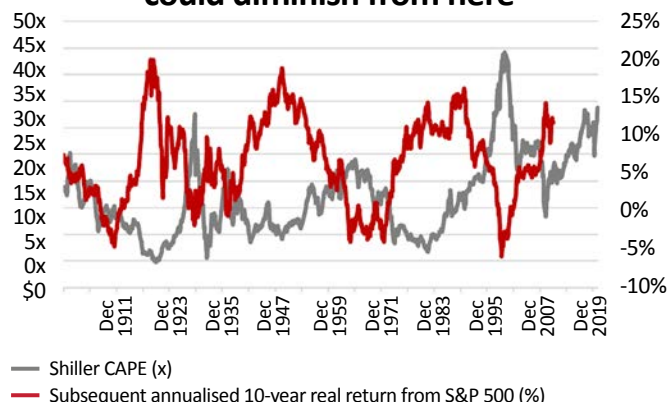
In terms of timing, some investors are already wondering whether American equities' decade of dominance is coming to an end. As this column noted [last week](#), emerging markets have outperformed US equities since autumn. Moreover, the key driver of US returns, tech and the FAANG stocks, have lagged their local market over the same time frame.

The mood music may therefore be changing, very subtly. As John Maynard Keynes said, markets can remain irrational for a lot longer than investors can stay liquid but once traditional valuation measures are cast aside then trouble generally lurks somewhere ahead, if only because multiples of earnings or cash flow provide insufficient downside protection.

As stock market historian Edward Chancellor wrote in his study of stock market bubbles *Devil Take the Hindmost*: 'The most striking similarity between the 1920s and the 1990s bull markets is the notion that traditional measures of stock valuation had become obsolete.'

The same could be said of markets now. Those investors who wilfully ignore the CAPE crusaders must therefore do so in the clear knowledge that they are taking a sizeable risk to do so and be equally certain that future rewards will be sufficient compensation for their actions.

If Shiller's CAPE analysis holds, history suggests returns from US equities could diminish from here



THE YEAR AHEAD FOR ASIA: RECOVERY BECKONS



- **There is cautious optimism about the path of the recovery in Asia as it starts to put the crisis behind it**
- **Asian governments will need to navigate the change in US administration**
- **Opportunities are emerging as economies revive**

For Asian economies, 2021 looks set to be a year of regeneration and renewal. The Covid-19 crisis has brought vast disruption to people's lives and livelihoods, to businesses and to economies. The region's competent management of the virus has allowed economic activity to resume, but businesses still need to find their footing in a changed world.

There is cautious optimism

about the path of the recovery in Asia. While some industries, such as travel and tourism, remain depressed, others, such as retail, have rebounded quickly. Economic statistics are improving across the region. Some countries, such as China, even saw positive economic growth in 2020 and look set to repeat this in 2021.

There is still some concern on the virus. James Thom, manager of **Aberdeen New Dawn Investment Trust**, says: "The course of the pandemic is the key question for Asia today. At the moment, it's looking relatively encouraging for Asia and the vaccine is a positive, but we still have some way to go and Asia remains vulnerable to waves of infection."

If the virus remains suppressed, Asian governments will be able to turn their attention to other priorities. First on their list may be to navigate the change in US administration. It is fair to say that US/China relations were both frosty and unpredictable under the presidency of Donald Trump. Biden is likely to bring a change of tone, even if he doesn't take a substantive change in approach.

A more measured approach to international relations should be good for the region's economies. Orsen Karnburisudthi, manager of **Aberdeen New Thai Investment Trust**, says: "Any less uncertainty on global trade is positive for Thailand. Around a third of Thailand's GDP is driven by global trade so the uncertainty over past

years has been negative headwind across a variety of products, from agricultural products to automobiles to electronics and fisheries. An improvement in trade will be positive not only for the Thai economy, but also for neighbouring countries.”

James agrees: “In aggregate, we believe the new administration will be marginally positive from a macro standpoint. We anticipate tensions will remain, but Biden should be a bit more multilateral and predictable in his dealings with China.”

In spite of a marginal thawing in the heated relationship between China and the US, Yoojeong Oh, manager of **Aberdeen Asian Income Fund**, expects China’s desire for self-reliance will grow: “Supply chain vulnerabilities were highlighted during the first stage of the pandemic and through the US trade war. We expect a stronger focus on boosting domestic consumption and localisation of new technology supply chains.” Nowhere is this clearer than in the growth of China’s nascent semiconductor industry. With its flagship telcos company Huawei cut off from US semiconductor companies, China has chosen to build its own.

This is innovation of necessity, but there is likely to be plenty of other innovation this year. In common with the US and EU, Asian government stimulus measures have come with green strings attached. China has now committed to being carbon neutral by 2060. Yoojeong says she is already seeing this reflected in corporate behaviour and it is likely to be an important trend in the year ahead.

The pandemic has prompted a shift from offline to online activities, whether that’s shopping or gaming, video content or remote



working. James says: “Asia has many companies that are active in these areas and we have several of them in the New Dawn portfolio. The pandemic hasn’t been all bad news for the corporate sector. It has brought about opportunity as well.”

The corporate sector appears to be emerging in good health, given the shock of 2020. James adds: “Earnings contracted quite a bit last year and into negative territory, but the market is expecting earnings in Asia to rebound by more than 20% in 2021, perhaps as much as 25%... From a fundamental earnings growth perspective, there is cause for optimism.”

Aberdeen Standard Investments’ Asian managers have been repositioning their portfolios to adjust to this new reality. Orsen says that while he trimmed riskier positions, such as banks and property developers, early in the pandemic, he has been strategically adding in areas that may benefit from a recovery. That includes Airports of Thailand, which is poised to benefit as tourism resumes.

