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The reaction to Biden's tax plan is overblown

Proposed increases to capital gains tax aren't as big a threat as some suggest

The latest tranche of Biden's tax plan is provoking wails of protest on Wall Street. Proposals to boost capital gains tax have prompted warnings of a big market downturn in the US and already sparked some weakness in shares.

The argument is that people will sell their stocks ahead of any tax increase, causing the market to crash. In turn this will have an impact on the real economy and lower living standards for ordinary Americans.

Beyond this short-term risk there are fears it would encourage the wealthy to spend today and not invest their cash for the future, which could have a negative impact on the health of the economy longer term.

Set against this situation is the fact higher tax rates should help to pay for big spending on infrastructure to make the US fit for the 21st century.

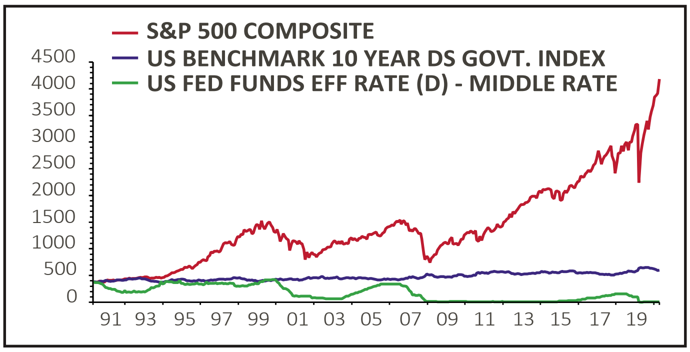
The Biden tax plans are certainly a risk to watch but there are a few things to consider before we get too concerned.

NO REASON TO PANIC

First, the increase to capital gains tax itself is worth keeping in perspective – the idea is to tax people earning more than $1 million a year 39.6% on capital gains, around twice the current level.

This is certainly a big hike but one affecting a relatively small section of the population and not totally out of whack with where the rate has been historically.

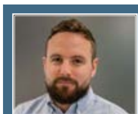
Second, this move, and the other increases to



corporation tax which have been trailed, are not in their final form. They still need to get past US lawmakers and while both houses of Congress are in the Democrats' hands, their control of the Senate is razor thin (relying on vice-president Kamala Harris' casting vote) and there are conservative members of the Democratic party who may well seek to soften the tax blow.

Think of what's been reported so far as the opening pitch, not the final settlement. Finally, the idea of mass-selling of stocks seems unlikely.

With rates set to stay low and some assets out of favour such as bonds, where else are wealthier individuals going to put their cash to earn a decent return than stocks and shares? Tax changes may make a difference at the margin but stocks' ability to deliver outsized returns over the long run should prove persuasive.



By **Tom Sieber** Deputy Editor

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News Provider of the Year (Highly Commended) CFA UK Journalism Awards 2020


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Global chip shortage threatens industrial growth forecasts

Second quarter output may disappoint but for some there is a silver lining

An unusual and unexpected side effect of the pandemic has been the strain on the global supply chain in manufacturing as products and parts made in far-clung parts of the world have been delayed reaching customers.

Added to this, a shortage of containers has sent freight rates sky high so not only are manufacturers facing shortages of parts but their input prices are rising sharply as well.

A growing number of UK firms are referencing increased costs in their first quarter trading updates with the warning that they are likely to face more of the same this quarter.

In Germany, the latest Ifo survey of business confidence for the next six months missed expectations due to a mixture of concerns over coronavirus and supply constraints.

A record 45% of manufacturing firms reported supply chain shortages, the highest level in 30 years. Ifo president Clemens Faust referred to the squeeze as 'a serious problem' which could hold back the economic recovery.

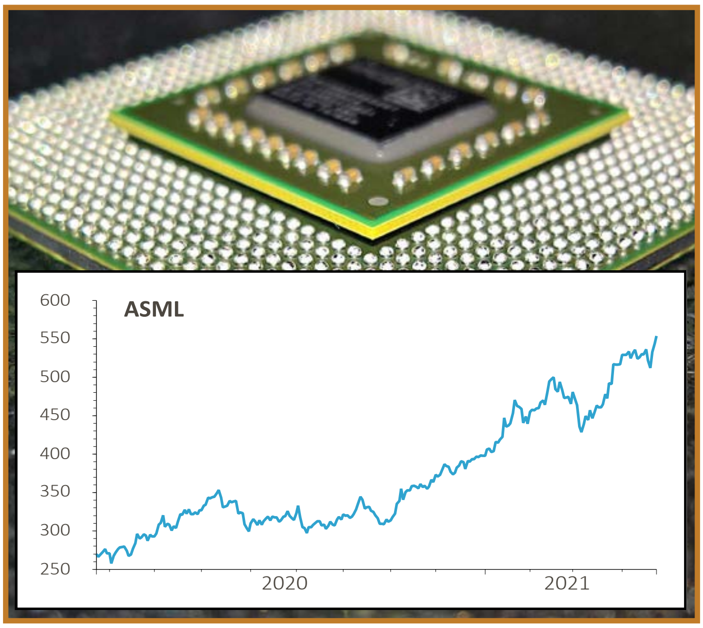
CHIPS WITH EVERYTHING

One of the biggest issues is a global shortage of computer chips, as some Asian firms slowed down or even stopped production at the start of the pandemic.

Meanwhile, the trend towards remote working has driven up demand for home PCs and laptops, and at the same time car makers have been increasing production of electric vehicles, which use several times more chips than normal vehicles.

Carmakers around the world have had to slow production in the last few weeks, with Jaguar Land Rover, Jeep and Mitsubishi idling plants or putting workers on short-term hours and laying off temporary staff as the try to deal with the shortage.

German giant Volkswagen recently warned there would be 'considerable challenges' in meeting its production targets this quarter. It has already had to cut manufacturing by 100,000 vehicles and is unlikely to be able to make up the lost output this year, according to chief executive Hubert Diess.



Mike Jackson, chief executive of Autonation, one of the largest car dealerships in the US, says he sees 'no end to the chip shortage this year', meaning deliveries of new car sales will fall short. Autonation has already had to fall back on used car sales to meet demand.

One firm which could benefit from the squeeze is Dutch semiconductor equipment maker ASML. The firm is a world leader in chip-making machines, and is a key supplier to big manufacturers like Nvidia, Samsung and TSMC.

Last week the firm raised its full year sales growth forecast from between 10% and 15% to around 30% due to increased demand for its machines, sending its share price to a new high of €550. [IC]

Superb figures from Alphabet and Microsoft leave Tesla in the shade

Investors react to the latest updates from big tech names

Both Google-owner Alphabet and software titan Microsoft beat market expectation with their latest quarterly earnings.

The performance helped to boost global stock market sentiment and demonstrated that despite the rotation out of growth into value stocks, areas of the technology growth space remain operationally buoyant in the wake of the pandemic.

Alphabet sees bumper profit growth post-Covid ($ billion)

Source: Alphabet • Created with Datawrapper

Results from Alphabet were particularly impressive with earnings way ahead of forecasts. The digital shift has accelerated across a variety of sectors helping online advertisements, where Alphabet is the market leader, to take a greater share of the overall global advertising spend.

This means the company is well positioned as economies recover and spending on advertising begins to increase. In the first three months of 2021, advertising revenue from Alphabet-owned YouTube was up 50% year-on-year and overall, the group saw its strongest earnings growth in eight years.

Alphabet's reliance on advertising is reflected in the fact that it accounted for 81% of first quarter revenue. The risk is that such outstanding results will catch the eye of policymakers and regulators in the US and increase the clamour to put checks on the company's power and influence as it faces up to monopoly lawsuits from several different parties including the US government.

REINVENTION OF MICROSOFT CONTINUES

Growth in cloud computing as businesses have had to show flexibility amid Covid restrictions helped Microsoft to a smaller but still material beat of earnings estimates.

In the run up to the numbers the company had been on the acquisition trail, buying speech recognition technology Nuance Communications for $16 billion earlier in April and gaming play Zenimax for $7.5 billion in October 2020.

This shows the reinvention of the business under Satya Nadella is set to continue. Since taking over in 2014, Nadella has helped revive the fortunes of a company which had lost its way after dominating the personal computing explosion of the 1980s and 1990s, and made the business fit for the 21st century. Since his appointment the share price has increased nearly seven-fold.

TESLA DISAPPOINTMENT

While quarterly earnings from Tesla on 28 April of 93c per share were also well above Wall Street's forecast of 80c the market reaction was negative, reflecting the fact this was a poor-quality beat driven by sales of environmental credits and bitcoin, and not cars.

Analysts were disappointed with the company's electric vehicle sales, which were a shade below estimates, and the lack of a specific target for 2021 deliveries. Tesla merely said it expected to grow production by 50% 'over a multi-year horizon'. [TS]

Copper predicted to reach $15,000 as metal hits 10-year high

The commodity is set to be in high demand this decade as the world transitions away from a fossil fuel world

Copper has been predicted to hit $15,000 per tonne by analysts at Goldman Sachs, up from its current level of around $9,700, as demand soars and supply fails to catch up, with the metal reaching a 10-year high on 26 April.

In a report titled 'Copper is the new oil', the Goldman analysts say there is 'no decarbonization without copper' and add that they expect demand to increase by up to 900% to 8.7 million tons by 2030 if there is widespread use of renewable energy and electric vehicles.

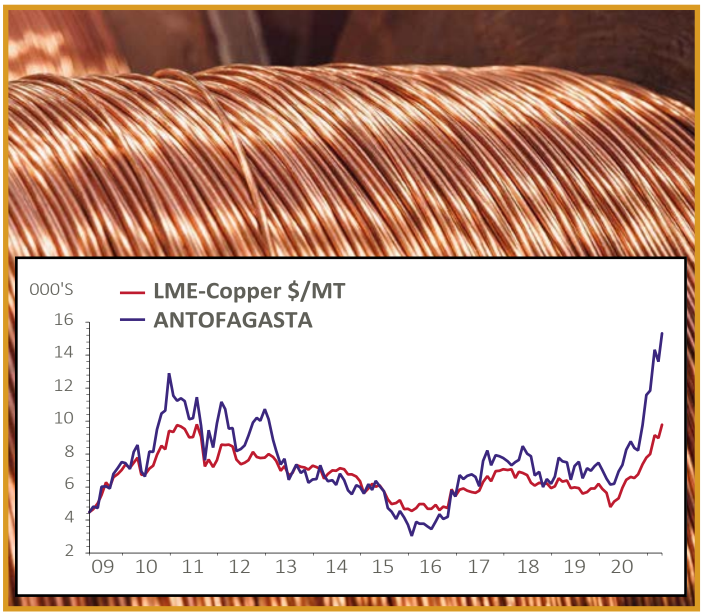
The report says: 'Discussions of peak oil demand overlook the fact that without a surge in the use of copper and other key metals, the substitution of renewables for oil will not happen', with copper critical for a wide range of renewable energy infrastructure including solar panels and wind turbines.

However, the analysts add that not enough attention has been given to this on the supply side, meaning there are likely to be capacity constraints in the coming years, noting that the copper price has risen 80% in the past year but that there hasn't been a matching rise in production output.

Goldman earned some credibility in the commodity markets in the late noughties when it was the first to predict that oil prices would hit $100 per barrel.

Copper has already been expected to do well ahead of the reopening thanks to its status as a bellwether metal for the global economy due to its wide range of uses.

Concerns about supplies from Chile – one of the world's top producers and home to FTSE 100 pure play copper miner **Antofagasta (ANTO)** – as well as sliding inventories, a lower dollar and expectations of stronger demand from top consumer China all



triggered recent buying by commodities traders.

Also helping sentiment has been US president Joe Biden's $2 trillion infrastructure plan, in which renewables are set to play a big part. Copper is seen as so important to the plan billionaire miner Robert Friedland, who owns mining giant Ivanhoe Mines, told a copper conference earlier this month that finding enough of the metal could become a national security issue in the US.

The 10-year high helped push Antofagasta's share price up almost 4% at the start of the week, while an exchange-traded fund which tracks the copper price, **WisdomTree Commodity Securities ETC (COPA)**, gained around 2%.

Antofagasta's shares are close to trebling since hitting a low after the market sell-off last March and have more than doubled compared to their pre-pandemic level. The WisdomTree copper ETF has also doubled since its March 2020 lows and is also significantly above its pre-pandemic level. [YF]

Get the lowdown on Wickes after its demerger

DIY retailer starts trading as an individual entity after being spun out of Travis Perkins

Shares in DIY retailer **Wickes (WIX)** have begun trading (28 Apr) as a stand-alone business on the London Stock Exchange (LSE) following its Covid-delayed demerger from **Travis Perkins (TPK)**, a deal which saw the erstwhile parent's shareholders receive one Wickes share for each Travis Perkins share owned.

Wickes operates in a fragmented and structurally growing market, yet home improvement is also fiercely competitive and the company is lapping tough comparatives, while delivery costs are weighing on margins.

Wickes – Group sales on an improving trend (£ million)

Source: Company, Liberum Capital estimates • Created with Datawrapper

DIY BOOM

Like-for-like sales grew by 5% in 2020 as Wickes rode the stay-at-home DIY boom alongside rivals such as **Kingfisher's (KGF)**, while like-for-like sales rose 19.7% in the first quarter of 2021.

Admittedly, the helpful work-from-home trend has peaked. However DIY activity could remain robust given the focus consumers now place on their homes.

