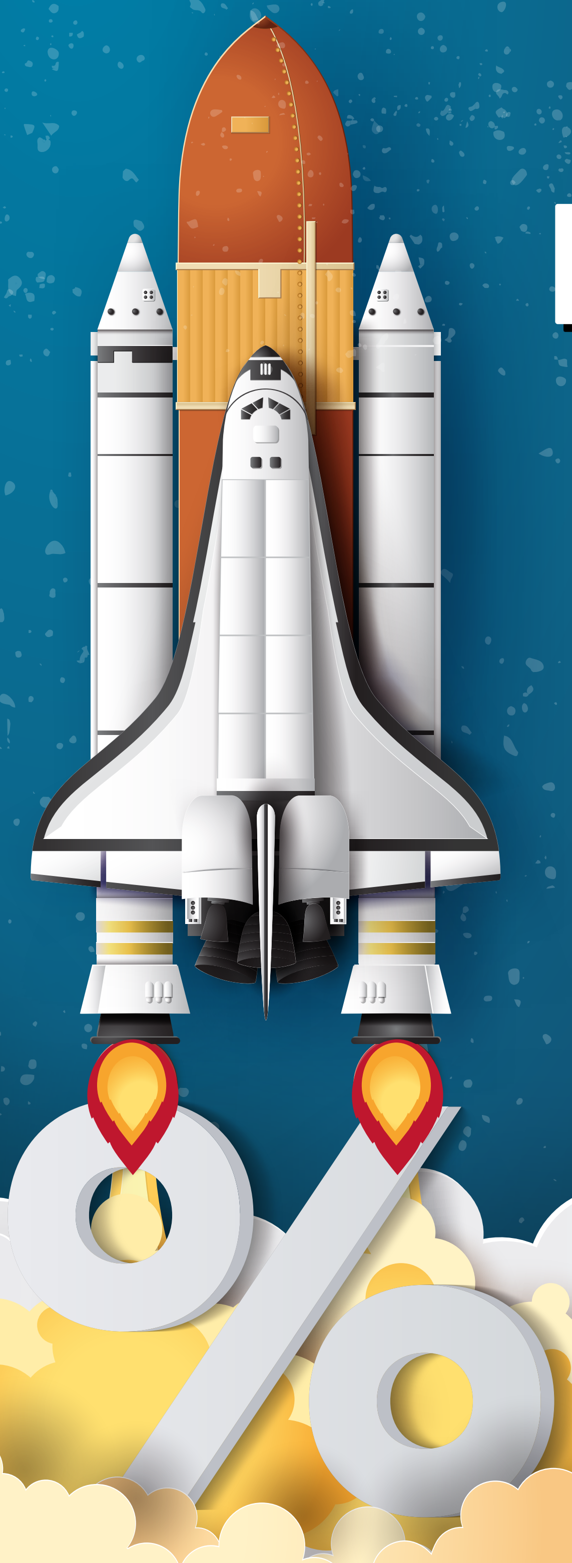
STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

VOL 23 / ISSUE 44 / 11 NOVEMBER 2021 / £4.49

SHARES

WE MAKE INVESTING EASIER



RISING INTEREST RATES

They're about to take off

WHAT DOES THIS MEAN FOR YOUR INVESTMENTS?

SECTOR REPORT: Car retailers with gas left in the tank

Your time is precious. Invest with Alliance Trust.

You've no doubt got plenty to get on with, so when it comes to investing, look to Alliance Trust. Our ready-made, global equity portfolio is full of attractive companies chosen by 10 carefully selected, expert Stock Pickers,[1] with the aim of outperforming world stock markets over the long term.[2] It may also shield you from some of the risks of relying on one fund manager.

Invest with ease in a Trust you can trust at alliancetrust.co.uk/ease

Alliance Trust
INVESTING FOR GENERATIONS

When investing, your capital is at risk. The value of your investment may rise or fall as a result of market fluctuations and you might get back less than you invested. TWIM is the authorised Alternative Investment Fund Manager of Alliance Trust PLC. TWIM is authorised and regulated by the Financial Conduct Authority. Alliance Trust PLC is listed on the London Stock Exchange and is registered in Scotland No SC1731. Registered office: River Court, 5 West Victoria Dock Road, Dundee DD1 3JT. Alliance Trust PLC is not authorised and regulated by the Financial Conduct Authority and gives no financial or investment advice.

1. As rated by Willis Towers Watson. 2. MSCI All Country World Index.

Contents

CFA UK Publication of the Year CFA UK Journalism Awards 2019

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

DISCLAIMER

IMPORTANT

Shares publishes information and ideas which are of interest to investors. It does not provide advice in relation to investments or any other financial matters. Comments published in Shares must not be relied upon by readers when they make their investment decisions. Investors who require advice should consult a properly qualified independent adviser. Shares, its staff and AJ Bell Media Limited do not, under any circumstances, accept liability for losses suffered by readers as a result of their investment decisions.

Members of staff of Shares may hold shares in companies mentioned in the magazine. This could create a conflict of interests. Where such a conflict exists it will be disclosed. Shares adheres to a strict code of conduct for reporters, as set out below.

1. In keeping with the existing practice, reporters who intend to write about any securities, derivatives or positions with spread betting organisations that they have an interest in should first clear their writing with the editor. If the editor agrees that the reporter can write about the interest, it should be disclosed to readers at the end of the story. Holdings by third parties including families, trusts, self-select pension funds, self select ISAs and PEPs and nominee accounts are included in such interests.

2. Reporters will inform the editor on any occasion that they transact shares, derivatives or spread betting positions. This will overcome situations when the interests they are considering might conflict with reports by other writers in the magazine. This notification should be confirmed by e-mail.

3. Reporters are required to hold a full personal interest register. The whereabouts of this register should be revealed to the editor.

4. A reporter should not have made a transaction of shares, derivatives or spread betting positions for 30 days before the publication of an article that mentions such interest. Reporters who have an interest in a company they have written about should not transact the shares within 30 days after the on-sale date of the magazine.

Changing consumer spending patterns matter for retailers

There are signs that people don't want, or cannot afford, to spend as much

Storms clouds are gathering for consumer spending. Thirty-six stocks in the FTSE All-Share index from the retail, travel and leisure sectors have underperformed the FTSE All-Share's 2% gain over the past three months, according to SharePad data. In comparison, only 18 stocks from these sectors beat the index over the same period.

The market is essentially saying that earnings prospects for many consumer-facing companies are becoming less attractive.

The Bank of England has made it perfectly clear that interest rates will have to go up soon, and we're already feeling the pressures from a rising cost of living as inflation grows. Energy bills, food prices and general merchandise costs are shooting up.

Growth in consumer spending slowed to 3% between July and September, compared to 14% in the previous quarter, according to Nationwide's analysis of more than 620 million transactions by its customers.

Interestingly, it seems that households are being more cautious with their spare cash rather than not having any in the first place. *The Sunday Times* claims that Britons are 'refusing to spend', and says households are now saving double the pre-Covid norm, citing data from the Bank of England and Bank of America.

Households are busy paying down debts and we're now hearing of big regrets from purchases made during the pandemic when everyone was bored. Aviva's latest 'How We Live' report suggests that millions of people wish they hadn't bothered buying items like hot tubs, musical instruments and bikes as they are now gathering dust at home. This regret could mean a lot of people think twice about what they buy in the near term.

Consumers are being told to shop early for Christmas if they want to avoid being disappointed because of stock shortages caused by supply chain issues. That could see many retailers do well in the coming weeks but then struggle over December if they can't give customers what they want.

Fashion retailer **Next (NXT)** issued a cautious statement on 3 November when it said pent-up demand would continue to diminish, stock availability remains challenging, and price increases in essential items like fuel may moderate demand for more discretionary purchases.

In theory, the signals from Next and elsewhere would suggest that companies with more affordable products or services could do better than those selling big-ticket items. However, the market doesn't seem to have the same view as the split between the different company types is not as clear-cut when looking at share price performance.

Over the past three months, trainer sellers and hotel operators have been among the best performing consumer-facing stocks. Among the worst have been pubs and restaurants. In the middle, with minimal share price gains or losses, have been gambling companies.

If you have any consumer-facing companies in your portfolio, watch the news flow carefully in case there are signs of a slowdown in demand as that could lead to nasty share price declines given the fragile backdrop.

By **Daniel Coatsworth** Editor

Pfizer breakthrough could see travel stocks finally play catch-up

Further defence against Covid should aid economic recovery

The end of the pandemic could finally be in sight after US pharmaceutical giant Pfizer said its Covid-19 oral antiviral pill Paxlovid could be a 'game changer' that reduced the risk of hospitalisations and death by 89% in high-risk patients. Add that to the existing mass-market vaccines and the pharmaceutical industry looks to have won the war against Covid-19.

Pfizer will apply for emergency use of the pill which means it could be available before Christmas. Its shares gained around 9% on the news. The company is also studying the treatment's impact on low-risk patients.

The news prompted widespread euphoria in sectors beaten up by the pandemic with US airline stocks and travel companies seeing big gains on the day as their earnings prospects in theory will improve as there will be broader treatments to fight against Covid-19.

Shares in cruise ship operator **Carnival (CCL)** advanced 8% on the day of the Pfizer news, Asia Pacific airline stocks gained around 5% while luggage manufacturer Samsonite International surged 14%.

Going in the other direction were shares in biotech company Moderna which plunged 17% as investors feared its relatively high-priced injectable Covid-19 vaccine might be less attractive compared with an oral equivalent.

The fall will have caused collateral damage to investment trust **Scottish Mortgage (SMT)** which recently highlighted that Moderna had become its biggest holding and largest contributor to its annual performance to the end of September 2021.

The Pfizer breakthrough comes hot on the heels of the first oral Covid-19 antiviral pill developed by US pharma peer Merck and its partner Ridgeback Biotherapeutics. The UK government has ordered 480,000 doses of Merck's drug Molnupiravir and 250,000 doses of Pfizer's Paxlovid.

The reason investors are so excited about the Pfizer pill is because its high efficacy rate is on a par with existing injectable vaccines on the market and significantly higher than the Merck oral tablet which is around 50% effective.

In addition, the treatment, which involves a five-day course of tablets, is likely to have a higher acceptance rate among the general population than injected vaccines because of its convenience and home setting use.

Ultimately, the tablet has huge potential to save lives and quicken the pace of global recovery. Pfizer has indicated that poorer countries will pay less for the course of tablets. [MGam]

Pfizer

Source: Refinitiv • Created with Datawrapper

Moderna

Source: Refinitiv • Created with Datawrapper

Elon Musk's stock sale could force tracker funds to buy more Tesla shares

Controversial Twitter poll could result in an increase in the car maker's free float

Elon Musk's pledge to sell 10% of his Tesla shares following his controversial Twitter poll could force US tracker funds to buy more stock because of the way they calculate index stock weightings.

In the UK, tracker funds work out how much of each FTSE index constituent they should own based on a company's market value. Tesla is a member of the S&P 500 in the US and this index use the free float-adjusted system, which only uses readily available shares for weighting calculations, excluding stakes held by founders, senior management and other insiders.

Musk, who is Tesla's largest shareholder, owns approximately 170.5 million shares, implying a sale of more than 17 million shares worth nearly $18 billion which will swell the number of easily traded stock (i.e. the free float).

Tesla's free float is currently calculated at 802 million shares or 79.9% of the shares in issue. Post Musk's proposed share sale the free float will increase to approximately 81.5%.

Exchange-traded funds that may need to adjust their equity weightings for Tesla include the **Vanguard S&P 500 (VUSA)** and **iShares S&P 500 (IUSA),** both of which track the S&P 500 index.

Shares in Tesla fell nearly 5% on 8 November in response to Musk's Twitter poll which voted in favour of the entrepreneur selling some of its holding in the company. [SF]

UK stock winners from the $1 trillion US infrastructure plan

Beneficiaries of increased spending have already enjoyed strong share price gains

THE BELATED APPROVAL of US president Joe Biden's $1 trillion infrastructure plan is a positive development for several UK-listed businesses.

However, this is not 'new' news to the market as the spending package had been in the post for months, held up by brinksmanship and haggling. The spending will be allocated across areas including roads, rail bridges, high-speed internet, green energy, clean water supplies and electric vehicle charging points.

Some of the more obvious beneficiaries of this spending include building products giant **CRH (CRH)**, road signage and barriers specialist **Hill & Smith (HILS)**, US-focused plumbing products group **Ferguson (FERG)**, groundworks firm **Keller (KLR)** and construction equipment hire outfit **Ashtead (AHT)**.

Investment bank Jefferies believes some 35% of Hill & Smith's current revenue stream is exposed to the increased spending.

Many of these stocks have already enjoyed strong gains in anticipation of Biden's spending spree. Year-to-date Ashtead is up 81.8% and CRH has advanced 18.4% while Ferguson has gained 28.9%, Hill & Smith is up 28.8% and Keller is trading 28.9% higher.