Yoojeong has also made use of price volatility to buy companies

sold down during indiscriminate market sell-offs. She says: “We were quick to pare back exposure to leisure areas, such as hospitality REITs and to sectors where dividends were suspended by the regulators, such as financials. We topped up some domestic China growth names, which are benefiting from the consumption story. We’ve also backed technology hardware companies that are beneficiaries of the increased use of cloud computing and data traffic.”

James has found interesting ideas in the healthcare sector, including makers of equipment going into intensive care units, ventilators or companies involved in manufacturing treatments or testing equipment and now holds several of these in the portfolio.

However, there is no question of wholesale changes in any of the Trusts. Managers take time to understand and perform due diligence on companies over the years and ensure they are invested in companies where the business model has the potential to withstand disruption. In most cases, there should be no need to make significant adjustments in

response to a crisis.

Overall, there is much to be optimistic about in the year ahead. James concludes: “Asia is still home to many attractive long-term

structural growth stories, which have the potential to underpin growth in the consumer sector, in the technology sector, in the healthcare sector and in the green

and renewables space. These are multi-year, long-term drivers of growth and that will provide a level of support no matter what comes next.”



Important information.

Risk factors you should consider prior to investing:

- The value of investments and the income from them can fall and investors may get back less than the amount invested.
- Past performance is not a guide to future results.
- Investment in the Company may not be appropriate for investors who plan to withdraw their money within 5 years.
- The Company may borrow to finance further investment (gearing). The use of gearing is likely to lead to volatility in the Net Asset Value (NAV) meaning that any movement in the value of the company's assets will result in a magnified movement in the NAV.
- The Company may accumulate investment positions which represent more than normal trading volumes which may make it difficult to realise investments and may lead to volatility in the market price of the Company's shares.
- The Company may charge expenses to capital which may erode the capital value of the investment.
- Movements in exchange rates will impact on both the level of income received and the capital value of your investment.
- There is no guarantee that the market price of the Company's shares will fully reflect their underlying Net Asset Value.
- As with all stock exchange investments the value of the Company's shares purchased will immediately fall by the difference between the buying and selling prices, the bid-offer spread. If trading volumes fall, the bid-offer spread can widen.
- The Company invests in emerging markets which tend to be more volatile than mature markets and the value of your investment could move sharply up or down.
- Yields are estimated figures and may fluctuate, there are no guarantees that future dividends will match or exceed historic dividends and certain investors may be subject to further tax on dividends.
- Derivatives may be used, subject to restrictions set out for the Company, in order to manage risk and generate income. The market in derivatives can be volatile and there is a higher than average risk of loss.

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Growth trusts are still performing well despite the value rally

Scottish Mortgage remains a top performer since value rally began, but bargain hunter City of London is now delivering stronger returns

Investors need not be too worried about what the rotation into value could mean for some of the most popular investment trusts geared towards growth names.

Some of the trusts that invest almost exclusively in growth names are still delivering a decent performance, showing there are some good fund



Tesla has been a standout performer for Scottish Mortgage

BAILLIE GIFFORD
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exciting than you think.**

managers despite what the critics of active management might say.

Naturally more value-orientated trusts have done well since Pfizer's vaccine announcement in November sparked a rally in value stocks and a sell-off in some growth names, with a visible rotation into previously unloved value stocks developing. The FTSE All-Share has returned 21.2% in the period from 2 November 2020 to 21 January 2021.

Despite the value rally however, Baillie Gifford-run **Scottish Mortgage (SMT)**, one of the most growth-orientated funds in the investment trust universe, is still delivering a strong performance.

According to FE Fundinfo, Scottish Mortgage has delivered a return of 27.6% in the period.

How some popular investment trusts have performed since the value rally began in November 2020

Trust	Performance (%)
Scottish Mortgage	27.6
Monks	22.7
City of London	21.1
F&C	16.0
Worldwide Healthcare	15.6
Smithson	12.2
Polar Capital Technology	11.9
Finsbury Growth & Income	11.8
RIT Capital	10.9
Scottish Investment Trust	6.8

Source: FE Fundinfo, data from 1 November 2020 to 21 January 2021.

The trust's holdings have been big beneficiaries of lockdowns and structural changes as a result of the pandemic, none more so than Amazon, while Tesla – its top holding and accounting for 8.9% of its total assets – has been

the standout performer, rising more than sixfold in 2020.

In the last three months Tesla has continued to do well, fueled by its inclusion in the S&P 500, despite ever growing fears about its valuation and its share price

Europe has a lot to offer the long-term growth investor, if you know where to look. We seek out those great businesses with durable competitive advantages and strong management teams, typically owner-managers. And as an investment trust we can invest in any exceptional company we find, whether it's listed or privately owned. So, if you're seeking out growth in Europe, take the exciting route.

Please remember that changing stock market conditions and currency exchange rates will affect the value of the investment in the fund and any income from it. Investors may not get back the amount invested.

Find out more by visiting our website bgeuropeangrowth.com

A Key Information Document is available. Call 0800 917 2112.



Actual Investors

has doubled since November.

And in a blow to the theory that growth stocks will underperform in a value rally, the second best performing trust since November has been another in the Baillie Gifford stable, **Monks (MNKS)**, which has returned 22.7%.

Its top holdings include Amazon, Tesla and Google owner Alphabet, as well as Japanese tech conglomerate Softbank and South African equivalent Naspers.

But the trust is more diverse than Scottish Mortgage and other top holdings include the likes of budget airline **Ryanair (RYA)**, a stock generally considered in the value bracket and one which has rallied 22% since the start of November with the vaccine rollout potentially saving the crucial summer season for airlines and holiday firms.

Veteran manager Charles Plowden twice added to his holding in Ryanair in the six-month period to 31 October, believing it will take market share as other operators retrench, and has initiated new positions in a number of companies where near-term demand appears bleak but the long-term growth could be compelling.