As Wickes' CEO David Wood recently explained, the past year has 'prompted many of us to think differently about our how we use our homes, and as a result, we are seeing strong demand from customers who are looking to make changes to their living spaces'.

Trade sales should recover into 2021 as the strength in housing transactions looks set to continue. Wickes should also profit from pent-up 'Do It For Me' (DIFM) demand as consumer confidence improves and excess savings are

redeployed into big ticket kitchen and bathroom purchases.

DIGITAL DISRUPTOR

Liberum Capital notes that Wickes' transformation since 2013 has driven sales growth of 2-3%, roughly in line with the 2.5% growth of the wider home improvement market. And during this time, the retailer's digital proposition has been 'significantly improved and the estate partially refitted'.

Over this period, Wickes sales have grown as the DIFM service proposition and its TradePro mobile app for trade members have gained traction.

In addition, its small store model and engaged workforce have 'underpinned sector-leading margins, and its curated and focused product range give it a sector-leading stock turn', says Liberum.

Despite last year's pandemic disruption, Wickes generated an adjusted operating profit of £82 million on revenue of just shy of £1.35 billion last year. Digital customers almost doubled in 2020, its click-and-collect orders rocketed 450% higher for the year and home delivered sales increased by 120%.

Forecasting a robust 7.5% profits compound annual growth rate for the years 2020-2023, Liberum believes there is upside risk to its estimates 'driven by RMI momentum and self-help'.

Risks include an overhang, if Travis Perkins investors offload shares in the demerged entity in numbers, or a failure of the pent-up demand for kitchen and bathroom installations to translate into the sales Wickes is looking for, leaving profit shy of forecasts. [JC]

Buy payments challenger Equals as it passes the 2020 test

The company has emerged from a tricky 12 months in really strong shape

For most firms, 2020 was difficult enough, dealing with the impact of Covid on their business and managing the shift to remote working.

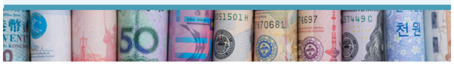
For electronic banking and international payments firm **Equals (EQLS:AIM)**, which offered among its many services pre-paid foreign exchange cards for travellers backed by now-defunct German firm Wirecard, it was even more tumultuous.

Yet with its bank-grade payments connectivity, partnership agreements with firms like Citi and MasterCard, superior customer experience and new product innovations, Equals continues to take market share among from the big banks while at the same time allowing customers to maintain their current banking partners.

We think these attractive dynamics make the shares worth buying with a 2022 price-to-earnings ratio of 20.5 (based on consensus forecasts) fully justified by the growth potential.

The UK payments sector becoming increasingly crowded with small, specialist operators, but Equals stands out for the breadth of its proposition both for businesses and consumers, including real-time settlement accounts with the Bank of England thanks to its

EQUALS GROUP
BUY
(EQLS:AIM) 43p
Market cap: **£77 million**



membership of the UK Faster Payments Scheme.

As individual travel restrictions came into force, the firm redirected its efforts away from the consumer space and towards the business-to-business or B2B market, generating a more than 30% increase in transaction values to £2.84 billion, leading to an 11% jump in B2B revenues to £20.3 million.

That wasn't quite enough to offset the drop in business-to-consumer activity, but it meant that at the year-end total group revenues were only down by 6% to £29 million.

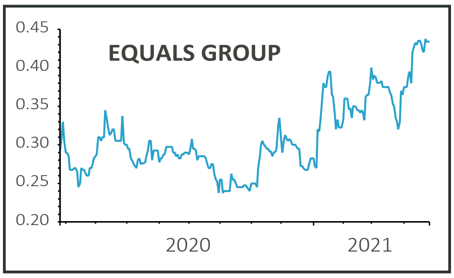
BLESSING IN DISGUISE

Meanwhile, the implosion of Wirecard in June last year due to an accounting scandal was possibly a blessing in disguise, as it pushed Equals to accelerate the development of its own in-house multi-currency card platform which had been in the works for some time.

By October 2020, the firm had completed the work, with both web and app support, and migrated its entire B2C customer base of over 150,000 cards. It was, as chief executive Ian Strafford-Taylor says, 'a remarkable achievement', and it has resulted in a superior platform with a better product and better economics for the firm.

The firm exited the fourth quarter in a cash break-even position, with earnings before interest, taxes, depreciation and amortization ahead of market forecasts, and the first quarter exceeded management expectations. Moreover, as well as being self-funding it has £9 million of free cash on the books, equal to 5p per share, which it can reinvest in the business.

Strafford-Taylor is also confident that, once travel restrictions are lifted, the £4 million to £5 million of revenues which it missed out on in 2020 will return, at no extra cost to the company, giving earnings a major lift. [IC]



Anglo American is an attractive play on electric vehicles and renewables

The miner is gearing up for the next level of growth as it targets commodities in all the right places

The world's shift to renewable energy and electric vehicles is going to require a lot of metals, and one of the best ways to profit from this could well be through FTSE 100 miner **Anglo American (AAL)**.

The mining giant has exposure to an exciting mix of commodities including those currently soaring at the moment – iron ore and platinum group metals – and those with what look likely to be very strong futures such as copper, nickel and manganese.

It also has the Woodsmith potash project in Yorkshire, acquired after buying Sirius Minerals in March last year, which although is a long way off from production could also become a significant revenue generator.

ANGLO AMERICAN
BUY
(AAL) £31.86
Market cap: £43 billion

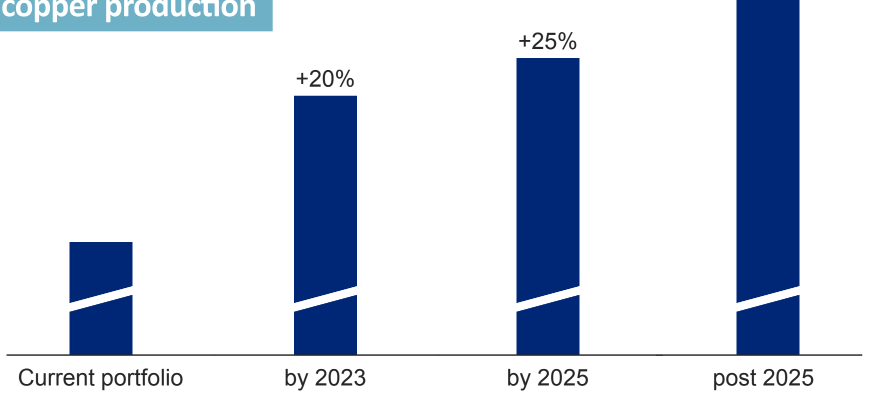
Anglo currently makes more money from iron ore than any other commodity, accounting for 46.5% of its underlying earnings in 2020. Its earnings aren't overly exposed to iron ore however, unlike rivals **Rio Tinto (RIO)**, which derived 76% of its underlying earnings for 2020 from iron ore, and **BHP (BHP)** which made 55% of its earnings from iron ore in the six months to 31 December.

STRONG FUTURE EARNINGS GROWTH

Anglo's shares have already gone up markedly since the iron ore boom started in November 2020, but the scope for continued strong future earnings growth is clear thanks to what could be huge structural demand for commodities including copper, nickel and manganese, metals key for electric vehicles and, in the case of copper and nickel, renewable energy infrastructure including solar panels and wind turbines.

It has a major new copper mine in Peru that is expected to begin production next year, something that should provide a significant tailwind for earnings if

Anglo American forecast increases in copper production



Source: Anglo American

analyst estimates of a 60% rise in the copper price by 2025 prove to be correct.

The miner trades on a price-to-book value of 2.3 times, which is admittedly on the more expensive side, but this is still lower than the 2.9 times Rio Tinto trades on and the 3.2 times level BHP, the world's largest miner, is trading at.

Given it has the same exposure to structural growth commodities as its peers, and none of the ESG issues which have plagued Rio Tinto, the shares look attractively valued on a relative basis.

ESG POSITIVE

One plus point Anglo American has over its London-listed peers from that all-important ESG angle is the disposal of its assets in thermal coal, the 'dirty' kind used for energy unlike metallurgical coal which is a key ingredient in steelmaking.

Its coal assets will be transferred to a separate company called Thungela, which will be listed in London and Johannesburg, and Anglo American shareholders will be awarded one new Thungela share for every 10 Anglo shares they currently hold, essentially meaning investors will be given free shares in a new business.

Anglo is also a solid option for someone looking for income with a forecast 5.5% dividend yield for 2021 with a dividend cover of 2.5 times.

Most of the big diversified miners have enormous levels of cash generation and Anglo American is no different with cash flows from operations of almost $8 billion and attributable free cash flow of $1.2 billion.

RISKS TO CONSIDER

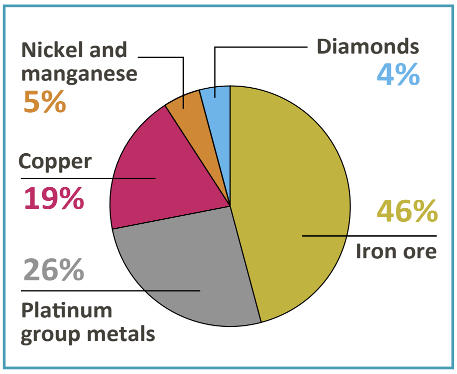
One of the risks with Anglo, like with any large diversified miner, is that share price can move in line with certain commodities, the prices of which can be volatile and go and up down depending on current macroeconomic conditions, so the stock could be better suited for someone with at least a five-year time horizon who is willing to ride out the bumps that come with commodity markets.

One other risk worth mentioning is that through its De Beers unit Anglo American is also the biggest player in the global diamond market, which isn't as positive as it sounds given the diamond market is in a structural decline and is something that could potentially weigh on the company's earnings in the next few years.

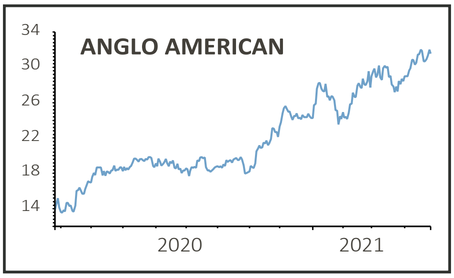
Despite these risks, the company has a lot going for it. It has a strong balance sheet, which includes net debt to EBITDA of just 0.6 times, and given its fixed costs is set to benefit from the cyclical upswing in commodities as economies recover from the pandemic, while it also has a rising exposure to the commodities with the most attractive structural growth profiles.

Analysts have pointed out that with the yield curve steepening and multi-year deficits forecast in key commodity markets, investor preference in mining is likely to shift away from dividend yield and free cash flow – though two areas Anglo does perform strongly, it must be said – towards focusing on the quality of growth in commodities with structural upward trajectories. This should help ensure Anglo American remains an investor favourite for many years to come. [YF]

Anglo American's 2020 earnings breakdown



Source: Anglo American 2020 full-year results



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% Total Return

12 months ending March	2021	2020	2019	2018	2017
Fundsmith Emerging Equities Trust Price	+41.0	-24.7	+2.9	+5.0	+17.6
AIC Global Emerging Markets Sector	+45.6	-24.1	+0.2	+6.6	+31.4

Source: Financial Express Analytics

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RWS

(RWS:AIM) 696P

Gain to date: 30.3%

Original entry point:

Buy at 534p, 23 December 2020

LEADING LANGUAGE services and technology group **RWS (RWS:AIM)** reported good progress on the integration of SDL at the interims (22 April), saying it had identified over £32 million annual cost synergies, more than double those initially stated at the time of the acquisition.

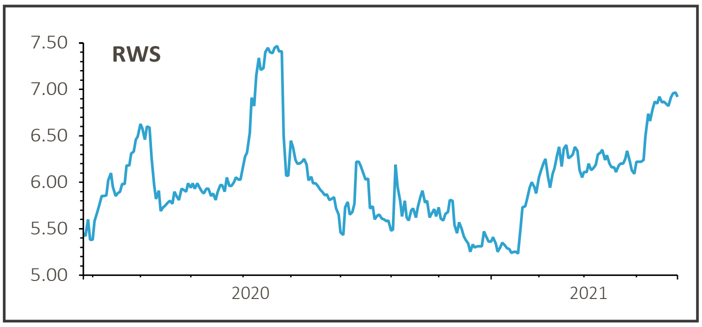
Plans are in place to deliver £13.2 million of those savings in the current financial year by removing overlapping costs.

In the first-half the company generated revenues of £326.4 million compared with £169.7 million in the prior year, in line with expectations.

The group expects to report adjusted pre-tax profit of at least £50 million in the first half compared with £31.1 million, ahead of its expectations.

Growth was achieved across all four of the recently formed divisions with the Regulated Industries segment achieving double digit revenue growth in constant currencies, driven by strong growth to the group's largest pharmaceutical business.

Analysts have been steadily increasing their earnings estimates since the start of the year according to data provided by Refinitiv.



SHARES SAYS:

The company's habit of overdelivering against conservatively set goals, and the current momentum within the business should be positive for the shares. [MG]

FOCUSRITE

(TUNE:AIM) £12.09

Gain to date: 75.9%

Original entry point:

Buy at 687p, 23 July 2020

GLOBAL MUSIC and audio products company **Focusrite (TUNE:AIM)** continued its impressive growth in its first half achieving a 91% increase in revenue to £95.3 million and a 310% increase in adjusted operating profit to £26.3 million.