The positive impact won't be felt in earnings straight away. Jefferies, for example, doesn't expect Hill & Smith's revenue and profit to benefit from the US infrastructure boost until 2023. [TS]

China's Singles' Day shopping event could disappoint

The world's biggest shopping day may be more low-key than usual

Inspired by the annual Black Friday sales event in the US, Singles' Day began as a way for people in China to celebrate being single by treating themselves to gifts, but is now popular with consumers across the board.

Moreover, it no longer just takes place on 11 November but begins weeks before as shoppers 'fill their carts' hoping for big discounts on the day itself.

It has also spread beyond China to become a phenomenon across Southeast Asia. In countries such as Singapore and the Philippines, local online retailers Shopee and Lazada compete head-to-head with Alibaba and Amazon for a share of the spoils.

However, this year investor attention is likely to be focused on China says Chetan Seghal, co-manager of investment trust **Templeton Emerging Markets (TEM)**, given the crackdown on tech companies and the drive to narrow the wealth gap in the economy.

'Sales are likely to be more muted, with less hype and fewer discounts,' says Seghal. 'Consumer sentiment has been impacted by the economic slowdown, and everyone wants to conform,' he adds.

Analysts will be watching closely the performance of big foreign brands like Apple, which is still highly regarded in China but faces growing local competition.

'Chinese consumers are increasingly choosing local brands where quality is improving and companies can react quickly to changing tastes,' notes Seghal. [IC]

Primark eyes US expansion as part of broader growth plan

The discount clothing chain sees 'considerable' potential for new stores across the pond

SHARES IN **ASSOCIATED British Foods (ABF)** rallied strongly on better-than-expected full-year results (9 Nov) and news the foods-to-fashion conglomerate will pay a 13.8p special dividend and seek to buy back shares under a new capital allocation framework.

Yet the real excitement surrounded the upbeat outlook for discount clothing chain Primark, which appears to have smartened up its stores during lockdown downtime and is stepping up its digital presence.

Primark is accelerating its selling space expansion across the US, where management insists 'the potential for new stores is considerable', as well as France, Italy and Spain. Over the next five years, Primark's store estate is expected to grow from a year-end total of 398 to 530 outlets.

Given rising awareness around fast fashion's damaging environmental impact, Primark has unveiled a far-reaching sustainability strategy, in common with **ASOS (ASC:AIM)** and **Boohoo (BOO:AIM)**.

Another significant aspect of Primark's evolution is that the budget fashion chain is rolling out a broader range of products which is helping to diversify the sales mix away from t-shirts, underwear and dresses.

Cookware, ceramics, rugs and outdoor items like boots and waterproof jackets increasingly feature in its stores, which is serving to widen the appeal of Primark as a brand. [JC]

Market fails to reward consensus-beating third quarter results

Investors are being hard to please despite a decent showing in latest results season

Research by the Morgan Stanley strategy team reveals that European third quarter earnings are on target to exceed consensus analyst forecasts. This should trigger a series of earnings upgrades which in theory provides support to equity markets.

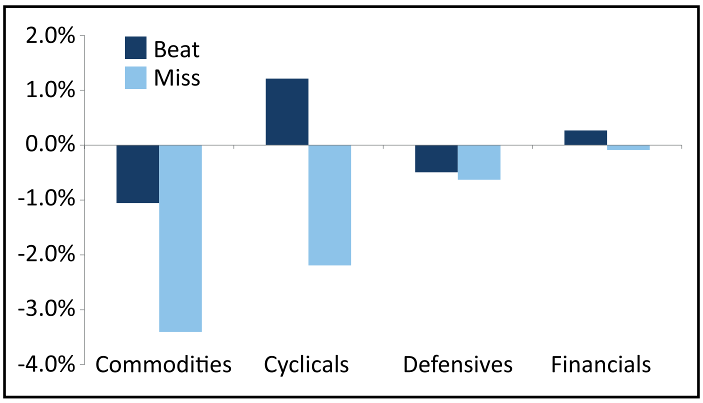
However, the response from the market to third quarters numbers has been decidedly lukewarm. This suggests that investors expected companies to exceed forecasts and only a significant beat to estimates was enough to push up share prices.

The bank says 55% of companies in Europe have beaten third quarter earnings per share estimates, while 23% have missed so far, giving a net beat of 32%.

It says companies that missed earnings per share expectations underperformed the market by 1.6% on the day of results on average, whereas those beating expectations saw their share price broadly flat in relative terms.

From a sector perspective, the strongest breadth of beats has been observed for financials and energy among European stocks. Conversely, industrials and communication services have recorded the narrowest breadth of beats. Commodities stocks have been punished if they missed their earnings per share forecasts.

Relative performance of stocks on day of results by sector based on EPS surprise



Source: MSCI, Bloomberg, Morgan Stanley Research

Percentage of S&P 500 stocks in the US beating estimates in Q3 results

Source: Bloomberg, JPM, Unigestion, 3 November 2021 Based on 73% of firms reported to date • Created with Datawrapper

For the US market, asset manager Unigestion says approximately three quarters of firms in the S&P 500 index have so far reported third quarter results and of these 83% have beaten earnings estimates. More than 90% of technology companies delivered better earnings than forecast. Overall, the same theme was seen in the US as in Europe, with investors hard to please.

'Market action suggests investors have not been so impressed by third quarter results and other drivers are pushing equity markets higher,' says Unigestion. However, the asset manager says the backdrop is still positive for equities.

'Earnings season has largely confirmed our expectations: firm revenue and profitability remain very strong, and though supply/labour bottlenecks are likely to continue to be a drag for the foreseeable future, healthy demand provides sufficient support to equity markets,' it comments.

'The (latest) Fed meeting also confirmed that the world's key central bank will remain patient and continue to provide ample liquidity to markets until the middle of next year.' [MGar]

Buy Essentra ahead of transformation into a higher quality business

Selling off cigarette filters and packaging arms to focus on components looks like a smart strategic move

Support services firm **Essentra (ESNT)** is on the cusp of a transformation which could address the discounted valuation associated with its current conglomerate structure. This should also address longstanding environmental, social and governance concerns and free up management to focus on its most profitable division.

Investors should buy now to benefit from these potential catalysts, with the shares trading on a modest 13.2 times 2022 forecast earnings per share.

ESSENTRA
BUY
(ESNT) 310p
Market cap: **£926 million**

A FORGOTTEN STOCK

Stockbroker Davy says Essentra had become a 'forgotten stock'. The shares trade at less than a third of the level they reached in 2015, stung by a disappointing operating performance amid the unravelling of an M&A spree under previous chief executive Colin Day.

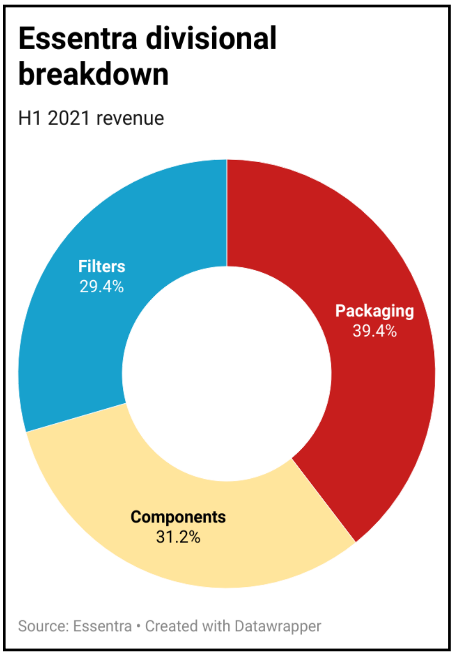
Now, under the leadership of his successor Paul Forman, the former CEO of industrial threads business **Coats (COA)**, the emphasis is switching from unfocused acquisitions to a much more streamlined approach.

Formerly part of FTSE 100 peer **Bunzl (BNZL)**, the business was spun off as Filtrona in 2005 before being renamed as Essentra in 2013. Historically the main line of business was the manufacture and distribution of filters for cigarettes – and this explains in part why the stock has been unloved, given investors' increased focus on ESG considerations.

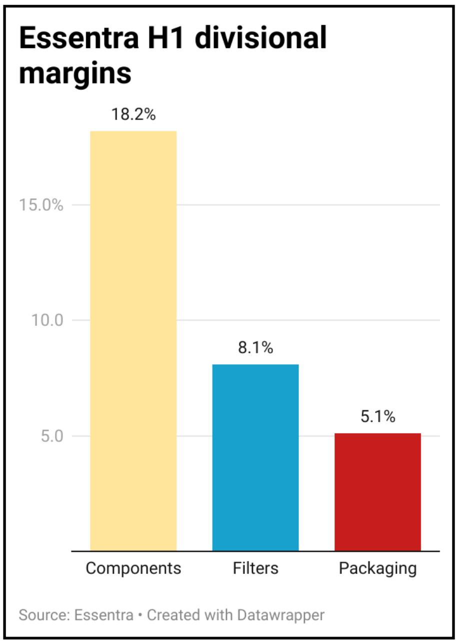
The modern-day incarnation is made up of three divisions: a filters business, a packaging arm and a components unit which makes and distributes plastic injection moulded, vinyl dip moulded and metal items. The packaging unit sells to the health and personal care sectors and focuses on cartons, leaflets, self-adhesive labels and printed foils used in blister packs.

On 27 October the company announced plans to potentially divest the filters and packaging operations and focus on the components arm which has by some distance the best recent growth rate and strongest levels of profitability and cash flow.

For the three months to 30



September 2021, for example, the components business saw adjusted like-for-like revenue growth of 28.5% compared with a 6.1% decline for the packaging arm, hurt by delays to elective surgeries and lower prescription levels due to Covid-related disruption, and just 2.8% growth in filters.



The components business is just the right kind of boring. It specialises in items like caps and plugs, cable management products, printed circuit boards and other electronics hardware as well as a variety of tools and precision instruments.

These are typically low-cost items but nonetheless essential to the business's 80,000-plus customers who are mainly equipment manufacturers. This should enable Essentra to pass on extra costs resulting from the current global supply chain crisis and protect margins in the short and long term.

Also encompassed within the components division is hardware supplies specialist Reid Supply which addresses a customer base

that is principally located in the US Mid-West.

An efficient set-up, led both by internal manufacturing and sourcing from third parties, is backed up by a sophisticated IT platform.

According to investment bank Berenberg, despite being a leading operator in components, it has just a 4% market share. This reflects the fragmented nature of the market and highlights the opportunity Essentra might have as a consolidator, backed by any funds it generates from the potential sale of the packaging and filters arms.

The company is expected to conclude its strategic review around the middle of 2022, with further details on its break-up plan likely to be supportive to the shares.

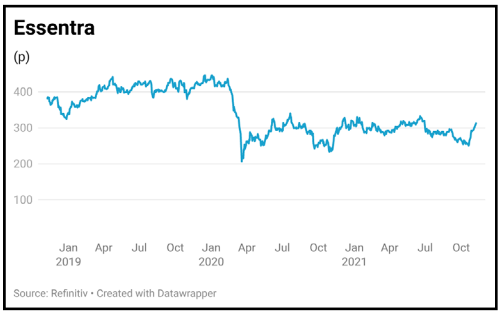
MANAGING RISKS

Risks in the near-term include supply chain pressures, which it appears to be managing effectively for now, while longer term there is uncertainty over the company's ability to realise a decent price if or when it sells the packaging business and, in particular, the filters division.

Mitigating this is the progress the group has made in improving performance on the filters side, led by expansion into eco-friendly products and a larger footprint in China. The packaging arm should benefit from a return to some normality in the healthcare space as we emerge from the pandemic as well as some self-help measures introduced by the group.

The balance sheet looks reasonably robust at a net debt to EBITDA (earnings before interest, tax, depreciation and amortisation) of 1.7 times, and Jefferies forecasts this ratio to drop to 1.0 times by 2023, regardless of any disposals.

This underpins a modest but likely growing stream of dividends, with the shares on a forward yield of 2.6% based on consensus forecasts. [TS]



Fidelity Special Values finds cheap stocks with big potential

This trust buys shares for less than their intrinsic worth and offers a play on the UK market's re-rating potential

Risk-averse investors wary about rising rates and their potential to roil long-duration assets including highly rated growth stocks should look at **Fidelity Special Values (FSV)**, the investment trust with stakes in cheap UK stocks that boast significant recovery potential.

While the shares have swung from a net asset value discount to a modest premium, this reflects the fund's strong performance and is no reason to shun a top-performing trust that looks well-placed to capitalise should borrowing costs rise and value names bounce back into fashion.

Fidelity Special Values is an all-cap investment trust with a value-contrarian philosophy which seeks to achieve long term capital growth through investment in special situations, i.e. UK companies which fund manager Alex Wright regards as undervalued or where the potential has not been recognised by the market.