TARGETING TRANSPORTATION-AS-A-SERVICE

New holdings in Monks include online travel agency Booking Holdings and car sharing company Lyft, where the manager sees growth potential in the transportation-as-a-service market.

New positions were also added in sports apparel company Adidas and cosmetics firm Estee Lauder, both brands



Rio Tinto has helped City of London Investment Trust's success

which Plowden believes will endure the current challenges to emerge stronger.

While the two growth-orientated trusts have performed well since the value rally started, the value-tilted **City of London Investment Trust (CTY)** has also done well, returning 21.1% between 2 November and 21 January as it finally starts to meaningfully claw back some of the losses it has suffered as a result of the pandemic-induced sell-off, though the trust is still down 10.5% on its pre-pandemic level.

RELYING ON FTSE 100 STALWARTS

Its top 10 holdings are all FTSE 100 stalwarts and some of them have bounced back strongly in the value rally, most notably multinational bank **HSBC (HSBA)**, which has rallied over 20% since the start of November ahead of what could be a strong economic recovery in 2021.

Another top holding in the trust to have enjoyed a strong couple of months has been miner **Rio Tinto (RIO)**, which has soared 26.5% since the start of

November on the back of rapidly rising iron ore prices – another sign the global economy could be in for a big bounce back this year.

During November and December, fund manager Job Curtis sold holdings in steam engineer **Spirax-Sarco Engineering (SPX)** and safety products group **Halma (HLMA)**, on valuation grounds.

The proceeds were switched into other holdings in the portfolio, such as supermarket **WM Morrison (MRW)** and **Direct Line Insurance (DLG)**, both of which have risen markedly in the past two-and-a-half months, as well as US hardware firm Cisco Systems, another previously beaten down stock whose share price has jumped from \$36 at the start of November to around \$45 in mid-January.

Elsewhere among popular trusts is **F&C Investment Trust (FCIT)** with a 16% return since the value rally began in November. The trust, which is highly diversified and marketed for a beginner investor looking for their first investment or a 'building block' holding for their

portfolio, has steadily risen since the March sell-off and thanks to the value rally is now back at its pre-pandemic level.

Its top holdings include big tech stocks such as Amazon, Alphabet, Apple, Microsoft and Facebook, which collectively make up 10.5% of the portfolio. Amazon and Facebook have remained relatively flat since the value rally took off, but Apple's stock has risen 20% in that timeframe in a sign that investors are still keen on growth names with the iPhone maker expected to have reported record earnings for the first quarter of its 2021 financial year as *Shares* went to press.

HEALTHCARE BOOST

Healthcare stocks in general have been a big beneficiary of the pandemic, providing a tailwind for **Worldwide Healthcare Trust (WWH)**. By May it had recovered from the March sell-off to go above its pre-pandemic level.

Despite the high ratings of some of its holdings, the trust has continued to perform strongly and has returned around 15.6% since the start of November.

In the trust's factsheet for November, portfolio managers Sven Borho and Trevor Polischuk said two of its top performers were Novartis and Takeda Pharmaceuticals, two highly-rated large cap pharma stocks which rebounded in November despite no news at all, showing that not all growth stocks sold off in the value rally.

Another strong performer was diagnostics company Natera, which rallied on 'positive fundamentals and the belief that a COVID-19 vaccine should allow for other parts of the



healthcare utilisation spectrum, such as routine diagnostic testing, to rebound,' says Worldwide Healthcare Trust.

POPULAR TRUSTS LAGGING THE MARKET

Meanwhile three of the most popular investment trusts on the market, **Smithson (SSON)**, **Polar Capital Technology Trust (PCT)** and **Finsbury Growth & Income (FGT)**, have all returned roughly 12% since the value rally began, lagging the FTSE All-Share's 21.2% return.

To be expected with manager Fundsmith's 'do nothing' strategy, there wasn't much in the way of buying or selling for Smithson during the period.

Its top performers included **Fevertree Drinks (FEVR:AIM)**, which has seen its share price bounce back on the expectation of the hospitality sector opening up again for good later this year, as well as credit reference agency Equifax, the American equivalent of **Experian (EXPN)**, which has rallied hard since the start of November.

As for Polar Capital Technology,

manager Ben Rogoff highlighted the trust's decision not to own Twitter, whose shares have taken a big hit since mid-December after suspending former US president Donald Trump.

The trust recently reduced its overall video game exposure and sold a position in CD Projekt Red, the video game developer badly hit by botched released of its highly-anticipated *Cyberpunk 2077* video game.

It also lowered exposure to several large internet stocks including Alibaba as regulation and politics remain a focus area for large tech firms. But regulatory changes could be a boon to other internet stocks, Rogoff believes. The trust participated in the recent IPOs of both Airbnb and Doordash.

DISCLAIMER:

Shares' editor Daniel Coatsworth owns shares in Smithson Investment Trust



By Yooosof Farah
Reporter

The shape of Brazil's Covid recovery

The country needs to look to 'digital transformation' as it emerges from the pandemic

Latin America's largest economy Brazil has suffered a devastating impact from Covid-19 which has translated into a big financial hit.

While the country's banks haven't fared as badly as some feared, with bad debts in particular remaining broadly under control, their valuations have suffered as a proxy for the wider country.

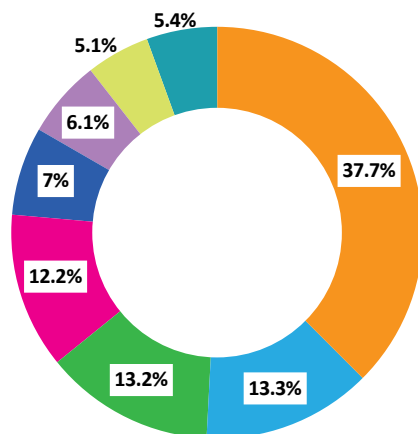
This is evident in the fact that when we last looked at this market in detail in July 2019, financials made up nearly 40% of the MSCI Brazil index – now they account for less than 30%.

