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Contents

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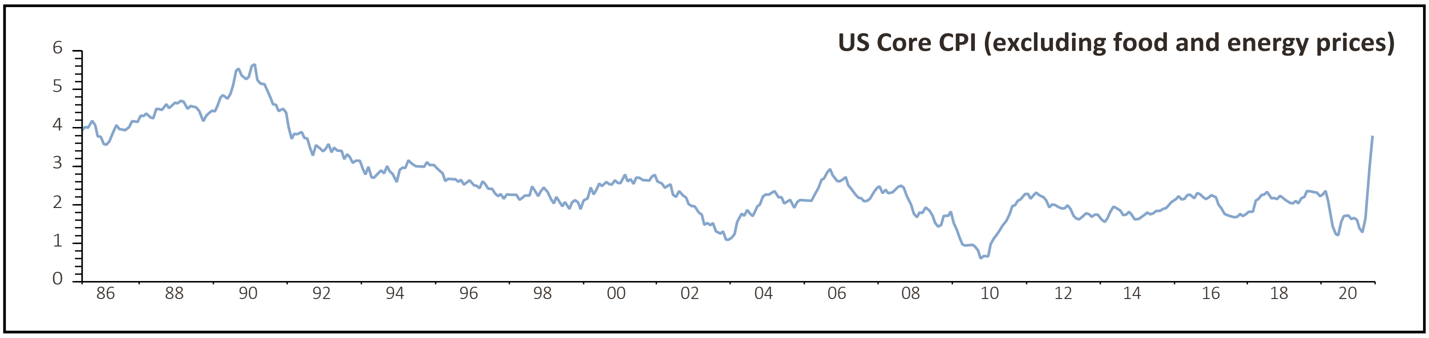
This is why markets are more relaxed about inflation again

Central banks seem to have offset concerns over rising prices for now



After a strong start to 2021 for global equity markets, as investors looked toward a post-Covid recovery, sentiment weakened sharply. This was down to fears that the pent-up demand and government's large stimulus efforts would send inflation spiralling through the roof and lead to a rapid tightening of monetary policy.

Bond yields surged, usually a warning sign of an overheating economy, and in the spring, there was significant volatility in stocks.

It is not as if those fears were unfounded. In the US, inflation hit 5% in May, its highest level since 2008. And if you look at core inflation, stripping out food and energy prices, this hit a 29-year high.

Commodity prices remain elevated, while housebuilder **Bellway (BWY)** recently became just the latest company to reference rising input costs.

However, investors have largely taken these developments in their stride with US shares moving to fresh record levels and the FTSE 100 is heading back towards pre-Covid levels, while bond yields have subsided.

What is going on? Chief investment officer at asset manager Kingswood, Rupert Thompson, puts forward one possible theory. 'The old investment adage "buy the rumour, sell the fact" may be part of the answer,' he says.

'Bond yields rose sharply early in the year on fears of the inflation spike now underway. Arguably, yields rose too far too fast and are now just correcting this overshoot. The only flaw here is that the surge in inflation is proving larger, not smaller, than expected.'

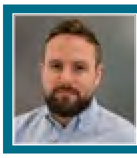
Ultimately the reason why inflation overshooting expectations is not causing more of a stir is that central bankers' efforts to assuage fears that rising prices will inevitably lead to a rapid increase in interest rates are proving successful.

The US Federal Reserve has tied its decisions to the jobs market instead, suggesting this may be the more relevant metric when it comes to trying to guess the timing and trajectory of a tapering of stimulus and raising of rates.

However, the likes of the Federal Reserve and European Central Bank have predicated their relaxed attitude to inflationary pressures on them being 'transitory' so the longer high levels of inflation persist, the more likely the market's current relaxed attitude will shift.

The level inflation settles at will also be important, as a relatively mild level of inflation might not be particularly bad news for equities.

As Thompson notes, shares do have an advantage over bonds when prices are rising. He says: 'As long as it remains below 3% or so, equities have tended to fare reasonably well when inflation picks up. This is because firms can pass on cost increases into higher prices, allowing earnings growth to keep pace with inflation. The coupon payments on conventional bonds, by contrast, are fixed.'



By **Tom Sieber** Deputy Editor

Regulator tells companies to prioritise pensions over dividends

Pay-outs could be put on hold where schemes are in deficit

Companies with large defined benefit pension deficits have been warned by The Pensions Regulator that dividends might have been to put on hold if they are under financial pressure amid efforts to recover from the pandemic.

Less than 200 pension schemes have asked to reduce or postpone their deficit contributions since April last year. However, with the Government looking to wind down its support to businesses, pension trustees will be under greater scrutiny.

'The Pensions Regulator's call for companies to avoid dividend payments if they are still recovering from Covid-19 and have pension obligations could affect the boardroom's willingness to sanction dividend payments, for fear of public or regulatory backlash,' cautioned Russ Mould, investment director at AJ Bell.

David Fairs, executive director for regulatory policy, analysis and advice at The Pensions Regulator, said: 'Trustees should remain vigilant as we emerge from the worst of the pandemic, there is still a lot of uncertainty and there could well be an increase in insolvencies.'

For companies hit hard by Covid, but which are recovering, there could be some short-term affordability constraints, according to Fairs. He added that trustees should consider any requests to lower contributions and said: 'We expect any request to be short term, and we want to see higher contributions in subsequent years.'

For firms still feeling the impact of Covid, trustees may need to be flexible, but the pension scheme should not be the only creditor feeling the pain, according to Fairs. 'They should be treated fairly among other creditors. Dividends may need to be put on hold. Robust risk management is essential.'

In 2020 the Bank of England's Prudential Regulatory Authority banned the payment of dividends by the banks in order that they build up their capital reserves to support their customers.

Insurance companies were advised by the regulator to suspend dividends, but the bigger firms weathered the storm well enough to be able to maintain their payouts.

For many investors in insurers, dividends make up a key part of their attraction.

According to data from SharePad, just under half of the companies in the FTSE 100 index have a pension deficit, with seven firms carrying multi-billion-pound liabilities.

Of the seven firms – **Astra Zeneca (AZN)**, **BAE Systems (BA.)**, **BT (BT.A)**, **GlaxoSmithKline (GSK)**, **Phoenix Group (PHNX)**, **Royal Dutch Shell (RDSB)** and **Tesco (TSCO)** – six paid dividends for the 2020 financial year.

BP, GlaxoSmithKline and Shell have already paid or declared their first quarter dividends for this financial year. [IC]

BILLION-POUND FTSE 100 PENSION DEFICITS

Company	FY 20 Pension Deficit	FY20 Dividends	FY21 Dividends
Royal Dutch Shell	£6.5bn	49p	51.1p
BT	£5.1bn	7.7p	7.5p
BAE Systems	£4.8bn	24.5p	26.1p
GlaxoSmithKline	£3.5bn	79.6p	59.2p
AstraZeneca	£2.5bn	202p	209p
Phoenix	£2.0bn	48.1p	48.4p
Tesco	£1.2bn	9.5p	10.5p

Source: Shares, Sharepad

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GlaxoSmithKline to spin-off £30 billion consumer healthcare arm in 2022

Loading demerged unit with the bulk of its debt could allow GSK to reduce leverage in the remaining businesses

Global pharmaceutical company **GlaxoSmithKline (GSK)** plans to demerge its consumer healthcare division by August 2022 and give investors a direct stake in the some of the world's most iconic consumer brands.

While details are still sketchy, the head of the division Brian McNamara told the *Financial Times* that the demerged company would make the top 20 of the FTSE 100 index, implying a market capitalisation of at least £30 billion.

McNamara joined the business from Swiss pharmaceutical company Novartis after GSK bought out their consumer products joint venture in 2018.

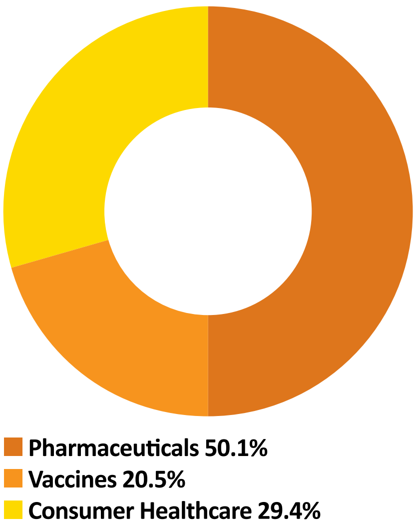
GSK merged its consumer products business with US firm Pfizer's consumer healthcare division to create the leading player in a fragmented consumer health industry.

A demerger would involve creating new shares and giving them to existing shareholders along the lines of one newco share for every three GSK shares held. Investors would then be free to hold those shares or sell them for cash in the market.

The advantage of going down this route is that it realises value for the parent company while also giving the new company freedom to pursue its own strategy and financing.

GSK is due to host an investor day on 23 June when McNamara will outline prospects for the business and clarify timing of the listing.

GSK – revenue by segment 2020



Source: GlaxoSmithKline, 2020 annual report.

Interestingly, under the original terms of the joint venture GSK can also sell its 68% interest via an initial public offering.

CONSOLIDATING A FRAGMENTED MARKET

McNamara has indicated that the vitamins and mineral supplement part of consumer healthcare could benefit from making small bolt-on acquisitions.

These activities received a boost from the pandemic as consumers spent more money on wellbeing products and GSK reported 16% sales growth last year, amid a 4% growth in overall consumer healthcare revenues to £10 billion.

An acquisition strategy could be financed from operations given the highly cash generative nature of the business.

But it might also imply raising fresh equity at the same time of the spin-off given the high indebtedness of the business. Management has indicated it could have net debt to EBITDA (earnings before interest, taxes, depreciation, and amortisation) of 3.5-to-4-times.

This is generally considered to be below investment grade, precluding some institutions from investing in the debt.

The new consumer healthcare business will be the largest global player in the over-the-counter market with a 7.3% share, almost double its nearest competitor, according to the company. [MG]

Markets unmoved by lockdown easing delay

The delay didn't have a big impact on most firms, with the news already priced in among leisure stocks

The delay in easing lockdown restrictions in England from 21 June to 19 July has caused consternation among many business sectors, but if the stock market's reaction to the news is anything to go by, it doesn't matter much to the UK's listed companies.