Organic constant currency revenue growth was 64.3%, reflecting record consumer demand across the company's Focusrite, Novation and ADAM Audio ranges from home-based amateurs and professional recording artists alike.

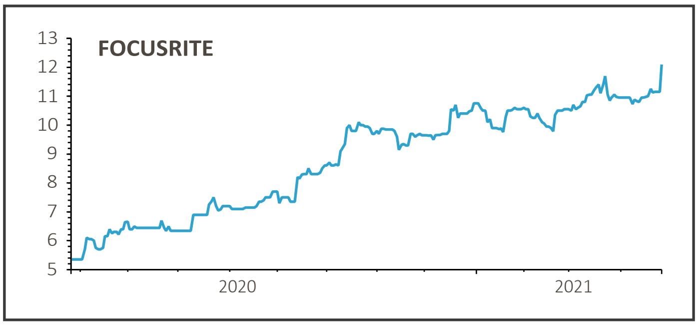
Chief executive Tim Carroll told *Shares* that he was more confident the firm's growth reflected underlying demand for the products rather than a one-off boost from the pandemic.

The company announced its third acquisition (27 April) under Carroll's watch with the addition of California based synthesiser company Sequential LLC for $24 million.

Sequential is a world-renowned, high-end synthesizer company with a strong brand and heritage which will continue to be run by founder and Grammy winner Dave Smith and his team.

The acquisition expands the footprint of Focusrite's electronic business under the Novation brand.

Focusrite launched Optimal Audio on 21 April serving the commercial audio market for producing music in workplace settings like restaurants, universities and nightclubs.

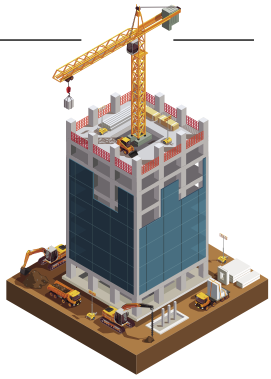


SHARES SAYS:

Keep buying. [MG]

MORGAN SINDALL
(MGNS) £22.80

Gain to date: 19.6%
Original entry point:
Buy at £19.06, 15 April 2021



RECENTLY ADDED *Great Idea* **Morgan Sindall (MGNS)** is off to a flier as a trading update on 22 April saw the construction and regeneration specialist guide for full year performance 'significantly ahead' of expectations.

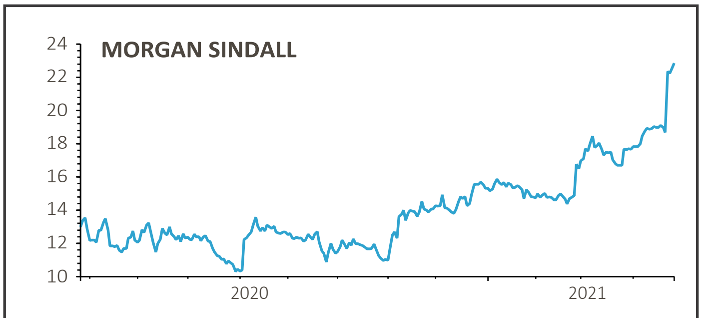
According to the update which covered the first three months of 2021, the company said all divisions made 'positive operational and strategic progress' in their markets and momentum across the group has continued to increase.

Based upon this situation and current forecasts to the year end, Morgan Sindall said the average daily net cash for the full year is now expected to be in excess of £180 million, also 'significantly ahead' of previous guidance.

We felt the company's robust financial position would leave it well placed to benefit from reopening and this already appears to be the case.

Reassuringly, chief executive John Morgan tells *Shares* there will be no change to the company's successful strategy of focusing on organic growth and maintaining a strong balance sheet.

Numis responded to the trading update by raising its pre-tax profit forecast for 2021 by 17%.



SHARES SAYS:
Keep buying the shares. [TS]

ANEXO
(ANX:AIM) 133P

Gain to date: 0.8%
Original entry point:
Buy at 132p, 20 August 2020

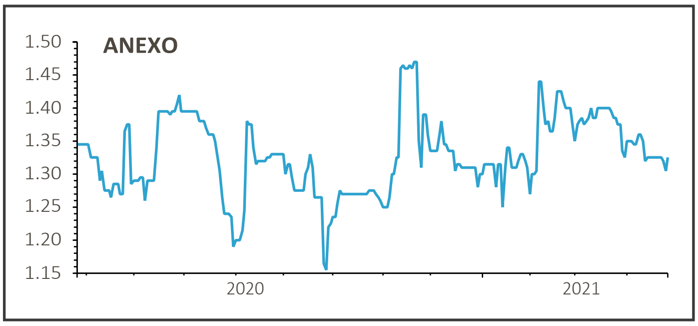
ALL SUCCESSFUL investors regularly review their holdings to ensure that the investment case is still solid and each stock deserves its place in their portfolio.

With this in mind, our 'spring clean' process has thrown up credit hire and legal services firm **Anexo (ANX:AIM)**, which we picked in August 2020 and has gone absolutely nowhere in the meantime.

The firm had been an AIM star, consistently raising guidance through 2019, and while the pandemic caused a drop in traffic in the first half of 2020 we expected a recovery in the second half, which combined with the firm's move to net cash generation should have lit a fire under the shares.

Investors disagreed and the shares continue to languish where we bought them. We may not have incurred a loss, but the opportunity cost has been high – the FTSE 100 is up more than 15% since mid-August and the FTSE 250 is up 29% at record highs.

We had hoped the full year results (27 Apr) might change perceptions, but despite better revenue, increased cash generation and further progress in its legal business, investors remain unconvinced, meaning it's time for us to wave the stock goodbye.



SHARES SAYS:
Investors should weigh the opportunity cost of holding onto stocks which underperform. [IC]

RISING PRICES

The investments to benefit from a higher cost of living

By **Steven Frazer** News Editor

Investors spent 2020 worrying about Covid-19 but as vaccines rollout and economies begin to gradually reopen, equity markets are getting increasingly jumpy about a new threat - inflation.

Investors should not treat these warnings lightly. The most obvious response to rising inflation for central banks (the Bank of England in our case) is to reverse 'lower for longer' interest rate trends, making borrowing more expensive for businesses, increasing mortgage payments and leaving us all with less to spend, save and invest.

These are big picture issues that may leave individual investors feeling helpless but you can prep your portfolios to give yourself a level of protection. We also suggest five stocks with sufficient growth levers, pricing power and inflation protection to do well even if prices start to rise sharply.

IS RISING INFLATION INEVITABLE?

In simple terms, the market is worried that trillions of dollars of government-backed stimulus, record low interest rates and millions of consumers with surplus cash eager to get out and about again, could unleash a wall of spending that forces prices up, and frees the inflation beast from three decades of hibernation.

Inflation has been out of mind for so long that it is easy to forget the savage economic hardships of say, the 1970s, 1980s and early 1990s in the UK. In the 1980s, for example, double-digit

Global inflation rate, 2015-2025

2015	2.71%
2016	2.69%
2017	3.22%
2018	3.59%
2019	3.51%
2020*	3.18%
2021*	3.39%
2022*	3.18%
2023*	3.14%
2024*	3.15%
2025*	3.17%

Source: IMF, World Economic Outlook Database October 2020 *forecast inflation was only cut by a savage recession during which unemployment rose to its highest level since the Great Depression.

'Moderate inflation is generally good for equities because it tends to be associated with positive economic growth, rising profits, and stock price gains,' says Schroders market strategist Sean Markowicz.

But things can quickly turn ugly for stock market investors if the economy overheats and inflation runs wild. The Bank of England base rate hit 14% in 1990, making life more expensive for consumers and businesses, and subduing company profits and dividends.

'Months of rising inflation are associated with lower relative real equity returns and one needs to understand that inflation raises the cost of capital and introduces volatility, making decision making more difficult for companies,' said Peter Garnry, head of equity strategy at Saxo Bank.

'The green transformation and ESG trend (environmental, social, governance) will also add to inflationary pressures as it's more costly to expand both non-renewable energy sources and mining capacity in the much-needed metals for the electrification of society.'

WHERE WE STAND NOW

Inflation in the UK is measured by the consumer prices index, or CPI, a theoretical basket of readily available goods and services, such as food, clothing, rent, transport, healthcare and much else. If homeowner mortgage costs are included the index is called the CPIH (H for housing).

Most recent CPI data showed price inflation rose 0.7% in March from a three-month low of 0.4% in February. The consensus expectation had been for inflation to rise to 0.8%, according to Howard Archer, chief economic advisor to the EY ITEM Club.

'Inflation was primarily lifted in March by higher fuel prices,' Archer said. Oil prices had fallen significantly early on in 2020 and the latest year-on-year increase was magnified by oil prices hitting a 13-month high in March. Small increases were seen in clothing prices and some household goods, versus falls in food prices.

'Inflation also continued to be held down by the temporary VAT cut from 20% to 5% introduced last July for the hospitality sector, hotel and holiday accommodation and admission to certain attractions,' said Archer.

Rather than something to worry about, March data is a source of optimism, according to Ian Warwick, managing partner at Deepbridge Capital. 'The inflation data is further evidence that the economy is moving in the right direction,' he said, and CPI is still way below target. This is not the kind of embedded, long-term inflation that will cause sleepless nights for anyone at the Bank of England.

WHAT'S IN THE CPI BASKET?

In March the consumer price index basket of goods was changed, including things like electric and hybrid cars, hand hygiene gel, men's loungewear bottoms and smartwatches. Staff restaurant sandwiches and gold chains were among the items removed.

The weight of different categories

Food & non-alcoholic beverages	8.9%
Alcohol & tobacco	3.5%
Clothing & footwear	5.9%
Housing & household services	32.8%
Furniture & household goods	4.9%
Health	2.0%
Transport	10.7%
Communication	1.9%
Recreation & culture	11.2%
Education	3.0%
Restaurants & hotels	6.9%
Miscellaneous goods & services	8.3%

Source: ONS

HOW BIG A THREAT IS RISING INFLATION?

Market strategists at broker Canaccord Genuity, however, say that the 'starting point matters enormously.' This time last year the pandemic caused inflation to collapse all over the world, setting a very low comparison threshold for this year's prices.

'As a result of lockdowns, partial re-openings and supply chain issues, many bottlenecks have emerged which will inevitably cause certain prices to rise,' the Canaccord team said. 'It doesn't take much more than that for the market to expect soaring inflation, and hence the prospect of the US Federal Reserve stemming it by raising interest rates.'

'Rising interest rates are likely to create a downward adjustment of equity valuations in the most speculative growth segments as we observed in late February and early March, and as vaccinations are rolled out and the US economy re-opens, it will be in a situation of very high stimulus and no output gap,' says Saxo's Garnry.

Iain Pyle, investment director at **Shires Income Trust (SHRS)**, remains relaxed, however. 'At the levels we are looking at it is of limited threat,' he believes, pointing out US inflation projections of 2.5% five years from now.

'This kind of inflation is relatively healthy for an economy and it would need to be higher before central banks stepped in to take action and slow economic growth.' The Fed has already explicitly stated they will let the economy 'run hot' for a while with the view inflation will be transitory, the manager says.

WHAT ABOUT THE US

While the Fed has steadfastly confirmed that it will not raise interest rates for years (2023 at the earliest), it has not ruled out tapering its asset purchases.

'Given that government bond yields have soared this year, from 0.9% to nearly 1.7% for the US 10-year bond and from 0.19% to 0.82% for the UK 10-year gilt, markets are concerned that this could spark another 'taper tantrum' as bond yields soar further and trigger a bigger correction in equities,' says Canaccord's analysts.

The Fed's inflation gauge - the Core PCE (Personal Consumption Expenditures) Price Index - has been consistently below the Fed's target of 2% during the whole of the last economic cycle, according to Canaccord, with a couple of brief exceptions. Going forward, inflation targets will be a more fluid range based on rolling averages over longer periods rather than the absolute numbers of the past.

'Given that Core PCE has lagged its 2% target for 12 years, the Fed is saying it would be willing to wait for a few years with inflation above the 2% target before stepping on the brakes,' says Canaccord, but markets are unconvinced and look for signs that a spike in prices will cause an interest rate rise soon.

'It is inevitable that we will see some nosebleed inflation readings in the next few months, but unless they are sustained for the whole year at least, it is unrealistic to expect that the Fed's interest rate policy will be reversed so soon after announcing it,' says the Canaccord team, especially given that the last Fed policy lasted 40 years.

The question is, will markets pay attention to what the Fed says and does, or will they keep expecting the worst, which will mean more volatility for share prices. 'Eventually, markets will get the message, but there could be some moments of extreme concern caused by inflation tantrums,' believe Canaccord's equity strategists.

INFLATION EQUITY HEDGE

Inflation-linked bonds can offer better protection from increased inflation, although the returns on offer may be pretty dismal. Gold and certain commodities, copper say, are also generally geared to higher prices. These investments can be woven into a balanced investment portfolio meaning an inflation spike need not be wealth-destroying for investors.

'For equities, the impact is modest on overall valuation as they are a natural hedge to inflation with rising prices leading to higher earnings and cash flow,' says Shires' Iain Pyle. On the other hand, this may be offset by a contraction in profit margins given an increase in companies' input costs.