Another notable takeaway from the sector breakdown of MSCI Brazil is that technology remains under-represented in the Brazilian market at less than 1% of the index. The broader MSCI Emerging Markets index by contrast has tech as the largest individual sector at a little more than 20%.

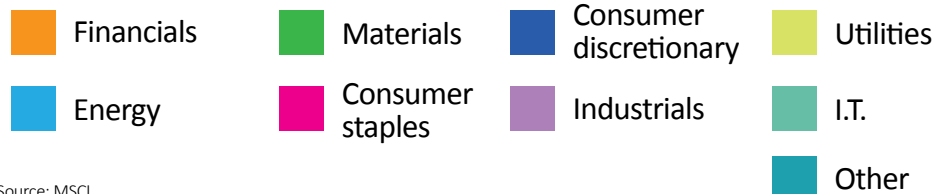
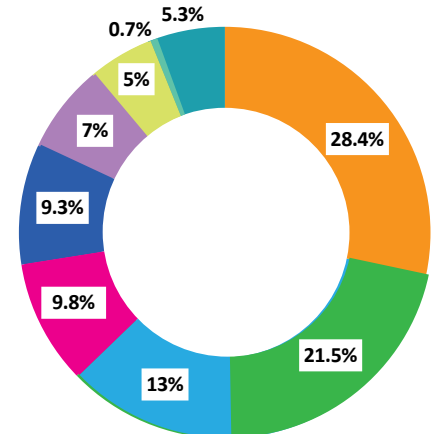
A report from the OECD published in October 2020 observed that as of 2018, 23% of Brazil's adult population had never used the internet. The report further noted that: 'More fundamentally, the favourable constellation that fuelled growth until the



MSCI Brazil – sector breakdown as of 31 July 2020



MSCI Brazil – sector breakdown as of 31 Dec 2020



Source: MSCI

2014 recession – an increasing labour force coupled with rising

commodity prices – now seems to be exhausted.'

The research added that policies to enhance digital transformation had a 'key role to play' in tackling the issues the country faces.



FRANKLIN
TEMPLETON

This outlook is part of a series being sponsored by Templeton Emerging Markets Investment Trust. For more information on the trust, visit [here](#)

Emerging markets: Views from the experts

Three things the Franklin Templeton Emerging Markets Equity team are thinking about today

1. Although the **Chinese** market lagged its emerging market counterparts in the final quarter of 2020, Chinese equities were among the leading outperformers for 2020. Geopolitical tension between China and the United States remains a key headwind that is likely to persist under new President Joe Biden's administration, though we could see a shift to a more constructive tone. The US Department of Defense (DoD) recently added a number of Chinese companies to a list of those deemed to have some military connection. The executive order prevents US investors from holding any companies on the list, starting in late 2021. We continue to see the emergence of high-quality companies that are well placed to benefit from ongoing market consolidation and booming domestic consumption.

2. **India** has seen surging Covid-19 infections, but with mortality having been contained, economic reopening has continued. Although the disruption of traditional business models has weighed on some companies, we expect to see a positive impact on Indian technology service providers. The information technology (IT) services sector

has been largely ignored over the last few years due to slowing growth and margin pressures, but both higher client traction as well as structural cost saving initiatives have offered support. As India embarks upon indigenisation and import substitution, the resurgence of manufacturing activity, as well as global efforts to diversify supply chains, could drive demand across a range of product categories including electronics, defence, automobile parts and pharmaceuticals.

Meanwhile, negative real rates in India will provide very significant support for the economy and markets going forward.

3. **Brazil**, despite the political noise, has continued to focus on important economic reforms that are leading to a structural

downward shift away from its historically high real interest rate. The central bank has also cut its policy interest rate to a record low, which reduces the cost of renegotiating or restructuring loans. Credit penetration in Brazil is far below many other markets, signalling room to head higher in the coming years; we think this supports prospects for the financial sector. More broadly, negative real rates should provide structural support to Brazil's growth outlook. Challenges remain in Brazil, however, including rising debt levels as a result of stimulus measures, paired with uncertainty surrounding continued economic reforms amid a politically fragmented environment. This may, in turn, place upward pressure on longer-term interest rates.

TEMPLETON EMERGING MARKETS INVESTMENT TRUST (Temit)

Portfolio Managers



Chetan Sehgal
Singapore



Andrew Ness
Edinburgh

Temit is the UK's largest and oldest emerging markets investment trust seeking long-term capital appreciation.

NUTRITION: INVESTING IN THE FUTURE OF FOOD



PICTET
Asset Management



The Pictet-Nutrition fund invests in companies that are developing solutions to help secure the world's future food supply.

These solutions include:

1. **Farming:** Innovations to improve productivity in farming.
2. **Transformation and distribution:** Increase efficiency in food transportation and processing.
3. **Food:** Maximise the nutritional content of the food we eat.

Food for thought

The Pictet-Nutrition fund takes a wholly positive approach, aiming to benefit from solutions, not problems – we do not invest in commodities or speculate in shortages in food. Rather, we focus on companies involved in helping to secure the world's future food supply and that therefore represent sustainable long-term opportunities for investors.



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

How can I avoid exceeding the lifetime pension limit?

Our expert considers some alternative places to allocate your retirement funds

I'm in my late 30s and have £600,000 in my defined contribution pension pot provided by my employer. I have done this by maximising the annual contribution limit (currently £40,000 subject to tapering) over the last six years.

Given that the lifetime allowance is currently £1,073,100 I'm thinking that I have potentially put too much in. For any money over the lifetime allowance, I might have to pay a lot of tax on the way out.

Is it worth reducing my monthly contributions to only take advantage of my company match rather than utilising the full annual contribution limit (£40,000)? Maybe it's worth focusing on pre-retirement investments like ISAs, Lifetime ISAs or VCTs?