Both the FTSE 100 and more domestically-focused FTSE 250 shrugged off the news.

The delay had been widely expected, with the announcement from prime minister Boris Johnson on Monday evening seen almost as a formality.

The live event and night-time economy sectors are the ones that are most affected, and these aren't represented on the stock market in any significant way.

Shares in the likes of pub group **Marstons (MARS)** and Wagamama owner **The Restaurant**

Group (RTN) were broadly unmoved following the announcement, with the likelihood of a delay already priced in.

One area which has taken a hit is travel stocks, with shares in British Airways owner **International Consolidated Airlines (IAG)** and budget airline **EasyJet (EZJ)** falling. Several countries have tightened restrictions on incoming visitors from the UK recently. [YF]

Record job additions not sparking inflation fears yet

Rates to stay on hold despite signs of recovery and wage pressure

NEWS (15 JUN) THAT a record 197,000 people had joined the workforce in May, as the re-opening of non-essential retail and other venues sparked a rush to hire, didn't contribute to any immediate ratcheting up of inflation or rate hike fears.

The increase marks the sixth consecutive month of job creation, taking the number of payrolled employees to 28.5 million although that figure is still some 550,000 short of the level seen before the pandemic.

In most industries, vacancies are above pre-pandemic levels while companies are having to pay more to hire and retain staff. For the three months to April average pay excluding bonuses rose by 5.6%, the fastest rate since 2007.

However, commentators called the rise 'transitory' and pointed to the number of people still not back at work as evidence that there was still slack in the economy.

'All the dials in the labour market are pointing in the right direction, but they're distorted by the furlough scheme, lockdown lifting bottlenecks and the effect of annual comparisons now lapping the first wave of the crisis', said Laith Khalaf, financial analyst at AJ Bell.

'We won't get a clear picture of the health of the economy until the back end of this year, which means the Bank of England isn't going to rush into any interest rate hikes in the next few months, even if the UK looks to be firing on all cylinders', he added. [IC]

Disclaimer: AJ Bell is the owner and publisher of Shares Magazine. The author Ian Conway and Editor Tom Sieber own shares in AJ Bell.

Space the new frontier for investors as ETF and investment trust launch

Stocks involved in out of this world activities are creating excitement not yet justified by their performance

The addition to the London market of an investment trust and an exchange-traded fund which invest in companies involved in space activities reflect the theme's move into the mainstream.

Seraphim Space Investment Trust is hoping to raise £150 million to launch the world's first listed fund investing in the space sector. This comes after the **Procure Space ETF (YODA)** joined the London Stock Exchange at the start of June.

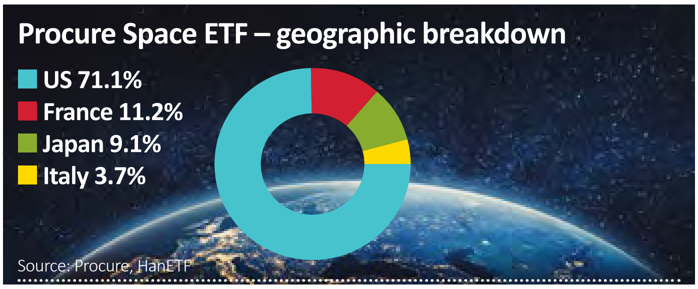
While sending passengers into space has caught the public's imagination, it's the ongoing commercialisation of the sector that's interesting investors.

The cost of building satellites, which are becoming increasingly lighter and smaller, and sending them into orbit has reduced dramatically in recent years, opening up a wide range of potential commercial applications.

The difference between the space-focused investment trust and the ETF is that the trust will invest in unlisted companies, while the ETF only holds listed stocks.

The trust will raise £150 million in new investor money and incorporate assets in Seraphim's existing fund, worth £100 million. It has invested half the money in 20 space-related firms, with many valued at more than $1 billion.

Two of its portfolio companies are planning stock market floats in the US by merging with SPACs. Spire Global, a provider of satellite-based global weather forecasting and analytics, and Arqit, a UK-based quantum computing encryption company, will be valued at $1.4 billion apiece if their US floats go ahead. The trust is targeting an eye-catching annual return of 20%.



BESPOKE SPACE INDEX

Meanwhile the Procure Space ETF, which tracks a bespoke index, only invests in companies that are listed on the stock market, with 80% of the index made up of stocks that derive over 50% of their revenue from space-related businesses.

To be included in the index a firm must have a market value of more than $100 million and the ability for the shares to be easily bought and sold with at least $1 million traded in its shares each day.

Since inception in April 2019, the US-listed version of the ETF is up 22.8% which lags behind a 39.7% rise for the MSCI World index over the same time period. The ongoing charge of 0.75% is quite high for an ETF but reflects the specialised nature of the vehicle.

One well-known investor in space-related stocks is Baillie Gifford-run investment trust **Scottish Mortgage (SMT)**.

Speaking in an investor update in April, co-manager Tom Slater highlighted unquoted SpaceX, created by Tesla founder Elon Musk, and said that as the cost per kilogram of cargo into space gets lower and lower, it opens up 'huge new applications'.

He added: '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.' [YF]

Change at the top to super-charge Brown Advisory US Smaller Companies

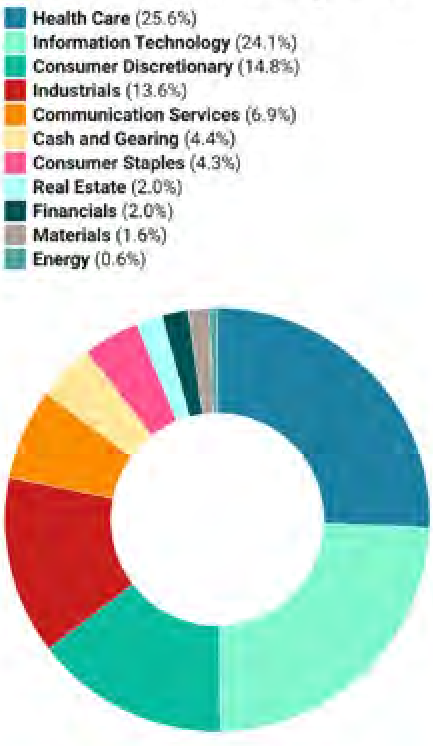
Why you should buy into Chris Berrier's tried-and-tested '3G' approach

A 10.6% discount to NAV (net asset value) is an exciting opportunity to buy **Brown Advisory US Smaller Companies (BASC)**, with Chris Berrier of new manager Brown Advisory wasting no time in enacting wholesale changes.

Formerly Jupiter US Smaller Companies, the trust's name was changed in May 2021 after Brown Advisory took over the mandate on 1 April.

Berrier's investment approach is tried-and-tested and there's no reason why a pick up in performance shouldn't see Brown Advisory US Smaller Companies trading at a premium alongside **JPMorgan US Smaller Companies (JUSC)**, its sole peer in the AIC (Association of Investment Companies) North American Smaller Companies sector.

Sector allocation - May 2021



Source: Brown Advisory • Created with Datawrapper

BROWN ADVISORY US SMALLER COMPANIES
BUY
(BASC) £13.26

Total assets: £176.6 million

EXCITING ENTRY POINT

Morningstar reveals the trust has generated 10-year annualised share price and NAV total returns of 11.5% and 13% respectively, underperforming the Russell 2000 Total Return USD index's 14.7% haul over the same period.

Yet this reflects poor performance under the value strategy pursued by the previous manager which new lead manager Berrier, who heads up the Brown Advisory US Small Cap Growth team, is seeking to reverse.

The change comes at an intriguing time for US small caps, with vaccines being rolled out at pace and giving America's domestic economy a shot in the arm.

New president Joe Biden's enormous stimulus package should boost economic activity further, in particular for domestically-focused US small caps.

This provides a favourable backdrop for Berrier, who has run a very successful quality growth strategy in the open-ended space since 2006 which has outperformed both the small cap Russell 2000 index and the Russell 2000 Growth index.

In fact, investment trust researcher Kepler points out the performance of Berrier's strategy over the past five years has been particularly strong, and it has continued its longer-term trend of generating above-market returns with below-market levels of risk.

'He focuses on companies that possess what he describes as '3G' qualities: durable growth, sound governance and scalable go-to-market strategies'.

Mobile games developer Zynga is included in Brown Advisory US Smaller Companies' portfolio

AIC North American Smaller Companies Sector	Total assets (£ millions)	Gearing (%)	Ten year share price total return (%)	Five year share price total return (%)
Brown Advisory US Smaller Companies	176.6	0	205.3	103.1
JPMorgan US Smaller Companies	303.4	6	377.1	147.6

Source: The AIC

'3G' QUALITIES

Berrier's proven process sees him hunting for opportunities within an 'advantaged universe' of companies with pricing inefficiencies he can exploit; analyst coverage becomes thinner the further down the market cap spectrum you go.

As he explained in a recent presentation: 'The US has a large and deep market of small caps. It is a highly innovative economy, things are constantly changing and that provides opportunities for us to pick off interesting investments, hopefully before they become broadly recognised.'

Berrier has a great number of companies he can choose from in this highly diversified space, many of them relatively immature, whether financially or operationally or in terms of management or market position, and with long growth runways ahead of them.

The rigorous stock-picker aims to find firms that can demonstrate consistent growth ahead of the market over the long run, usually by opening up a new market, dominating a niche, or by having a differentiated business model or product.

He focuses on companies that possess what he describes as '3G' qualities: durable growth, sound governance and scalable go-to-market strategies. Unsurprisingly, such high-quality assets pop up on the radars of potential bidders before too long, and Berrier's small cap strategy routinely benefits from premium-priced takeovers.

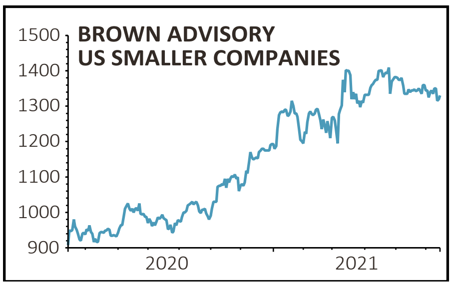
One example is Nuance Communications, the AI specialist best known for its deep learning voice transcription service popular in the healthcare sector, which was initiated in the trust when Berrier took over in April and was subsequently acquired by tech titan Microsoft for a bumper $19.7 billion.