A portfolio of 80 to 120 stocks at different stages of their recovery process enables the trust to deliver outperformance across different market environments; Wright wants to see a balance sheet that can withstand economic weakness, as well as a valuation that provides him with a margin of safety.

FIDELITY SPECIAL VALUES
BUY
(FSV) 306.6p

Premium to NAV: 1.6%

Market cap: £966 million

The trust delivered a net asset value total return of 56.2% for the year to August 2021, outperforming the benchmark FTSE All-Share's 26.9% return, while investors were also treated to a 15% increase in the total dividend to 6.67p.

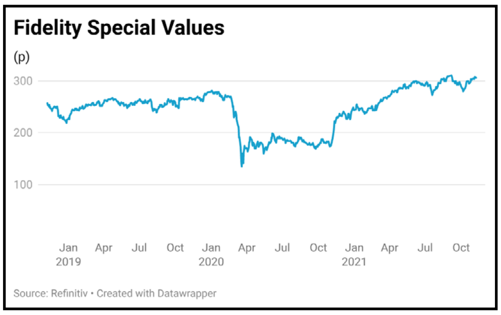
Among the largest contributors were car parts-to-cycles seller **Halfords (HFD)**, car distributor **Inchcape (INCH)** and vehicle rental business **Redde Northgate (REDD)**, while takeover activity boosted several key holdings.

The trust offers exposure to financials (mainly life insurers) such as **Legal & General (LGEN)** and **Aviva (AV.)** as well as outsourcer **Serco (SRP)**, which is delivering earnings upgrades. Other holdings include services group **DCC (DCC)** and housebuilder **Vistry (VTY)**.

Despite rallying from 2020's pandemic lows, Wright, who has found many opportunities in the small cap space, stresses UK equities remain 'significantly undervalued compared to global markets' and are well positioned not only to benefit from a recovery from the pandemic, but also from the lifting of Brexit uncertainty. This is now translating into companies committing to making new investments in Britain.

'Based on 2022 and 2023 earnings estimates, the company's portfolio trades on a 10% to 20% discount to the UK market, which is itself attractively valued both in relative and absolute terms,' says Wright.

'We remain comfortable with how the company's portfolio looks from a valuation, return on capital and risk perspective, and continue to see meaningful upside potential for our holdings.' [JC]



SDI

(SDI:AIM) 216P

Gain to date: 23.7%

Original entry point:

Buy at 174.5p, 27 May 2021

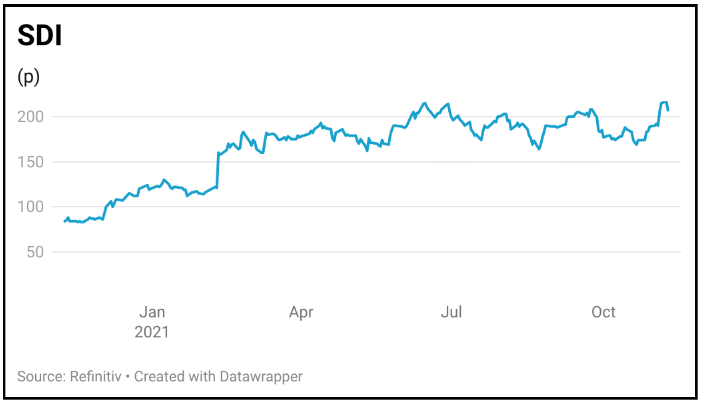
AS PANDEMIC recoveries go **SDI's (SDI:AIM)** should be counted as very encouraging by investors. A 4 November half-year update revealed that the science kit maker expects 'very strong sales and profits' with approximately £24.7 million in revenue. That's just £800,000 less than it did in the whole of last year, albeit a Covid capped one.

Part of this boost can be explained by a stronger-than-expected performance from Monmouth Scientific, bought last December, slightly higher Atik sales but largely from broad-based growth across its businesses.

SDI is a collection of multiple subsidiaries that design and manufacture digital imaging, sensing and control equipment used in life sciences, healthcare, astronomy, manufacturing and other technology-heavy industries.

Analysts responded to the latest update by increasing expectations by mid-single digits for the next two financial years. While it is not yet clear if first half sales strength was simply a pull forward, 'if not, it offers scope potentially for upgrades later in the year,' says FinnCap.

Shares previously said SDI represented a multi-year growth story with the potential to add substantial value to retail investor portfolios and that optimism remains undimmed now.



SHARES SAYS: ↗

SDI remains a great growth stock to own. [SF]

CURRYS

(CURY) 133.7P

Gain to date: 3.6%

Original entry point:

Buy at 129p, 15 July 2021

OUR BULLISH call on electrical goods retailer **Currys (CURY)** is modestly in the money. The shares started to move up on 4 November after the laptops-to-smart TVs seller unveiled a £75 million share buyback programme off the back of a robust sales performance and positive outlook.

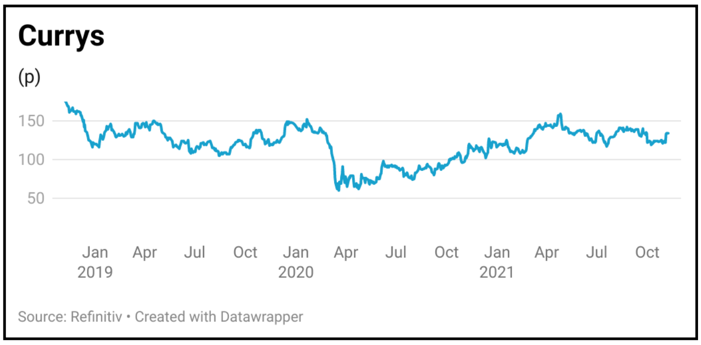
Group like-for-like sales for the six months to 30 October were 1% lower year-on-year as the impact of lockdown and consumers buying computers for home working and gaming eased, but were up 15% compared to two years ago.

Looking ahead to the key Christmas period, Currys said it expects to deliver a 'robust peak trading season', having managed to mitigate supply chain and staffing issues.

'We are on track to meet consensus expectations for full year 2021/22 pre-tax profit of £161 million,' the retailer added.

The leader in a competitive market, Currys is a great way to gain exposure to the increasing role technology plays in all our lives and its balance sheet and free cash flow have strengthened significantly in recent years.

Liberum Capital argues the shares 'remain far too cheap' and upped its price target from 175p to 200p on the back of the encouraging update, implying there's the best part of 50% upside on offer in the next 12 months.



SHARES SAYS: ↗

Stick with Currys as its sharper focus should soon pay off. [JC]

FORD MOTOR COMPANY
$20.50

Gain to date: 193%
Original entry point:
Buy at $6.99, 13 August 2020

SAYING TO BUY Ford shares in the middle of a restructuring during the pandemic was a calculated risk which has paid off.

The company has benefited from its own actions, refreshing the product range as it pivots to manufacturing more electric vehicles.

This seems to be working with Ford the top selling US automaker in the last two consecutive months boosting its market share.

This followed a strong third quarter earnings report where the company raised full-year guidance and restarted its dividend.

Ford has also made progress on repairing its balance sheet after a move to buy back expensive debt and improve its credit rating.

It also plans to issue green bonds to increase investment into battery technology and clean manufacturing. The bonds would have coupons of around 4%.

Furthermore, Ford holds a stake greater than 5% in electric truck maker Rivian which was scheduled to join the US stock market as *Shares* went to press.

SHARES SAYS:
Although Ford's shares have performed strongly, the fundamentals have also improved significantly. Remains a buy. [MGam]

RISING INTEREST RATES

They're about to take off

By Tom Sieber, Martin Gamble, Steven Frazer and Mark Gardner

Bank of England governor Andrew Bailey may have earned the tag of an 'unreliable boyfriend' after the Bank's Monetary Policy Committee confounded market expectations and kept interest rates at record lows at its latest meeting (4 Nov), but the message was clear: rate rises are coming.

Mounting inflation means the Bank of England must do something and investors need to be prepared.

In this article we consider what rising rates mean from a market perspective and how it might impact stocks and sectors depending on their various sensitivities to rates.

ARE RATE RISES BAD FOR STOCKS?

Received wisdom is that an increase in interest rates is bad news for stocks and shares as they boost the attractiveness and returns on offer from lower risk assets like cash.

The evidence, in the form of the FTSE All-Share's performance during periods when rates are in an upwards or downwards cycle, backs this truism up, though only to a limited extent.

This makes sense given changes to interest rates don't happen in a vacuum and there are lots of other influences on how stock markets perform and often when rates are rising it's because the economy is doing relatively well.

The most obvious example of rate increases accompanying a pronounced fall in the markets comes in the mid-to-late 1970s when the UK endured a period of stagflation, which is rising inflation and slowing growth.

There are some fears we could see a repeat of this damaging economic trend now as shortages and supply chain issues lead to rising prices but also choke off the recovery from the pandemic.

HOW FAR AND HOW FAST WILL THE BANK RAISE RATES?

Investors must consider just how far and how fast the Bank will increase rates. While they will almost certainly go up, some observers believe they won't move by much.

While delivering his Budget in October chancellor Rishi Sunak noted the country's public finances were twice as sensitive to an increase in rates as they were before the pandemic and six times as sensitive as they were before the 2007/8 financial crisis. That suggests the Bank of England needs to tread carefully.

Capital Economics' chief UK economist Paul Dales said the Bank's latest decision did 'throw on the bonfire the markets' expectations that interest rates will rise to 1% by the end of next year. This provides some support to our view that rates will end next year at 0.5%'.

IMPACT OF HIGHER RATES ON THE POUND AND HOW THAT AFFECTS THE FTSE 100

Typically, higher interest rates increase the value of a country's currency.

A stronger pound would be negative for the FTSE 100 because of the high proportion of sales and revenues made by blue-chip companies in dollars, estimated at about 70% of the index. If sterling strengthens then dollar revenues, once converted back into sterling, are worth less.

But the traditional link between higher rates and a stronger currency isn't holding given other factors in play, such as doubts about the robustness of economic recovery, Covid cases increasing and sky-high energy prices squeezing consumers and industry.

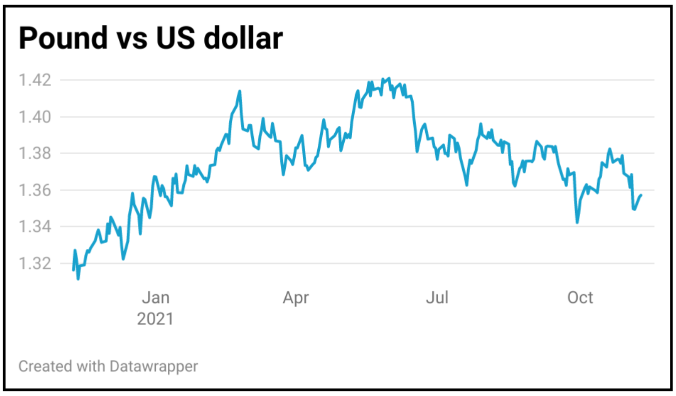
We can see this broken linkage over the past three months. Despite many finance experts and the market increasingly anticipating rate rises late this year, and certainly into 2022, the pound has fallen against the greenback, losing about 2.5% since early August.

That might not seem like much but on such relatively meagre margins fortunes can be won and lost, savings pots preserved or eroded given the millions, even billions of pounds of exposure worn by financial institutions and large companies.

For example, energy, basic resources, industrials and healthcare stocks make up more than 40% of the FTSE 100 market weighting, according to FTSE Russell data, sectors that are almost exclusively dollar earners.

This implies that if the pound does start to firm down the line, then profits, cash flows and potentially dividends from the likes of large cap stocks including **BP (BP.)**, **Unilever (ULVR)**, **AstraZeneca (AZN)**, miners and many others could come under pressure.

A lot of investors may think the FTSE 250 is safer territory on the assumption that it is more representative of the UK economy as it contains mostly domestic businesses. This is not quite the case as something like 50% of sales and profits from members of the FTSE 250 still come from overseas.



According to a recent Bloomberg survey, strategists have shifted and see the pound stuck around current levels over the next few months. The median year-end forecast is now $1.37, down from as high as $1.43 four months ago.

At the time of writing, the pound traded at $1.35, having weakened after the Bank of England's decision on 4 November not to put rates up yet.

WILL BANKS REALLY BENEFIT FROM HIGHER RATES?

Traditionally banks have been viewed as being a key beneficiary of a rising interest rate environment. This is because they have a greater scope to increase their net interest margins (the difference between the rates at which they lend money and the interest they pay on customers' savings) when interest rates are rising. However, there is a potential future situation which could dampen profit accretion.

At present the UK financial sector has £900 billion of cash reserves that are remunerated at the Bank of England's base rate. However, there is risk this may change.

The recent Covid-19 pandemic has resulted in a marked increase in the public sector borrowing requirement. This means that Government debt is particularly sensitive to any increase in interest rates.