Anonymous



Tom Selby

AJ Bell

Senior Analyst says:

The first thing to note about the lifetime allowance is that, under current rules, it rises each year in line with consumer prices index (CPI) inflation. For anyone with a fund close to the lifetime allowance who has stopped contributing, as long as your funds don't grow faster than CPI then you shouldn't go over the limit.

You can read more detail on the workings of the lifetime allowance [here](#).

If you go over the lifetime allowance, a charge will be applied to the excess amount when you access your SIPP. This will be 55% if you take it out as a lump sum, or 25% if you leave it in the SIPP. There may be another charge applied at age 75, but this depends on what income you take from your SIPP and the investment returns you receive.

It's worth remembering the aim of this charge is to recoup the tax benefits you enjoyed for saving in a pension, rather than to act as a penalty.

In terms of your available options, continuing to receive your workplace employer contributions – essentially free money from your employer – should be a priority. Even if these contributions take you over the lifetime allowance it can still be worthwhile as you receive the matched employer contribution (albeit subject to a lifetime allowance charge). It's also worth speaking to your employer to see if they will offer alternative remuneration to your workplace pension.

That said, for additional personal contributions breaching the lifetime allowance is not ideal and you could get better tax benefits, more flexibility, or

both, elsewhere.

ISAs offer a flexible, tax-efficient alternative to pensions which are worth considering. If you're aged 18-39 then the Lifetime ISA is also a useful retirement saving option with a 25% bonus Government payment.

Lifetime ISA withdrawals are tax free for a first home, from age 60 or if you're terminally ill, but a 20% early withdrawal charge will apply otherwise (due to increase to 25% from April 2021).

Finally, you mention VCTs and EISs. These are tax-incentivised vehicles aimed squarely at more risky investments, so if you go down this road be prepared for a bumpy ride.

You can read more about how VCTs and EISs can work alongside your pension [here](#).

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.

Your checklist for the end of the tax year

As the self-assessment deadline looms we highlight some of the savings you could make next January

It is that time of the year when many of us will be logging onto the HMRC website and filling in our self-assessment tax returns to meet the 31 January deadline.

It's a pretty soul-destroying process. It requires quite a lot of work, and at the end of it, the reward for your efforts is usually a tax bill to pay. There's not a great deal you can do to make it better this time around, because you're paying for the last tax year (2019/2020).

But there are some things you can do to save tax in this financial year, before it ends on 5 April. Most of them will make next January a little easier on the wallet.

ISAS AND PENSIONS

ISAs and pensions are a great way to save for the future because your investment returns are free from income tax and capital gains tax.

All adults can save a maximum of £20,000 each year in ISAs, whether that be a cash ISA, Stocks and Shares ISA or a Lifetime ISA.

Importantly, if you don't use all of the allowance, it can't be carried forward, so you lose it for good. Investors with unused ISA allowance for this year should consider using it if they can before the 5 April deadline.



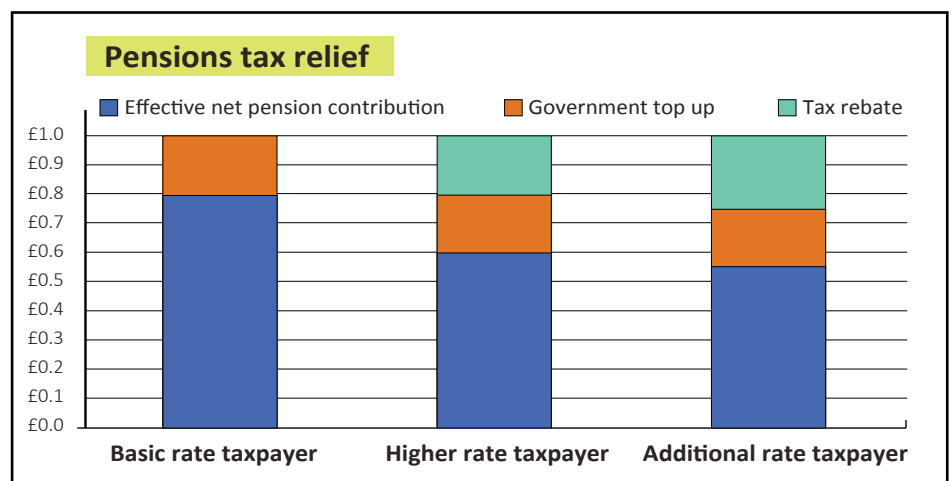
The pension annual allowance for adults is 100% of earnings, up to a maximum of £40,000. People with no earnings can still save up to £3,600 a year in a pension.

The pension annual allowance can be carried forward for up to three years but it will be lost eventually, so investors should consider whether they have made as much use of their pension annual allowance ahead of the end of the tax year.

If you don't want to commit fresh money to the market, or you don't have any spare cash at the moment, you can do a Bed and ISA, or a Bed and SIPP, which involves funding an ISA or SIPP contribution using investments you already hold outside a tax shelter.

GOVERNMENT TOP-UPS

A significant benefit of pensions and Lifetime ISAs is that any money paid into them will



Source: Shares

benefit from a top up from the government. This is most generous in pensions, where personal contributions are automatically topped up by 20% in the form of pension tax relief.

That means that every 80p you pay into your pension is automatically topped up to £1. Higher rate and additional rate taxpayers can reclaim an additional 20% or 25% tax relief respectively via their tax return. So, for a higher rate taxpayer, every £1 that ends up in their pension only costs them 60p.

With the Lifetime ISA, you can get up to £1,000 a year in the form of a Government bonus, up until the age of 50. If you opened a Lifetime ISA at age 18, that is a maximum Government bonus of £32,000 (or £33,000 if you're lucky enough to have your 18th birthday before 6th April).