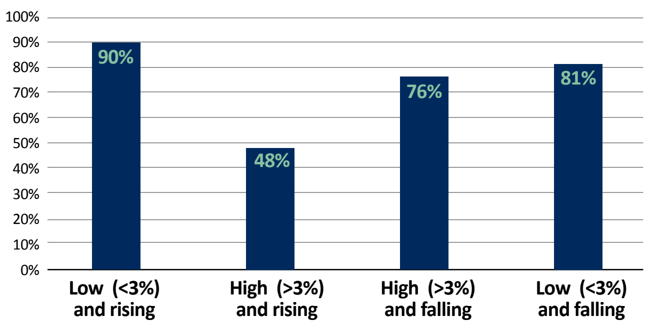
In practice, the impact of inflation on earnings will vary by economic sector and its ability to pass on higher input costs to end consumers. As long as input costs do not increase at the same rate as revenue the rise in profit margins should translate into greater nominal earnings.

'The problem is that the market will often discount those future cash flows at a higher interest rate when inflation rises, to compensate for the fact they are worth less in today's money,' says Schroders' Sean Markowicz. All else being equal, the higher the level of inflation, the greater the discount rate applied to earnings and therefore the lower the price to earnings ratio investors are likely to be prepared to pay.

WHAT INVESTORS CAN DO

'Our research has found that equities outperformed inflation 90% of the time when inflation has been low, below 3% on average, and rising,' says Schroders' Markowicz. This is where we are today. But when inflation was high (above 3% on average) and rising, 'equities fared no better than a coin toss,' the strategist says.

How often equities outperform during different levels of inflation



Source: Schroders

This means that investors should at least consider their options. 'Even if you believe the argument for balanced inflation at the moment, we are coming out of an extended period when inflation was not even discussed, bond yields were in terminal decline and growth outperformed value equities for a long period of time, causing some very stretched valuations,' says Shires' Iain Pyle.

Even just normalising those forces, as we have seen in the last six months, creates a rotation in the market and investors can't just assume growth equities will keep having their valuation supported by falling yields. 'In my view there is a need for more balanced portfolios, with many investors still underweight areas like energy and financials that would benefit from higher inflation,' Pyle says.

'Moderating those underweight positions seems sensible to me.'

There is also a greater need for active management with genuine fundamental analysis to find those companies that have pricing power and can benefit from this cycle, such as our five company picks.

SECTORS WITH PEDIGREE

Pyle says that sectors which to do better in rising inflationary environments tend be those that are more economically sensitive and cyclical, partly because it correlates with economic growth. He flags oil and gas, mining, autos, chemicals and financials. Staples, healthcare and utilities tend to lag, he says.

Schroders' Markowicz agrees. His research shows that energy firms, including oil and gas companies, beat inflation 71% of the time and delivered an annual real return of 9% per year on average. This is a fairly intuitive result because the revenues of energy stocks are naturally tied to energy prices, a key component of inflation indices.

'By definition, energy stocks will perform well when inflation rises,' says Markowicz.

Equity REITs (real estate investment trusts) may also provide protection, according to the Schroders man. They outperformed inflation 67% of the time and posted an average real return of 4.7%. 'This makes sense too. Equity REITs own real estate assets and provide a partial inflation hedge via the pass-through of price increases in rental contracts and property prices,' Markowicz says.

The opposite is true, in theory, of the promised future growth in profits for technology stocks. The bulk of their cash flows are expected to arrive in the distant future, which will be worth less in today's money when inflation increases.

Financials, on the other hand, perform comparatively better, according to Schroders research, as their cash flows tend to be concentrated in the shorter term. That said. high inflation can still be harmful, especially for banks, because it erodes the present value of existing loans that will be paid back in the future.

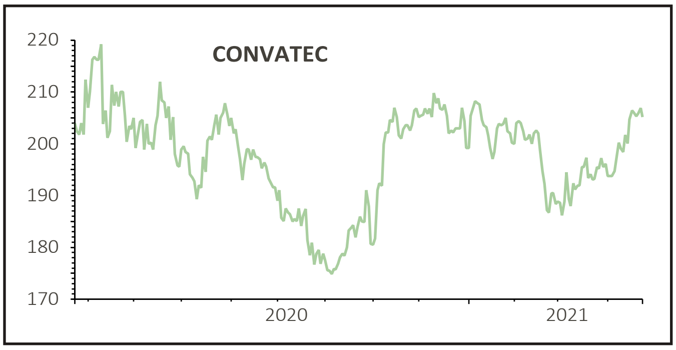
'I think the current trends for rising inflation and higher yields are more relevant for short-term investors,' says Shires' manager Iain Pyle, but everyone should be aware of it. 'The long-term is made up of a number of short-terms and after a long period of deflation and a concentration of investment into growth equities, even a partial unwind of that trend could be meaningful.'

FIVE INFLATION-BUSTING PICKS

CONVATEC (CTEC) 205.3P

ConvaTec (CTEC) is a medical products group focused on the treatment and management of chronic conditions. Its key franchises are advanced wound care, infusion care, continence and ostomy care.

The firm's products will always command a premium price due to the sensitive nature of demand and the growing spend on healthcare by governments both in developed and developing markets.



While the UK was in lockdown and the health service managed the virus, elective surgeries were naturally put on hold, impacting Convatec's sales. However, other parts of the business saw incremental demand and the firm still grew its revenues by 4% last year.

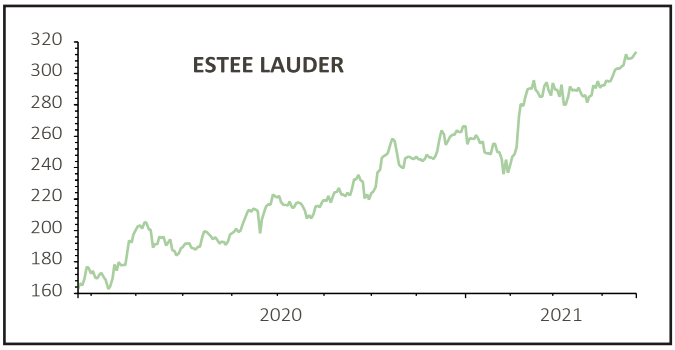
With the vaccine successfully rolled out in the UK and restrictions lifted, demand is expected to increase. Meanwhile, the firm has stepped up its spending on research and development and its investment in key markets such as the US and China, laying the foundations for future growth.

ESTEE LAUDER $314

We believe it is worth buying quality skin care, makeup and fragrances maker Estee Lauder, whose wide economic moat and scarcity value are reflected in an attractive long-term share price chart.

Blessed with a valuable portfolio of global prestige beauty brands which confer pricing power upon the business, Estee Lauder should prove a reliable inflation hedge given its capacity to pass on input costs to customers prepared to pay up to look glamorous and generate robust margins and copious cash flow as a result.

Controlled by the Lauder family, Estee Lauder's prized portfolio of brands includes Estee Lauder, Aramis, Clinique and Tommy Hilfiger, not to mention La Mer, Jo Malone London, Michael Kors, DKNY and TOM FORD BEAUTY.

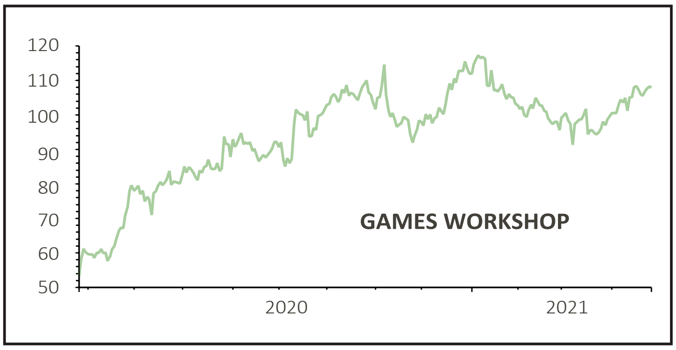


The $112.4 billion cap's attractions also include a thriving online business and good scope for growth in emerging markets. Having returned to growth in the second quarter to December despite retail store closures, sales growth forecasts could prove conservative as department stores, specialty beauty outlets and travel retail locations reopen and the world returns to socialising and travelling.

GAMES WORKSHOP (GAW) £107.40

Fantasy miniatures and table-top war games manufacturer **Games Workshop (GAW)** has a loyal and still growing fan base.

This has been built through the company's single-minded dedication to creating the highest quality figures and investing in the best manufacturing and tooling equipment, which protects the company from inferior imitators.



Its retail shops provide enthusiasts with a space to share their passion while thousands of hours of online content support the brand value.

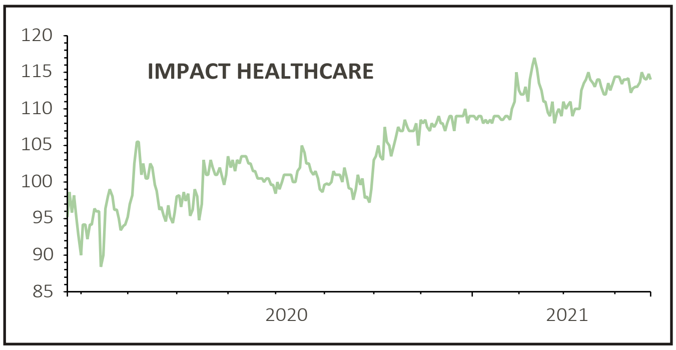
This interaction is designed to create a feeling of being part of a community and strengthens loyalty while increasing the likelihood of repeat sales.

In addition, there is still a lot of potential to exploit the value of the brand and intellectual property which the company has been developing in recent years as seen by growing royalty revenues.

These economic advantages built by the company suggests it has strong pricing power.

IMPACT HEALTHCARE (IHR) 114.8P

Shares in care home investor **Impact Healthcare (IHR)** trade at a more modest premium to net asset value than peer **Target Healthcare (THRL)** (6.3% against 11.1%) and offer a generous 5.6% yield backed by 100% inflation-linked leases.



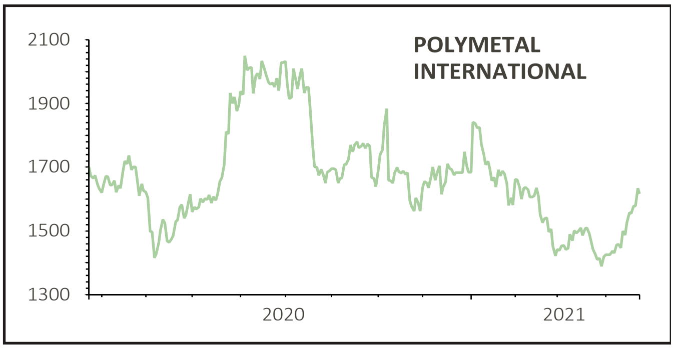
The company was clearly impacted by the Covid-19 pandemic given the disproportionate impact of the virus on its tenants – the care home operators – and the people living in care homes too.

However, having paused M&A in 2020 due to the disruption, the REIT recently returned to the acquisition trail. It has bought an 86-bed care home in Lowestoft, Suffolk via a sale and leaseback transaction with the current owner and operator, Carlton Hall, and entered into a pre-let forward funding arrangement with Carlton Hall for a new 80-bed care home in Norwich.

Numis commented that 'the introduction of Carlton Hall as a tenant adds 'further diversification to the tenant roster'.

POLYMETAL INTERNATIONAL (POLY) £16.03

Because it is possibly the best long-term store of value, gold has always been considered an inflation hedge, and should be part of anyone's portfolio if they're looking to protect against inflation.



But rather than hold the commodity itself, for real inflation-busting returns pick a gold miner. Miners are leveraged plays on the commodities they produce, and as gold rallied over 20% last year some miners saw their shares double.

Choosing the right miner is important and we like **Polymetal International (POLY)**. It's expensive on a price-to-book value of 5.2 times, but that didn't stop the shares rallying hard last year as gold rose and reflects the fact it's arguably the most operationally sound London-listed miner, with none of the production hiccups that affected its peers.

It also has industry leading quality metrics with a 38% return on capital, 55% return on equity and profit margins of over 50% as it successfully capitalised on the soaring gold price, as well as a forecast 7.5% dividend yield.

The next generation of Scottish Mortgage stars

Looking at the stocks the Baillie Gifford trust hopes can emulate the likes of Tesla and Amazon

After the roaring success of investment trust **Scottish Mortgage (SMT)** in 2020, fueled by the rocketing share prices of firms such as Tesla and Amazon, investors are wondering two things: has the good money already been made in the trust, and where are the next generation of winners going to come from?

Certainly this year is unlikely to be as good as last for Scottish Mortgage given the market rotation away from growth stocks with investors able to pick up earnings growth much more cheaply elsewhere at the moment.

But clearly the Baillie Gifford-run trust backs its holdings over the coming five years (the minimum period in which it says it should be judged), and has a number of holdings it believes will be the next generation of winning stocks.

WHERE MOORE'S LAW FITS IN

Scottish Mortgage looks for stocks that will be involved in technological change and says that central to this will be Moore's Law. Moore's Law refers to the prediction of Intel co-founder Gordon E Moore in the 1960s that the capacity of microchips would double every two years.

Baillie Gifford investment specialist Claire Shaw says: 'What this means in practice is come the 2030s, computing power should be 60 times more powerful than today, and this has huge implications for industries that are ripe for disruption.'