This logic extends to the banking sector's reserve balances. Numis estimates that for every 25 basis points increase in the base rate, applied to £900 billion of reserve balances, this could add £2.3 billion to the public sector borrowing requirement.

Numis says there are major implications on the UK banks if half of their reserve balance stopped receiving interest at base rate.

The sector's sensitivity to higher rates could be reduced by 40% to 50%. The positive impact on domestic sector profits of a 25 basis-point UK rate rise could fall from 5% to 3%. At **NatWest (NWG)**, which is the most rate sensitive, pre-tax profit accretion would fall from 11% to 7% because of the move.

WATCH OUT FOR LOW MARGIN COMPANIES

Rising interest rates could put pressure on family finances and impact discretionary spending on big ticket items and 'nice-to-have' purchases.

To find potentially vulnerable stocks, investors should look at consumer cyclical stocks that have wafer-thin margins and high operating leverage.

The latter means a company has a high proportion of fixed costs which means profits are more sensitive to a fall in revenues. A relatively small drop in sales can have a disproportionate impact on earnings.

Conversely, businesses with high margins and low operating leverage are more resilient to falling revenues and are better able to absorb a drop in revenues and inflationary pressure.

GOOD NEWS FOR COMPANIES WITH LARGE PENSION DEFICITS

Higher interest rates can lead to a reduction in the liabilities of corporate pension schemes, potentially benefiting companies with big deficits.

That's because pension liabilities are comprised of future pension payments and most schemes match those liabilities by buying long-dated bonds. Actuaries value long-term liabilities by applying a discount rate which is linked to interest rates. Actuaries are specialist statisticians who provide services around modelling risk and uncertainty.

If interest rates rise, pushing long-term bond yields higher, actuaries can justify applying a higher discount rate which has the effect of lowering liabilities and reducing a deficit or increasing a surplus.

However, it's not that simple because not all maturities of bonds respond in the same way to a rise in government interest rates.

For example, if investors believe that raising interest rates today will put the brakes on economic growth and reduce the level of inflation then longer-term bond yields might fall.

This may have the seemingly bizarre effect of lowering the discount rate that actuaries use to value liabilities. Therefore, to see a positive effect, long-term yields need to rise.

Telecoms group **BT (BT.)** has one of the largest pension deficits in the UK, worth over £5 billion.

The company has pledged to pay £900 million a year until 2030 to plug the gap, so if the deficit were lowered due to higher interest rates, it might be good news for international telecoms provider Altice, which has built a 12% stake and rumoured to be interested in buying BT.

A change to the regulation of pension funds has given trustees more influence in takeover situations, to protect the interests of pension holders.

Examples of companies with high pension deficits relative to their market cap

Name	Pension Deficit / Market Cap Last Year	Pension Deficit Latest (£m)
BT	32.6%	5,096
BAE Systems	29.0%	2,357
Phoenix Group	31.2%	1,901
Currys	31.1%	482
Firstgroup	26.0%	272
Stagecoach	57.7%	264
Reach	36.9%	155
Capita	33.2%	82
Lookers	31.0%	65
Pendragon	28.9%	35

Source: Stockopedia, Refinitiv • Created with Datawrapper

One word of caution, just remember that a company with a large pension deficit isn't suddenly worth buying because it could benefit from rising rates. In theory, its share price might get a small bump, but you must always look at the fundamentals of the business and be comfortable with its growth prospects, financial strength and competition positioning before considering an investment.

WHAT HIGHER RATES MEAN FOR COMPANIES WITH LOTS OF DEBT OR CASH

An increase in interest rates is typically bad news for companies with lots of debt and good news for companies with plenty of cash on their balance sheet.

With this in mind, we ran a screen of the UK market using Stockopedia to identify stocks with a market value greater than £500 million and where net debt to assets is greater than 60%. This is a measure of indebtedness and is calculated by comparing net debt to total assets.

Net debt is total debt minus cash. Net debt to assets of 60% or more is often considered to be unsustainable. We excluded the financial sector because the complexity of their balance sheets renders such measures largely meaningless.

We narrowed the search further by insisting on an Altman Z-score of less than 1.2 times. The Z-score is designed to identify companies which have a higher risk of bankruptcy, with readings below the 1.2 threshold considered riskier than average.

Selected indebted UK firms

Company	Six-month relative strength*	Net debt to assets
Cineworld	−34.1%	81.1%
IWG	−22.6%	80.4%
SSP	−26.6%	75.0%
J D Wetherspoon	−30.3%	68.1%
Contourglobal	−2.1%	66.7%
WH Smith	−20.6%	64.1%
Tullow Oil	−22.1%	60.5%

**Relative strength is a ratio of a stock price performance to a market average performance*

Source: Stockopedia, 4 November 2021. *Relative to FTSE All-Share • Created with Datawrapper

It is no surprise to see plenty of travel, hospitality and leisure businesses on the list as they are bearing the scars of the pandemic. For an extended period, they incurred plenty of fixed costs but effectively generating zero revenue thanks to Covid restrictions. Inevitably this resulted in big increases in borrowing.

These businesses could face a double whammy from a rate increase. Interest costs may rise, although many firms will have fixed rates of interest at least in the short term.

At the same time consumers will see increased costs on their mortgages, credit cards and other loans at a time when they are already seeing rising fuel, food and energy prices.

This is hardly the platform for a boom in spending on leisure activities and holidays. It's little wonder that many of these stocks have underperformed the market over the last six months.

On the flipside, companies with lots of net cash should be better placed in a rising interest rate environment. We used Stockopedia again to find firms worth more than £500 million with a price to net cash ratio of eight or less. This effectively means their market value is no more than eight times the value of their net cash.

Cashed up UK firms

Company	Six-month relative strength*	Market cap to net cash
Crest Nicholson	−18.2%	7.1
Yellow Cake	28.0%	6.9
Naked Wines	−10.9%	6.6
Persimmon	−18.4%	6.5
Taylor Wimpey	−17.2%	6.4
Serica Energy	67.2%	6.0
Hutchmed	14.6%	5.9
Tremor International	−7.9%	5.6
Centamin	−24.5%	5.3
Barratt Developments	−18.0%	5.2
Craneware	−18.1%	4.7
Berkeley	−12.3%	4.2
Puretech Health	−10.0%	3.8
Cairn Energy	6.5%	3.7
Morgan Sindall	−5.9%	3.6
Indivior	62.6%	3.5
Deliveroo	5.4%	3.3

**Relative to FTSE All-Share*

Source: Stockopedia, 4 November 2021 • Created with Datawrapper

The cash should earn a higher level of interest and these companies won't be exposed to the same pressures as those firms which are weighed down by heavy debts.

Housebuilders feature heavily in this list of cashed-up stocks, though the downside for this sector of a rate increase is that it will reduce the availability of cheap mortgages for potential purchasers.

WATCH OUT FOR HIGHLY RATED STOCKS IF RATES RISE

Perhaps one of the market oddities of rising interest rates is that it can make the market far more short-term in its thinking.

In theory, if low risk returns become more attractive and more readily available, there's less incentive to take higher risks on stocks where returns are less certain and likely to come further down the line.

This is particularly relevant in the technology space, where over-hyped companies may struggle to maintain current valuations against a backcloth of more predictable, lower risk (albeit lower return) investments.

That's why investors could see investment flows shift from expensive stocks, such as those with price to earnings ratios of 30-plus, towards lower valued stocks and even cash in the bank as interest rates expand.

While we wouldn't necessarily argue with the concept of lower risk assets for shorter time horizons, investors could run the risk of turning too cautious and ejecting higher quality stocks with the capacity for substantial wealth creation from portfolios.

If you have highly rated stocks in your portfolio, you might want to prioritise the ones with a track record of making good returns on capital employed rather than ones which are growing fast but where their higher valuation reflects jam tomorrow rather than jam today.

The UK and global trusts beating the market

These two sectors contain great examples of actively managed funds

The simple option for investors these days is to choose a tracker fund which mirrors a certain part of the market. Therefore, actively managed funds really need to add value and deliver market-beating returns if they are to convince investors not to go for the easy option of a tracker fund.

All products classified as investment trusts are actively managed funds and there are certain areas which have a solid track record of adding value.

Shares has found that all nine investment trusts in the UK All Companies sector have beaten the market (as measured by the FTSE All-Share index) on a five year-basis. The returns vary between approximately 50% and 98% versus around 34% from the FTSE All-Share.

In the global equity category, 13 out of 17 investments trusts have beaten the MSCI World index which is typically used as the benchmark. Of the four laggards, two have changed (or are about to change) managers in recent years which goes to show how investment trusts have the advantage of having a board of directors who can try something new if performance isn't up to scratch.

UK WINNERS

In the UK All Companies sector, the top performer on a five-year basis is **Artemis Alpha Trust (ATS)** which focuses on growth-orientated businesses, many of whom pay growing dividends. A

98% return over that period is nearly three times better than the market.

Artemis Alpha Trust's portfolio currently includes stakes in Sports Direct-owned **Frasers (FRAS)**, airline **EasyJet (EZJ)** and electronics group Nintendo.

Interestingly, the investment trust's five-year performance is better than its 10-year return of 92%. It underwent a strategic review in 2018 after going through a bad patch thanks to large exposure to small energy stocks just as oil prices crashed. A new manager was appointed, and fresh thinking has helped to revive the trust.

On a 10-year basis, the best performer in the UK All Companies sector is **Henderson Opportunities Trust (HOT)** with a 348% return.

UK All Companies sector: Investment Trusts

	3 years	5 years	10 years
Artemis Artemis Alpha Trust	53%	98%	92%
Schroder UK Mid Cap	51%	93%	284%
Henderson Opportunities Trust	48%	91%	348%
Mercantile Investment Trust	49%	90%	297%
JPMorgan Mid Cap	34%	73%	345%
Fidelity Special Values	27%	71%	290%
Independent Investment Trust	3%	65%	264%
Baillie Gifford UK Growth Trust	38%	63%	155%
Aurora Investment Trust	20%	51%	85%
FTSE All Share	**18%**	**34%**	**110%**

3 November 2021. Total return

Table: Shares magazine • Source: FE Fundinfo • Created with Datawrapper

Global Sector: Investment Trusts

	3 years	5 years	10 years
Scottish Mortgage Investment Trust	217%	375%	1211%
Monks Investment Trust	79%	164%	365%
Manchester & London IT	39%	130%	158%
Mid Wynd International Investment Trust	75%	108%	295%
Martin Currie Global Portfolio Trust	76%	107%	329%
Lindsell Train IT	24%	107%	603%
Brunner Investment Trust	54%	99%	252%
Alliance Trust	52%	95%	286%
F&C Investment Trust	41%	90%	287%
The Bankers Investment Trust	47%	90%	283%
AVI Global Trust	59%	89%	199%
JPMorgan Elect Managed Growth	45%	77%	241%
Witan Investment Trust	31%	67%	254%
FTSE All Share	**18%**	**34%**	**110%**
Scottish Investment Trust	11%	29%	145%
Keystone Positive Change Investment Trust	23%	26%	116%
EP Global Opportunities Trust	1%	15%	119%
Blue Planet Investment Trust	-24%	-7%	65%

3 November 2021. Total return

Table: Shares magazine • Source: FE Fundinfo • Created with Datawrapper

GLOBAL WINNERS

Looking at the global investment trust sector, Baillie Gifford-managed **Scottish Mortgage Investment Trust (SMT)** is the best five-year and 10-year performer, returning 375% and 1,211% respectively.

At 0.34%, it has one of the lowest ongoing charges of all active funds. However, the trust is prone to higher levels of volatility as witnessed earlier this year. This is in part due to its decision to invest in privately-owned companies as well as ones which trade on a stock market.

The second-best performer in the global equities sector with a 164% return over five years is **Monks Investment Trust (MNKS)** which is also managed by Baillie Gifford.

It seeks to invest in companies whose growth prospects are under-appreciated by the market and where there is a greater than a 30% probability of doubling shareholder funds over a five-year period.

Recent performance has been boosted by strong returns from electric vehicle maker Tesla, Singapore-based consumer internet company Sea Limited and drugs firm Moderna.

By **Mark Gardner**
Senior Reporter

Why are investment trusts appealing?

UNLIKE UNIT TRUSTS and open-ended investment companies, investment trusts have a fixed number of shares which can be bought and sold. As their price is determined by the market, investment trust can trade at a premium or discount to the value of their assets.

Investment trusts benefit from their ability to smooth dividends. In marked contrast to open ended funds, investment trusts can keep up to 15% of their dividend income in reserves each year rather than paying it all out immediately.

In difficult times, should any portfolio holdings cut their dividends, the trust can still maintain a consistent dividend payment to its shareholders by dipping into its reserves.

The closed-ended structure of investment trusts also enables the fund manager to adopt a longer-term investment approach, because they do not have to sell assets to pay for investors who wish to exit the fund.