Lifetime ISAs are more restrictive than other ISAs. You can only open one if you're between 18 and 40, and you can save up to £4,000 each year. You can withdraw the Lifetime ISA money once you've reached age 60, or to buy your first property. But be warned that if you take the money for any other reason you'll pay an exit penalty which is currently 20% but will increase to 25% on 5 April.

USE YOUR CGT ALLOWANCE

For investments held outside an ISA or pension, the annual capital gains tax (CGT) allowance is very valuable. Investors can make investment gains of up to £12,300 a year without paying any tax.

Gains over that amount are added to income and if they fall in the basic rate tax band



are taxed at 10% and if they fall in the higher rate tax band are taxed at 20%. An additional 8% is added if the gains are from a second property.

The annual CGT allowance cannot be carried forward into future years so if you don't use it, you lose it. If you have investments with gains outside of an ISA or pension therefore, you might consider taking some profits before the end the tax year to make the most of the tax free allowance. You can also transfer investments to your spouse or civil partner, in order to use their annual CGT allowance too.

CONSIDER LIFETIME GIFTS

Gifting money in your lifetime needs careful consideration to avoid any surprise tax bills. Lifetime cash gifts are known as PETs, or potentially exempt transfers, and can create an inheritance tax charge if you, as the donor, pass away within seven years of the date of the gift.

However, you also have an annual gift allowance of £3,000, and any unused allowance can be carried forward, but only for one year. Gifts of up to £250 made to an individual are also exempt each tax year. You can also make regular gifts of any size out of surplus income without

paying tax, provided your lifestyle is not affected.

START SAVING FOR YOUR KIDS

Like adults, children also have tax allowances that can be utilised each year. The Junior ISA allowance is now a very generous £9,000 a year, which enables you to start building a very healthy fund to help them transition into their adult lives. They won't be able to access the money until they are 18, at which point it automatically turns into a normal ISA and transfers into their name, giving them full access.

If you'd prefer something longer term, you can pay up to £2,880 into a Junior SIPP each year, with Government tax relief automatically boosting that to £3,600. They won't be able to access the money until they are at least age 57, maybe later if the Government increases the minimum retirement age.

This ensures there is plenty of time for them to benefit from compound investment returns. Either a Junior SIPP or a Junior ISA is a great way to encourage children into the savings habit, and using tax-efficient shelters, from an early age.



By **Laith Khalaf**
Financial Analyst

MONEY & MARKET\$

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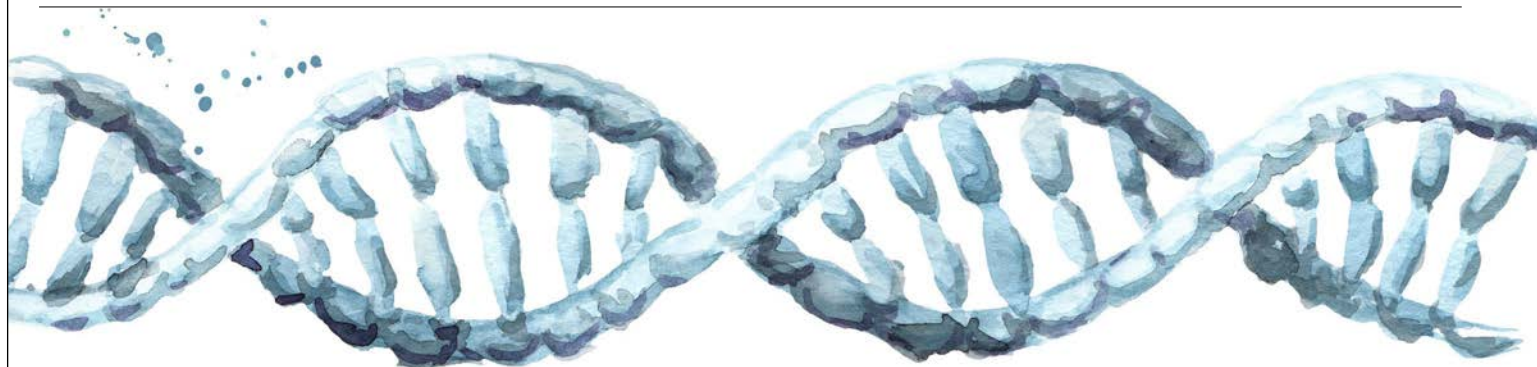
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HOW I INVEST:

Using the strategies of Terry Smith and Nick Train to generate income

John from Ruislip applies the approach used by well-known fund managers to his own portfolio



Following the professionals and mirroring what they do has long been a strategy used by some investors.

John from Ruislip is among that group and follows the strategies of three well-known UK fund managers – Terry Smith, Nick Train and Keith Ashworth-Lord.

He believes ‘they all clearly define their strategies, so they are easy to copy, they act as my mentors’, and has been in contact with all three. Despite being busy he adds they have all been willing to correspond with him directly and give him ‘helpful responses’.

Explaining why he chose those three, John adds: ‘My main goal was to identify a method or methods of investing which were attractive to me in terms of risk to reward ratio. I partially achieved this goal

after the financial crash of 2008 by investing in low risk funds, such as those run by Ruffer and Troy Asset Management, with a track record of preserving capital, although this approach significantly reduced returns.

‘I did not fully achieve my goal until 2011 when I became aware of the type of approach used by Terry Smith which, in my opinion, provides a great deal more upside in return for relatively little extra risk.’

He believes ‘the wisdom of this approach was subsequently confirmed by the success of other fund managers, notably as Nick Train and Keith Ashworth-Lord who, in my opinion, have philosophies which have a lot in common with Terry Smith.’

RELIANCE ON PENSIONS

John is semi-retired and his

wife is retired. Most of their income is from work-related pensions and from one of his SIPP's, and occasionally he cashes in investments accumulated outside of their pensions to supplement their income.