On the backdrop of Moore's Law, manager Tom Slater picks

Scottish Mortgage's next generation of winners

Company	Description
Illumina	Develops and manufactures systems for gene sequencing
Moderna	Produces mRNA treatments including vaccines
TransferWise	Allows consumers to make international payments
Stripe	Processes payments, including cross-border payments, for online firms and smaller retailers
Adyen	Processes payments, including cross-border payments, for large retailers
SpaceX	Aerospace manufacturer and space transportation services provider
Nuro	Provides autonomous, zero-occupant vehicles for delivery services
Zipline	Makes medical supply and device deliveries by drone
DoorDash	Online food ordering and delivery platform
Ocado	Online grocery retailer and technology platform

Listed Unlisted

Source: Scottish Mortgage, Shares

out healthcare as a sector with huge and rapidly expanding opportunities.

He explains: 'We've traditionally seen progress move at the pace of the lab bench or the capabilities of individual humans. But as we see technology applied to a greater breadth of healthcare applications, what you do is kick that pace of progress onto the trajectory of Moore's Law.'

Scottish Mortgage Top 10 Holdings

	% of total assets
Tencent	6.2%
Illumina	5.9%
ASML	5.1%
Amazon	5.0%
Tesla	4.6%
Alibaba	4.4%
Meituan Dianping	4.0%
Moderna	3.6%
NIO	3.5%
Delivery Hero	3.0%

Source: Scottish Mortgage factsheet, 31 March 2021

MORE TO MODERNA THAN COVID VACCINES

One of the top holdings in the trust is US biotech firm Moderna, which successfully developed a Covid-19 vaccine last year using mRNA technology, and subsequently almost became a 10-bagger in 2020 as its shares soared.

But Slater says Moderna should be seen as a lot more than just a play on Covid vaccines, pointing to its mRNA platform more generally which he thinks has 'a lot of potential', with a Ballie Gifford colleague likening the view of Moderna as just a Covid vaccine-maker to Amazon being seen as a bookshop.

Slater dismisses the idea Moderna will be less relevant once Covid vaccines are rolled out and explains, 'The potential to address all sorts of other areas with this technology is hugely increased. In the case of Moderna itself, the company has always had very large ambitions.

'What Covid has allowed it to do is go from a company with interesting science and interesting technology, but in the experimental phase, to a company which is generating substantial revenues, has a significant cash position and therefore can invest heavily to commercialise this technology in lots of other areas.'

Where Moderna's technology can be developed the most, Slater adds, is in vaccines for other diseases, and he says its ambition is to develop a number of drugs at a time and create a whole new category of medicines, with the revenues from Covid vaccines giving it the resources to 'go and pursue a really big opportunity'.

POTENTIAL IN PAYMENTS PROCESSING

The other big area Slater points to, and one which has a lot of investors excited about the growth potential, is payments processing with two currently private companies in the portfolio – Stripe and TransferWise – and one listed firm, Adyen, falling in this category.

Global payments processor Stripe reached a valuation of $96 billion in a funding round in March, in which Scottish Mortgage was a backer.

The company helps businesses – including the likes of Amazon, Uber and Spotify – process online payments and navigate different regulations and systems across the globe, and what has investors excited about the stock is the untapped opportunity

in many different parts of the world, with the firm looking to launch in Brazil, India and Indonesia this year.

Stripe is well-established in the UK and it's estimated that three out of four UK adults made a payment via Stripe over the last year. Its business has boomed during the pandemic as online shopping exploded.

Slater explains why the company's proposition is so highly valued by its customers: 'Something like Stripe becomes really valuable because not only does it allow you to do point of sale but it allows you to take payments across all these other channels.

'That can dramatically expand the reach of your business because trying to take payments in different jurisdictions or different geographies is a vastly complex process which you can now completely outsource [to Stripe].'

Complementing Stripe in the portfolio is Dutch-listed Adyen, which is longer established having been founded in 2006 and is highly profitable. It has a market cap of €63 billion.

While Stripe is focused on online companies and smaller retailers, Adyen has a greater bias towards the retailing giants.

Slater says that for larger businesses, payment processing across the world can get 'exponentially more complicated' and adds that that's where a company like Adyen comes in, 'because they can help the biggest retailers, companies like McDonalds for example'.

Slater explains: 'If McDonalds wants to take payments in lots of different countries, if it wants to

take payments online, it needs pretty powerful tools that have a level of complexity you don't see in smaller retailers.

'We think Adyen is doing a really great job of providing that much more complex set of tools and a deeper level of integration with those enterprise customers.

'So there's this huge new opportunity that's arisen because of all these different channels and we think these payment platforms and associated companies as a result have just this vast opportunity in front of them.'

OTHER HOLDINGS

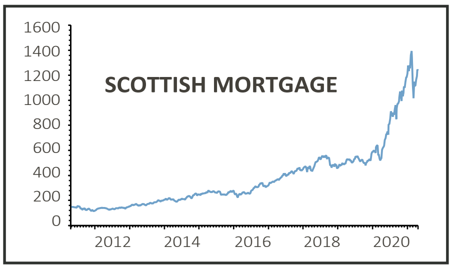
Other holdings in the portfolio which have captured investors' imagination include Elon Musk's unquoted aerospace firm SpaceX.

Slater notes SpaceX is 'driving down cost of access to space' and 'not just incrementally but by orders of magnitude' and points out that as the cost in terms of dollars per kilogram of cargo into space gets lower and lower, it opens up 'huge new applications'.

Slater adds: 'One of the first is telecommunications, so moving away from having mobile phone masts to having communications access to doing that from satellites. We think there's all sorts of applications that this enables.'

Another stock well-known to UK investors which Slater highlights is **Ocado (OCDO)**, and says the fact the market for online grocery deliveries is well developed in the UK compared to other countries can help set the company apart globally, particularly as it has found a model that 'allows costs to remain very low.'

He says: 'What Ocado can point to is a functioning model in the UK that actually has better margins than the big UK grocery chains through an online model, and that's a really powerful example to be able to take to other supermarkets in other countries and make it really desirable for them to want to take on this technology offer.'



By **Yoosof Farah**
Reporter

COMING UP

Next week plan to take a detailed look at other trusts which invest in unquoted businesses.

DO THE BEST INVESTMENTS COME IN **SMALL PACKAGES?**

By Abby Glennie

- **Smaller companies have done well as economies have started to recover**
- **Cyclical companies have rallied in recent months on the back of stronger economic data**
- **We are maintaining our focus on quality companies that score highly on ESG metrics**

Smaller companies often lead stock markets in a recovery phase. This time, as the world emerges from the pandemic, has been no exception. However, investors need to be careful in their exposure to ensure they aren't left holding poor quality companies, bought for their cheapness rather than their long-term durability.

Over the past year, since the lockdowns started across the UK, the IA UK Smaller Companies sector tops the league tables, with the average fund rising 71.7% (source: Trustnet, to 29 March 2021). There are plenty of reasons for this strength: smaller companies often reflect the most dynamic areas of the economy. The sector is full of profitable companies, paying good dividends with good governance. The sector had been hit unfairly by fears of economic stagnation and the impact of Brexit, so was due a reappraisal.

However, while this vindicates our faith in smaller companies, we are also being careful not to get caught up in the recent enthusiasm for poorer quality companies – a so-called 'dash for trash'. While the early months of the pandemic saw investors seek out quality small companies, with strong balance sheets and capable management – the type of companies we hold in our portfolios – the last few months have seen weaker companies recover. This has partly been driven by the more cyclical recovery, and troubled sectors looking to emerge from lockdowns.

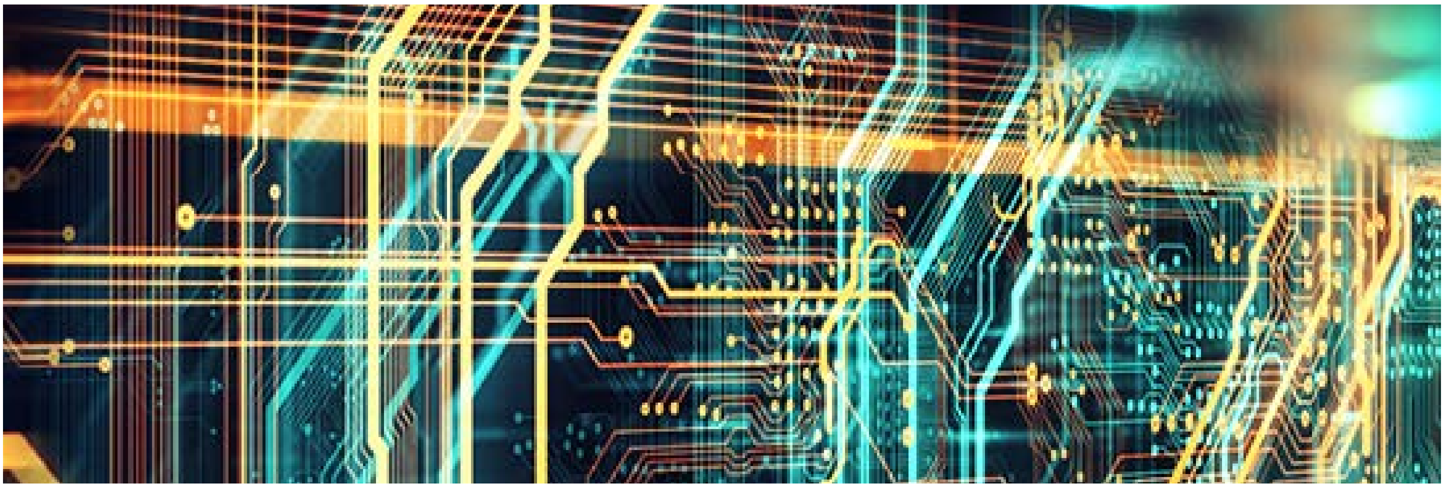
We're not tempted to change our focus. This shorter-term rally may be seductive, but these are not the type of companies we want to hold for the longer-term. We've taken the same approach, focused on quality, growth and momentum, for over 20 years and it has worked through many different market conditions. The pandemic showed its resilience.

The recent crisis has made a powerful case for prioritising those companies with strong balance sheets. Those without debt were able to invest, grow and build market share. Good management teams were able to tilt their businesses, finding new opportunities in a changed world.

The problem with buying lower quality companies is that share prices are only being supported by a recovery in the economy. In the longer-term, there is no growth in the companies themselves and the growth is often cyclical rather than structural. In our view, this seems a risky tactic in a fragile environment.

Instead, we have gravitated

AberdeenStandard Investments



to areas of structural growth – financial services, leisure goods, media. One of the largest sectors in the portfolio is software and, in particular, companies that are contributing to the digitisation trend. We own Kainos Group, for example, a Belfast-based company providing digitisation services to government institutions. It has played an important role in setting up the government furlough programme.

The pandemic has seen many people start to manage their investment portfolios online and has also contributed to a new interest in sustainable investment. With this in mind, we have weightings in companies such as AJ Bell and Mattioli Woods, plus specialist fund managers such as Impax. We also hold a number of fund administrators, which is a long-term, resilient business area with plenty of visibility.

In leisure goods, we hold several video game groups, including Games Workshop, plus music and audio group Focusrite. These companies have done well from Covid, but we don't believe their strength will end there, but that they could return to the strong growth pathways they were enjoying well before the pandemic.

In general, we have been downplaying cyclical sectors in the portfolio and we don't hold housebuilders and conventional retailers. Certainly, some of these companies have ended up looking very cheap, but among smaller companies low valuations are often a sign of distress rather than a bargain. To our mind, portfolios of cheap companies tend to underperform in the longer-term. Also, valuations for many of the companies we like have come down since November. We don't need to look for cheap companies to find value.

In both Standard Life UK Smaller Companies Trust and Aberdeen Smaller Companies Income Trust, as for the wider Aberdeen Standard business, environmental, social and governance (ESG) considerations are becoming increasingly important. We have an on-desk analyst helping us day to day, who also works closely with the central ESG team. Smaller companies often don't have the same reporting and disclosure mechanisms in place, so we need to do the fundamental research ourselves. It is a two-way process, with many keen to engage with us to improve their scores.

We are optimistic about the prospects for smaller companies today. We are at the start of a new economic cycle and it is usually a fertile time for this part of the market. However, investors shouldn't be distracted by the rally in poorer quality companies – good quality companies are well positioned to benefit in the longer-term.

Important information

Risk factors you should consider prior to investing:

- The value of investments and the income from them can go down as well as up and you 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.
- Investment trusts are specialised investments and may not be appropriate for all investors.
- There is no guarantee that the market price of a Trust's shares will fully reflect its 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 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.
- The Company invests in the securities of smaller companies which are likely to carry a higher degree of risk than larger companies.
- 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.
- The Alternative Investment Market (AIM) is a flexible, international market that offers small and growing companies the benefits of trading on a world-class public market within a regulatory environment designed specifically for them. AIM is owned and operated by the London Stock Exchange. Companies that trade on AIM may be harder to buy and sell than larger companies and their share prices may move up and down very sharply because they have lower trading volumes and also because of the nature of the companies themselves. In times of economic difficulty, companies listed on AIM could fail altogether and you could lose all your money.
- Certain trusts may seek to invest in higher yielding securities such as bonds, which are subject to credit risk, market price risk and interest rate risk. Unlike income from a single bond, the level of income from an investment trust is not fixed and may fluctuate.
- With funds investing in bonds there is a risk that interest rate fluctuations could affect the capital value of investments. Where long term interest rates rise, the capital value of shares is likely to fall, and vice versa. In addition to the interest rate risk, bond investments are also exposed to credit risk reflecting the ability of the borrower (i.e. bond issuer) to meet its obligations (i.e. pay the interest on a bond and return the capital on the redemption date). The risk of this happening is usually higher with bonds classified as 'subinvestment grade'. These may produce a higher level of income but at a higher risk than investments in 'investment grade' bonds. In turn, this may have an adverse impact on funds that invest in such bonds.
- Specialist funds which invest in small markets or sectors of industry are likely to be more volatile than more diversified trusts.
- Yields are estimated figures and may fluctuate, there are no guarantees that future dividends will match or exceed historic dividends and certain investors may be subject to further tax on dividends.
- Certain Companies treat the generation of income as a higher priority than capital growth; such Companies may deduct part or all of their management charge from capital. This will increase the amount of income available but at the expense of capital growth.
- Shares of smaller companies may be more difficult to buy and sell than those of larger companies. This means that the Investment Manager may not be able to buy and sell at the best time or may suffer losses. This could reduce your returns.
- Companies selected for illustrative purposes only to demonstrate the investment management style described herein and not as an investment recommendation or indication of future performance.