Best performing Asian funds and investment trusts

Discover which names have delivered the strongest returns for investors

In response to a reader request, *Shares* will publish performance tables each week for the main categories of funds and investment trusts, starting with a look at the Asian market.

While readers should always appreciate that what's done well in the past won't necessarily keep winning in the future, studying performance tables can help to spot funds and trusts that have been doing something right.

The tables have been ranked by five-year performance as it is important to judge funds on a longer-term track record rather than recent gains or losses. However, the figures for one, three and 10-year performance have been included for context.

Over the five-year period, the benchmark index – MSCI Asia Pacific excluding Japan index – returned 54.6% including dividends. In comparison, **Baillie Gifford Pacific Fund (0606323)** achieved more than three times this return at 170.1%.

'Asia is facing a period of change. We look to embrace the opportunities afforded by this change, by investing in companies disrupting the existing order,' says the fund's asset manager.

By **Daniel Coatsworth**
Editor

Best performing Asia Pacific ex-Japan funds by 5-year performance

	1 year	3 years	5 years	10 years
Baillie Gifford Pacific B Acc	24.8%	118.4%	170.1%	383.6%
Fidelity Asia Pacific Opportunities W Acc	19.1%	71.0%	99.1%	n/a
Wellington Asian Opportunities N Acc	7.3%	56.0%	81.0%	202.4%
Allianz Total Return Asian Equity C	1.4%	67.7%	80.7%	192.5%
T. Rowe Price Asian Opportunities Equity Q	6.1%	50.9%	76.6%	n/a
Fidelity Sustainable Asia Equity W Acc	8.9%	50.1%	72.3%	207.6%
FSSA Asia Focus B Acc	13.1%	44.3%	71.1%	n/a
T. Rowe Price Responsible Asian Ex Japan Equity	5.9%	49.9%	67.9%	161.9%
Fidelity Asia W Acc	1.2%	42.2%	67.6%	189.6%
GS Asia Equity Portfolio R Acc	0.0%	42.7%	66.1%	165.3%
Benchmark: MSCI Asia ex-Japan	**6.6%**	**34.3%**	**54.6%**	**146.9%**

4 November 2021. Total return in GBP
Table: Shares magazine • Source: FE Fundinfo • Created with Datawrapper

Asia Pacific investment trusts ranked by 5-year performance

	1 year	3 years	5 years	10 years
Pacific Horizon Investment Trust	37.7%	194.0%	307.8%	553.5%
Schroder Asian Total Return	13.1%	59.8%	112.1%	263.1%
Schroder Asia Pacific	10.5%	56.1%	84.2%	239.4%
Aberdeen New Dawn Investment Trust	13.8%	59.9%	80.5%	154.4%
Invesco Asia Trust	22.9%	57.6%	75.3%	218.2%
Asia Dragon Trust	10.4%	51.2%	73.6%	150.1%
Pacific Assets Trust	24.1%	35.5%	48.4%	253.1%

4 November 2021. Total return in GBP
Table: Shares magazine • Source: FE Fundinfo • Created with Datawrapper

Janus Henderson
INVESTORS

TRUST TV: THE RETURN OF DIVIDENDS TO THE UK INVESTMENT LANDSCAPE

***Laura Foll**, Co-Portfolio Manager of the Lowland Investment Company*

For UK portfolio managers and investors alike, the experiences of 2020 will prove difficult to erase from the memory. However, after the protracted pandemic winter for dividends, the green shoots are sprouting.

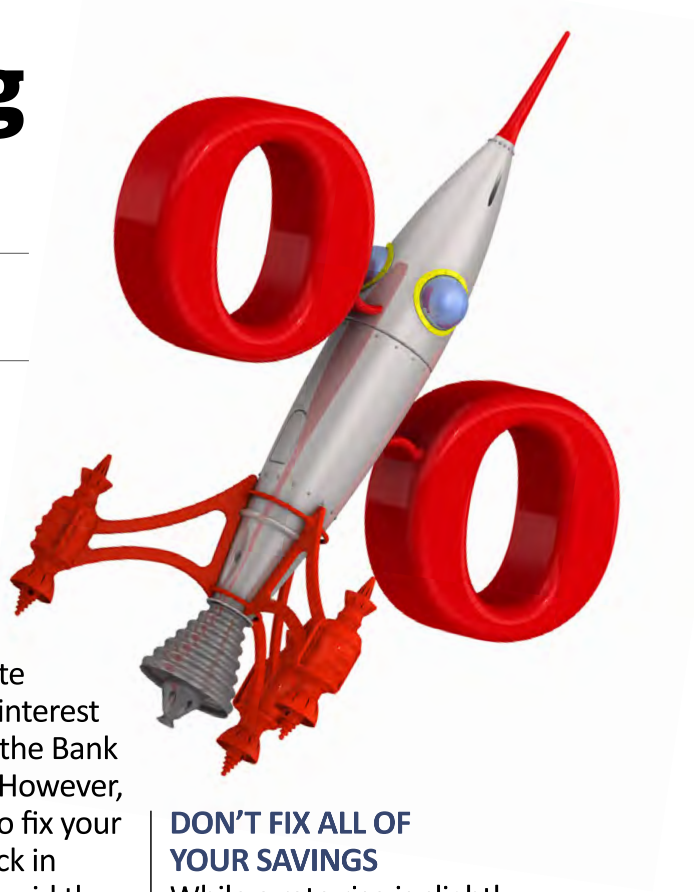
After nearly five years of Brexit uncertainty, UK equities have come into favour, with the swift rollout of COVID-19 vaccines and the re-opening of the economy bringing hope of a return to relative 'normality'. Continued central bank and government support, coupled with the release of pent-up consumer demand, have also led to increased optimism about the prospects for the UK economy.

Amidst all the talk of a return to normality, one further aspect casts a positive light on the UK: regular service being resumed with regard to the payment of dividends.

Find out more in our latest Trust TV

How to beat rising interest rates

The steps you can take ahead of an increase in borrowing costs



The Bank of England surprised markets by keeping interest rates on hold at 0.1% on 4 November but says it will probably hike rates in the coming months.

Beyond that, more interest rate rises almost certainly lie in store, though they might be slow and steady. The Bank won't want to put too much pressure on the economy, and thinks inflation is going to be a flash in the pan, even though it's expected to peak at 5% next April.

Although the pace of tightening monetary policy is going to be glacial, a sustained rise in interest rates would be a tectonic shift from the low interest rate environment we've seen since the global financial crisis in 2008.

There have only been two interest rate rises in the last 14 years, and based on ONS data, AJ Bell estimates around 10 million people in the UK haven't seen interest rates above 1% in their adult lives. Inevitably we have all become accustomed to extremely cheap borrowing costs, so when they arrive, higher interest rates might well come as a bit of a shock to the system.

But there are some concrete steps you can take ahead of any rate rise, to minimise the financial pinch you feel when the Bank of England finally lurches into action.

FIX YOUR MORTGAGE

Anyone on a variable rate mortgage will see their interest rates go up overnight if the Bank of England raises rates. However, if you are in a position to fix your mortgage now, you'll lock in current low rates, and avoid the effect of interest rate rises until your fixed rate period comes to an end.

Mortgage companies have already started to increase their rates, and they'll probably bump up again, once a rate rise actually happens. Someone with £250,000 of borrowing on the average variable rate mortgage rate of 2.45% could save £2,088 a year by switching to the current top two-year fix.

If rates rise to 0.25% they would save £2,316 a year (figures based on a repayment mortgage with a 25 year term and 80% loan-to-value). If you lock in for an even longer period, then you'd save less each year, but potentially more over the term of the fix. Most people re-mortgaging recently have been buying fixed rate deals, because they're really cheap, and give you good visibility over your monthly outgoings.

DON'T FIX ALL OF YOUR SAVINGS

While a rate rise is slightly positive news for savers, who've suffered more than 12 years of ultra-loose monetary policy, buying a fixed rate now means you'll miss out on any increases. The top two-year fixed rate account is currently paying 1.76%, which is significantly more tempting than the top easy-access account of 0.65%.

But both those rates should increase if the Bank of England raises the Base Rate – and if you've already locked in for two years at today's rate, you won't be able to switch without penalties. There is a really delicate balance to strike here, because the longer you sit in an easy access account, waiting for interest rate rises to come along, the more you miss out on the extra interest you could have earned by fixing.

There's no easy answer to this conundrum, beyond spreading your cash around between fixed rate savings and easy access accounts. That hedges your bets, giving you some flexibility for the future, and some extra interest today.

SHOP AROUND WITH YOUR CASH

The supermodel Linda Evangelista is famous for saying that she didn't get out of bed for less than $10,000 a day. Cash savers will perhaps (partly) empathise with this, as interest rates have been so measly, it hardly seems worth getting out from under the covers to shop around for a better rate.

The good news is that rising rates will mean greater rewards for those who seek out the best deals. The bad news is that some accounts won't pass on the benefits of rising rates quickly, if at all, so those who don't shop around might well miss out.

Interest rate rises mean it's time to get out of bed, and start sniffing around for the best deals for your cash.

SORT YOUR DEBT

Anyone with debt is going to really feel the pinch of an interest rate rise, as the interest they pay each month will increase. Banks are very quick to pass on any rate rise to customers when it suits them, so those with debt should be braced for higher costs straight away. This will probably be compounded by rising inflation and higher taxes, putting pressure on household budgets.

Anyone with debt needs to work out if they can switch to cheaper borrowing, before rate rises start taking their toll. Look at whether you can take

Paying off any credit cards should be a high priority

advantage of a 0% balance transfer deal on your credit card, or if you might be eligible for an interest-free overdraft.

If you have money to pay down some of your borrowing, start with the most expensive first, as that will free up more of your disposable income to come back for another swipe at your debt pile.

CONSIDER INVESTING YOUR MONEY

Even with interest rates rising, if savings rates increase by the same amount as the Bank of England's base rate you'll still be nowhere near beating inflation. The current top easy-access savings account pays 0.65% interest. If the base rate rises from 0.1% to 0.25% and all of that increase gets passed on to savers, then the top account will pay 0.8%.

That's still miles below current inflation of 3.1% and even further away from the 5% inflation expected next year. Cash is a great place for money you might need quick access to, but for long-term savings it's very likely to lose its buying power.

So, work out what you need in the next five years, or as an emergency pot, and see how that stacks up against the amount you've got in cash. If you've got way more than that set aside, think about investing the excess in a Stocks & Shares ISA, to shelter it from tax.

The Bank of England has made it clear an interest rate rise is on the way. For some time to come though, borrowing will still be cheap by historical standards, and on the flip side, savings rates will be low.

Rate rises will be gradual, so there's no need to panic. But interest rate policy is a little bit like the tide, slow and powerful, so it's best not to leave it too long until you shore up your finances.

DISCLAIMER: Financial services company AJ Bell referenced in this article owns Shares magazine. Tom Sieber who edited this article owns shares in AJ Bell.

By **Laith Khalaf**
AJ Bell Head of Investment Analysis

DANNI HEWSON
AJ Bell Financial Analyst

Can ethical investing help narrow the gender investment gap?

Green policies matter to a lot of females when they are looking for investment opportunities

Women invest less than men, that's a fact. A new study* commissioned by AJ Bell suggests the average level of savings and investments held by women is less than half the amount held by their male counterparts.

To put a number on it, if you extrapolate the average difference in savings and investments between the men and women questioned and factor in the UK population then the gender investment gap comes in at a staggering £1.65 trillion.

There are many reasons for the gap from pay differences to maternity leave and the fact women simply think differently to men, but there could be one change that might start to make a difference.

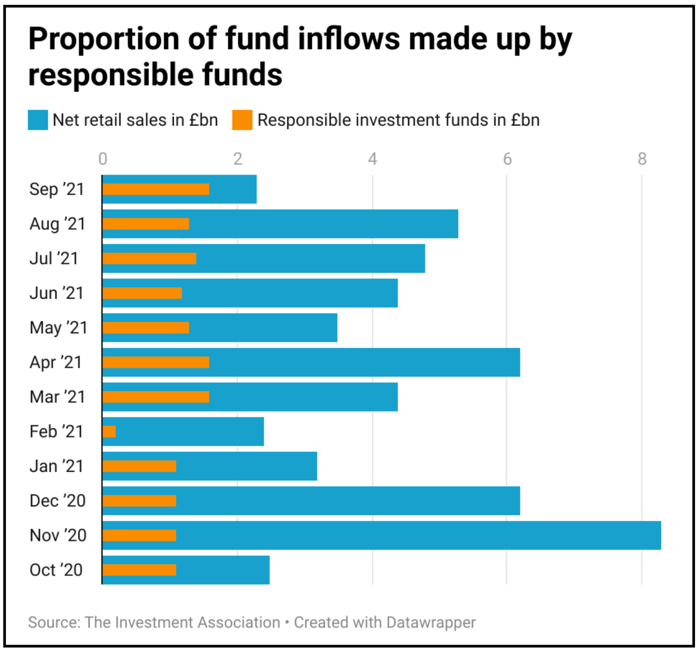
SEEKING POSITIVE CHANGE

Chatting to two first time investors during research for our new Money Matters campaign it emerged that while both women had different reasons for starting their investment journeys both had really focused on the ability to have their money work for positive change.