Admittedly, smaller companies tend to be riskier than larger companies, but Berrier's portfolios are diversified across sectors, business models and economic sensitivities in order to mitigate risk, as demonstrated by the trust's top ten holdings. This eclectic group includes the likes of Workiva, a SaaS platform expanding its capabilities in the financial management space, mobile games developer Zynga, payment processing services play Evo Payments and solid waste-to-recycling services company Waste Connections.

'We typically try to offset the higher growth names in the portfolio, earlier stage like a Workiva, with things like a Waste Connections or a Charles River Laboratories, that might have a little bit more ballast and history to them,' said Berrier recently.

It is also worth noting that as part of the new management contract, the board negotiated a fee cut, with the management fee falling by five basis points to and a tiered system introduced which will see it fall further as and when the trust's net assets grow.

The overall ongoing charge is 0.97% according to the AIC which compares with 1.06% for JPMorgan US Smaller Companies. [JC]



SkinBio Therapeutics' psoriasis supplement has big potential

The company is well positioned to be a major player in the emerging skin health probiotic market

Investors should buy **SkinBio Therapeutics (SBTX:AIM)** as it prepares to launch a new product which could generate tens of millions of pounds in fresh revenue for the business.

The company has developed a proprietary technology platform which harnesses the human microbiome to improve skin health and access the growing market for probiotic products.

On 26 May the company reported impressive results from a study testing the effectiveness of its AxisBiotix-Ps food supplement which is a blend of bacterial strains developed with its partner Winclove Probiotics.

The idea is to balance the gut microbiome and reduce the over production of new skin cells, which causes skin conditions such as psoriasis.

Over 72% of participants who took the oral product for 56 days reported 76% reduced itchiness, 75% less redness, a 73% reduction in irritability and a 65% reduction in flaky patches.

In addition, participants reported improvements in general health including better sleep and energy.

Psoriasis is an autoimmune condition impacting up to 125 million people globally according to the National Psoriasis Foundation.

SKINBIO THERAPEUTICS
BUY
(SBTX:AIM) 63.4p
Market cap: £105 million

SCALING UP

The company now plans to scale-up manufacturing with its partner Winclove Probiotics, targeting a commercial launch in the UK, Europe and the US during the final quarter of 2021.

The study data will be submitted for approval by the authorities as a food supplement in targeted regions. The revenues model is 'click-and-pay' where customers subscribe and pay a fee to receive the product.

Management is acutely aware of the risks of overpromising and underdelivering, so it has taken a measured approach and will initially limit the number of subscribers.

Pricing strategy and initial capacity hasn't been revealed but the chief executive Stuart Ashman told *Shares* that the company would price the product in line with market prices of between £1.20-and-£2 a day.

HOW MUCH MONEY COULD IT MAKE?

Broker Cenkos has taken a conservative approach and assumed pricing at £30 per month and a slow initial take-up, focused only on the UK market.

After five years the modelling suggests revenues of £47 million, which assumes a 10% penetration of the UK market of 1.3 million sufferers, which looks conservative relative to the study results.

SkinBio is due to give an update on its pricing and marketing strategy over the next three months.

In addition to AxisBiotix-Ps, the company has identified other opportunities. For example, in 2019 it signed a contract with FTSE 100 company **Croda International (CRDA)** which is using the firm's core SkinBiotix technology to design and manufacture a new skincare ingredient.

While there are uncertainties and risks to commercialising AxisBiotix-Ps, we believe the current market capitalisation doesn't fully reflect the potential financial rewards. [MG]

TOP STOCKS FOR 2021

DIAGEO

(DGE) £34.60

Gain to date: 17.5%

Original entry point:

Buy at £29.45, 23 December 2020

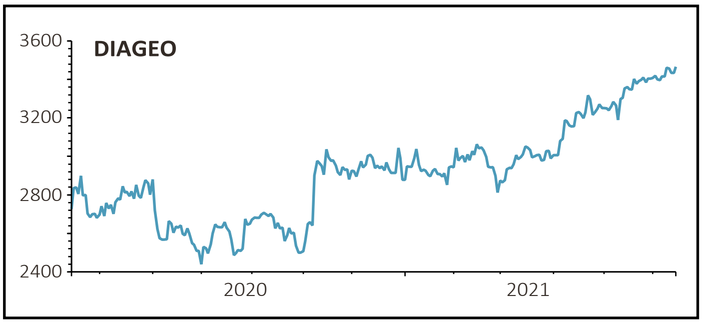
WE ARE NOT the only ones to have spotted potential in alcoholic drinks giant **Diageo (DGE)** with Nick Train's **Lindsell Train Global Equity Fund (B644PG0)** noting the recent uptick in performance in its latest factsheet.

Train's colleague Michael Lindsell commented that the company has come a long way since the early stages of the pandemic: 'Now, one year on, the clouds have parted,' he said.

'Based at home, consumers have guzzled spirits with unanticipated enthusiasm, buying into the trend for cocktails and premium offerings. Organic sales have started to recover, up 1% in the last half of 2020 with further momentum building since.

'Reinforcing a five-year trend, spirits as an alcoholic beverage category continues to take share from beer and wine.'

Lindsell also noted the strong performance of tequila which is making the purchase of Casamigos, albeit at a high price, in 2017 look 'well-timed'. And he is encouraged by the recent purchase of premium gin brand Aviator Gin, observing that 60% of revenue is now derived from premium products.



SHARES SAYS: ↗

Like Lindsell Train we are encouraged by recent performance and still think the shares are worth buying. [TS]

INDITEX

(ITX:BME) €31.75

Gain to date: 32.3%

Original entry point:

Buy at €24, 8 October 2020

SHARES IN SPANISH fashion firm Inditex, which owns the iconic Zara brand along with half a dozen lesser-known (in the UK) brands, continue to enjoy a re-rating after the firm beat forecasts with a return to profit in its first quarter.

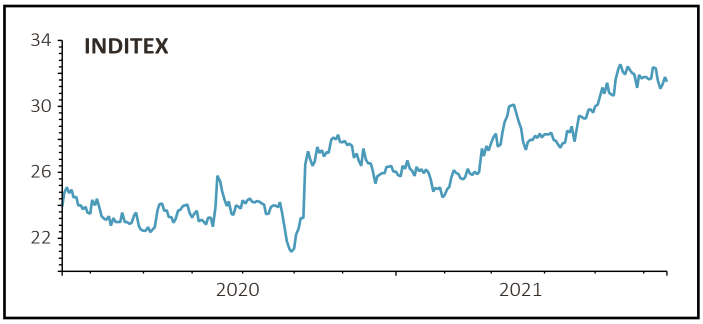
Despite losing a quarter of trading hours due to a high number of its stores still being closed, sales in the three months to April increased by 50% to €4.94 billion thanks to a 67% surge in online revenues.

Also, while almost a fifth of its stores remained shut at the end of April, the company stuck to its expansion plan and managed to open new stores in 21 countries.

Even after this investment, net cash at the end of April was €7.2 billion, up 25% on last year and the highest-ever first quarter level for the business.

Strong trading continued into May with sales online and in-store up 102% on last year and 5% ahead of the same month in 2019, even with a 10% reduction in trading hours due to many stores still being closed.

Analysts have rushed to upgrade their earnings forecasts, yet a number are stoically sticking with their 'hold' recommendation despite the shares trading above their target prices. We expect them to capitulate in time.



SHARES SAYS: ↗

We expect the company to keep beating expectations. Stick with the stock. [IC]

BLACKROCK THROGMORTON

(THRG) 916.59P

Gain to date: 30.4%

Original entry point:

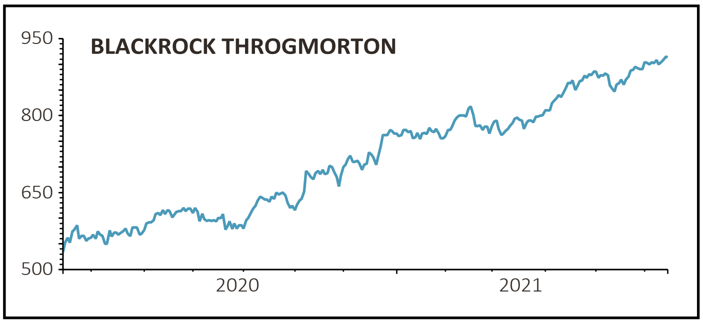
Buy at 702.79p, 26 November 2020

OUR CALL TO buy investment trust **BlackRock Throgmorton (THRG)** for its focus on quality companies which had been sold off in the initial value rally has proved a canny trade.

The portfolio is dominated by small and mid-cap names which have performed strongly in the interim. A portfolio update on 11 May revealed that in the three months to 30 April the net asset value and share price had increased 18.4% against a 15.6% advance in the benchmark.

A big contributor to this positive showing has been ESG-focused asset manager **Impax Asset Management (IPX:AIM)** as well as building materials firm **Grafton (GFTU)** and pharmaceutical services company **Ergomed (ERGO:AIM)**, which announced an expansion in Japan in April.

Commenting on the recent performance fund manager Dan Whitestone said: 'The general pattern was of strong trading with good growth even for those who grew very fast in 2020, and so the higher share prices now are justified by the higher profits than had been expected a year ago.'



SHARES SAYS:

The trust's focus on quality small and mid caps should stand it in good stead for the longer term. Still a buy. [TS]

AURORA INVESTMENT TRUST

(ARR) 233.99P

Gain to date: 38.4%

Original entry point:

Buy at 169p, 22 October 2020

WE SAID TO buy value-focused **Aurora Investment Trust (ARR)** last October in the belief that value investing could make a comeback, which has since proved correct.

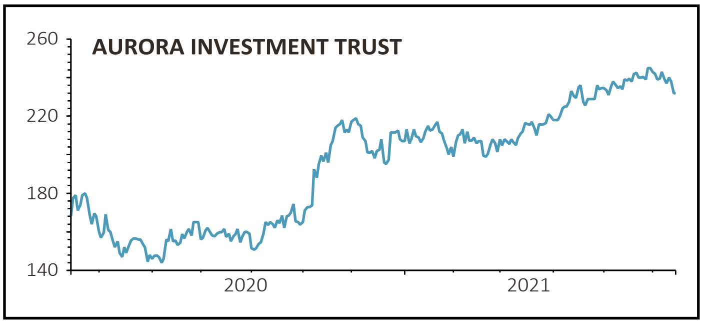
Full-year results on 2 June revealed that Aurora had beaten the FTSE All-Share by 4.5% in 2020, albeit falling by less than the market. The investment trust declined by 5.3% versus a 9.8% fall in the benchmark index.