Other important information:

- Issued by Aberdeen Asset Managers Limited which is authorised and regulated by the Financial Conduct Authority in the United Kingdom. Registered Office: 10 Queen's Terrace, Aberdeen AB10 1XL. Registered in Scotland No. 108419. An investment trust should be considered only as part of a balanced portfolio. Under no circumstances should this information be considered as an offer or solicitation to deal in investments. You should obtain specific professional advice before making any investment decision.

Find out more by registering for updates or by following us on Twitter and LinkedIn.

Help, I want to start saving for the future

40-year-old Charlotte was gifted some shares by her grandparents but is otherwise new to the financial markets

Charlotte is 40 and works as a legal secretary for a firm in Derby. She's married to Steve, who also has a good job with a car manufacturer, and they own a house together in the western suburb of Mickleover.

They both have a good work pension schemes, which their employers pay into, but they have no savings as such.

Charlotte wants to get her finances in order, but Steve gets bored when she talks about money and is more interested in holidays than saving.

They have 15 years left on their mortgage, which charges interest at 3.5% per year, and after their monthly payment of £1,000 and all their other outgoings they have around £450 left for meals out, the cinema, holidays or potentially to save.

Charlotte is also in the fortunate position of having a portfolio of shares, which was gifted to her grandparents when she was born and is now worth £10,000, but she has no idea about the stock market and doesn't know what to do with it.

WHAT ARE THE OPTIONS?

The first option that Charlotte and Steve should consider is overpaying their mortgage, assuming their lender doesn't charge a penalty for doing so. By

overpaying, they are shortening the term of the mortgage which means they could be debt-free in less than 15 years.

If they paid £200 of their monthly 'surplus' on top of their regular £1,000 payment, they could pay off their mortgage in 12 and a half years, leaving them with an extra £1,000 a month which they could then save or use for holidays.

Charlotte is keen to save, so they could increase their contributions to their workplace pensions, but that money is then 'locked away' and can't be touched until they retire.

Alternatively, they could both open a SIPP or self-invested personal pension and start building up a pot. Although they can't access the money until they move into retirement, the big benefit of investing in a pension is that for every £100 they contribute the government adds another £25, so they're effectively getting 25% interest every year on whatever they pay in.

If they each put in say £100 at the start of each month, with the government's contribution that would be £250 in total, which means £3,000 per year. If they go for an income fund with an annual yield of 5%, within 10 years their 'pot' would be worth an impressive £38,980, of which £8,980 would be the benefit of compound interest.

LOOKING FOR INCOME

If Charlotte and Steve kept up their contributions for 20 years, their pot would be an even more

This is the latest part in a regular series in which we will provide an investment clinic based on hypothetical scenarios. By doing so we aim to provide some insights which can help different types of investor from beginners all the way up to experienced market participants.

impressive £103,186 of which £43,186 would be thanks to compound interest.

The table shows examples of investment trusts yielding 5% or more. One benefit of trusts is they can dip into reserves in leaner periods to help sustain their dividends.

Meanwhile, although Charlotte is just too old to qualify for a lifetime ISA, which offers an upfront government bonus, she could put some money into a normal ISA. The maximum annual contribution to ISAs is £20,000, so £200 a month would be well within the limit. Unfortunately, cash ISAs pay very little in interest, but they do have the benefit of easy access.

However, Charlotte has a portfolio of stocks worth £10,000, which she could transfer into a stocks and shares ISA so that that any capital gains on the holdings would be tax free.

LOW-COST EXPOSURE TO GLOBAL MARKETS

Given that she doesn't have time to understand what all the different companies in her portfolio do, and she doesn't want to run the risk that one of them blows up and loses her a lot of money, a stress-free alternative would be to sell some or all of the shares and buy a global exchange traded fund such as the **iShares Core MSCI World (SWDA)**.

The ETF has an annual fee of just 0.2%, which would be just £20 on £10,000, and her money would be 'in the market' earning a return.

Plus any income from the basket of stocks in the portfolio, of which there are well over 1,000 will be automatically reinvested.

Researching one or two exchange-traded funds should be more straightforward and less time consuming than lots of individual stocks.

Unless they want to pay off their mortgage early, a combination of regular SIPP contributions and transferring Charlotte's stock portfolio into an ISA could be a winning combination.

That way they are investing regularly for the future and they still have £250 left over each month to save for a holiday or treats.

Selected investment trusts yielding 5% or more

Trust	Yield (%)
TwentyFour Income	5.9%
Henderson High Income	5.8%
BMO UK High Income	5.7%
Merchants	5.3%
Shires Income	5.0%

Source: AIC, data as at 23 April 2020

WHERE TO START

It all begins with sitting down and making a plan together. Charlotte should involve Steve, as they want to share their future together.

Having the resolve to run through the options and do the maths may be a challenge, but all it takes is a couple of rainy Sunday afternoons and they would have the bulk of their plan lined up and ready to go.

Once they have agreed on a way forward, Charlotte and Steve need to stick with it. Setting up direct debits to fund their SIPP investments is the best way to make sure they don't get diverted from their goals, rather than having to remember to transfer money each month.

If they set up direct debits for the day after they are paid they may not even notice the money going out of their account.

DISCLAIMER. This article is based on a fictional situation to provide an example of how someone might approach investing. It is not a personal recommendation. It is important to do your research and understand the risks before investing.

By **Ian Conway**
Senior Reporter

MITON GLOBAL OPPORTUNITIES

Premier Miton
INVESTORS

Private Investors would do well to have a look at the opportunities thrown up within the investment trust sector. In recent years, a whole raft of these listed funds has fallen below the radar, so the market in their shares has often become extraordinarily inefficient. Therefore, the market price can dramatically vary from the true value of the underlying portfolio. We have spent the last few years building MIGO's portfolio of exciting opportunities that have been ignored by mainstream investors. Effective vaccines against Covid are now a reality and this development triggered a broadening of markets. We are now witnessing an influx of investors seeking hidden value amongst trusts, suggesting that it will not be long before the potential of MIGO's portfolio is unlocked.

Unlike open-ended funds, investment trust share prices are decided by supply and demand in the market rather than solely by the value of the underlying assets. Many of these own attractive portfolios, but a lack of interest dictates that their shares can be bought at a discount.

We look for investment trusts where we are not only bullish about the outlook for the portfolio but where we believe there is a special situation that offers further upside. When we capture a rising asset value and a narrowing discount, it is a powerful combination. Recent successes include River & Mercantile Micro Cap and Third Point Investors.

River & Mercantile Micro Cap became deeply unloved as investors eschewed the very smallest listed companies; the trust languished at a wide discount as a result. To remain small and flexible, this trust undertakes to return capital to shareholders once the portfolio exceeds £100m. Now the market seems to have embraced micro-caps again, shareholders in the trust have already had a significant proportion of their shares redeemed at a level significantly higher than the prevailing share price. Third Point invests in the eponymous Wall Street hedge fund that suffered a difficult Covid and as a result traded at close to a 30% discount to the value of the portfolio. The founder Dan Loeb reacted to this setback by returning from a life of philanthropy to retake the reins and turned performance around. Furthermore, the board of this trust have introduced formal tenders that ensure that the discount will narrow.

Being a closed-ended fund itself, we believe that MIGO is well positioned to exploit pricing anomalies in this sector. It is protected from daily inflows and outflows, which allows greater conviction, and larger positions can be taken with the knowledge that the shares will be held until it is the right time to sell.

The largest holdings in MIGO's portfolio trade at an average discount of a little over 20%. In other words, we are buying these assets at 80% of their latest open market valuation. Our strategy is to focus on situations where we believe the catalyst exists to trigger a narrowing of the discount. There is no point in owning trusts simply because they trade on a wide discount.

We have the luxury of spending our days researching the whole spectrum of investment trusts, from shipping leases to residential property in Berlin, and Miton Global Opportunities plc provides a one-stop shop access to an area of the market where assets are trading at far below their intrinsic worth.

Fund Manager:
Nick Greenwood

Assistant Fund Manager:
Charlotte Cuthbertson

Source: Morningstar, as at 31.03.2021.

RISKS

Reference to any particular stock does not constitute a recommendation to buy or sell the stock. The value of investments may fluctuate which will cause trust prices to fall as well as rise and investors may not get back the original amount invested. The performance information presented in this document relates to the past. Past performance is not a reliable indicator of future returns. Future forecasts are not reliable indictors of future returns.

Ongoing uncertainty for commercial property stocks

We still don't know how the working from home trend will affect real estate owners in the long term

As restrictions are eased attention will turn from a return to shops and pubs to the somewhat more humdrum reality of getting back to the office.

Working from home has been one of the big themes of the Covid-19 – for office workers at least – and there is still a debate about the lasting impact of the virus on this trend.

The most likely outcome seems to be a hybrid approach judging by the comments from major organisations and the preferences of their workers, with at least a portion of the week spent at home.

The implications for owners of commercial property may not be as cataclysmic as some had predicted early in the pandemic but, at the very least, owning the right kind of offices in the right places will be important for some time to come.

Investment bank Morgan Stanley has been running surveys on working from home over the past 12 months and its latest data shows that in mainland Europe expectations of a return to work have shifted to later in the year but are unchanged in the UK, potentially reflecting the head start seen on vaccine rollout domestically.

Interestingly UK workers appear to be slightly keener to spend more time working from home, although the average appears to be a preference for around two days a week.

Owners of offices trade at big discounts to the reported value of their assets

REIT	Discount to NAV
Land Securities	-34.2%
BMO Commercial Property	-33.2%
British Land	-26.9%
Shaftesbury	-16.0%
Regional REIT	-12.5%
UK Commercial Property	-11.8%
Derwent London	-11.7%

Source: AIC, Google Finance, Company Reports (based on last reported net asset value). Data as at 23 April 2021.

You can understand why employees and employers might want a return to the office for at least some of the working week.

Collaborative working just makes more sense face to face than it does over video conferencing and people may well be missing the social interactions which come with being around other people in their working lives.

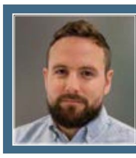
However, when it comes to getting to the office people may well be less than keen to use busy public transport. This makes owning office assets with ample car parking space an advantage, at least in the near term.

Providing this kind of facility is harder in more built-up environments and central London also faces the complication of the congestion charge.

Flexible office space is also likely to be in demand, given the hybrid situation we appear to be moving towards, and this could be good news for serviced office group **IWG (IWG).**

As the table shows owners of commercial property are trading well below their net asset values, perhaps because the market believes the buildings are now worth less and so the book value in a company's accounts could be overstating the true value.

Morgan Stanley observes: 'Current discount levels are wide, but understandably so for a flat/downwards drift scenario (for rental growth).'



By **Tom Sieber**
Deputy Editor

Kepler | Trust Intelligence

THIS IS AN ADVERTORIAL

Tapping into the UK smaller companies revival

A year ago, the outlook seemed not far off dire for UK smaller companies. On the back of the pandemic – and the subsequent, shocking national lockdown – the market fled from these stocks as many smaller businesses grappled with how to adjust their models for a newly-distant world.

Yet, come March 2021 and the story is very different. UK equities, in general, have fallen back into favour in the first part of this year, as positive news across the board has fuelled optimism in the outlook for UK equities. For investors that held their nerve, the UK has proved a profitable place to be. A trend that seems likely to continue for some time to come.

NOT ALL DOOM AND GLOOM

In March 2020, the halting of much of our day-to-day lives seemed like a death knell for companies with a physical presence. Indeed, investors flocked to technology and healthcare stocks, sure that these would be the clear beneficiaries of the pandemic.

But while both these sectors undoubtedly flourished for much of 2020, other companies also surprised on the upside.

While some analysts mooted a potential baby boom, one surprising, and almost immediate, consequence of the lockdown was a dash for dogs and charge for cats. Prices for premium puppies surged to double or triple their pre-pandemic norms.

A clear winner from this trend was Pets at Home, the UK's largest pet shop operator. The business was already gaining a reputation pre-pandemic for its strong growth strategy, such as incorporating vets and grooming salons into its stores. However, a lockdown pet bonanza meant that the company saw its share price rise 60.84% in the twelve months to 31 March 2021.