His state pension starts this year at the same time as his mortgage is paid off, and he says this will mean that he will no longer have to sell any investments to generate income, unless making large one-off purchases such as buying a car.

John doesn't have any particular investment goals in terms of money saved or things he might want to own, but rather, with a professional background in the biotech sector as a biological scientist, he sees investing as ‘something akin to a scientific challenge’.

PERSONAL INVESTMENTS

In his portfolio at the moment are open-ended funds or investment trusts run or overseen by Smith, Train and Ashworth-Lord – including **Fundsmith Equity (B4Q5X52)**, **Lindsell Train UK Equity (B18B9X7)** and **CFP SDL Buffettology (BFOLDZ3)** – and John believes the ‘type of buy and hold approach used by these fund managers provides an attractive risk to reward ratio’.

He also holds individual shares selected by the above managers in their own funds, held directly to avoid fund management fees, as well as shares of small to medium sized companies selected by applying the methods of the managers.

In some cases these companies are too small to be included in their funds, he says, but believes they ‘also provide a good risk to reward ratio’.

LIFE SCIENCE INTEREST

Two of the stocks he highlights are life science research tools supplier **Abcam (ABC:AIM)** and antibodies developer **Bioventix (BVXP:AIM)**, and he believes both their business models are ‘attractive for a number of reasons’, including the fact their products are consumables ‘so they generate a lot of repeat business from the same customers’.

Both Bioventix and Abcam produce reagents (typically antibodies), he explains, which in the case of Abcam are used to produce its own tests/assays and are also widely sold for researchers to produce their own tests/assays. In the case of Bioventix these reagents are

supplied to other companies for use in their commercial tests/assays.

On Abcam, he believes sales are distributed ‘over a huge number of customers (it has been described as the Amazon of research antibodies) so there is little reliance on any one customer’.

The markets for these products are growing steadily as the role of biotechnology in developing new products increases, he explains, and John believes the response to the Covid-19 pandemic ‘is a good example of how biotech can be used to develop products to solve particular problems in the medical field.’

YEARS OF EXPERIENCE

John has been investing for more than 35 years and while he has some success, there have also been some investments which haven’t worked so well.

Regarding these, John provides a cautionary tale. He says: ‘My worst investment decision was to believe the CEO of a speciality

pharmaceutical company who, at a press conference in 2002, painted a very positive picture of his company’s prospects and this was one reason why I increased my investment in the company.

‘Unknown to the market, it seems he was involved in last-ditch attempts to renegotiate the company’s banking covenants owing to the company’s debt burden becoming unmanageable. The market was shocked when the company went into administration a few months later.

‘I learnt two very important lessons from this loss. Firstly, I take anything said by a company’s management with a large pinch of salt no matter how convincing they sound and secondly, I do not invest in companies which have a significant amount of debt. These lessons have been very valuable.’



By Yoosof Farah
Reporter

WOULD YOU LIKE TO FEATURE AS A CASE STUDY IN SHARES?

We are looking for individuals or couples who can discuss their experience with investing and some details about their portfolios.

Anyone interested should email editorial@sharesmagazine.co.uk with ‘case study’ in the subject line.

DISCLAIMER: Please note, we do not provide financial advice in case study articles and we are unable to comment on the suitability of the subject’s investments. Individuals who are unsure about the suitability of investments should consult a suitably qualified financial adviser. Past performance is not a guide to future performance and some investments need to be held for the long term. Shares’ editor Daniel Coatsworth has a personal investment in Fundsmith Equity referenced in this article.

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Understanding what really represents a 'strong' balance sheet

It's not just about a strong metrics, but having the optimal amount of funds in place to support the growth of a business

Following on from [our two-part](#) look at the income statement we now focus on the balance sheet, again in two parts.

Many companies state they have a 'strong' balance sheet, almost hoping that shareholders will take it as read and move on. In this article we will explore the factors that actually determine balance sheet strength and look at the financial consequences.

WHAT ARE ASSETS AND LIABILITIES?

Assets are what a company owns, and liabilities are what a company owes. In other words, assets represent value to a company while liabilities are obligations and detract from asset value.

Long-term assets, also called fixed assets include physical assets such as land, plant and equipment. Short-term assets include inventories, cash on deposit and debtors, which are outstanding invoices, representing money owed to a company.

Accounting convention defines short term as a period under a year.

These days intangible assets often represent a large

proportion of fixed assets and include patents, copyrights, brands, customer relationships and proprietary knowhow.

Tangible assets are easier to account for than intangible assets because they have a finite life and a market resale value while intangible assets can be considered indefinite or definite and are harder to pin a value upon.

Fixed assets are purchased with cash or borrowed money and then depreciated over their estimated useful lives.

Depreciation is a non-cash expense which goes through the profit and loss account.

Accumulated depreciation reduces asset values over time and therefore the value of fixed assets is effectively gross asset value minus accumulated depreciation.

INTANGIBLES

Intangible assets are treated differently, costs associated with acquiring patents or spending on advertising are expensed through the profit and loss account when they occur.

But the value of these assets doesn't always appear on the balance sheet.

If a company can associate

specific development costs with expected future cash flows, then those costs are capitalised and appear on the balance sheet.

They are then amortised over their expected useful life. Software companies often capitalise rather than expense development costs.

GOODWILL

While goodwill is also an intangible asset it only appears on the balance sheet in relation to past acquisitions and represents the premium paid over book value of the acquired assets.

Unlike intangible assets like patents and licenses which can be sold separately, goodwill cannot be sold or purchased independently of the business and has an indefinite useful life.

However, goodwill can be written off when a company recognises that the premium it paid was a mistake. Some of the biggest losses in history relate to writing off of goodwill.