In the five years since Phoenix took over management of the trust to the end of 2020, the net asset value grew by 47.7% versus a 34.5% rise in the benchmark.

Those figures are impressive, but they only include two months of the market's shift in preference of value investing which began in November 2020.

In share price terms, rather than net asset value, Aurora has increased by 42% since 1 November 2020. This compares with 31.9% from the FTSE All-Share, says FE Fundinfo – demonstrating further outperformance.

Its portfolio has benefited from owning several companies that should benefit from the reopening trade, such as Sports Direct owner **Frasers (FRAS)**, as well as positions in housebuilders **Barratt Developments (BDEV)** and **Bellway (BWY)** which are benefiting from a surge in the UK property market.



SHARES SAYS:

Impressive performance figures. Keep buying. [DC]

Five dividend growth stars to buy

Dividend growers and initiators have historically performed better than the market, while also providing protection against market volatility

By **Martin Gamble**
Senior Reporter

Dividends are an important contributor to every sensible long-term investment plan and yet they are probably underappreciated by investors, because they are sometimes perceived as dull.

They are often associated with 'income seeking' investors or companies which have low growth prospects.

However, that view is misleading, especially considering the role dividends play in creating shareholder value.

According to research from Ned Davis Research, from 1972 to 2019, dividend paying companies in the S&P 500 index delivered an annualised total return of 12.8% compared with 10.9% for non-dividend paying stocks. Total return accounts for capital gains/losses and dividends.

A 1.9% gap might not sound like much but compounded over 47 years it means the dividend paying shares could have returned more than double the non-paying shares.

Even better, in times of relatively scarce earnings during periods of low economic growth, the contribution from dividends to total returns is even higher. For example, in the 1940s and 1970s dividends accounted for 75% of total shareholder returns.

The calculation assumes that dividend income is used to purchase new shares and it is this compounding effect which turbocharges shareholder returns.

INFLATION PROTECTION

With investors increasingly worried about inflationary pressures, you may be surprised to learn that companies which pay dividends have historically been a good hedge against inflation.

According to data from US economist Robert Shiller, since 1940 the average growth in dividends over rolling 10-year periods has been 4% a year, double the rate of inflation as calculated by the US Bureau of Labour.

DON'T FOCUS ON YIELD ALONE

With historically low interest rates across the developed world, investors have been starved of yield. This may have led some investors down the path of searching for the highest dividend yields, irrespective of the underlying fundamentals of the business.

Data from Ned Davis Research shows that companies earning just enough to pay out dividends, implying a high payout ratio, significantly underperformed the S&P 500 from 2002 to 2020.

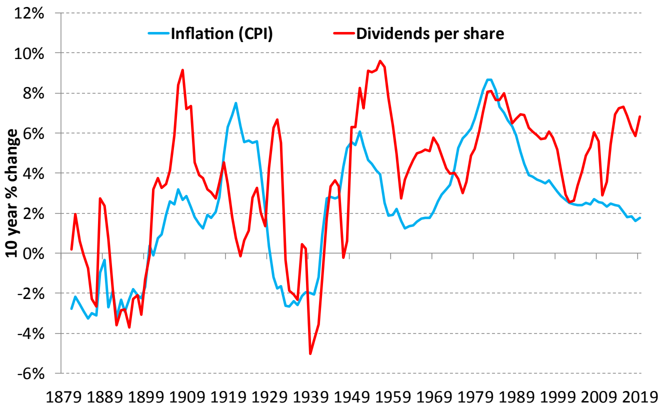
That's because they tend to be companies in highly competitive industries which don't generate enough cash to sustainably pay a dividend. Conversely, stocks with medium to low payout ratios outperformed.

There seems to be a good case for accepting lower, but potentially more sustainable income over higher, but possibly less sustainable income. Particularly as this leaves capacity for dividends to grow.

By reinvesting your dividend and using it to buy shares in the same firm you'll be steadily increasing your holdings of that particular stock. In turn, you'll be setting yourself up for even more dividends down the line. Your benefits are enhanced further if the actual dividend payment is also growing each year.

It should also be remembered that even a 2%-to-3% yield is very attractive relative to current risk free rates of interest.

Rolling 10-year growth in inflation and S&P 500 dividends per share



Source: Robert J. Shiller. Stock Market Data Used in "Irrational Exuberance" Princeton University Press, Guinness AM

DIVIDENDS PROVIDE USEFUL SIGNALS TO SHAREHOLDERS

It's often forgotten that the decision to pay a dividend is part of management's capital allocation policy and as such it signals a lot about a company's ability to generate cash, its growth opportunities as well as its attitude towards shareholders.

As a reminder, firms have three choices for the cash that they generate, and they aren't mutually exclusive. They can reinvest in the business to grow, purchase growth via acquisition or payout cash in the form of dividends or share buybacks.

Mature companies with strong market positions often generate higher than average returns on capital, which means they generate excess cash even after reinvesting for growth. These are great to own because investors potentially get growth and a progressive income.

Portfolio Managers at **Guinness Global Equity Income Fund (BNGFN77)**, Ian Mortimer and Matthew Page, believe that committing to a dividend can act as a discipline on management and keep them from spending on 'vanity projects or frivolous uses of capital'.

Once a dividend policy has been set and communicated to the market, management have effectively set a line in the sand and will then only cut if absolutely necessary because of economic circumstances.

It can take a long time to build the trust of shareholders so companies will be very reluctant to blow that trust by cutting the dividend.

This means they tend set the dividend payout conservatively, below the level of earnings, which gives management some flexibility to maintain the dividend even if earnings splutter from time to time.

SHARE BUYBACKS

In recent years the trend for buying back shares has become commonplace, especially in the US.

SHARES' DIVIDEND GROWERS SCREEN

Name	Div Yield (%)	FCF / Sales (%)	Payout Ratio (%)	ROE 5y Avg (%)	GP/Assets (%)
B&M	4.2	15	41	27	53
RELX	2.9	17	71	59	33
Sage	2.8	17	53	21	48
Spirax-Sarco Engineering	1.1	18	50	25	52
Ashtead	1.1	30	30	28	36
Halma	0.8	19	21	18	34
Fevertree Drinks	0.8	14	44	33	39

Source: Stockopedia, Refinitiv, SharePad. Div Yield = average next two years' forecast forecast. FCF = free cash flow. GP = gross profits. ROE = return on equity.

From a capital allocation perspective, buybacks should only be considered if they have a good chance of increasing shareholder value.

Theoretically, if a firm buys back shares when management considers them to be undervalued, it can be one way to create shareholder value. However, assessing fundamental value is tricky and not a precise science.

Also, management greed has muddied the waters. Compensation is often contingent on earnings per share growth and buying back shares increases per share growth, everything else being equal.

Studies have shown that companies tend to buy back shares when they have the cash to do so. It often happens at the back end of economic expansion cycles, rather than when they believe their shares are cheap.

FINDING SUSTAINABLE DIVIDEND GROWERS

Guided by the results of the academic studies mentioned we have created a fundamental screen to find potential dividend growers, principally using data from Stockopedia.

Essentially, we are looking for established, large businesses which have a history of steady, rather than spectacular earnings growth.

They will ideally generate higher than average returns on capital and exhibit a history of regular, progressive dividends and a solid balance sheet. We have insisted on a maximum payout ratio of 80% of earnings.

The screening criteria we used was demanding – we isolated the top 25% of firms with the highest five year returns on equity and gross profits to assets, a free cash flow to sales ratio above 12% and at an unbroken trend of dividend increases over the past nine years.

Gross profit to assets was popularised by Robert Novy-Marx of the University of Rochester and is considered a good measure of quality. His research found that companies with the highest returns outperformed those with the lowest and interestingly the ratio was more predictive than widely used earnings and cash flow valuation metrics.

The screen identified just seven names and we discuss the merits of our top five companies below.

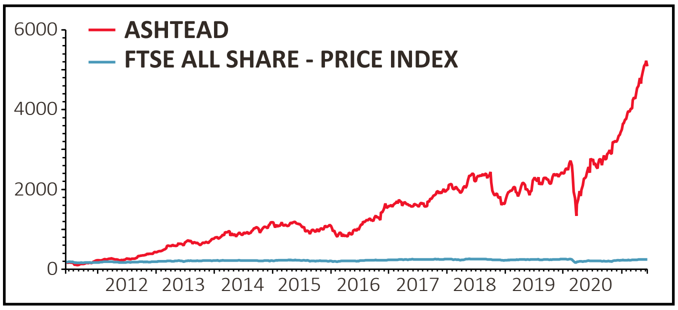
OUR TOP FIVE PICKS

1

Ashtead (AHT)

£49.85

Based on near-term forecasts, equipment hire business **Ashtead (AHT)** is not cheap and offers a modest yield marginally above 1%.



However, investors should focus on the long-term potential for dividend growth and Ashtead's track record is exceptional on this measure. It even maintained its progressive dividend policy in the teeth of the pandemic.

Dividends have gone from 2p in 2010 to 40.65p in 2020 – that latter payment representing a yield of 35% on the price you could have purchased the shares at the beginning of that decade.

The company generates most of its earnings in the US through its Sunbelt operation and it is seen as a beneficiary of the big infrastructure spending plans outlined by the Biden administration.

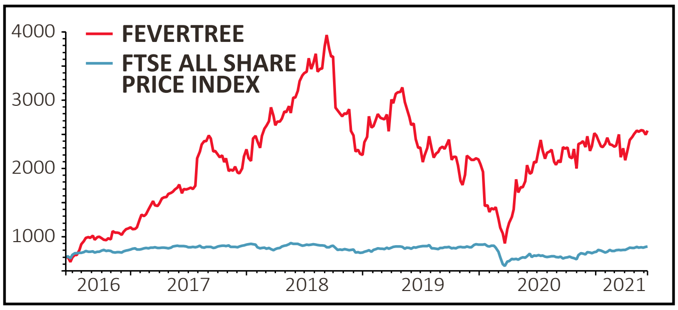
High margins and substantial cash generation enable the company to both invest in the business and underpin the company's standout dividend growth.