It is stories like these that show how some investors oversimplified the challenges facing some businesses as the pandemic took hold. For those, such as Georgina Brittain and Katen Patel, managers of the **JPMorgan Smaller Companies (JMI)**, who held their nerve and topped up their market holdings in the post-lockdown sell off, this disconnect has helped fuel their returns heading into 2021.

CUTTING THROUGH THE FOG

Over the last twelve months, the trust has offered a share price total return of 91.4%, putting it in the top quartile of the AIC Smaller Companies sector. This is reflective of the trust's longer-term track record, with a share price total return of 164.8% over five years, again leaving it among the top-performing trusts in its sector.

They were able to do this in part due to having a long-held and proven investment process, which enabled them to keep cool heads through a trying period for the sector. Georgina Brittain has been a named manager on the trust for over two decades, weathering multiple market storms including the 2008 financial crisis in the process. Over that time, the trust has a consistent track record of outperforming both its AIC sector and its benchmark.

Georgina and her co-manager Katen Patel, who joined the trust in 2014, invest on the understanding that pricing among smaller company stocks is fundamentally inefficient, a theory borne out in style by the post-lockdown sell off. Crucially, the managers look to identify stock opportunities in companies which display varying degrees of three different characteristics: quality, value and momentum.

This approach enabled them to identify companies that had some combination of the strategic capabilities to take advantage of the changed conditions under the pandemic, would perform well in more 'normalised' times, or were experiencing strong earnings momentum during the lockdown and pandemic.

Another of their success stories was Future, a publishing company. Most of Future's publications have significant online footprints and include areas such as technology reviews, which have seen a rise in readership demand. With a strong organic presence in search engine results, Future has been able to support its earnings growth through rising advertising sales, and earnings have been towards the top-end of consensus expectations. The net result of this has been an 88.31% rise in its share price in the twelve months to 31 March 2021.

A SUNNY FORECAST

While much of the UK smaller companies market has bounced back from the early lockdown sell-off, there is support for the notion that the market has further to run. One of the factors that had held smaller companies back recently was uncertainty over Brexit, as many dealt with Europe-based supply chains and distribution channels.

However, Georgina and Katen highlight that the UK has now made a relatively clean break from the EU, with the long-awaited trade deal in December 2020 bringing heightened clarity for businesses and investors. Whilst companies continue to work through what the implications of a life outside Europe actually means, they have, at the least, a clearer view of what the future looks like. A new era of austerity for the UK economy also looks less likely, with the current government indicating that it will continue to invest in the country's recovery from the pandemic for the short term at least.

Combined, these factors paint a sunny forecast for the UK economy and, in turn, its smaller companies. With the deep resources of JP Morgan at their fingertips, and experience of investing through several market cycles, the management team of JMI are well-placed to take full advantage of this outlook.

Click **here** to read our latest research on JPMorgan Smaller Companies.

Why value shares win when interest rates rise

Falling rates in recent times have given a big boost to growth shares

Since the first successful vaccines were announced in November 2020 value shares have made a huge comeback after many years in the wilderness.

You may have wondered why value shares have continued to perform well this year on expectations of rising interest rates. In this article we explain how rising rates impact value and growth shares using a concept that is more often used in the bond world, namely duration.

SHORT DURATION VS LONG DURATION

In short, value shares are considered short duration and growth shares are considered long duration. As any bond fund manager will tell you, when interest rates rise, you want to make sure you lower a portfolio's duration.

That's because longer dated bonds are more sensitive to changes in interest rates. For example, a portfolio with a 10-year duration is expected to fall 10% for every 1% increase in rates while a three-year duration portfolio will only fall 3%.

Just remember the rule of thumb, a 1% change in interest rates will affect bond prices by 1% in the opposite direction (an increase of 1% will push prices lower) for every year of duration.

The popularity of value shares in favour of growth shares has in large part been down to rising interest rates.

The traditional way to value shares is to apply discounted cash flow techniques which are very sensitive to the risk-free rate of interest.

If rates increase, it affects the companies which have a stronger growth profile more than those with modest growth.

This is a better way to think about value and growth, after all, in a classic sense everyone should be a value investor.

Higher growth shares can be undervalued relative to their growth while low growth value shares can be overvalued if they disappoint.

A BIRD IN THE HAND

It comes down to what famed investor Warren Buffet called a bird in the hand versus three birds in the bush.

Companies that have lower growth opportunities tend to pay out more of their earnings as dividends, while companies with big growth opportunities reinvest back into the business.

There is no guarantee that the investment will pay off, but if it does, the results can be very rewarding. But, the crucial point to recognise is that growth investors are betting that birds in the bush are worth a lot more than the one in the hand.

Conversely value investors are more comfortable with a bird in the hand and getting paid regular dividends.

If you think about the dividend as the equivalent of the coupon (interest paid) in the bond world, the similarities become clearer and the role of duration starts to

LOW DURATION

M&G (MNG) 210.1P

Fund manager **M&G (MNG)** has a diversified business with around 5.5m retail clients and over 800 institutional clients, contributing to assets under management of £367.2 billion.

The distribution platform is global and serves 28 markets from 20 offices.

The shares trade on nine times 2021 expected earnings while the dividend of 18.1 pence per share (down from 18.2 pence last year) provides a yield of 8.6% which is well covered by earnings.

The implied duration of the shares at current levels mean that investors will recoup their investment in 11.6 years, assuming the dividend is held at the same level. There is scope for it to grow over time, reducing duration.

Low duration and implied growth suggest investors have become too pessimistic on the prospects of the business, despite the shares recently hitting 12-month highs.

The company said recently that cash levels had surpassed 20% which would allow the manager to meet redemptions.

HIGH DURATION

STHREE (STEM) 396P

Recruitment firm **Sthree (STEM)** is poised to benefit from the economic upturn that economists expect this year as vaccinations programmes are rolled-out across the globe.

That's because the firm is focused on Contract as apposed to Permanent staffing which makes up less than 20% of fee income.

New chief executive Mark Dorman believes the opportunity for specialist recruiters in the science, technology, engineering and mathematics fields is 'both enormous and growing' and the company is uniquely positioned to benefit among the listed staffing firms.

The dividend is expected by analysts to grow to 9.44 pence per share in 2021 from five pence last year, which we have used as the base. If we assume the dividend can grow at 7% a year, the shares have an implied duration of 20 years. The company pays out around half of earnings in dividends.

Rising interest rates may act as a dampener on the valuation of the shares, but the higher expected growth should benefit long-term holders.

make sense.

Companies where more of the total return (capital gain plus dividend) is composed of dividends have lower duration because investors get regular income payments which reduces their original cost of investment.

If we know the expected growth rate of the dividend, we can calculate the amount of time it takes to recoup the initial investment and calculate an implied duration.

We can't use this type of analysis for companies that either don't pay dividends or dole out relatively small amounts.

A low duration example is tobacco company **Imperial Brands (IMB)**, where investors pay nine times the 138p dividend per share, representing a dividend yield of 9.4% based on a share price of £14.76.

The dividend has been reduced over the last few years, so we have assumed it will continue to fall around 5% a year. Investors buying at today's price and holding for 11 years would recoup their original investment, implying a duration of 11 years.

Imperial Brands	
Price	£14.76
Dividend growth (%)	-0.50%
Base dividend (p)	138
Total dividends (p)	1,473.21
Dividend (p)	
year 1	137.3
year 2	136.6
year 3	135.9
year 4	135.3
year 5	134.6
year 6	133.9
year 7	133.2
year 8	132.6
year 9	131.9
year 10	131.3
year 11	130.6

A higher duration example is international distribution company **Bunzl (BNZL)** where investors pay 45 times last year's dividend of 54.1 pence per share.

Assuming Bunzl can grow its dividend at the same 7% rate as the last few years, it would take 20 years for investors to recoup their original investment, implying a duration of 20 years.

Bunzl	
Price	£24.43
Dividend growth (%)	7%
Base dividend (p)	54.1
Total dividends (p)	2,373.11
Dividend (p)	
year 1	57.9
year 2	61.9
year 3	66.3
year 4	70.9
year 5	75.9
year 6	81.2
year 7	86.9
year 8	93.0
year 9	99.5
year 10	106.4
year 11	113.9
year 20	209.3

Source: Stockopedia, Refinitiv, Shares

RANKING STOCKS BY SENSITIVITY TO RATES

By calculating the implied durations of stocks in this way we can rank them according to their sensitivity to changes in interest rates, bearing in mind that other factors, such as level of indebtedness will also impact sensitivity to rates.

It should also be noted that Bunzl may ultimately provide a higher total return for investors over the long run than Imperial Brands, but the longer duration of Bunzl makes the shares more sensitive to changes in interest rates.

In other words, sensitivity to interest rates is just one of many inputs that investors need to consider when weighing up the risks and rewards.

By **Martin Gamble**
Senior Reporter

Understanding China's dominant but under pressure internet stars

You may have heard of these big tech plays but what do they actually do?

After a strong start to 2021 Chinese internet businesses including Alibaba and Tencent saw their share prices come under mounting duress on a mix of heightened regulation and dampened sentiment towards the wider technology sector.

Alibaba has been hit by a $2.8 billion anti-trust fine amid increased regulatory pressure domestically, while in the US the Securities and Exchange Commission is requiring Chinese stocks with a US listing to meet stricter criteria.

Yet these companies still dominate the Chinese equity markets. The collective weighting of Tencent and Alibaba along

with their smaller counterparts Meituan, JD.com and Baidu in the MSCI China index was more than 35% as at the end of March 2021.

Given this dominance it is worth having some idea of what each of these businesses do in a little more detail.

Alibaba – China's answer to Amazon – with a big footprint in online shopping and dominant position in cloud computing.

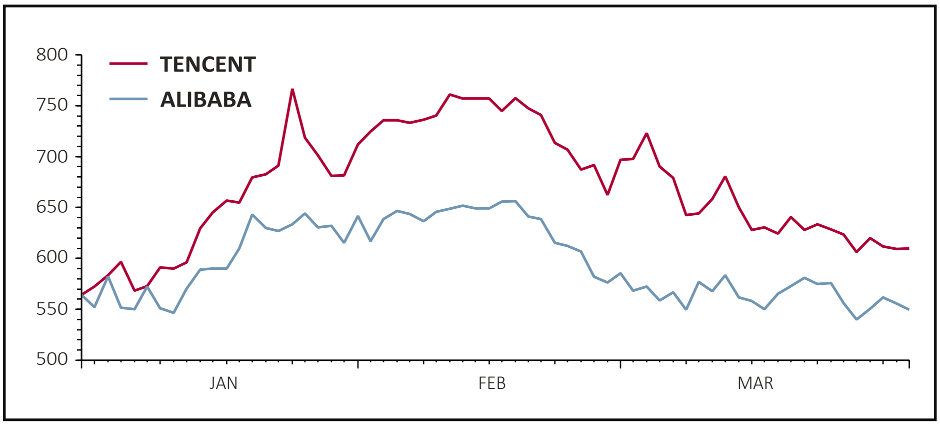
Tencent – owns hugely popular web portals, messaging and social media apps as well having a substantial presence in the video games market.

Meituan – online shopping platform which focuses on locally sourced consumer products and services as well as hosting customer reviews and offering Groupon-style discounts.

JD.com – China's second largest e-commerce business with a burgeoning logistics arm, which opened up its services to third parties in 2017 and is subject to a proposed spin-off.

Baidu essentially a Chinese Google – alongside search engine services it specialises in areas such as online advertising and artificial intelligence.

Chinese internet stars endure volatile first quarter of 2021



Emerging markets: Views from the experts

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

1. Chinese internet stocks have struggled in recent weeks amid tighter regulatory scrutiny, higher US Treasury yields and block trades linked to a troubled hedge fund. China's increased emphasis on fair competition, consumer protection and data security within the internet industry has been a chief concern. Though regulatory news could drive near-term share-price volatility, we remain largely confident in the longer-term fundamentals of several leading internet companies. These companies have grown rapidly by offering superior user experiences and efficiencies, and we expect these strengths to continue underpinning their structural earnings power. We also think that regulators are keen to ensure the sustainable development of the internet space for all stakeholders, rather than curb its growth.

2. Brazil's fiscal challenges have returned to the spotlight as an intensifying pandemic adds pressure on the government to ramp up already-massive spending. Concerns about the country's mounting debt burden have weighed on its stock market and currency. Complicating matters, rising domestic inflation has narrowed the scope for monetary policy support. The central bank raised its key interest rate from a record low in March, signaling the start of a rate-hike cycle. We believe that Brazil's economic recovery will rely heavily on the government's ability to implement long-awaited structural reforms. Meanwhile, as a major commodity exporter, Brazil is likely to benefit from rising prices for commodities, as well as their broad appeal as an inflation hedge. We expect higher interest rates in Brazil to bode well for banks, especially market leaders that have weathered the pandemic with the help of strong capital positions and large deposit franchises.

3. The global competitiveness of emerging market (EM) companies has been a standout feature amid market swings and pandemic worries. A widespread chip shortage has underscored the world's reliance on Taiwanese and South Korean semiconductor firms, which have dominated the global industry with their strong manufacturing capabilities. South Korean battery makers have become key suppliers of electric vehicle (EV) batteries, supporting EVs' growing penetration on the back of favourable policies and advancing technology. Chinese biotechnology companies working on innovative treatments for cancer and other major diseases have reaped growing success in licensing their new drugs to global pharmaceutical firms.