For example, when Time Warner purchased AOL for \$165 billion in 2001 it was the largest corporate transaction up until that time. A year later it wrote-off the attributable

goodwill resulting in a net loss of \$99 billion. This was a non-cash charge but did result in a fall in asset value.

LIABILITIES

On the other side of the balance sheet are a company's short and long-term obligations.

Long-term liabilities include multi-year borrowing facilities while short-term items include bills that the company

hasn't settled yet, referred to as creditors.

You might have wondered why shareholders' equity appears on the liability side of the balance sheet and it's because it represents the amount which in theory would be returned to shareholders if a company's assets were liquidated and its debts repaid.

Every balance sheet must balance which means the total

value of a company's assets must equal the value of its liabilities plus shareholder's equity.

SOLVENCY AND LIQUIDITY

Now we have discussed the main items on the balance sheet we can start to define strong and weak balance sheets.

There are two categories of risk, the first is short term in nature and the second is longer term. Not having

WHAT A STRONG BALANCE SHEET REALLY LOOKS LIKE

Fictitious company, Careful Plc, has current assets of £30 million and fixed assets of £40 million of which £10 million are intangible.

Long-term debts are £10 million, and shareholders' equity is £50 million.

We could say with some confidence that Careful plc

possess a strong balance sheet. Let's examine why.

The debt to assets ratio, also called the leverage ratio measures the proportion of assets that are financed by debt. Banks and creditors use this ratio to determine the amount of debt a company can afford.

Almost without exception, higher leverage leads to higher risks of a company failing to meet its long-term obligations.

This doesn't mean a company is in immediate trouble, but without remedial actions poor solvency measures are more likely to lead to bankruptcy.

Industries with more dependable cash flows like utility companies can sustain higher levels of leverage, so as ever, business context is important.

Careful Plc has a debt to assets ratio of 10/70 or 14%, a very comfortable position. This means that 86% of its assets are financed by equity.

Some value investors prefer to focus on tangible assets because they consider tangible value more certain and also banks generally only lend against tangible assets.

On this measure, debt to tangible assets increases to 10/30 or 30% which is still

Example Balance Sheets

	Careful Plc	Reckless Plc
Fixed Assets		
Plant and Machinery	30	15
Intangibles	10	15
Current Assets		
Inventories	15	10
Accounts receivable	10	15
Cash (E)	5	0
Total Assets (A)	70	55
Long Term Liabilities	10	30
Current Liabilities	10	20
Total Liabilities (B)	20	50
Shareholders' Equity (A-B)	50	5
Total Liabilities+Equity	70	55

Source: Shares

Continues on the next page

comfortable.

Looking at the proportion of equity to debt financing, the gearing ratio is a very modest 10/50 or 20%. This means that shareholders' equity covers debt five times.

Leverage and gearing ratios below 50% are considered healthy while values above 75% are riskier. Also relevant is the amount of equity in relation to total assets. A value below 30% is considered risky.

Looking at liquidity the current ratio gives a good picture of a company's ability to meet short term obligations. It is defined as current assets divided by current liabilities. Careful Plc has a ratio of 2.5 which is very comfortable.

A ratio below 1.5 is considered tight and below one could indicate cash problems. As we have mentioned before in this

series, looking at the trend is more informative than single years.

The quick ratio shows a company's ability to pay its current liabilities without needing to sell inventory and is therefore a more conservative measurement of liquidity.

Careful Plc is in a strong

position to pay all its short-term debts while Reckless Plc would struggle to do so without selling inventory.

Reckless Plc is in a precarious position financially because it has too little equity and too much debt financing its assets. Debt to equity of 600% is considered dangerously geared.

Ratio analysis

	Careful Plc	Reckless Plc
Solvency Ratios		
Debt to Assets	14%	55%
Debt to Tangible Assets	17%	75%
Debt to Equity	20%	600%
Equity to Total Assets	71%	9%
Liquidity Ratios		
Current Ratio	2.5	1.25
Quick Ratio (Acid Test)	1.5	0.75

Source: Shares

enough liquidity to run current operations and service debts is called liquidity risk.

The second category is known as solvency risk and concerns the ability of a company to meet its long-term obligations.

When a company is solvent, technically it means the value of assets is greater than liabilities. In other words, it has a positive 'net worth' or book value.

It implies that a company can meet all its long-term obligations even if it had to liquidate all its assets.

Liquidity on the other hand refers to short term financing requirements. Even the most solvent company can run into liquidity problems if it doesn't

manage its short-term cash flows properly.

One high profile casualty of short-term cash mismanagement is Bargain Booze and Wine Rack owner Conviviality which went to the wall because it couldn't pay its £30 million VAT bill.

When a company can pay off its current liabilities with its current assets it has adequate liquidity to fund current operations and service debts.

There are specific ratios that investors use to help determine adequate or safe levels of solvency and liquidity.

Solvency ratios include debt-to-assets, also called the leverage ratio, debt-to-equity, sometimes called the gearing ratio, and

interest coverage.

Commonly used liquidity ratios are the current ratio and quick ratio, also known as the acid test, because it has stricter parameters.

Next week we look further at balance sheet strength by incorporating cash flow measures including EBITDA (earnings before interest, taxes, depreciation and amortisation).

We also look for more red flags by analysing working capital trends and how long it takes a company to collect cash.



By **Martin Gamble**
Senior Reporter



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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

1 February: Porvair. **2 February:** BP, IDOX, Sureserve. **4 February:** Royal Dutch Shell, Unilever.

Half year results

1 February: Hargreaves Lansdown. **2 February:** Filtronic, NWF. **3 February:** Frontier Developments. **4 February:** Alumasc, Barratt Developments, NCC, Renishaw.

Trading statements

29 January: Airtel Africa, Evraz, Paragon Banking, Stenprop. **2 February:** SSE. **3 February:** GlaxoSmithKline, Vodafone. **4 February:** BT, Compass, Cranswick.

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