2

Fevertree Drinks (FEVR:AIM)

£25.58

Since premium spirits mixer company **Fevertree Drinks (FEVR:AIM)** initiated a maiden dividend of 3.08p per share in April 2015, the firm has grown the payout to 15.68p per share, representing a compound average growth rate of 38% a year.



The company is highly cash generative due to its capital light business model, where it outsources capital-intensive activities such as manufacturing, enabling it to spend more resources on sales and marketing and building brand value.

There is plenty of growth potential for the company to exploit its differentiated products and expand its global footprint.

Liberum estimates that if the US premium market reaches the same penetration as the UK by 2030, Fevertree's US revenues could increase six-fold.

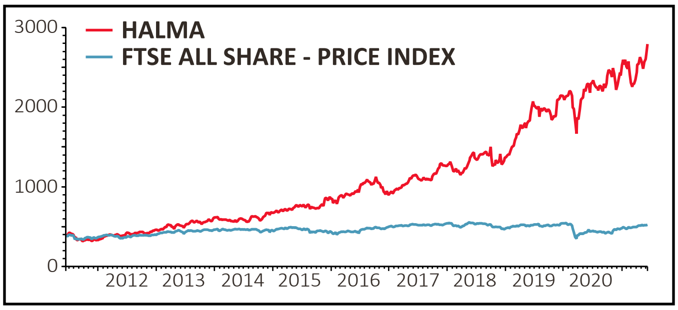
There is scope for good dividend growth in line with earnings while the payout could also increase as the company matures over time, so don't be put off by the 0.8% yield.

3

Halma (HLMA)

£26.32

The electronics engineer remains one of those stock market rarities – a company that never seems to put a foot wrong. Shareholders have benefitted from this reliability for years with capital returns close to 1,000% since the end of 2009, yet **Halma (HLMA)** remains a company with an underappreciated income story to tell.



Typically offering a dividend yield below 1%, it is easy to see why many investors wouldn't put much stock in Halma's income angle. Yet the consistency of its year after year above-inflation increases (42 years above 5% to date) can make a significant difference over time.

For example, had you bought Halma shares in early 2011 at around the prevailing 350p level, you would have since earned 143.27p back in the shape of dividends, including the latest declared 10.78p payment. That works out at nearly 41% of your original capital outlay.

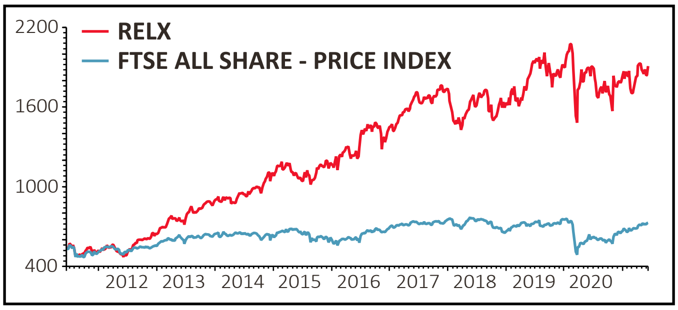
Halma has been increasing its dividend for years and with excellent cash generation (104% of operating profits last year) and easily manageable net debt (£256.2 million). We believe it will continue to reward investors for years to come.

4

RELX (REL)

£18.80

Information services firm **RELX (REL)** has successfully managed the transition in the publishing sector from print to digital over the past decade or so and become a high-quality business.



Scientists, lawyers or people in the insurance industry subscribe to the tools and information provided by RELX as they are considered essential for doing their job.

RELX benefits from subscription-based recurring revenue which should support its ability to grow the dividend. It has achieved 9.6% compound annual growth rate in dividends since 2015, according to Stockopedia. While a yield of 2.9% may not look overly generous, the capacity for income growth is the key attraction. A price to earnings ratio for 2021 of 25.7 times isn't overly expensive either.

The group generates 60% of its revenue from subscriptions. The rest comes from transactional activities (39%) and advertising (1%).

Where the company adds value is by taking large sets of data and distilling this into salient information which is useful for its clients.

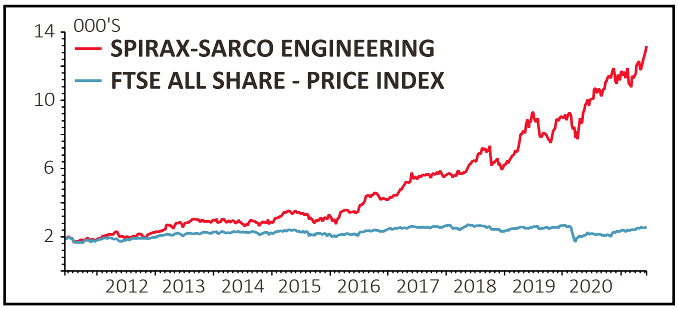
Investment bank Berenberg notes that RELX has demonstrated its ability on an underlying basis, to deliver c4% sales growth, 6% operating profit growth and 8% earnings per share growth in recent years.

5

Spirax-Sarco Engineering (SPX)

£132.15

Specialist steam technology and pumps company **Spirax-Sarco Engineering (SPX)** has delivered an incredible 53 years of consecutive dividend growth, representing a compound annual growth rate of 11%.



The company operates in a global market worth £10 billion and yet the firm estimates it has a market share of only 12%, suggesting scope for further penetration.

Spirax's business is highly cash generative, reflecting strong margins and visible revenues. Roughly 85% of the group's sales are generated from its customers' annual maintenance and repairs contracts which tend to be more resilient.

Over 55% of group revenues are derived from defensive, less cyclical end markets.

A key driver for the business is industrial production and population growth.

The company's strong track record and solid market positioning suggests it will continue to deliver consistent growth in earnings and dividends per share.

Kepler | Trust Intelligence

Time for the stock pickers

As a decade of growth-led momentum gives way to a choppy value resurgence, the outlook for markets is uncertain. Stock pickers are poised for their moment in the sun...

While it has been widely discussed, it bears repeating: 2020 was a truly tumultuous year for global equity investors.

In the latter quarter of the year, the growth-led momentum trade that had driven markets for the previous decade came shuddering to a halt. Stocks that had sat on historically high price-to-earnings ratios widely fell out of favour, with many global markets rotating into 'value' stocks instead.

This was problematic for many investors, with the majority having tilted their portfolios towards growth-focused managers and funds in the preceding years. However, as the market has relatively indiscriminately turned to those stocks sitting on more depressed valuations, some observers are suggesting that this trade may too be nearing maturity.

All of this makes it challenging to work out where exactly to put your money. With styles coming in and out of favour, are you better off tilting towards value or growth? Rather than looking to these two 'styles' of investing, it may be worth considering the old-fashioned approach: true stock picking.

OUT OF STYLE

For those who have been investing for a while – or at least since prior to the 2008 crash – the changing favours of different investment styles are a familiar phenomenon. In 2000, following the collapse of the dot-com bubble, value stocks rallied for a period.

However, data from S&P Global suggests that the longer-term picture is much more straightforward. Over 40 years, S&P's value index has returned 11.2% annualised, while its growth index has returned 12.1% annualised, a marginal difference. This data implies that investing purely on the basis of style is not the route to consistently generating alpha, or returns in excess of the market.

It is also reflective of the practicalities of investing in the real world. The general rotation from growth to value during the coronavirus pandemic was not driven merely by sentiment, but also by the practical implications of the pandemic. Some trends, such as the emphasis on and appetite for "experiences", which had come to drive swathes of the market during the preceding years, have been delayed or even reversed by its impact.

For growth managers (and passive funds which track the indices that growth stocks have typically dominated over the last few years) the reversal of these trends was painful.

At the same time, the trends that have most driven the value recovery – the reopening of global economies and the vaccine rollout – are already starting to mature in some markets, namely the US and UK. Some investors argue that this leaves a large group of these stocks with a relatively limited runway for further price increases. US and UK. Some investors argue that this leaves a large group of these stocks with a relatively limited runway for further price increases.

A GOOD LOOK

The complicated outlook for markets suggests the challenges for style-based investing could go on for some time. Knowing when to switch between styles when inflation, rising rates, a recession or all three could be on the horizon is difficult for most investors, verging on guesswork.

This opaque picture applies to companies too; with such an unusual economic context facing them, it is likely that companies within specific sectors will chart divergent courses out of the pandemic. Within this context, investing in global equities on the basis of style or sector preferences is fraught with risk at the moment – and in the long term.

An alternative is to consider a stock picking fund, like **Alliance Trust (ATST)**, which leaves that job in the hands of expert stock picking fund managers. ATST seeks to offer a 'core' allocation to global equities, avoiding active factor, sector and country risk relative to the benchmark, meaning it seeks to show no preference to either value or growth.

Instead, the trust consists of ten 'best ideas' portfolios, each built from a maximum of 20 stocks. This means that the underlying managers of these funds identify what they consider to be the very best stocks within their own investment remits, whether these include a preference towards value or growth or not.

Since bringing in this investment approach on 1 April 2017, the trust has performed marginally ahead of its MSCI ACWI benchmark in share price terms, by 2.5% to 30 April 2021. Crucially, for a large part of this period it was underweight the highly valued 'mega caps' which drove markets for much of the last decade.

This underweight weighed on the trust until last year, when the market turnaround saw some of these companies fall out of favour and those on depressed valuations experience an uplift. Over the twelve months to 30 April 2021, the trust outperformed the MSCI ACWI total return by 4.6%.

IT PAYS TO BE PICKY

While advocates of growth or value investing can make their case for their preferred style from dawn to dusk, the reality for most investors is that tracking the changing favours of these two styles is extremely difficult. In an unprecedented economic environment, seeking to identify the companies that are genuinely strong enough to survive seems intuitively sensible. By employing a truly stock selecting fund like Alliance Trust, targeting steady, reliable returns, this is what investors can aim for.

Click **here** to read our latest research...

More investment trusts look to invest in private companies

Baillie Gifford UK Growth and Fidelity China Special Situations look beyond the stock market to generate better returns

Despite the many thousands of stocks listed around the world, a rising number of investment trusts are looking to add or increase their exposure to unlisted companies as more businesses stay private for longer.