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

RUSS MOULD
AJ Bell Investment Director

Why gold and bonds are rallying

Making sense of some contradictory market moves

Some regular readers may think it does not take much to puzzle this column at the best of times and there can be no denying that the big picture right now seems to be full of contradictory eddies and whirls which make it particularly difficult for investors to form a clear-cut view.

For instance, US retail sales jumped by 28% year-on-year in March, according to data released by the US Census Bureau on 15 April.

While allowances can be made for the soft base for comparison offered by the pandemic-hit month of March 2020, the 9.8% *month-on-month* advance looks to be testament to the power of America's unlocking, vaccination programmes, ongoing loose monetary policy from the Federal Reserve and fresh fiscal stimulus, in the form of the latest direct payments to consumers – the first direct deposits began to arrive on 17 March.

For the same month, the UK showed the fastest increase in producer (or factory gate) prices, just as America and Germany showed the highest rate of increase in nearly a decade. China showed signs of an increase too.

Economists will tend to argue that a sustained increase in companies' input and output costs will eventually force them to raise prices so they can preserve margins. That in turn leads to higher prices for buyers to pay and could begin to stoke inflation, or so the theory goes.

And yet, as this data came through, government bond yields in the US and UK began to fall, the direct opposite of what investors would normally expect during a robust upturn. After all, who would buy government paper that offered a yield of say 1.75% a year for ten years in the USA or 0.88% a year in the UK over the same time frame if inflation was about to gallop higher? (Those are the levels at which yields peaked on 31 March). That would surely be locking in a real-terms (post inflation) loss.

Even more intriguingly the perceived haven (and therefore potential harbinger of doom) gold began to forge some progress for the first time in well over a year.

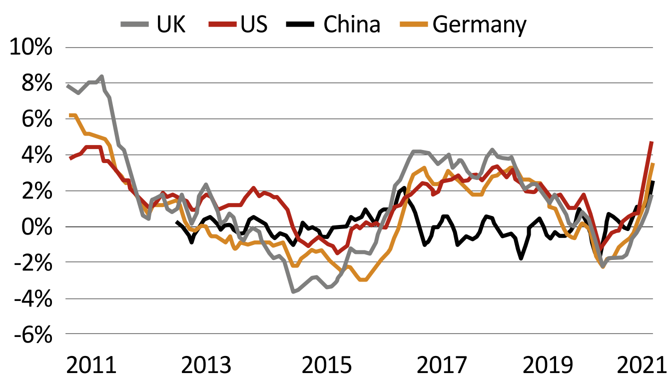
So how can investors explain what looks like strong, maybe even inflationary economic data on the one hand, which an apparent resurgence of interest in haven assets on the other?

GENTLE WARNING

To this column's mind, there are three possible explanations.

This is the market's way of saying this is as good

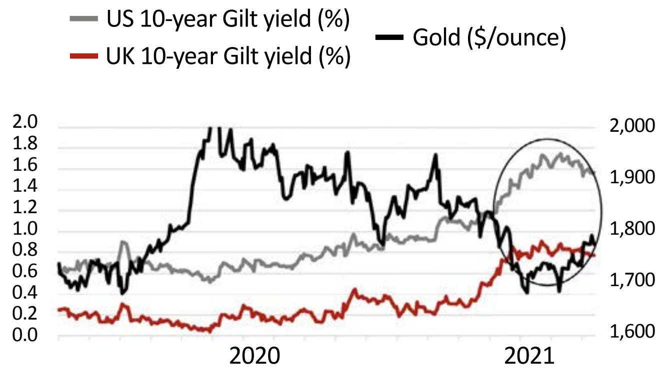
Factory gate price increases hint at the return of inflation



Source: Refinitiv data

RUSS MOULD
AJ Bell Investment Director

Haven assets are trying to stage a comeback



Source: Refinitiv data

as it gets, at least in the near term. Even as the EU considers permitting Americans who have been vaccinated against Covid-19 to travel over the Atlantic in the summer, India is struggling to contain a new outbreak and even Indian Premier League cricketers are heading home before they find themselves potentially barred from doing so. Perhaps the path out of lockdown might not be quite as straightforward as we all hoped.

The bond and gold markets could be wrong. Fixed-income investors have become so used to debt, technology and demographics driving disinflationary or deflationary forces that they are missing a trick as the easing of lockdowns gives velocity to money supply even as central banks and governments pour on the quantity of money.

Buyers of bonds and gold are right and may be seeing something which rising stock market indices, exuberant merger and acquisition activity and increasing numbers of fresh company listings do not. In this case, the trick is finding out what that might be.

WORTHY OF INTEREST

This column's instinct is always to look to the further-flung corners of the markets, in the view that trouble usually starts where investors are operating beyond their normal appetite for risk.

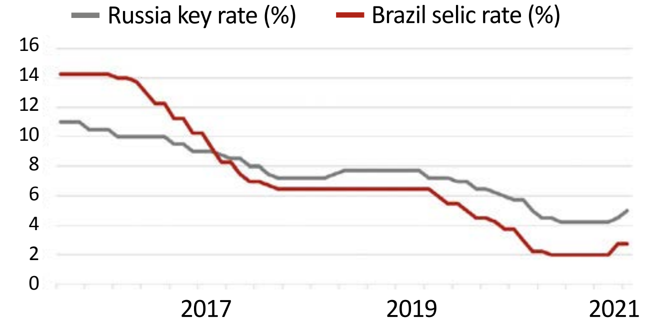
Once they get into difficulty at the periphery – in frontier or emerging markets say – they will pull back pretty quickly and hunker down in search of what they view as safety in core, developed markets and hope to avoid any squalls or full-blown storms.

What is clear is that interest rate increases from Brazil (2.75 percentage points in one go) and Russia (a quarter point and then another half in quick succession) both caught markets by surprise and both were overtly designed to combat inflation.

Again, this may be something, it may be nothing. But add in the emerging market rate rises to the Bank of Canada's move to cut quantitative easing by a quarter and the Reserve Bank of New Zealand being told to keep a wary eye on a bubbly housing market and the very, very early signs of monetary tightening are appearing.

And for financial markets which have bathed in cheap, abundant central bank liquidity for over a decade, this is a potentially disturbing trend which must be watched carefully, even if it seems unlikely that the Fed, Bank of England, ECB or Bank of Japan are going to turn off the taps for a while.

Do emerging market interest rate increases signify a turn in the monetary tide?



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The times when it pays to take financial advice

Deciding when the extra cost of consulting an adviser is worth it

It's never been easier to be a DIY investor with all the tools and information now available online. The internet has democratised information, and many people have consequently become their own financial advisers.

This saves on charges, with advice usually costing upwards of £500, depending on the precise level of service required. But while many investors are now confident about going it alone, there are still times when the services of a professional financial adviser can be extremely valuable.

PENSIONS COMPLEXITY

Pension planning is one example. For someone simply putting £100 a month into a workplace pension, there's probably little call for financial advice, but things can get a whole lot more complicated than that. Pension savers who are bumping up against the annual or lifetime pensions allowance might consider getting advice, not least because getting things wrong can result in highly punitive tax charges.

Those who are approaching or at retirement might also benefit from taking advice, because their pot is likely to be close to its peak level, so there's lots at stake, and the options aren't always straightforward. At retirement you need to decide how to draw your pension, and that will determine how you invest in the lead up to retirement, so it requires some dedicated planning, which may be best done with the help of a financial adviser.

If you're thinking of transferring out of a defined benefit pension into a SIPP (self-invested personal pension) or money purchase pension, it's can be a really good idea to take advice. Sometimes there are perfectly valid reasons for wanting to transfer out of a defined benefit plan, but it's difficult to assess the value of the guaranteed income provided by such a scheme.

It's easy to overvalue the benefit of having a lump sum up front and undervalue the importance of having an income year in, year out, for life, and a financial adviser can help you get to the bottom of that conundrum.

ESTATE PLANNING

Inheritance tax planning is another area where taking advice can be really helpful. Again the sums involved tend to be large, and so the tax benefits of a well-considered plan can more than outweigh the costs of taking advice.

Inheritance tax comes with a high degree of complexity around rules, allowances, and gift exemptions, which is a bit

of a minefield to navigate on your own. It can also be easily ignored, because naturally we all like to keep our own mortality out of sight and mind as much as possible.

Taking financial advice can help bring this difficult subject out in the open in a guided and thoughtful way. Financial advice could also be useful to help you manage your overall investment portfolio, if you feel you don't have the time, or knowledge to do it yourself. Part of the service will normally include making this as tax-efficient as possible.

Generally speaking, the more complex your planning needs, and the bigger your portfolio, the more value you are likely to get from a financial adviser. Financial advice does have a bit of a bad image, but that is really an outdated hangover from the 1980s and 1990s.

MAKE SURE YOU GO WITH A REGULATED FIRM

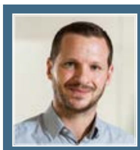
Advisers today are extremely well qualified and very heavily regulated. Of course, always make sure the advisory company you are dealing with is regulated by the FCA; any reputable firm won't mind showing you their regulatory credentials. Not everyone will need advice, but sometimes paying a professional to tackle your finances can lighten the load.

By **Laith Khalaf**
Financial Analyst

How can I spot someone trying to scam me?

Our expert has some tips for limiting the risks posed by pensions fraud

How can I really know if an investment is legitimate or not? What checks can someone do to reduce the risk of being taken in by a scammer?
Emma



Tom Selby
AJ Bell
Senior Analyst says:

Financial scams are depressingly common and often target people's hard-earned pensions. This has particularly been the case since 2015, when government reforms gave savers total freedom and choice over what they do with their retirement pot from age 55.

Official estimates from the Pension Scams Industry Group suggest £10 billion has been stolen from pensions in the past six years.

Scam activity has increased during the coronavirus pandemic, with fraudsters aiming to take advantage of increased vulnerability among UK savers.

And while efforts are being made by the authorities to protect people from financial crime – including banning pensions cold-calling and giving providers more power to reject suspicious transfers – the onus remains on individual investors to protect themselves.

Here are five things you can do:

1. Be suspicious of unsolicited calls, texts or emails about your pension: Scams often start with a call, text or email out of the blue offering 'help with' or perhaps a 'review of' your pension arrangements. To be safe, if someone you don't know contacts you about your pension – or indeed your finances in general – do not engage with them. If you believe someone is trying to scam you, report them to Action Fraud to help protect other investors.

2. Be extremely wary of anyone promising large, guaranteed returns: Another tell-tale sign of a scam is the promise of huge, guaranteed investment returns, often over relatively short spaces of time. These investment 'offers' take many weird and wonderful forms, while the rise in popularity of cryptocurrencies has also been an obvious target for financial fraudsters.

3. Only deal with regulated companies and individuals: At the heart of scams are often unregulated 'introducers' peddling unregulated investments. While there is nothing wrong with investing in unregulated assets, where fraud occurs these often turn out be vastly overhyped or entirely fictitious. Even where an unregulated investment is real, if you suffer losses through misselling you will not qualify for FSCS protection worth up to £85,000.

4. Do your due diligence: Scammers' tactics have become more sophisticated in recent years, with 'clone' scams – where fraudsters impersonate a real firm to con you out of your cash – increasingly common. You can cross-check the phone number or email address provided by someone who contacts you with the FCA register to make sure they are who they say they are.

5. Don't be rushed and if in doubt, speak to a regulated financial adviser: High-pressure sales tactics – such as telling someone they need to invest by a set deadline – are a classic scam tactic and should immediately set off alarm bells. Do not under any circumstances be rushed into a decision you aren't completely happy with. If you want help with your options or are unsure what to do, consider speaking to a regulated financial adviser or visit Government-backed retirement guidance service www.pensionwise.gov.uk.

Please note, we only provide information and we do not provide financial advice. If you're unsure please consult a suitably qualified financial adviser. We cannot comment on individual investment portfolios.

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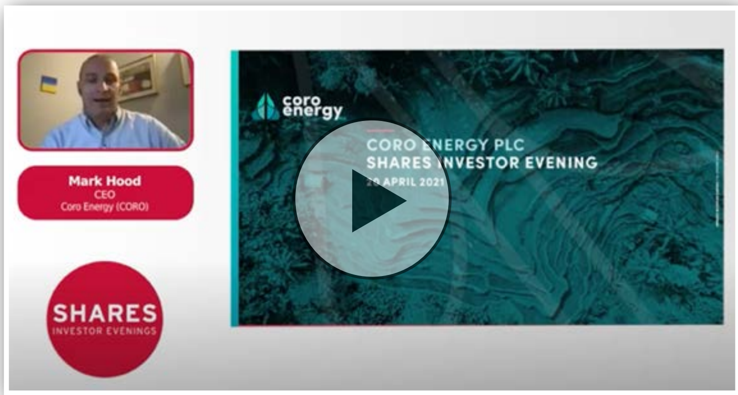

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KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results

30 April: UK Oil & Gas, Westminster Group. **4 May:** Frenkel Topping. **5 May:** Keystone Law, Wandisco. **6 May:** Trainline.

Half-year results

30 April: Infrastrata, UP Global Sourcing. **5 May:** Cambria Automobiles, Smiths News, Virgin Money UK.

Trading statements

30 April: AstraZeneca, Barclays, Smurfit Kappa. **5 May:** Direct Line, Smith & Nephew. **6 May:** AIB, Barratt Developments, Derwent London, Equiniti, Hansard, Kosmos Energy, Mondi.

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