31-year-old Dee told me: 'When I first started investing... I was just happy to give it a go to see if it was for me. As I got more experienced it very much became a conscious decision of what company I invested in and any organisations that I would like to support.

'I started reading an organisation's green policies... and it actually did become an emotional decision and it still is. Now I will only invest in a company that I believe will do good for the planet or at least has a green initiative.'

Similarly, Georgia, who is 28, said, 'I think the first time I looked at (investing) I was getting a sense of how it worked. I invested a small amount, but I got to grips with what all the different words meant. Now I've been able to use that information to make more ethical decisions about where I put



DANNI HEWSON
AJ Bell Financial Analyst

money and decide the best options for me that fit my values as well.'

RESPONSIBLE INVESTING ON THE RISE AMONG MEN AND WOMEN

That's not to say women are the only ones putting their money where their ethics are. Two thirds of fund inflows in September went into products that invest specifically according to ESG (environmental, social and governance) principles and over the past year most months saw around £1 billion of funds being invested in 'responsible' funds.

But as Dee says, at least among her friends, investing means different things to different people. 'I've got a small circle of friends that invest. Some are female, some are male. Most of my female friends only invest in companies they believe in. Most of my male friends, in fact all of them, invest in the company they think will get them the most money or most reward. In return they very rarely look at the company as a whole.'

Ethics isn't a barrier to rewards and when you look at AJ Bell's most traded lists for this year and compare it with five years ago you can see change is coming, albeit slowly.

Top trades on AJ Bell Youinvest platform in 2021 vs 2016

2021 - year to date	2016
Scottish Mortgage Investment Trust	Lloyds Banking
VT AJ Bell Adventurous Fund	Fundsmith Equity
VT AJ Bell Moderately Adventurous Fund	Barclays
VT AJ Bell Global Growth Fund	Scottish Mortgage Investment Trust
Fundsmith Equity	Woodford Equity Income Fund
VT AJ Bell Balanced Fund	Glencore
Scottish Investment Trust	Legal & General
VT AJ Bell Responsible Growth Fund	Royal Dutch Shell
Argo Blockchain	BP
GlaxoSmithKline	Vodafone
BP	GlaxoSmithKline

Source: AJ Bell Youinvest • Created with Datawrapper

INVESTMENT APPETITES ARE CHANGING

Several high carbon emitters have slipped out of the top 10 most traded stocks, but **BP (BP.)** remains a popular choice and its ESG credentials come with great big caveats.

Pre-packaged funds which tell investors exactly what's 'in the tin' have become more popular, and making sure that investors have easy access to clear information might be the most significant thing to emerge from COP26, the Glasgow-based climate change summit of world leaders.

From April next year over 1,000 of the largest UK registered businesses will be required to disclose mandated climate-related financial information, and investment products will also come under the spotlight with the FCA, the financial regulator, due to consult on criteria for ESG labels.

It's often said knowledge is power but there have been many complaints that ESG reporting has lacked clarity and a mechanism for judging whether all those net-zero promises are more than just lip service.

In this case the knowledge might make a double impact, helping make the UK and the world a cleaner, greener place and giving more women the impetus and the confidence to seek out investing for the first time. Helping the planet and helping themselves.

For more information about AJ Bell's Money Matters campaign please visit AJ Bell Youinvest's website and listen to the Money Matters podcast.

*AJ Bell commissioned an independent survey of 5,000 people from Opinium, conducted between 26 and 30 August 2021, creating the AJ Bell Money Matters report

DISCLAIMER: AJ Bell is the publisher of Shares magazine. Daniel Coatsworth who edited this article owns shares in AJ Bell.

At what point is the lifetime allowance calculated?

AJ Bell pensions expert Tom Selby considers the options for managing money in retirement

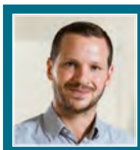
I have several pension pots with various companies of different sizes. I will be using all of them as drawdown. From what I understand, I can take 25% tax-free allowance from each pot, with the remainder subject to income tax.

I plan to take 25% from each of the pots over a number of years, while using my tax-free personal allowance each year.

When I start taking money from one of the pots, do I then take a snapshot of my other pots, adding them together, to get my lifetime allowance?

In other words, when is the lifetime allowance calculated? My pots may continue to grow over a few years and so is this taken into account when calculating the lifetime limit? Is it going to be calculated from each pot when I access each one?

Alan



Tom Selby
AJ Bell Senior Analyst says:

Most pension savers are entitled to take 25% of their fund tax-free from age 55 (rising to 57 in 2028). The remaining 75% is taxed in the same way as income.

In order to take your 25% tax-free cash, you need to choose a retirement income route for the rest of your fund. This could be buying a guaranteed income for life (an annuity) or keeping the money invested while taking flexible withdrawals (drawdown).

Instead of taking your whole 25% tax-free cash at once, another option is to take ad-hoc lump sums over time (known as UFPLS).

Each time you choose to access one of your pensions this will result in a 'benefit crystallisation event' and trigger a lifetime allowance test. This will only be in relation to the part of the pension that has been 'crystallised'.

For example, let's take a 60-year-old who has four personal pensions each worth exactly £40,000. If they decided they wanted to take a quarter of one of the pots (£10,000) tax-free, they might crystallise the remaining £30,000 in drawdown.

In this example two benefit crystallisation events have occurred:

- Taking £10,000 of tax-free cash.
- Committing £30,000 to drawdown.

Each of these events would use up a percentage of the person's available lifetime allowance. If we assume they have the full £1,073,100 lifetime allowance available and no protections:

- Taking £10,000 tax-free cash will use 0.93% of their available lifetime allowance.
- Committing £30,000 to drawdown will use 2.79% of their available lifetime allowance.

Another lifetime allowance test is carried out at age 75 which will capture any growth in the drawdown fund for those who choose that income option. If in the above example the drawdown fund has increased in value from £30,000 to £50,000 by age 75 because the investor has taken no actual income withdrawals, then the £20,000 of growth will be tested.

One other thing to note is that when taking taxable income from your drawdown fund you may initially be overtaxed. You can read more about this and how to reclaim your money here.

Government changes rule for many people on pensions access at 55

Retirement savers hit by the Treasury closing pension age protection window

Last week I answered a question about Government plans to change the minimum age you can access your retirement pot. In typical fashion, on the day the article was published the Treasury closed a loophole that would have given some individuals access to their retirement money from age 55 by transfering their pension.

Firstly, let's look at the parts of the rules that aren't changing. From April 2028 the minimum age you can access your pension – referred to as the normal minimum pension age or NMPA – will increase from age 55 to age 57.

Rather than apply this increase across the board, the Government has proposed creating a 'protection' regime so that savers in a scheme which gave an 'unqualified right' to a normal minimum pension age below age 57 on 11 February 2021 can retain that earlier pension access age. This will be known as a 'protected pension age'.

If people with this protection subsequently make an individual transfer to another scheme, the transferred funds will be able to keep the lower normal minimum pension

age – although any benefits held in the receiving scheme before the transfer, or new contributions, will have normal minimum pension age of 57 from April 2028.

People with a protected pension age who transfer as part of a 'block' with at least one other member of the same old pension scheme to the same new scheme will be able to retain the lower normal minimum pension age for all their funds in the new scheme.

All of these reforms are going through as planned.

However, changes have been proposed in relation to people not currently in a scheme with a protected pension age.

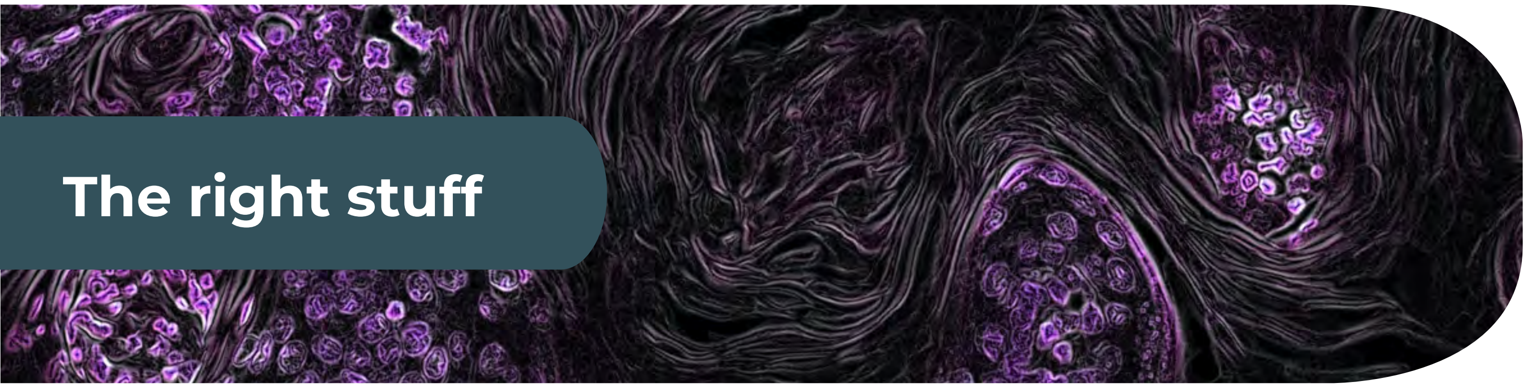
Plans to allow people who join or transfer to a scheme with a normal minimum pension age of 55 by 5 April 2023 to benefit from the lower NMPA have been dropped.

Instead, the Government says only people who are already members, or have started a transfer to a scheme offering protection before 4 November 2021, will be able to retain the lower normal minimum pension age of 55.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

Send an email to **asktom@sharesmagazine.co.uk** with the words 'Retirement question' in the subject line. We'll do our best to respond in a future edition of *Shares*.

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



The right stuff

Biotechnology is a complex field and investors can face a wild ride during volatile periods – so a highly experienced management team is crucial to success...

In July 2020 Forbes Magazine printed an article under a headline which read: “The record breaking biotech funding tsunami of 1H 2020”. Pithy it is not, but the language used here captures the wild-eyed greed which can lure investors when they scent a bargain in this high octane sector.

Less than a year later money was pouring out of biotech stocks as investors sought to take advantage of battered share prices in other areas of the market.

Biotechnology is a high risk, high reward sector. Whilst the latter has obvious appeal to investors seeking growth for their portfolio, it is crucial to understand what lies at the core of success for companies in this field in order to really make consistent gains in the long term. Even the most deeply resourced projects have no guarantee of success.

Against that backdrop, real experience counts, and the team at SV Health – manager of the £320m **International Biotechnology Trust (IBT)** – has plenty.

Kate Bingham, well-known thanks to her role as chair of the UK’s COVID-19 vaccine taskforce, runs the unlisted portfolio which makes up a small element of the trust’s assets. Less famous, but with deep experience in the sector, are joint lead managers Ailsa Craig and Marek Poszepczynski who run the listed portfolio which makes up 91% of the trust’s assets.

Between them, the managers bring a wealth of complimentary experience and skill to a portfolio which has delivered NAV total returns of 65% over the five years to 13 October, not far behind the Nasdaq Biotechnology ETF which tracks the index – but with lower beta (a measure of risk versus the benchmark), lower volatility, and a lower maximum drawdown throughout the period.

Ailsa and Marek stepped up to lead the listed portfolio in March this year. Between them, and via as many as three companies meetings a day, their aim is to gather enough data to create a complete picture of a biotech company which they can use to decide whether to buy, sell or hold its stock. The final decision depends on red and green flags that they have identified while creating that picture.

“Very often it’s what they do not talk about that’s bad,” says Ailsa, “You have to have the experience to notice what you aren’t being told about – and if there’s a gap where there shouldn’t be in what they’re saying, that’s a big red flag for us.”

Not making the wrong decision is so important in this field that red flags outnumber green significantly, but obvious positive indicators are, for example, a focus in one specific disease area, steady dose response throughout the dose increments, and rigorous, consistent trial designs. Again, however, these tangible clues are only part of the picture. Marek’s experience on the front line of life-sciences business gives him the ability to analyse companies in a less binary way.

“When you are talking to a management team it’s the ones who are most upfront about the challenges they face that you can put your faith in. If somebody is too bombastic I don’t really feel they’re acknowledging the risks, whereas you can have more confidence in somebody who understands the limitations they’re faced with.”

Looking ahead, the managers are excited about the future. Whilst the trust’s recent performance has been hampered by its inability to hold vaccine related stocks – a consequence of doing the right thing by lending Kate Bingham’s skills to the nation in its time of need – they see the rapid advances in scientific discovery as a key tailwind for the sector.