Baillie Gifford UK Growth (BGUK) is one such trust, and in August will seek shareholder approval to invest up to 10% of its portfolio in unquoted stocks which have a valuation of £500 million or more.

In total 22 investment trusts on the London Stock Exchange, not including ones which focus exclusively on private equity, offer some exposure to unquoted stocks, including household names like **Scottish Mortgage (SMT)**, **Lindsell Train (LTI)** and **F&C Investment Trust (FCIT)**.

In outlining its decision to add unlisted exposure the Baillie Gifford trust says: 'We see the private company space as potentially an interesting area to find exciting growth companies to invest in that we believe can help us in our objective of generating total returns in excess of the FTSE All-Share index.'

It adds that any unlisted stock added to the portfolio would have to 'offer something that cannot be accessed in the listed space', and points out there is a trend for private businesses in the UK, and more globally, to stay private for longer than in the past, with the permanent capital structure of an investment trust making them the 'ideal vehicle' to own such businesses.

The trust's managers also stress adding unquoted stocks doesn't mean a change in investment philosophy nor that they'd be investing in 'small, early stage venture capital style businesses.'

Fidelity China Special Situations (FCSS) has proposed to boost its maximum exposure to unlisted stocks from 10% of net asset value plus gearing to 15% of NAV.

The trust was a notable beneficiary of being an early investor in Chinese tech giant Alibaba, generating a large gain after the firm's record-breaking $25 billion stock market float in 2014. It says the unlisted space in China has 'expanded quite markedly and offers some excellent opportunities for patient, long-term investors.'

Like Ballie Gifford UK Growth, the Fidelity trust also points out the period from investment in a company to a stock market float has lengthened as unlisted companies are finding it possible to fulfil their capital needs with more rounds of capital raising before becoming a listed business.

Despite the enthusiasm on the part of trusts to broaden their investment universe, investors should note key risks including lower liquidity for unquoted holdings and more difficulty in accurately valuing them.

FURTHER EVIDENCE OF A SHIFT TO PRIVATE MARKET INVESTING

Asset manager BlackRock says its portfolio advisory business is moving away from the traditional model of 60% equities, 40% bonds to 50% public equity, 30% bonds and 20% unlisted assets.

By **Yoosof Farah**
Reporter

Managers with large 'skin in the game' outperform those without it

We look at the investment trusts where managers' interests are aligned with other shareholders

When you invest in a fund or investment trust you are putting your hard-earned cash in the hands of a professional fund manager and asking them to make decisions on what to do with it.

Knowing that said professional has at least a portion of their own wealth tied up in the fund offers a level of confidence that they will weigh portfolio decisions carefully and with a long-term perspective because they have what is often called 'skin in the game'.

THE MANAGERS WITH 'SKIN IN THE GAME'

A new report from Investec notes that the aggregate investment by boards and managers of trusts is £4.79 billion, a seven-fold increase on the £687 million invested as of 2010.

The research also reveals there are 77 investment trusts where managers or the management team have a personal investment in their fund of £1 million or more as at close on 1 June 2021. Interestingly, SharePad data shows an average five-year share price total return of 77% for

these trusts against 66.4% for trusts in general.

What could be the reason behind this performance differential? While in most cases managers will be working to the best of their ability to deliver returns for investors, the manager of a trust might only be in-situ for a few years and they therefore could be tempted to make decisions which boost performance in the short term.

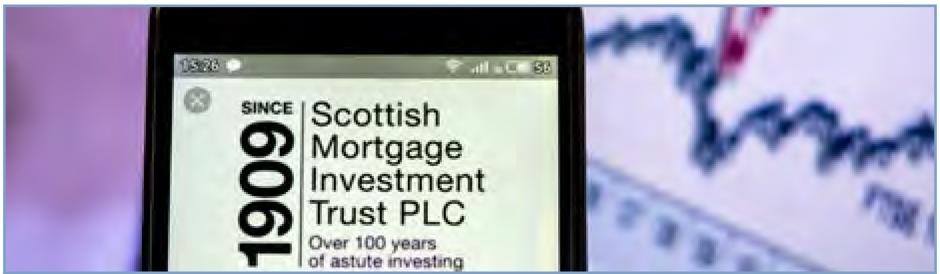
However, managers with their own personal wealth tied up in their investment trust are likely to exercise more patience. Indeed, a patient approach to investing is typically a more rewarding one.

Skin in the game is no guarantee of success and investors should not invest in a product just because the managers have a material holding in it. However, at the very least there should be transparency so you can be fully informed and feed this into your ultimate decision on whether to invest or not.

A CHEF SHOULD EAT THEIR OWN COOKING

Terry Smith, chief executive and chief investment officer of asset manager Fundsmith, comments: 'It is important fund managers have skin in the game to truly deliver alignment of interest with investors and disclosure of their stake should be mandatory. Who would trust a chef who wouldn't eat his/her own cooking?'

Yet as Investec notes: 'While



A selection of trusts where managers have bought shares with their own money

Trust	Value of managers' stake	Five-year share price total return (%)
Scottish Mortgage	£200 million	379.0
Herald	£8.5 million	215.0
Impax Environmental Markets	£1.2 million	169.0
Lindsell Train	£34.2 million	136.0
F&C Investment Trust	£1.5 million	108.0
Henderson Opportunities	£1.3 million	99.5
Third Point Investors	£104.9 million	97.6
Montanaro UK Smaller Companies	£19.7 million	91.6
BMO Private Equity Trust	£3.4 million	89.4
Baillie Gifford UK Growth	£4 million	79.6
Witan	£2.7 million	77.8
Finsbury Growth & Income	£31.7 million	67.2
Ruffer Investment Company	£3.8 million	51.5
Capital Gearing	£21.9 million	46.1
Personal Assets	£9.6 million	35.1
Fundsmith Emerging Equities	£11.6 million	34.7
City of London	£1.1 million	29.9
Lowland	£1.3 million	27.2
Tetragon Financial	£243.5 million	25.2
Pershing Square	£1.3 billion	n/a
Smithson Investment Trust	£53 million	n/a
Average five-year return for all UK-listed trusts where managers have holdings worth £1 million or more (not just the examples listed above)		**77.0**
Average five-year return for all UK-listed trusts		**66.4**

Source: Investec, Shares, SharePad. Data on holdings to 1 June 2021, data on performance to 10 June 2021

investment companies are required to disclose transactions by board members, there is no such requirement for managers. Given strong investor demand for such information, this is disappointing.'

The accompanying table shows a selection of investment trusts where managers have invested their own money. The names include Fundsmith-run **Smithson Investment Trust (SSON)** and **Fundsmith Emerging Equities (FEET)** as well as **Lindsell Train Investment Trust (LTI)** and **Scottish Mortgage (SMT)**. Private equity and hedge fund trusts also feature heavily on the list.

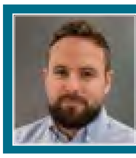
While it is useful for there to be alignment between the interests of shareholders and those charged with running their money, there is a danger if managers have too much control through a large personal holding that oversight and challenge to their decision-making is undermined.

Investec says: 'There have been a number of companies where significant management stakes have given managers too much power, and in a number of cases, matters have been compounded by poor corporate governance.'

The wealth manager notes this could be at work in the case of **Third Point Investors (TPOU)** – a vehicle run by Wall Street luminary and activist investor Dan Loeb. He is part of a management team which owns more than £100 million worth of shares in the trust and holds 17% of the stock himself.

Third Point Investors has consistently traded at a wide discount to net asset value – 16.9% at present according to industry body the Association of Investment Companies.

Recent attempts to address this discount through buybacks and tender offers (invitations for investors to sell some or all of their holding back to the trust) have not had any significant impact.



By **Tom Sieber**
Deputy Editor

Investors are being asked for money. What's a placing, rights issue and open offer?

We explain different ways companies raise money on the market

When a company is looking to raise cash to fund an acquisition, build a new project or pay down debt for example, there are several avenues they can take.

Sometimes they will issue bonds, which is a type of loan between a company and an investor. This can be appealing because a company can get money from investors without any changes to ownership or how the company operates.

But it also has the downside of adding debt onto the company's balance sheet, something which could potentially weigh on that company's growth prospects down the line when the time comes to repay that money.

CREATING A BUFFER

Another way companies can raise cash is through the stock market. This became the most popular way for companies to raise money when the Covid-19 pandemic started in 2020, as they looked to protect their balance sheets and ensure they had enough funds to weather the storm.

This cash doesn't need to be repaid and so is appealing for companies, although it is not always popular with existing shareholders as the amount of the company they own is diluted when new shares are issued.

There are three main ways companies raise money via the stock market – placings, open offers and rights issues. We explain what all three mean and provide examples of each.

WHAT IS A PLACING?

A common way for firms to raise cash is through placings.

Placings are where companies, or more accurately their brokers, approach investors and offer them new shares, often at a small discount to the current market price. Once the order book is full and the placing is closed, the firm gets its money and the brokers pocket the fees.

Companies often use this method if they need to raise money quickly – for example when lockdown restrictions were imposed and many businesses' income fell to zero overnight – because it's typically the fastest and cheapest way of tapping shareholders for cash.

It's important to note that placings for larger companies are usually restricted to institutional investors like fund managers, and that it is hard for retail investors to participate.

It's easier to sell a substantial

amount of new shares to a handful of major investors rather than many smaller lots of shares to thousands of individuals.

Another part of the problem when it comes to retail investors is that many hold their shares in nominee accounts, meaning they are invisible to the issuing company as individuals. Without a complete list of retail shareholders, companies can't offer them equal rights.

GETTING ACCESS TO PLACINGS

One company which provides access for retail investors is PrimaryBid. Investors can download the firm's app, put in their account details and when a company announces a new share issue with a retail tranche the investor receives an email notification. They can then opt to take part via the app on a first come, first served basis.

As these retail tranches don't qualify as 'corporate actions' – events that need to be approved by shareholders such as stock splits, dividends, mergers and acquisitions, rights issues and spin-offs – ISA and self-invested pension providers are unlikely to make their customers aware of them.

These offers are also typically fully subscribed not long after they are announced at 7am or after the market close because the retail investment community is only given a small allocation of the overall fundraise. Fundraising from retail investors without issuing a prospectus is capped at €8 million (£7.2 million).

WHAT ARE OPEN OFFERS?