“When I read biology twenty years ago the things we are seeing today were science fiction.”, says Ailsa.

She adds: “Fifteen years ago we saw a new breast cancer drug introduced which has saved millions of lives since, and we are now looking at potentially the same thing for lung cancer – ultimately that’s what investing at the cutting edge of science is all about.”

To learn more about the team at IBT and their skilled approach to stockpicking, click **here...**

The rallying car retailers with gas still in the tank

Unusual automotive retail upgrade cycle could stall before long, but there's still value to be found

Quoted car retailers are enjoying an upgrade cycle fuelled by the highly unusual supply and demand dynamics seen in the UK automotive market since the summer of 2020.

Post-lockdown, pent-up consumer demand is being released at the same time as the global semiconductor shortage impacts new car production, which is driving up second hand vehicle prices in particular and boosting sector-wide profit margins in the process.

Given that consumers are still sitting on cash, employment levels are high and wages are rising, demand for cars should remain robust. Yet investors should also note that automotive dealers face threats ranging from digital competition to staffing shortages.

And while supply constraints should underpin vehicle values short term, a reversion to more normalised margins in the medium term is a risk to weigh.

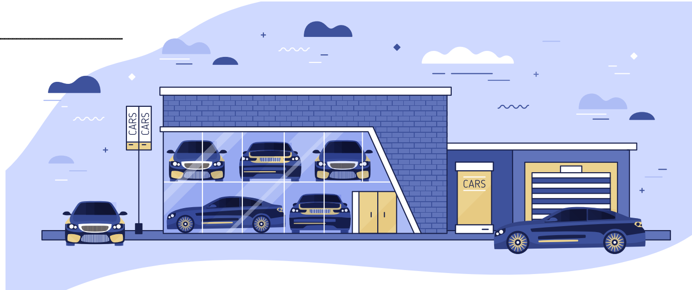
An economic downturn and the increased cost of living could also hit consumer spending on big ticket items.

Based on the valuations of most of the companies in the sector a lot of these headwinds looked priced in and we think the best ways to play the sector are **Vertu Motors (VTU:AIM)** and **Motorpoint (MOTR)**.

THE SECTOR AT A GLANCE

Car retailers are emerging from their biggest stress-test in living memory. Pandemic-induced lockdowns drove massive disruption with car retailers forced to close their showrooms to customers. However, the well-capitalised leading players have emerged stronger from the experience and have also accelerated the digitalisation of their businesses.

Following the takeover and de-listing of Cambria Automobiles, London's quoted automotive retail sector consists of just six constituents, seven if you include global automotive distributor **Inchcape (INCH)**, which is now listed in the Industrial Goods and Services FTSE supersector, not the Retail supersector.



Pendragon (PDG), the company behind the Car Store, Stratstone and Evans Halshaw brands, has undergone a remarkable turnaround under CEO Bill Berman, the former president and chief operating officer of American automotive retail titan AutoNation.

At the height of the pandemic, indebted Pendragon held merger talks with **Lookers (LOOK)**, though the former's overtures were reportedly spurned by the latter.

Lookers itself is now restructured and delivering upgrades under newish CEO Mark Raban, who has restored investor confidence following some serious accounting issues.

Other names in the sector include deal-hungry dealership **Marshall Motor (MOTR:AIM)** and **Caffyns (CFYN)**, the family-controlled outfit that keeps a low profile despite its main market listing.

Marshall is a running *Shares Great Idea* and continues to test new all-time highs following a series of profit upgrades.

The company has outperformed the new car market whilst benefiting from the strengthening of used car margins. And the ambitious company recently announced another strategic expansion through the £64.5 million acquisition of multi-franchise dealership Motorline, a deal which further increases Marshall's top tier industry credentials.

UPGRADE FUEL

Tightness in used car supply has coincided with a period of strong customer demand for used vehicles. Consumers accrued increased savings during lockdown and wished to avoid public transport so car demand went up.

Whilst supply constraints will continue to underpin vehicle values in the short-term, once the logjam breaks, vehicle margins could reduce to more normalised levels.

Car finance expert ChooseMyCar has even warned UK car prices are set to plunge dramatically in the new year due to the combined effect of a potential winter lockdown and the impact this may have on jobs and disposable cash, as well as mounting fuel prices.

Disappointing new car sales data (4 Nov 2021) from the Society of Motor Manufacturers and Traders (SMMT) revealed a 24.6% year-on-year drop in new car registrations to 106,265 in October, the weakest October since 1991.

Though new car registrations fell for the fourth consecutive month, plug-in vehicle uptake remained positive in the month before COP26, with battery electric vehicles equalling their September market share of 15.2% with 16,155 units and plug-in hybrid vehicles growing to 7.9% or 8,382 units.

SOUPED-UP COMPETITION

With physical sales showrooms shuttered during lockdowns, many customers have become more comfortable with purchasing cars at the click of a mouse rather than through a dealership visit.

The listed players face competition from disruptors such as online car marketplace Cinch.

Cinch is owned by the same group which operates Webuyanycar and BCA Marketplace: Constellation Automotive. Investors can gain exposure to Constellation through investment trust **NB Private Equity (NBPE)** which owns a stake.

Used car website Cazoo, which operates an online showroom and delivers vehicles direct to customers' homes in the UK and Europe, recently floated on the New York Stock Exchange.

Hype surrounding the listing has seen it command a $7.3 billion (£5.4 billion) market tag, more than all the UK-listed car dealers combined.

However, pure online-only transactions remain a small percentage of overall industry sales and the majority of customers prefer to visit dealerships so they can chat to sales staff and undertake test drives.

As Vertu's Forrester explained in his full year results review back in May: 'Disruptors who have recently entered the used car market have very little, if anything, to add to the sector in terms of customer proposition or experience, and they do not sell new cars or in some cases, support customers thereafter with their servicing needs.

'The best in class in the sector, and Vertu in particular, have a fully established "bricks and clicks" platform and sell far more used vehicles than these new entrants.'

Forrester also emphasised that his charge 'builds relationships with customers over many years facilitating the supply of new and used cars and customer servicing activities'.

His view is that a 'bricks and clicks' model is crucial in this sector, as a network of physical dealerships is vital for the delivery of service and repair work to customers.

'The fact disruptors to the sector such as Cazoo and Tesla have been developing physical networks is illustrative of their recognition of the need to have a physical presence in addition to their purely online capabilities,' he continued.

KEY METRICS

Gross margin – A gauge of the return on each vehicle sold and an indicator of both the pricing dynamics in the market and the pricing discipline of each automotive retailer.

Like-for-like new car sales – A metric that reveals how a retailer's new vehicle sales have performed versus the prior year. Like-for-likes are often compared with SMMT private registrations to show how the company is faring against the wider new car market.

Net tangible assets – A useful snapshot of the strength of a car dealer's assets including property, as well as its net cash position. A fortress balance sheet gives a dealership firepower for future growth including acquisitions in what remains a fragmented UK market.

Motor retailers snapshot

Company	Market cap	Prospective dividend yield (%)	Forward price to earnings ratio
Cazoo	£5.4 billion	n/a	n/a
Inchcape	£3.3 billion	2	16
Lookers	£252.1 million	2	4
Marshall Motor	£223.7 million	5	6
Motorpoint	£325.1 million	n/a	24
Pendragon	£257.7 million	n/a	5
Vertu Motors	£224.6 million	3	4

Source: SharePad, 4 November 2021. • Created with Datawrapper

The growth of electric vehicle sales is reinforcing the need for dealership visits as customers are unfamiliar with the product.

Physical dealerships with established aftersales operations should have an advantage over online only disruptors as the world gradually goes electric, given the need for increased specialist equipment, technology and knowledge to maintain these vehicles.

STOCK PICKS

MOTORPOINT (MOTR) 338P BUY

A share price pause for breath at **Motorpoint (MOTR)**, which *Shares* added to our *Great Ideas* list in May 2020 at 190p, presents a compelling entry point for new investors in this used car retailer with an accelerated growth strategy.

With CEO Mark Carpenter at the wheel, Motorpoint focuses on selling vehicles under three years old and an agile omni-channel model suggests it can hold its own against online disruptors.

Motorpoint outlined exciting new growth ambitions alongside resilient full year results in June – its new target is to at least double annual sales to over £2 billion in the medium term, of which more than £1 billion is targeted to be online sales.

In the first half to September 2021, Motorpoint's revenues sped 57% higher year-on-year, or up 14% on a two-year view, as the company benefited from buoyant used car demand.

However, full year expectations were sensibly left unchanged given uncertainty around a normalisation in used vehicle prices as the supply shortage gradually eases. Numis forecasts a pre-tax profits rebound from £9.7 million to £18 million for the year to March 2022, ahead of £25.6 million in 2023.

VERTU MOTORS (VTU:AIM) 62P BUY

Robert Forrester-steered **Vertu Motors (VTU:AIM)** has positive forecast momentum and a strong balance sheet with at least £90 million of firepower to execute on a strong acquisitions pipeline. It is also well-equipped to fend off online-only challengers given its ongoing investments in winning digital capabilities. Buying back shares and returned to the dividend list, Vertu is now guiding to pre-tax profit of at least £65 million for the year to February 2022.

Liberum notes the company has freehold property backing of £229.4 million, net cash of £57.3 million and tangible net assets of £222.6 million or 61.5p a share, meaning the trading business is effectively in for free at current levels.

By **James Crux**
Funds and Investment Trusts Editor

Invesco

WHAT DOES **ESG** MEAN TO US?

Ciaran Mallon
Fund Manager

James Goldstone
Fund Manager

Stephen Anness
Head of Global Equities

Our focus as active fund managers is always on finding mispriced stocks and ESG integration underpins our investment process at every stage.

Our incorporation of ESG considers ESG factors as inputs into the wider investment process and forms part of a holistic consideration of the investment risk and opportunity, from valuation through to engagement and monitoring.

The core aspects of our ESG philosophy include: materiality; ESG momentum; and engagement.

- Materiality refers to the consideration of ESG issues that are financially material to the company we are analysing.
- The concept of ESG momentum, or improving ESG performance over time, indicates the degree of improvement of various ESG metrics and factors and helps fund managers identify upside in the future. We find that companies which are improving in terms of their ESG practices may enjoy favourable financial performance in the longer term.
- Engagement is part of our responsibility as active owners, which we take very seriously. We see engagement with companies as an opportunity to encourage continual improvement. Dialogue with portfolio companies is a core part of the investment process for our investment teams. As such, we often participate in board level dialogue and are instrumental in giving shareholder views on management, corporate strategy, transparency, and capital allocation, as well as wider ESG aspects.

ESG integration is an ongoing strategic effort to systematically incorporate ESG factors into fundamental analysis. The aim is to provide a 360-degree evaluation of financial and non-financial materially relevant considerations, and to help guide the portfolio strategy.

While we consider ESG aspects, we are not bound by any specific ESG criteria and have the flexibility to invest across the ESG spectrum from best to worst in class. However, we think that the philosophies behind ESG deserve to be embedded in an investment framework which encourages positive change. Coupling this with a focus on valuation is, to our minds, the best way to deliver strong investment outcomes over the long term for our clients.

Our investment process has four stages. In this note, we detail how ESG is integrated at each stage.
Download the full paper

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange-rate fluctuations) and investors may not get back the full amount invested.

When making an investment in an investment trust/company you are buying shares in a company that is listed on a stock exchange. The price of the shares will be determined by supply and demand. Consequently, the share price of an investment trust/company may be higher or lower than the underlying net asset value of the investments in its portfolio and there can be no certainty that there will be liquidity in the shares.

Invesco

The product uses derivatives for efficient portfolio management which may result in increased volatility in the NAV.

The use of borrowings may increase the volatility of the NAV and may reduce returns when asset values fall.

As a result of COVID-19, markets have seen a noticeable increase in volatility as well as, in some cases, lower liquidity levels; this may continue and may increase these risks in the future. In addition, some companies are suspending, lowering or postponing their dividend payments, which may affect the income received by the Invesco Select Trust plc UK Equity Share Portfolio and the Invesco Select Trust plc Global Equity Income Share Portfolio during this period and in the future.

The Global Equity Income Share Portfolio invests in emerging and developing markets, where difficulties in relation to market liquidity, dealing, settlement and custody problems could arise.

The UK Equity Share Portfolio invests in smaller companies which may result in a higher level of risk than a product that invests in larger companies. Securities of smaller companies may be subject to abrupt price movements and may be less liquid, which may mean they are not easy to buy or sell.

Important information

All data is as at 31/05/2021 and sourced from Invesco unless otherwise stated.

Where individuals or the business have expressed opinions, they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice.

If investors are unsure if this product is suitable for them, they should seek advice from a financial adviser. For details of your nearest financial adviser, please contact IFA Promotion at www.unbiased.co.uk.

This document is marketing material and is not intended as a recommendation to invest in any particular asset class, security or strategy. Regulatory requirements that require impartiality of investment/investment strategy recommendations are therefore not applicable nor are any prohibitions to trade before publication. The information provided is for illustrative purposes only, it should not be relied upon as recommendations to buy or sell securities.

For more information on our products, please refer to the relevant Key Information Document (KID), Alternative Investment Fund Managers Directive document (AIFMD), and the latest Annual or Half-Yearly Financial Reports. This information is available using the contact details shown.

Issued by Invesco Asset Management Limited and Invesco Fund Managers Limited, Perpetual Park, Perpetual Park Drive, Henley-on-Thames, Oxfordshire, RG9 1HH, UK. Authorised and regulated by the Financial Conduct Authority.

The importance of reinvesting dividends and why costs matter

Reinvest dividends if you don't need the income, but watch out for the dealing charges on small amounts

Reinvesting dividend income is fundamental to making the most of your investments and getting the full benefit from the effect of compounding.

To give an idea of the advantage let's look at how £100 invested over the last 121 years would have theoretically grown with and without reinvesting dividend income.

The annual Barclays Equity-Gilt study shows that over the last 121 years UK equities as represented by the FTSE All-Share index have delivered a CAGR (compound annual growth rate) of 8.9% a year, including reinvested income, which would have turned £100 into £2.9 million.

Without reinvesting the income, the CAGR drops by over half to 4.2% a year. That is a big drop in return but looking at the data this way isn't as illuminating as seeing the difference in actual money terms.

What might surprise you is that the same £100 invested would have in theory only turned into £15,179 over the last 121 years, a staggering loss in potential value of £2,897,759.

That might seem like an extreme example, after all almost no one could live long enough to invest over such a period, but the principle still holds, so it makes a lot of sense to reinvest dividend income that you don't need for other purposes.

MIND THE COST GAP

In this section, we look at the cost of reinvesting dividends and look at ways to optimise the process.

Most investment platforms will offer an automated reinvestment service where they will do the work for you. Alternatively, you could place an order to purchase more shares in the company that paid out the dividend.

In most cases it is better to choose the automated reinvestment option because it is cheaper and more convenient. However, as we explain below, sometimes reinvesting small amounts isn't cost effective.

Let's look at some hypothetical examples to illustrate the different costs of reinvesting dividend income.

If you choose the dealing option, you will incur a charge which is usually a fixed price.

Using some ballpark numbers, let's say your platform charges you £12.50 to deal in shares online and charges 1% of the value of each dividend with a minimum payment of £1.50 and a maximum of £9.95.

Because the maximum reinvestment charge is below the dealing charge, it's clearly cheaper to make use of the automated reinvestment service.

UNDERSTANDING THE PRICING STRUCTURE

The pricing structure means that higher value dividends have the lowest proportional cost to reinvest. For example, if you were fortunate enough to have a £5,000 dividend payment, the maximum charge to reinvest it would be 0.2% (£9.95 divided by £5,000).

However, that implies an underlying stock position of around £160,000 assuming the stock paid a typical 3.1% yield. Given the need for a diversified portfolio of at least 30 stocks, this implies a portfolio value of £4.8 million, beyond the reach of most retail investors.

The 1% charge and minimum £1.50 threshold converge at dividends worth £150 because 1% of £150 is £1.50.

However, that implies an underlying stock value of £4,839, assuming a 3.1% yield. (£150 divided by 0.031) A well-diversified portfolio comprising of at least 30 equally weighted holdings implies a portfolio value of around £150,000.

Data provided by Platforum suggest that a more typical retail portfolio value is around £55,000. Assuming a similarly diversified portfolio and 3.1% yield implies a stock position size of £1,800 paying a dividend of £56.

Reinvesting £56 would incur the minimum charge of £1.50.

REINVESTING REMAINS KEY

As we explained earlier, reinvesting dividends is the key to building wealth in the stock market, so any lost income via dealing costs should be considered very carefully.

Additionally, most UK companies pay dividends twice a year in a rough ratio of one-third-to-two thirds with the final dividend being the larger. This means in the example above the first half dividend would be worth around £18.65.

The minimum £1.50 charge represents just over 8% of the value of the dividend (£1.50 divided by £18.65).

With smaller portfolios the costs can become prohibitive, for example, if your average stock position is £200 paying an annual dividend of £6.20, the first half dividend would be around £2 and paying the minimum fee would wipe out 75% of the dividend. (£1.50 divided by £2).

An alternative to immediately reinvesting income is to allow multiple dividends to accrue over time and reinvest at the point where the cost of reinvestment is say, below 2% or whatever threshold you consider reasonable.

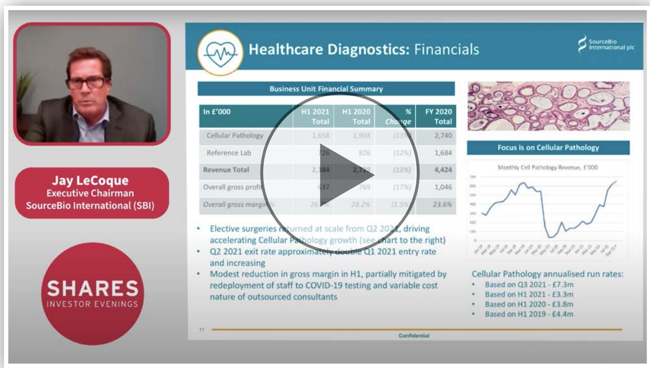
PUTTING IT INTO PRACTICE

On 4 November telecoms giant **BT (BT.A)** announced a first half dividend of 2.31p per share. Based on a share price of 161p an investor with £500 worth of shares would receive a dividend of around £7.16. If they chose to reinvest this, the typical platform minimum platform charge of £1.50 would amount to more than 20% of the total value of the dividend.

There isn't a perfect solution unfortunately, it's more of a trade-off between getting the money to work as quickly and efficiently as possible while also keeping costs to a minimum.

By **Martin Gamble,** Education Editor

WATCH RECENT PRESENTATION WEBINARS



SourceBio International (SBI)
Jay LeCoque, Executive Chairman

SourceBio International is an international provider of integrated state of the art Laboratory Services and Products. Headquartered in the UK, with offices in UK, Europe and the USA.

Frenkel Topping Group (FEN)
Mark Holt, COO

Frenkel Topping Group is engaged in the financial services sector. Its activities include specialist independent financial advice and wealth management with the objective of growing the assets under management.

Allergy Therapeutics (AGY)
Nick Wykeman, CFO

Allergy Therapeutics is active in the healthcare sector in the United Kingdom. It is a pharmaceutical company mainly engaged in the treatment and prevention of allergy with aluminium-free product.

Visit the Shares website for the latest company presentations, market commentary, fund manager interviews and explore our extensive video archive.

CLICK TO PLAY EACH VIDEO

SHARES SPOTLIGHT

www.sharesmagazine.co.uk/videos

INVESTOR DIARY: How I manage money in retirement

Private investor Malcolm from Edinburgh weighs up his performance since taking a more active role with his investments

On an invested sum of £210,000, the return over two years on my SIPP and stocks and shares ISA active retirement portfolio of around 30 shares is 12.4% excluding dividend payments.

I have been documenting my investing experience in *Shares* since August 2020 and these articles have provided readers with an insight into how I try to make money from the markets and manage my investments.

SAFETY-FIRST APPROACH

Based on modest reading, I initially adopted a safety-first approach, investing in several biggish FTSE 100 shares that were expected to provide ballast to my portfolio. However, shares including **Associated British Foods (ABF)**, **BP (BP.)** and **Vodafone (VOD)** have proved more hindrance than help and I am currently losing money on these stocks.

Nowadays, working out which shares to buy has become a more detailed process, with an increased focus on expectations of growth, revenue, profit, share price and dividends. From my perspective, key to analysis is tracking performance over time and gauging companies' fundamental business contribution and outlook. I also now listen to investment podcasts and read the business press avidly, albeit with a critical and sometimes sceptical eye.

To develop a depth of reading, I concentrate on a few areas of interest, most particularly science and technology. I have invested in companies with a focus on battery innovation, hydrogen carbon capture and sustainable bio-energy alternatives.

If there is a new Telsa out there, I have yet to find it. However, trying to constructively respond to new global challenges is appealing relative to investing in areas in which I have less curiosity, such as leisure and retail.

KEEPING BUSY

Reading about personal investment plans fits in well with being retired. Most of my hobbies are outdoors – walking, cycling and gardening – so reading about investment adds a welcome balance to life. There is always something to do on a poor weather day.

Diversification is a sound guiding principle, to an extent. The argument for diversification is that holding a breadth of shares across many sectors provides stability and reduces excessive risk. However, more than half of my shares are losing money for me rather than making a profit. Thus, at some point diversification thinking needs to acknowledge the importance of performance.

I have begun making more

substantial investments in selected companies which are making larger performance gains. So rather than each share contributing between 2.5% to 4% to the portfolio, I have larger investments in the winners with many now representing between 5% and 6% of the portfolio.

This has worked quite well for me through enhanced investments in names such as **Croda International (CRDA)**, **Drax (DRX)** and **Spirax-Sarco Engineering (SPX)**. If any of these stocks take a sharp downturn, my strategy might be to sell some but not all the shares. Most of these companies are in the FTSE 250 index. Exploring this mid-cap index and working out worthwhile shares to hold has so far been both interesting and rewarding.

PENSION WITHDRAWALS

As part of my 'making up for lost time' investment strategy, I have made no withdrawals from the portfolio. I am fortunate in being able to live quite well off my two workplace pensions. The intention is to retain the active nature of the portfolio and pass it on to my adult-age children. Tax is a complex issue in all of this but keeping the portfolio active appears a wise idea.

I intend to hold little money

Warren Buffett is one of the world's most famous investors

in cash savings in years to come. The challenge will be saving sufficiently to make full use of my stocks and shares ISA allowance each year. Any withdrawals are likely to be for hefty items such as helping with house buying or paying for health or social care.

DEALING WITH SETBACKS

Sometimes decisions do not work out well and it can be difficult to not fret about the poor ones. When its share price was doing well, I invested in **Blue Prism (PRSM:AIM)**. The company has a focus on increasing intelligent automation in the digital workplace – just the type of new technology I'm interested in. Unfortunately, within months of my investment, Blue Prism's share price more than halved, by far my biggest loss.

Even though I have been quite frugal with spending throughout my adult life, it helps if you can avoid dwelling on loss-making disappointments.

Focusing on the overall sum of your portfolio and embracing the Warren Buffett-infused thinking that the right time to sell a share is when you have something better to buy is probably a more helpful approach. That said, I still struggle with buying shares when markets are falling, lacking the confidence that markets will recover anytime soon.

DISCLAIMER: Please note, Shares does not provide financial advice in case study articles, and is unable to comment on the suitability of the subject's investments. Individuals who are unsure about the suitability of investments should consult a suitably qualified financial adviser. Past performance is not a guide to future performance and some investments need to be held for the long term. Tax treatment depends on your individual circumstances and rules may change. ISA and pension rules apply.

FOLLOW MALCOLM'S INVESTMENT JOURNEY:

Part 1: Taking control of my pension
Part 2: Expanding horizons
Part 3: Paying more attention to FTSE 250 stocks
Part 4: Looking for value and growth
Part 5: Facing up to the inflation challenge

WE WANT TO HEAR FROM YOU

Shares is looking for individuals or couples who can discuss their experience with investing and some details about their portfolios. We are particularly interested in anyone who has only just started investing or someone who has given up their job to become a full-time investor.

Email editorial@sharesmagazine.co.uk with 'case study' in the subject line.

INDEX

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full-year results

15 Nov: Nightcap. **16 Nov:** Imperial Brands, Focusrite, Revolution Bars. **17 Nov:** Sage. **18 Nov:** Euromoney, Grainger, Daily Mail & General Trust.

Half-year results

12 Nov: Castings. **15 Nov:** Totally. **16 Nov:** Vodafone, Homeserve, McKay Securities, Gear4Music, Premier Foods. **17 Nov:** SSE, Experian, CMC Markets, Workspace, Tatton Asset Management, Speedy Hire. **18 Nov:** Royal Mail, Halma, Investec, Jet2, Biffa, Mitie, Redcentric, Charles Stanley, FinnCap. **19 Nov:** Great Portland Estates, Wincanton, Carclo.

Trading updates

12 Nov: AstraZeneca. **17 Nov:** Safestore.
18 Nov: Close Brothers.

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; Mark Gardner

CONTRIBUTORS Danni Hewson, Laith Khalaf, Russ Mould, Tom Selby, Laura Suter

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

Shares magazine is published weekly every Thursday (50 times per year) by AJ Bell Media Limited, 49 Southwark Bridge Road, London, SE1 9HH.
Company Registration No: 3733852.

All chart data sourced by Refinitiv unless otherwise stated