Where retail investors can take a

more active participation when companies raise cash is through open offers.

Open offers are where a company offers its existing shareholders the right to buy new shares, often at a discount to the market price. In this way, it works very similarly to a rights issue, which we'll discuss later.

Let's say you own 400 shares in a company. They announce an open offer of subscription shares, giving you the right to buy one share for every five you own – meaning you could buy up to 80 overall. This is known as the 'basic entitlement', a guaranteed offer that can't be scaled back. And let's say the company is offering these shares at £1.20 each, rather than the market price of £2. That means you can buy these 80 shares for a total of £96 (a discount of £64 versus buying at the market price).

To take a real-world example, in May 2021 leisure group **Revolution Bars (RBG:AIM)** announced, in order to help fund its growth post-pandemic, an open offer in which retail investors were offered the right to buy one share for every 25 they owned at a price of 20p per share, a discount of 41.2% compared to the closing price the day before.

WHAT ARE RIGHTS ISSUES?

Similar, but not the same, to an open offer is a rights issue. A rights issue involves shareholders making the decision whether or not to buy discounted shares in a company.

Shareholders must take one of four routes. They can either buy some or all of their allocated stock; can sell all their rights; sell some of their rights and potentially use the proceeds to buy some of the cut-price shares (known as 'tail swallowing'); or do nothing at all.

Rights issues can be an effective way for companies to raise new money for large acquisitions or strengthen their balance sheet, but they aren't

IAG RIGHTS ISSUE

British Airways owner **International Consolidated Airlines (IAG)** is a noteworthy example of a company that raised a hefty sum of money – £2.5 billion – through a rights issue in 2020, or a 'capital increase' as the company called it. In this instance, it was increasing its capital, i.e. the amount of money it has, through a rights issue.

Shareholders could buy three shares for every two they already owned.

In these situations, to calculate the price the shares should fall to after a rights issue, analysts seek to calculate the TERP or theoretical ex-rights price.

How does this work? Let's suppose an investor held 100 shares in IAG ahead of its issue – we'll use the listing on the Madrid stock exchange as the issue was priced in euros.

The market price of the shares was €2.21 the day before the terms of the issue was announced. The subscription price for the extra shares was set at €0.92.

The value of the investor's holding before the rights issue was €221 (100 x €2.21). If they decided to take up their full allocation they would have had to buy 150 shares at the new price of €0.92. In that case the amount of cash passing from the investor to IAG would have been €138.

In order to arrive at the TERP we have to divide the new total value of the investment by the number of shares. In this case €359 (€221 + €138) divided by 250 to give €1.44.

always welcomed with open arms by investors.

Their discounted price tends to pull down the market price of a stock, so shareholders typically take a hit to the value of their investment.

Many companies would argue that's the price to pay to allow their business to grow – and that the longer-term benefits will more than compensate for the short term hit to the value of their shares.

As an investor, when it comes to rights issues it's key to ascertain why the company is asking for more money. One important question to consider is whether the desired cash only provides a quick fix to a financial problem and not a permanent solution.

If the rights issue isn't a permanent solution, you have to consider whether the company can generate the extra cash needed longer term from operations, or whether it will have to take more drastic action such as selling assets, borrowing more money or tapping shareholders for more cash.

As well as strengthening their balance sheet, companies also turn to rights issues to fund acquisitions. In this instance it would be important to consider whether the acquirer is paying the right or wrong price for the target business, whether the acquisition will improve its scale and if it will boost or dilute group profit margins.

By **Yoosof Farah**
Reporter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RUSS MOULD
AJ Bell Investment Director

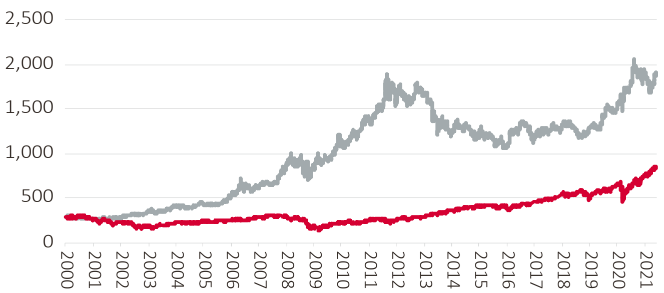
Reasons why deficits and inflation matter to gold

The precious metal is struggling to hit new highs despite clear drivers for its price

Gold bugs get a kick out of telling investors with a heavy weighting toward equities that the precious metal has a better performance record than the S&P 500 index of US shares since the turn of the millennium.

The commodity is up by 547% over that period, while the S&P 500 has offered a capital gain of 192% and a total return of 337% (which includes dividends), in dollar terms.

Gold has beaten US equities since 2000



Source: Refinitiv data

Yet gold buyers may be frustrated by the metal's inability to break above $1,900 an ounce, especially as inflation is starting to run hot in China, the UK and US.

For many, an increase in the cost of living and the implicit devaluation of the purchasing power of paper money forms the investment case for gold.

The metal's inability to progress to new highs is reminiscent of its struggles to crack $1,300 between 2013 and 2019. It fits with the view of central banks that the current spike in inflation is merely 'transitory' and

the result of pent-up demand, as economies slowly unlock, and supply-chain bottlenecks.

Fans of gold will point to its price chart, which shows the metal's rapid ascent in the wake of a successful assault on $1,300 per ounce in May 2019.

It then shot up by nearly 60% to a peak of $2,053 in just 15 months. Sceptics will counter by pointing to gold's long slump from 1980 to 2000 as inflation ebbed and argue that the metal will regain its status as a 'barbarous relic' if increases in producer and consumer price indices do indeed prove temporary.

Gold surged in 2019 once it broke the $1,300 barrier

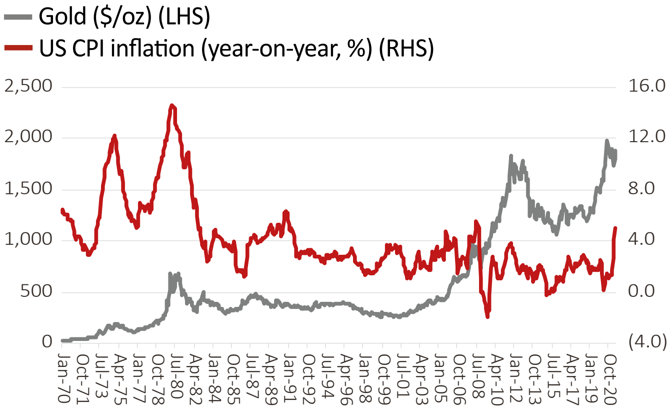
Source: Refinitiv data

RUSS MOULD
AJ Bell Investment Director

DEBT BONANZA

The past is no guarantee for the future but an analysis of gold's performance relative to inflation since 1970 helps to explain why precious metal fans think that rising prices may bring gold back into the mainstream when it comes to portfolio allocation strategies.

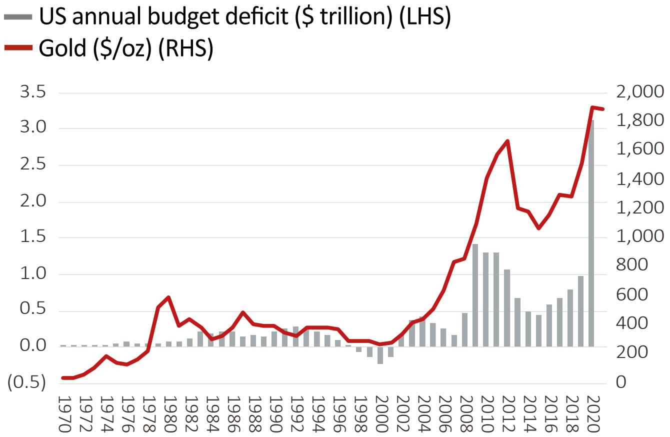
Gold has a reputation for being a hedge against inflation



Source: Refinitiv data, FRED- St. Louis Federal Reserve database

Government budget deficits, record-low interest rates, quantitative easing and rampant money supply growth are also persuading some investors to abandon 'paper' money and 'fiat' currencies in favour of 'real' assets.

Some warm to gold as a hedge against deficits and money creation



Source: Refinitiv data, FRED- St. Louis Federal Reserve database

The inflation debate is likely to rage for some time but even the fiercest critic of gold may accept that politicians are still inclined to spend, either to fund what they view as vital, planet-saving projects, support the economy during the pandemic or simply curry favour and buy votes. Austerity is a vote-loser.

The issue of taxation and who should pay more and by how much is gathering pace, but whether it is enough to fund ambitious spending programmes in the US, for example, remains open to question, even if the Republicans seem unwilling to embrace all of President Biden's projects.

A British Prime Minister whose own personal financial arrangements seem unorthodox at best is unlikely to be a good choice as someone willing to apply rigorous checks and balances toward the use of other peoples' (taxpayers') money either.

ALL IN THE TIMING

One reason behind gold's outperformance of the S&P 500 since 2000 is the metal was trading at its lowest levels since 1979 at the turn of the millennium, following a two-decade bear market for the metal, while the US equity market stood near record highs after a near 20-year bull market for stocks.

As with any investment, the price paid is the ultimate arbiter of investment return. The trickier bit now is that gold is trading near a record peak, in absolute terms, even if the S&P is there already.

But history suggests government spending and rising deficits are good for gold because investors look for stores of value to preserve their wealth. Gold is hard to find and costly to mine, so supply grows slowly, in contrast to the supply of money.

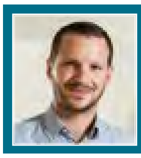
Investor Warren Buffett is not known to be a fan of gold but in 1980 he wrote: 'The rub has been that government has been exceptionally able in printing money and creating promises, but it is unable to print gold or oil.'

An unexpected tightening of monetary policy, or a new round of tax rises and austerity measures, could easily stop gold in its tracks as well as being negative for stocks. The question is whether central bankers and politicians are able and willing to go down those paths.

Have I left it too late to start saving for retirement?

Our pensions expert explains why there are benefits to building a retirement pot even if you're older

I'm 55 and, for various reasons, have only just started saving for retirement. Have I left it too late?
Lisa



Tom Selby
AJ Bell
Senior Analyst says:

Although automatic enrolment will provide a solid retirement saving foundation for millions of younger people, for those later in their careers there might be a feeling the reforms are too little, too late.

In particular, there will be plenty of people in a similar position to you who have missed out on generous defined benefit pensions in the private sector and for whom auto-enrolment at the minimum will fall well short of their expectations.

In this situation it might be tempting to question whether there is any point in building a retirement pot.

However, provided you are under age 75 then money saved in a pension should be a good investment as it benefits from tax relief as well as a matched contribution in your workplace scheme.

Furthermore, with a bit of careful planning and diligent saving you can still make up for lost time.

PLAYING PENSIONS CATCH-UP

Take someone aged 55 who hasn't saved anything for retirement. While they may feel time is working against them, provided they are in good health they could easily live for 40 years or longer.

They could also keep saving onto a pension and benefitting from tax relief for the next 20 years.

If they made a personal contribution of £3,000 a year into a pension – around 10% of the average UK salary – this would automatically be boosted to £3,750 via basic-rate tax relief. Higher and additional-rate taxpayer could also claim extra tax relief from HMRC.

If they kept saving this until age 67 – the projected state pension age for a 55-year-old today – and enjoyed 4% inflation-adjusted investment growth after charges, they could have a fund worth £65,000. If they continued contributing until age 75, the fund could have grown to £125,000.

Someone who is able to save £10,000 in a pension from age 55, meanwhile, could build a fund worth £216,000 by age 67 and £416,000 by age 75 if they enjoyed similar levels of investment growth.

PENSIONS ARE NO LONGER JUST ABOUT PROVIDING A RETIREMENT INCOME

It's worth remembering as you build your retirement pot that pensions are no longer just a vehicle to provide an income in later life – although of course this is still important for lots of people.

Pensions can be passed on tax-free if you die before age 75, while if you die after age 75 they will be taxed in the same way as income when your beneficiary or beneficiaries come to access it.

So saving in a pension, whenever you decide to do it, is an investment not just in your own future, but potentially in the futures of your loved ones as well.

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

The great ISA mysteries

The latest figures on the tax wrapper reveal two puzzling trends

The amount of money held in ISAs reached a record £620 billion in 2020, according to freshly published figures from HMRC, demonstrating how successful these tax shelters have been in the two decades since they took over from PEPs and TESSAs.

The number of people contributing to a Lifetime ISA also doubled in a year, with more than half a million people subscribing to one of these new ISA accounts in 2019/20. However, there are a couple of behavioural mysteries in the ISA data, which suggest savers might not be using ISAs quite as productively as they might.

CASH OVER STOCKS

ISA savers are still largely plumping for cash rather than equities, despite incredibly low interest rates, and a personal savings allowance which means basic rate taxpayers don't pay any tax on annual interest below £1,000 (£500 for higher rate and £0 for additional rate taxpayers). £49 billion was placed in Cash ISAs in 2019/20, compared with £24 billion into Stocks and Shares ISAs.

The big gap may well have something to do with the first lockdown and market turmoil hitting right at the end of the tax year, when many people make their ISA contribution.

That's not the whole story though, because 2019/20 wasn't a flash in the pan; Cash ISAs have proved much more popular than Stocks and Shares ISAs year in, year out. There are of course good reasons for people to hold money in cash, particularly if they need it in the next five years.

However, given how much people now seem to have in cash accounts, most paying measly rates of interest, the question does arise whether people are holding too much, and missing out on higher long-term returns they might harvest from investing in the stock market instead. Indeed, last year the financial regulator went so far as to flag holding too much cash as a risk for savers.

WHY DO SOME PEOPLE SHUN ISAS

The second puzzling aspect of the data is quite how many high earners don't have an ISA. An estimated 40% of those earning over £100,000 don't have any ISA savings whatsoever. That's in spite of the fact they face marginal tax rates of up to 60%, which an ISA could protect them from.

People earning this amount also clearly have the capacity to save lots of money, unless they have a particularly lavish lifestyle.

It's possible that higher earners are choosing to divert their savings into a pension instead, given the high rates of tax relief they can get on contributions. But there's still a limit of £40,000 a year on pension contributions, including those from employers, which are likely to be quite generous for high earners.

It also doesn't properly explain why so many high earners don't have any ISA savings at all, seeing as they work well alongside pensions as a more accessible tax shelter which you can draw on before retirement.

Some high earners may be business owners, and recycle spare earnings back into their business. That's understandable, but risky, seeing as your income and your savings are all then tied up in the same business, rather than adding a bit of diversification by putting some money into an ISA.

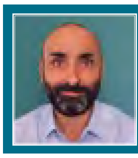
Low interest rates may also mean that high earners don't think it's worth getting a Cash ISA. Additional rate taxpayers don't get any personal savings allowance though, so for each £100 of cash interest they receive, they are taxed £45, making a Cash ISA worthwhile, even if they don't want to invest in shares.

LACK OF TIME

Perhaps some high earners are simply monumentally busy, committing a lot of time to their work responsibilities, and leaving little gas in the tank to get their financial affairs in order.

Whatever the reason, there is a significant proportion of higher earners who appear to be missing out on the tax benefits of an ISA.

There are even more who aren't taking advantage of the full £20,000 allowance, which was only used by around 20% of those earning a six figure sum in 2018/19. The ISA has undoubtedly been a success story in getting people to save for their future, but some high earners who could benefit most appear to be unmoved by its attractions. It's a puzzler, for sure.



By **Laith Khalaf**
Financial Analyst

HOW I INVEST:
Farewell funds, hello shares

Robert from North Yorkshire details how he makes the most of his SIPP and ISA accounts

The coronavirus pandemic and the subsequent volatility in financial markets has made many people think again about their investments and review their portfolios.

One such person is Robert from North Yorkshire, who has switched his SIPP and ISA investments from funds into shares as he looks to take a longer-term view.

Before the pandemic all his SIPP and ISA investments were in funds, and Robert explains: 'One reason I moved from funds to shares was to make long term investments. With the funds I held, because it was so inexpensive to sell and buy holdings I was too often tempted to sell and then buy funds as the market fell and rose again.'

Robert is retired and lives off his investments, having transferred the cash equivalent transfer value of his defined benefit pension scheme into a SIPP.

He also started investing in ISAs when they were introduced more than two decades ago and has tried to invest the maximum allowance every year from their inception.

He bought technology shares before the technology bubble burst and concedes he was 'badly affected by the collapse in technology share prices'. He then invested in India and China and his investments increased in value until the financial crisis in 2008, after which he started transferring a 'substantial amount' of his investments to the American market.

In 2006, Robert took voluntary redundancy, and with part of the payoff received as well as using some existing investments he bought a holiday home in Cyprus. He invested the remainder in ISA and non-ISA funds, intending to move the non-ISA investments to ISA investments to maximise the use of his yearly ISA allowance.

All of his SIPP and ISA holdings are now in US stocks, mainly in the tech sector, and Robert says he switched from funds to US shares a week before the market bottomed stateside.

He says: 'Since then my investments have exceeded my wildest expectations, although they have fallen back recently. I repeated the process with my ISA funds in April this year. I had seen evidence that the market was recovering, unfortunately since I invested my ISA fund in US shares the markets have fallen again.'

LONGER HOLDING PERIODS

On his strategy Robert says: 'As buying shares directly in the US markets is considerably more expensive I intend to hold most of the shares I buy for a longer period of time, at least three to five years, and ignore the frequent changes in the markets.'

Robert was already considering transferring to shares and says the pandemic 'gave me an opportunity' to switch from the funds he held to US shares.

Other reasons he states for investing in shares directly are that he receives dividends from the shares. Also, although his initial cost of investing in shares is higher he points out there are no ongoing management charges, which you incur with funds.

Due to the increasing likelihood that the benefits he takes from his SIPP will exceed his lifetime allowance at some point in the near future, Robert has changed the way he uses his SIPP and ISA accounts.

Previously Robert crystallised a certain proportion of his SIPP, which gave him a £12,500 tax free lump sum and then each year took up to his personal tax allowance from the remaining crystallised amount each year until the residual crystallised amount was less than the tax allowance for a given year. He would then repeat the process.

A CHANGE IN APPROACH

He explains: 'The money I took from the SIPP I would then invest in an ISA and take tax free income throughout the year by selling the ISA funds as required. Using this process I was paying no tax.'

But he adds: 'With the success of my investments I realised that if I allowed my investments to build up in my SIPP and I exceeded my lifetime allowance I would be liable to pay much higher tax.

'So I have decided to build up the money in my ISA by taking out enough money each year from my SIPP to pay in the maximum amount into my ISA, whilst at the same time also taking enough money from my SIPP to provide an income.

'In this way I will build up my ISA investments which are not taxable and minimise the growth of my SIPP investments so that my lifetime allowance is not exceeded until a much later date.'

It is worth noting that Robert may still pay income tax on withdrawals from his SIPP depending on the scale of the income he is taking.

By **Yoosof Farah**
Reporter

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

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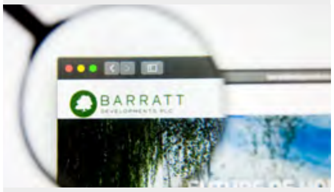
Main Market



AIM

Overseas shares

IPOs coming soon

Investment Trusts

Funds

ETFs

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results

18 June: Inspecs, Telecom Plus. **21 June:** Brandshield Systems, SysGroup. **22 June:** DS Smith, Gear4Music, Trackwise Designs, Trifast. **23 June:** Berkeley, Liontrust, Manolete Partners. **24 June:** Alpha Financial Markets, James Latham, Redcentric, XPS Pensions.

Half-year results

18 June: Blue Prism.

Trading statements

18 June: Tesco. **23 June:** Joules. **24 June:** Wood Group.

WHO WE ARE

EDITOR: Daniel Coatsworth @Dan_Coatsworth

DEPUTY EDITOR: Tom Sieber @SharesMagTom

NEWS EDITOR: Steven Frazer @SharesMagSteve

FUNDS AND INVESTMENT TRUSTS EDITOR: James Crux @SharesMagJames

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

REPORTER: Yoosof Farah @YoosofShares

CONTRIBUTORS Laith Khalaf, Russ Mould, Tom Selby

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

PRODUCTION
Head of Design: Darren Rapley
Designer: Rebecca Bodi

CONTACT US:
support@sharesmagazine.co.uk

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